V Outlook

1 Economic conditions

1.1 Global economic trends

As 2018 began, a substantial recovery was under way in the global economy. In particular, the United States was continuing to advance along its growth trajectory, sustaining the fairly high pace of expansion established since the spring of 2016. The official growth figure for the Chinese economy in 2017 was 6.9 percent. Economic growth in the country has therefore picked up again following a downward trend over a number of years. The economic uptrend is also advancing in key emerging markets, Russia and Brazil continuing to benefit from the recovery in commodities markets. In Europe, neither the various elections nor the Brexit negotiations between the EU and the UK have led to any noticeable adverse economic impact to date. Quite the contrary in fact, with growth in the eurozone gaining even greater momentum.

Against this background, global economic growth in 2017 is likely to be confirmed at around 3.5 percent. At the moment, there are no obvious signs that this trend in global expansion is going to fall away. A further uptick is probable in 2018, with growth forecast to be approximately 3.8 percent for the year.

Expansionary monetary policies tending to be pursued by key central banks are also continuing to boost the current growth rates in the global economy. This very much applies to the ECB, which has not yet initiated any serious normalization of its monetary policy. By contrast, the US Federal Reserve has implemented modest interest rate hikes and has been taking action since October 2017 to reduce its massively swollen balance sheet. Nevertheless, money supply remains abundant overall.

The inflation rate will probably rise slightly from around 3.4 percent in 2017 to approximately 3.6 percent in 2018.

1.2 Trends in the USA

The economy in the United States is on a robust path of growth. Consumer spending, in particular, continues to be the key driver behind this growth. Surveys conducted in industry and construction, and among service providers and consumers, show that sentiment remains very upbeat.

In 2018, a further economic boost could come from the tax reform set in motion by Congress before the end of 2017 and now approved. The reform will lead to comprehensive tax cuts. Some of the strong economic growth at the end of 2017 is likely to have been caused by spending brought forward as a consequence of the imminent tax reform. This is suggested by the very hefty spending on capital equipment, in particular. This trend is likely to continue in 2018.

In these conditions, the US economic growth rate is forecast to rise from approximately 2.3 percent in 2017 to around 2.5 percent in 2018.

Inflationary pressure remains rather subdued despite both the upturn, which has already lasted for eight years, and the slightly expansionary monetary policy, which still remains in place. A significant, and also protracted, rise in the oil price could push up inflation markedly. Although the solid uptrend in employment is predicted to continue, there is only expected to be a slight increase in momentum in terms of wage rises. Overall, conditions for higher inflation are projected to remain moderate. Therefore, the Federal Reserve has little reason to hurry in pursuing a tighter monetary policy.

Currently, an average inflation rate in the region of 2.3 percent is projected for 2018.

1.3 Trends in the eurozone

The economic recovery in the eurozone is broadly based and gathered further pace in the second half of 2017. Consumer spending and gross capital investment are the most significant contributing factors. The positive overall picture is also confirmed by a review of the individual countries of the eurozone. The top performers include the Spanish economy, which has enjoyed very high growth rates now over a number of quarters, and the economic heavyweight Germany. The French economy is also picking up speed. Even Italy – which admittedly still has comparatively weak growth rates – is being increasingly pulled along by the powerful economic cycle within the eurozone.

The extremely favorable economic position currently prevailing in the eurozone is likely to continue through

2018. However, some potential for a setback is looming from the UK's planned exit from the EU. The outcome of the exit negotiations remains unresolved. Even recent progress in these negotiations has done little to reduce the current level of uncertainty. However, results of surveys indicate that the potential negative consequences for the eurozone economy from any uncoordinated exit by the UK are likely to remain relatively limited.

The robust growth figures are also reflected in the labor market. The average unemployment rate in the eurozone fell once again in November 2017, dropping to 8.7 percent, which was the lowest level since January 2009.

In view of the developments described above, it is reasonable to assume that a sound rate of economic expansion will be sustained in the eurozone in 2018. The rate of GDP growth is likely to be in the region of 2.0 percent in 2018 compared with around 2.3 percent in 2017.

Overall, inflation in the eurozone is lagging behind the positive economic conditions. The upward trend in consumer prices has been comparatively modest. Even in the case of industrial goods (excluding energy) or services, price inflation has been rather low. The inflation rate in 2017 was an average of approximately 1.5 percent. Current forecasts for 2018 are predicting an inflation rate in the vicinity of 1.5 percent.

1.4 Trends in Germany

At the end of 2017, the German economy was experiencing a strong broadly based economic recovery. According to the latest surveys, corporate optimism is at its highest level since reunification. In addition, the economy continues to be boosted by exceptionally positive consumer sentiment and the excellent position in the job market.

The expansion in the global economy is helping German exports to get back to the good years prior to the financial crisis and the problems in the eurozone. Overall, the country's industry is growing very rapidly, driven by buoyant export demand. Furthermore, the domestic economy in Germany has also been enjoying a positive trend for several years. Household consumption and capital investment in residential construction have risen significantly with the benefit of a strong tailwind from the very good employment rate in the job market. Following years of caution, businesses are now once again responding to the strong upturn with noticeably rising spending on capital equipment.

The economic recovery in Germany is likely to become increasingly mature, as a result of which the rate of expansion will probably ease off over the medium term, coming closer to the trend growth rate. In particular, a shortage of labor could restrict further growth opportunities.

Against this backdrop, Germany's unemployment rate for 2018 is predicted to fall further to around 5.5 percent.

At the moment, all the indicators suggest that the favorable economic conditions in Germany will continue in 2018, with economic output projected to rise by around 2.2 percent.

The inflation rate in 2017 crept up to 1.7 percent, mainly as a result of a rise in prices for crude oil and foodstuffs, and increases in housing rents. The projected inflation rate for 2018 is also approximately 1.7 percent.

1.5 Trends in the financial sector

For some years, the financial sector has faced considerable pressure in terms of both adjustment and costs caused by the need to comply with regulatory reforms and implement structural change to adapt to competitive conditions.

The regulatory measures introduced since the financial crisis have had a range of objectives, including the restructuring of the financial sector to make it more resilient in the event of a crisis, to be achieved by reorganizing the supervisory architecture and improving capital and liquidity adequacy. A further objective is to ensure that the risks arising from the business activities in the financial industry are not borne by the public sector.

However, there is always a possibility that European banks could be more heavily impacted as a result of the variation in the way that the rules are applied at international level.

Significant rules and regulations coming into force in 2018 include the application of the financial reporting standard IFRS 9, covering the accounting treatment of financial instruments with implications for the calculation of regulatory ratios, and the implementation of the Markets in Financial Instruments Directive (MiFID II), together with the accompanying Markets in Financial Instruments Regulation (MiFIR), with tighter requirements for the provision of investment services in relation to a large number of financial instruments as well as comprehensive transparency and disclosure requirements for transactions involving these products.

Further information on the regulatory environment can be found in section 5.1.2 of the opportunity and risk report.

In response to these regulatory requirements, banks have reduced their leverage over the last few years and substantially bolstered their risk-bearing capacity by improving capital and liquidity adequacy.

However, in addition to the regulatory environment described above, new competitors with approaches based on the use of data and technology are presenting the financial sector with the challenge of scrutinizing its existing business models, adapting them as required, and substantially improving its efficiency by digitalizing business and IT processes. The corresponding capital investment is initially likely to push up costs in the industry before the anticipated profitability gains can be realized.

Efforts to address the challenges described above will once again be made more difficult in 2018 by the expected continuation of low nominal interest rates, which are currently accompanied by a relatively flat yield curve and are likely to prevent any significant increase in margins in interest-related business.

This assessment is based on the continuation of the expansionary monetary policy pursued by the ECB, which decided in October 2017 to extend its asset-buying program until at least September 2018.

By contrast, at a meeting in September 2017, the US Federal Reserve decided to begin the process of unwinding its crisis-era quantitative easing policy. It is anticipated that, at the same time as the change in balance sheet policy, the Federal Reserve will continue to gradually hike interest rates with the objective of keeping US economy on a growth trajectory while ensuring price stability.

The expected growth in large swathes of the global economy is also forecast to provide a boost for the financial position and financial performance of the European financial sector.

However, the potential implications from uncertain political and economic trends for the economic position of banks and insurance companies should not be ignored. Further information on macroeconomic risk factors can be found in section 5.1.3 of the opportunity and risk report.

2 Financial performance

Key features of the 2018 financial year alongside a continuation of the tough market and competitive conditions will include measures by the DZ BANK Group to modify the strategic direction in certain aspects of its business, such as the pooling of real estate activities in DZ HYP and the realignment of the VR LEASING operating segment.

According to the planning for 2018, total assets will end the year somewhat higher compared with the figure as at the end of 2017. This planning is based on the forecast of a growth-driven increase in the volume of business, especially in the BSH, DZ BANK, TeamBank, VR LEASING, and WL BANK operating segments, which will have a corresponding impact on the balance sheet. However, the level of total assets will also reflect the countervailing effect from the planned contraction of the portfolios of loans and advances in the DG HYP and DVB operating segments.

In these circumstances, it is estimated that it would be ambitious to replicate the 2017 performance in terms of profit, so **profit before taxes** in 2018 is predicted to be at the lower end of the long-term target range of €1.5 billion to €2 billion.

Financial performance will be impacted by the low level of interest rates, which continue to be maintained as a result of the expansionary monetary policies pursued by central banks, and by the higher expenses resulting from regulatory requirements. The future financial performance of the DZ BANK Group could be subject to risks arising from the political and economic climate outlined above. The management of the potential implications for financial position and financial performance arising from these risks forms part of the DZ BANK Group's strategic and operational management of its business and resources.

In 2018, it is anticipated that **net interest income** including **income from long-term equity investments** will remain steady overall, although there could be some income volatility in the interest-rate-sensitive business models within the DZ BANK Group.

The low interest rates are expected to persist in 2018 and this could have a negative effect on net interest income.

Following the charges in 2017, mainly in the DVB operating segment, expenses for **allowances for losses on loans and advances** are likely to return to normal levels overall in 2018 and change in line with the lending portfolio, the targeted volume of new business, and the long-term standard risk costs.

The potential effects of uncertain political and macroeconomic developments on credit markets could have a detrimental impact on allowances for losses on loans and advances.

Once again, **net fee and commission income** is projected to rise significantly in 2018 and make a very hefty positive contribution to the earnings of the DZ BANK Group.

Based on the predicted growth in the volume of assets under management and the associated volume-related income, the UMH operating segment will again be responsible for a substantial portion of the net fee and commission income.

Any lasting uncertainty in capital and financial markets could have a negative impact on confidence and sentiment among retail and institutional investors, thereby depressing net fee and commission income.

Gains and losses on trading activities in 2018 are predicted to be at a similar level to those in 2017.

Customer-driven capital markets business in the DZ BANK operating segment may well continue to provide some impetus in 2018.

The primary prerequisite for a steady level of net gains under gains and losses on trading activities is considered to be a stable financial and capital markets environment.

Net gains under gains and losses on investments are predicted to make a modest contribution to profit before taxes in 2018 because of the absence of non-recurring items this year.

Other gains and losses on valuation of financial instruments are once again projected to come to a net gain in 2018 in view of the available potential for reversals of impairment losses in the portfolios of instruments from government issuers in the DG HYP and WL BANK operating segments (DZ HYP operating segment going forward).

Volatility in capital markets and especially the widening of credit spreads on securities from government issuers could have a negative impact on the forecast gains and losses.

Net income from insurance business is expected to contract in 2018. Given the expected growth in the gross premiums from the different divisions, the decline in net income is expected to be caused by a deterioration in gains and losses on investments held by insurance companies, reflecting the current environment of low interest rates.

Exceptional events in financial and capital markets, changes in underwriting practices, or potential changes in the regulatory requirements faced by insurers may adversely affect the level of net income expected to be earned from insurance business.

Administrative expenses are predicted to rise slightly in 2018. While administrative expenses in most operating segments will contract or remain steady, it is likely that this item will rise in the UMH operating segment in view of the planned growth and capital spending requirements.

Despite a slight increase in income forecasts, the **cost/income ratio** for the DZ BANK Group is likely to rise in 2018 as a consequence of higher expenses. Against this backdrop, the DZ BANK Group will be focusing energies on managing costs and generating growth in the operating business.

Regulatory RORAC, the risk-adjusted performance measure based on regulatory risk capital, will decrease marginally in 2018.

3 Liquidity and capital adequacy

Based on the position in the year under review and the funding measures planned for 2018, the DZ BANK Group predicts that it will be able to continue satisfying the economic and regulatory **liquidity adequacy** requirements. Further information on liquidity adequacy can be found in sections 6.2.7 and 6.3.3 of the opportunity and risk report.

As matters currently stand, the DZ BANK Group's **capital adequacy** will continue to be assured for 2018 from both economic and regulatory perspectives; that is to say, it will continue to have at its disposal the available internal capital necessary to cover the risks associated with the finance business and other risks arising from the group's business operations. Further information on capital adequacy can be found in sections 7.2.4 and 7.3.2 of the opportunity and risk report.

Over the last few years, the DZ BANK Group has strengthened its capital base from its own resources – by retaining profits and reducing risk – and by implementing a capital increase in 2015. In 2018, a high priority will once again be given to capital management activities.

4 Operating segments in detail

4.1 DZ BANK

Despite potential for growth in the operating business, profit before taxes at DZ BANK is under pressure because of fiercer competition in both domestic and international markets. Fintech companies are also stepping up the competition by substituting new approaches in place of traditional services in parts of the value chain.

Moreover, the protracted period of low interest rates combined with reduced potential for reversals of impairment losses is hindering a more positive level of financial performance.

Excluding the income subsidy or absorption of losses in connection with the DVB operating segment, **profit before taxes** is forecast to fall sharply in 2018. This contraction is attributable in part to non-recurring items in the year under review.

The non-recurring items with a positive impact on profit before taxes in 2017 were the disposal of the shares in Concardis GmbH and the deconsolidation of WGZ Finance plc.

Net interest income (excluding income from long-term equity investments) in 2018 is predicted to be significantly below the 2017 level. This forecast reflects the challenges presented by the current market and competitive environment coupled with the downward pressure on margins.

Income from long-term equity investments will probably go down significantly in 2018 because of a rather conservative estimate of the financial performance of the other management units and because the 2017 figure included non-recurring items.

Expenses for **allowances for losses on loans and advances** will probably rise in 2018. Reversals of allowances in the year under review are not included in the planning. This forecast is in line with the change in the expected loss from the lending business, particularly in corporate banking.

Net fee and commission income is expected to rise substantially in 2018, with particular stimulus being provided by volume growth in transaction banking and retail banking.

The net gain under **gains and losses on trading activities** is projected to decline slightly despite the exploitation of potential growth in the customer business. Both the institutional customer business and the retail customer business are believed to offer opportunities for growth in spite of the tough market conditions. The consolidation of marketing activities in line with the corporate strategy should in this case lead to additional operating income in the capital markets business.

Gains and losses on investments will probably deteriorate significantly compared with 2017 because of the non-recurring items arising from the disposal of securities in the banking book.

In all probability, **administrative expenses** will see a considerable decline in 2018. The main reasons are the absence of merger-related expenses, especially as a result of the completion of the migration projects, and the fall in costs as planned synergies materialize.

From the current perspective, it is anticipated that the **cost/income ratio** will be up slightly in 2018 owing to the absence of the non-recurring income items described above.

Regulatory RORAC is likely to fall sharply in 2018 because of increasing capital requirements and the absence in the 2018 figures of the positive non-recurring items that boosted profit before taxes in 2017.

4.2 BSH

According to forecasts, house-building will continue to be a driver of economic growth in Germany in 2018. The demand for additional homes is expected to remain high in 2018 as a result of inward migration and population movements within Germany; this applies particularly to urban centers offering good economic and demographic prospects. The German construction industry estimates that 350,000 homes will be completed in Germany in 2018. For the first time for many years, this volume matches at least the lower end of the predicted annual demand of 350,000 to 400,000 homes. BSH, a specialist in home finance, will also benefit from these conditions.

In its home finance core business, BSH once again anticipates a slight rise in new business based on the record level achieved in 2017. As regards home savings, the second core business at BSH, new business is predicted to be at the prior-year level because of the continuing challenges presented by the low interest rates and significant regulatory requirements; this forecast is in line with the home savings market as a whole.

BSH is anticipating a significant fall in **profit before taxes** in 2018, largely because of a sharp decrease in net interest income.

The low interest rates are likely to have a substantial detrimental impact on income in 2018. Based on these expectations, **net interest income** is forecast to decline sharply this year.

With regard to **allowances for losses on loans and advances**, BSH will continue to benefit from Germany's good economic performance and low unemployment rate. As a consequence, allowances for losses on loans and advances in 2018 will remain at the relatively low level of 2017 despite the marked expansion in non-collective lending business in previous years.

Net fee and commission income is predicted to improve slightly in 2018 assuming a steady level of new home savings business.

Administrative expenses will be marginally higher in 2018, a consequence of strategic projects and action plans in connection with the further development of the home savings and home finance core businesses. Strict cost discipline and savings will help to limit the increase.

From the current perspective, the **cost/income ratio** is likely to deteriorate significantly as a result of the lower net interest income and slight rise in administrative expenses.

Regulatory RORAC will probably also be well down because of the slightly higher capital requirements and the considerable fall in profit before taxes.

4.3 DG HYP

Since 2013, the German economy has remained impressively robust in an environment exposed to global political and economic risks. According to forecasts prepared by DG HYP, the German commercial real estate market is likely to remain resilient and stable in 2018. From today's vantage point, the high volume of capital chasing real estate investment opportunities coupled with Germany's economic strength and the ECB's expansionary monetary policy will once again result in high turnover in the commercial real estate market. The strong labor market is likely to ensure that demand for office space is maintained at a good level. Rising wages are expected to give a boost to retailers and help consumers pay housing rents, which continue to increase. This also means that the downward pressure on yields is likely to remain significant and risk premiums could continue to go down.

The portfolio of real-estate lending is anticipated to remain steady in 2018, as a result of which **net**

interest income will probably be slightly higher than the 2017 level. The non-strategic real-estate lending business for retail customers will continue to be gradually replaced by higher-margin commercial real-estate lending business.

Allowances for losses on loans and advances are predicted to return to normal levels. Net reversals of loan loss allowances at the level of the last few years will no longer occur.

The spreads in government financing are only expected to narrow by a tiny amount in 2018. The significant net gain in 2017 under **other gains and losses on valuation of financial instruments** is therefore projected to decrease sharply, with the result that **profit before taxes** is likely to decline substantially despite the ongoing success of DG HYP's operating business.

Administrative expenses will see another slight rise because of the further increase in merger activities in this operating segment.

From the current perspective, the **cost/income ratio** will show a significant year-on-year deterioration, caused by the sharp fall in net gains under gains and losses on valuation of financial instruments.

Regulatory RORAC is likely to see a hefty fall in 2018 as a result of the substantial decrease in profit before taxes.

Once again it is clear that non-strategic public-sector financing, which is accounted for at fair value, is limiting the ability of DG HYP to present the positive performance of its operating business transparently.

Information on the intended merger between DG HYP and WL BANK to become DZ HYP as part of the project to reorganize real estate activities within the DZ BANK Group can be found in section 2.3.

4.4 DVB

In 2017, DVB reported significant losses in what was the most challenging year in the history of the company, which stretches back almost 95 years.

At the beginning of 2017, the Board of Managing Directors of DVB developed a strategy to increase productivity and efficiency and to lay the foundations for a return to a reasonable level of profitability in the business model. The strategy was to consist of structural modifications, the refinement of existing products and services, and the development of new ones. Further work was carried out on the strategy during the course of the year to turn it into an updated business plan, which was then presented to, and approved by, the relevant decision-making bodies. By way of example, measures to be implemented as part of the plan included the following:

– Discontinue the offshore finance division from January 1, 2018
– Reorganize the portfolio breakdown with a balanced distribution between the remaining transport finance areas, but with a greater focus on aviation finance and land transport finance business
– Permanently bolster the team of experts responsible for managing non-performing loans
– Develop a new non-core assets strategy
– Increase risk-free fee and commission income in the various divisions, for example by focusing more on an originate-to-distribute business model, in which it is possible to add to and enhance the income generated from using the bank balance sheet
– Review the cost structures in the business model.

One of the critical competitive advantages still offered by the DVB business model is the cycle-neutral lending policy, which focuses on the quality of the financed asset in terms of the extent to which it can be remarketed and its value recovered.

DVB plans to exploit the current macroeconomic position to continue to offer its transport finance products, consulting, and other services at an international level in 2018. DVB will therefore remain available to its transport customers in 2018 for new business in the areas of shipping finance, aviation finance, and land transport finance.

In these circumstances, DVB will make best efforts in 2018 to avoid reporting a **loss before taxes**, as was necessary in 2016 and 2017. The bank thus plans, in particular, to significantly reduce **allowances for losses on loans and advances**. The continuing dislocation in some shipping markets could cause an adverse impact in legacy portions of portfolios, mainly in shipping finance and offshore finance. Even in the tenth year of the current crisis in shipping, DVB estimates that there is still tonnage overcapacity in some international shipping segments – this structural oversupply will create yet more pressure on charter rates and ship asset values. It remains unclear when this overcapacity will be eliminated to return transport markets to a situation where supply and demand are roughly in balance.

In 2018, the aviation and land transport finance markets are also expected to continue to be affected by the significant levels of available cash looking for an investment and by the fierce competition between banks and other finance providers, all of which is likely to have a detrimental impact on new business volume and new business margins.

Taking all the above into account, DVB is projecting a significant improvement in the **cost/income ratio** in 2018.

From an overarching perspective, DVB's financial performance is subject to uncertainty because of the conditions in the maritime market and the review of strategic options.

4.5 DZ PRIVATBANK

The eurozone economy is likely to continue to recover moderately over the medium term. The inflation rate will probably not exceed the ECB's target of 2 percent for any length of time in the next few years.

As things stand, any greater acceleration in business growth in 2018 will be hindered, mainly by the persistently low interest rates and the rise in costs associated with regulatory requirements.

Earnings are projected to improve in virtually all divisions in 2018. **Administrative expenses** are only expected to rise by a modest amount thanks to the ongoing efforts to manage efficiency and effectiveness.

Net interest income is forecast to contract significantly in 2018 because of the persistently low interest rates and the inadequate options available for replacing maturing interest-bearing assets.

In all probability, **net fee and commission income** will go up in 2018 on the back of the uptrend in the private banking and fund services businesses. The main value driver is fund volume, which is likely to continue to grow in the case of both third-party funds and Union Investment funds, aided by continuation of benign market conditions. The assets under management in private banking will also increase, with margins projected to improve as a result of efforts to optimize the fee model. At the same time, a fiercely competitive market continues to prevail, reflected in persistent downward pressure on margins.

The customer-driven foreign exchange business will continue to have a positive impact on **gains and losses on trading activities**. A significant improvement in this figure is anticipated in 2018.

From today's perspective, the encouraging trend in income combined with only a moderate rise in costs is likely to mean that **profit before taxes** will increase significantly in 2018.

The **cost/income ratio** and **regulatory RORAC** are both forecast to improve substantially.

4.6 R+V

In the opinion of R+V, the 2018 financial year will continue to be shaped by the challenging conditions. The market environment will remain very tough from any number of perspectives, including political issues, regulation, low interest rates, economic conditions, and consumer behavior.

Customers hold DZ BANK, the Volksbanken Raiffeisenbanken cooperative financial network, and the latter's insurance specialist, R+V, in very high standing due to their financial strength, resilience, fair advice, good service, and tailored solutions.

In the year under review, R+V launched its 'Wachstum durch Wandel' (growth through change) program with the overall objective of consolidating its strong position in the market. The main aims within the strategic program are to safeguard profitable growth over the long term, bring about further growth in sales, refine the strong R+V corporate culture, and sharpen the focus on customer needs. This future-oriented strategy is being driven forward with support from the implementation of a digitalization strategy, encompassing a broad range of activities from the provision of products and services for customers and sales partners to the processing of customer concerns.

In line with this strategy, R+V is planning to continue on its trajectory of profitable growth in 2018. R+V, the composite insurer in the Volksbanken

Raiffeisenbanken cooperative financial network, is aiming to use its highly effective product portfolio to steadily increase its market penetration. Further consolidation of R+V's market leading positions in a number of areas, including personal pension products, occupational pension provision, vehicle fleets, and credit insurance, will be based on developing the potential available from both corporate and retail customers. R+V intends to achieve a lasting increase in market share by focusing on organic growth to be achieved by leveraging the potential available in the cooperative financial network, increasing cross-selling activity, offering innovative products, and expanding online and multichannel activities. This will also help to steadily increase the value added for the cooperative financial network.

Substantial growth is expected in **gross premiums written**. It is anticipated this will be generated from non-life insurance, personal insurance business, and inward reinsurance.

In non-life insurance, **gross premiums written** are forecast to grow significantly in 2018. The **claims rate** will probably be higher than in 2017. Based on a steady expense ratio, the **combined ratio** (total of insurance business operating expenses and claims expenses divided by premiums earned) is projected to rise.

In the life insurance and health insurance business, R+V aims to back up the successes achieved in previous years with a long-term diversification strategy. The **gross premiums written** predicted for 2018 will be slightly above the level of 2017.

The public at large has recognized that the statutory pension needs to be topped up by private and/or occupational pension provision. These circumstances alone already offer potential for growth. Particular momentum in the occupational pensions business could be provided by small and medium-sized enterprises in Germany. In businesses with fewer than a hundred employees, many of these employees do not yet make use of the benefits available under occupational pension schemes. The German Act to Strengthen Occupational Pensions (BRSG), which comes into force in 2018, addresses this situation in particular. This will give rise to new sales opportunities that will be actively exploited by R+V. Collectively agreed pension schemes such as the dedicated schemes available in Germany for the chemicals industry (Chemie-Versorgungswerk), engineering industry (MetallRente), and healthcare industry (KlinikRente) are helping to popularize occupational pension provision.

R+V expects the fierce competition in the reinsurance sector to continue. Nevertheless, following the major loss events that occurred in 2017 in North America and in the Caribbean, it is anticipated that there will be an increase in the price of reinsurance cover around the globe in 2018. In both commercial and retail business, the natural catastrophe segments adversely impacted in 2017 are expected to benefit, in particular, from this trend. R+V will continue to pursue its strategy of profitable growth in its inward reinsurance business. The retention of the stringent underwriting guidelines will ensure rigorous compliance with the income-oriented business policy. On the costs side, R+V anticipates a stable **administrative expenses ratio** (net insurance business operating expenses divided by net premiums earned) and an improvement in the **combined ratio** in 2018.

The long-term investment strategy based on asset protection combined with a state-of-the-art approach to risk management will also be decisive factors in 2018. The net gains under **gains and losses on investments held by insurance companies** are forecast to fall to a normal level in 2018 against the backdrop of persistently low interest rates. This item will thus continue to make a significant contribution to overall profit before taxes at R+V in the future.

Overall, these developments are projected to cause a decline in **profit before taxes** year-on-year, but the figure will remain at a satisfactory level.

Regulatory RORAC is expected to fall in 2018 in line with the forecast decline in profit before taxes combined with a slight rise in capital requirements.

4.7 TeamBank

The German consumer finance market is forecast to continue to expand significantly in 2018, boosted by the positive economic growth, negative interest rates in real terms, and continuation of the favorable labor market.

Digital transformation is also putting traditional banks under a noticeable degree of pressure. Furthermore, new market players with disruptive business models are becoming increasingly popular, while the efforts of technology giants from the US and China are gradually bearing fruit in the German financial sector. Agile operating structures, digital solutions, and alliances – including collaboration with fintechs – are of critical importance for banks if they are to keep up with the rapid pace of innovation in the market.

In collaboration with the cooperative banks, TeamBank is aiming in 2018 to generate profitable, sustainable growth at a rate that is constantly higher than the market average. TeamBank remains focused on establishing connectivity between the various methods of customer access, amalgamating online and mobile activities with the branch business of the cooperative banks, and attracting new customers and members as well as retaining existing ones.

TeamBank is forecasting a significant gain in **net interest income** for 2018 based on strong portfolio growth.

The risk provision policy will be switched in January 2018 so that it is in line with IFRS 9. As part of this change, allowances for losses on loans and advances will be recognized at an earlier point in the lending relationship and at a greater level. As TeamBank continues to anticipate strong growth in its portfolio, it is projected that there will be a corresponding rise in **allowances for losses on loans and advances**.

Rigorous management of costs by focusing on the core business and targeted capital investment to ensure TeamBank's future competitiveness will help ensure that **administrative expenses** in 2018 are only slightly higher than the 2017 level.

Taking into account the hefty rise in net interest income, the slight increase in administrative expenses, and the greater level of allowances for losses on loans and advances, **profit before taxes** is once again forecast at a high level in 2018, although it is unlikely to reach the exceptional figure achieved in 2017.

As a consequence, the **cost/income ratio** will remain at the encouraging level achieved in 2017 and is also expected to stay below the industry average.

The rise in minimum capital requirements will lead to a sharp drop in **regulatory RORAC** in 2018.

4.8 UMH

UMH has continued to set itself ambitious targets for 2018, even though it has just completed a financial year in which it generated the highest net profit in its history, attained significant net inflows, and achieved a record level of assets under management.

Against the backdrop of persistently challenging conditions – the change in the German political landscape after the latest elections, the ongoing Brexit negotiations between the UK and the EU, the increasing centrifugal forces in Europe, such as those in Poland, Hungary, and Catalonia, the developments in Turkey, the behavior of Russia, the tensions with North Korea, and not least the policies of the United States under the Trump administration – UMH aims to systematically exploit opportunities to deliver a positive business performance in both the national and international environments.

In 2018, UMH is also aiming to maintain new business at a very high level and forecasts that the positive trend in assets under management will continue with the volume reaching a new all-time high, despite modest expectations regarding overall performance.

A sharp contraction in **net fee and commission income** is predicted for 2018. Volume-related income is likely to increase substantially as a consequence of the higher average level of assets under management. However, this positive effect will probably be entirely offset by a greater decrease resulting from a sharp fall in the expected returns from performance-related management fees and a significant drop in real estate transaction fees.

Administrative expenses are projected to rise significantly in 2018. This increase will be caused largely by the transfer of research expenditure to UMH's own books, capital investment in infrastructure, and subsequent operating costs. Staff expenses will rise in 2018 because of a projected increase in the number of employees, the effect over a whole year from prior-year appointments, and planned salary increases. On the other hand, from the current perspective, the reduction in variable remuneration components will also have a countervailing impact.

Based on the factors described above, UMH is again forecasting a significant **profit before taxes** for 2018, even though the projected figure represents a considerable decline compared with 2017.

In line with this forecast, there is also likely to be an increase in the **cost/income ratio** and a fall in **regulatory RORAC**.

4.9 VR LEASING

Advancing digitalization and the associated changes in customer requirements will be the focus of activities at VR LEASING in 2018. The ongoing policy of low interest rates and the implementation of regulatory requirements (including the EU General Data Protection Regulation (GDPR), the Insurance Distribution Directive (IDD), and the Principles for Effective Risk Data Aggregation and Risk Reporting (BCBS 239)) represent further challenges in the business environment.

Transformation into a digital provider of finance for the self-employed and small businesses

The priority for VR LEASING in 2018 will be to transform the corporate group into a digital provider of finance for the self-employed and small businesses, as approved in December 2017. This will be accompanied by a focus on the cooperative banks and their decentralized support for the financing of small and medium-sized enterprises in the BVR corporate customer clusters 2-4 (self-employed and small businesses).

As part of the transformation, it was decided that negotiations should be initiated for the disposal of the business activities other than sales via banks (i.e. centralized settlement and BFL Leasing GmbH) because they have no connection with the cooperative financial network. In the case of leasing or hire purchase business (single assets) with a value of more than €750,000, this business is to be operated henceforward with an associated partner. The factoring business will be taken over by the DZ BANK segment and the operating segment thereby reinforced, in particular in terms of the range of products.

By sharpening the focus of the business model, it is anticipated that VR LEASING will be able to exploit new potential sources of income, which will also cause a corresponding increase in the commission it pays to the cooperative banks. However, as a consequence of the costs incurred in connection with the transformation, a small **loss before taxes** is forecast for 2018.

Further development of simple, automated financing solutions

VR LEASING will forge ahead with the further development of its simple, automated financing solutions for leasing, hire purchase, and lending with a value of up to €200,000 with the aim of establishing further sources of income for the cooperative banks and generating long-term growth for itself. In 2018, it plans to take the market penetration enjoyed by its 'VR Leasing flexibel' business lending product to yet another level and raise the financing limit for the 'VR Leasing express' hire purchase solution from €60,000 to €200,000. Looking ahead, the limit for automated decisions on financing is to be increased in stages to €750,000.

The online order channel, which for the first time enables corporate customers to enter into a borrowing agreement in a process that is entirely online, has been in testing since September 2017. Once the pilot phase is completed, it will be rolled out as quickly as possible.

Expansion of digital value-added services

In 2018, VR LEASING intends to continue the systematic development of digital value-added services that it has created as part of an ecosystem of digital solutions. One example is SmartBuchhalter, a simple accounting and liquidity management application launched in 2017 across the whole of the German market. Another solution known as Bonitätsmanager (credit status manager) is also currently being tested. There are plans for a rapid market launch after the pilot phase has been successfully completed.

The stimulus generated from initiatives introduced as part of the sales and product strategy and production processes is once again expected to result in rising income from the core business in 2018. It is anticipated that the expansion of the core business will be reflected in a sharp year-on-year rise in **net interest income** in 2018.

The greater level of market penetration achieved by the 'VR Leasing flexibel' business lending product will probably be accompanied by an increase in **allowances for losses on loans and advances** in proportion to the planned growth in new business.

As a result of the significant investment involved in the transformation to become a digital provider of finance for the self-employed and small businesses,

administrative expenses are likely to rise accordingly. These increases are projected to be more than offset by the budgeted rise in income and are expected to lead to a vast improvement in the **cost/income ratio**. The reduction in headcount in 2017 as part of a voluntary severance program is forecast to result in a substantial fall in staff expenses.

In 2018, earnings performance is expected to be considerably better than in 2017. As a result of the transformation investment costs, VR LEASING will report a small **loss before taxes** in 2018, but this is likely to be a significant improvement on the figure in 2017.

Taking into account the predicted improvement in earnings and the stability in risk-weighted assets compared with 2017, a sharp improvement in **regulatory RORAC** is forecast for 2018.

4.10 WL BANK

The strategic shift in focus at WL BANK, which dates back to 2010, toward a commercial bank servicing the real estate and local authority loans business will be systematically maintained in 2018. The requirements that need to be satisfied to successfully achieve the target structure continue be as follows: nationwide customer access, a high degree of business referrals by the cooperative banks, and consistently favorable funding opportunities, especially using Pfandbriefe. Direct access to capital market partners and significant investor confidence are also indispensable for obtaining advantageous funding arrangements.

Following the successful merger of DZ BANK and the former WGZ BANK to become a joint central institution on August 1, 2016, WL BANK has been gradually integrated into the organizational structures and committee activities of the DZ BANK Group. This has also included the integration of WL BANK into the DZ BANK Group's functional, methodological, and technical processes.

Sustained positive economic trends with an extremely favorable job market and rising collective pay deals combined with historically low interest rates will continue to create good conditions in real estate markets in 2018. The German building industry expects the current construction boom to be sustained.

WL BANK is forecasting new business growth in 2018 compared with 2017 in both the real estate and the local authority lending businesses. The resulting portfolio expansion will be greater than the further contraction of the portfolio of securities and promissory notes, as a result of which total assets will once again increase slightly.

In 2018, **net interest income** will see a further hefty increase year-on-year as a consequence of WL BANK's success in generating new business over the last few years.

Allowances for losses on loans and advances in 2017 were affected by a non-recurring item and are likely to be sharply reduced to a low level in 2018.

Net fee and commission income is forecast to grow in line with the acquired new business.

From the current perspective, the net gain under **other gains and losses on valuation of financial instruments** is forecast to be significantly lower than in 2017.

Both the allowances for losses on loans and advances and other gains and losses on valuation of financial instruments will be substantially impacted in 2018 by the switch in accounting standard from IAS 39 to IFRS 9, with the result that it will not be possible to present a meaningful comparison with the previous year.

Administrative expenses will be affected by costs related to regulatory requirements together with consulting expenses in connection with the planned merger of WL BANK and DG HYP to become DZ HYP, as a result of which they are expected to rise significantly.

Profit before taxes is forecast to be at a lower level in 2018 as a result of the factors described above.

The **cost/income ratio** is projected to rise marginally.

Regulatory RORAC will probably fall slightly.

Information on the intended merger between WL BANK and DG HYP to become DZ HYP as part of the project for the reorganization of real estate activities within the DZ BANK Group can be found in section 2.3.