Regulatory Disclosure Report for Q1 2020
of Aareal Bank Group

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Regulatory Disclosure Report for Q1 2020

Preface

Aareal Bank Group is classified as a significant institution within the scope of the Single Supervisory Mechanism (SSM) and is therefore subject to direct supervision by the European Central Bank (ECB).

The European Banking Authority (EBA) published its guidelines on disclosure requirements under Part Eight of Regulation (EU) 575/2013 (the Capital Requirements Regulation – "CRR") (EBA/GL/2016/11) on 14 December 2016. These substantiate the existing disclosure requirements of the CRR.

Aareal Bank Group is – in principle – not covered by the EBA guidelines and is therefore not formally required to meet the disclosure requirements formulated therein, as it is not classified by the ECB as a Global Systemically Important Institution (G-SII) on the basis of Delegated Regulation (EU) 1222/2014 or as an Other Systemically Important Institution (O-SII) on the basis of Article 131 (3) CRD IV. Nor is it obliged to meet the EBA guidelines. Nonetheless, Aareal Bank Group meets the EBA guidelines in full, on a voluntary basis.

The scope of quarterly disclosure as at 31 March 2020 is oriented upon the guidelines EBA/GL/2016/11, in conjunction with the revised guidelines on materiality, proprietary activity and confidentiality, and on disclosure frequency (EBA/GL/2014/14). According to these guidelines, Aareal Bank Group is obliged to disclose the following information, on a quarterly basis:

- regulatory capital structure and capital ratios;
- risk-weighted assets (RWAs) and regulatory capital requirements;
- development of RWAs and regulatory capital requirements for all exposures covered by the AIRBA; as well as
- the Leverage Ratio.

Aareal Bank complies with the requirements of parts 2, 3 and 7 of the CRR at a Group level, due to the fact that Aareal Bank Group has elected to use the waiver option provided by section 2a (1) sentence 1 of the German Banking Act (Kreditwesengesetz – "KWG") (in conjunction with Article 7 (3) of the CRR), whereby reports for financial holding companies or banking groups may be prepared on a consolidated basis. Aareal Bank AG, whose registered office is in Wiesbaden, Germany, is the parent institution of the Group.

The details we have published in this condensed disclosure report are based on both the Credit Risk Standard Approach (CRSA) and the Advanced IRB Approach (Advanced Internal Ratings-Based Approach – AIRBA).

Minor differences may occur regarding the figures stated, due to rounding.

Aareal Bank does not apply the transitional provisions, pursuant to Article 473a of the CRR, to mitigate the impact of the introduction of IFRS 9 on regulatory capital requirements. Accordingly, the obligation to provide additional disclosures (as specified in detail in EBA guidelines EBA/GL/2018/01) is waived.

Regulatory Capital Structure and Ratios

€ mn	31 Mar 2020
Common Equity Tier 1 (CET1) capital before regulatory adjustments	2,526
Regulatory adjustments	-285
Common Equity Tier 1 (CET1) capital	**2,241**
Additional Tier 1 (AT1) capital before regulatory adjustments	300
Regulatory adjustments	–
Additional Tier 1 (AT1) capital	**300**
Tier 1 (T1) capital	**2,541**
Tier 2 (T2) capital before regulatory adjustments	858
Regulatory adjustments	–
Tier 2 (T2) capital	**858**
Total capital (TC)	**3,398**
%	–
Common Equity Tier 1 ratio (CET1 ratio)	19.5
Tier 1 ratio (T1 ratio)	22.2
Total capital ratio (TC ratio)	29.6

Compared to the previous reporting date (31 December 2019), the capital ratios reported to the supervisory authorities[1] (CET1, T1 and TC ratio) declined slightly, in particular due to a € 268 million increase in RWAs and a simultaneous € 55 million increase in own funds.

The RWA increase resulted mainly from quality changes in the credit portfolio due to changed borrower probabilities of default (PD), or changes in loss given default (LGD). This is also a reflection of the increased uncertainty about the economic outlook worsened since the COVID-19 outbreak, which impacts different valuation parameters.

The increase in regulatory capital was largely due to a € 50 million increase in CET1 capital, which was in turn due, in particular, to the increase of retained earnings[2], the mandatory deduction of (gross) additions to loss allowance (€ -70 million) and to other changes (€ +14 million).

[1] The capital ratios reported to the supervisory authorities differ from those communicated in the interim financial information, as Aareal Bank did not submit an application for an inclusion of profits to the ECB as at 31 March 2020.

[2] The Annual General Meeting on 27 May 2020 resolved, as proposed by the Management Board and Supervisory Board, not to distribute a dividend for the financial year 2019, and to transfer the net retained profit reported in the annual financial statements in full to other retained earnings. This move by Aareal Bank is in line with the express request issued by the European Central Bank to the banks it supervises not to pay any dividends for financial years 2019 and 2020 until at least 1 October 2020. Accordingly, annual profits for 2019 were once again included for the purpose of determining regulatory capital as at 31 March 2020.

Regulatory Capital Requirements

The capital requirements for a transaction's counterparty credit risk under the CRSA are essentially based on the following:

1. the regulatory classification (balance sheet, off-balance sheet, or derivatives business);
2. the amount of the loan at the time of default (Exposure at Default, EaD);

and, under the AIRBA, additionally depends on

3. the Probability of Default; as well as
4. the Loss Given Default.

The credit conversion factors for off-balance sheet transactions are predefined by the supervisory authorities for capital requirements under the CRSA. The borrowers are subdivided into exposure classes; the exposure amounts are risk-weighted, using their respective risk exposure amounts.

As at 31 March 2020, no risks associated with outstanding delivery as part of counterparty risks had to be taken into account when determining counterparty usage limits.

Based on the AIRBA or CRSA calculation approach, the following RWAs and capital requirements were determined as at the reporting date for the types of risk that are relevant for regulatory purposes.

EU OV1: Overview of risk-weighted assets (RWAs)

		RWAs		Regulatory capital requirements
€ mn		31 Mar 2020	31 Dec 2019	31 Mar 2020
1	**Credit risk (excluding CCR)**	**9,263**	**8,774**	**741**
2	of which: Credit Risk Standard Approach (CRSA)	578	595	46
3	of which: Foundation IRB Approach (FIRB)	–	–	–
4	of which: Advanced IRB Approach (AIRBA)	7,885	7,388	631
5	of which: Equity IRB under the simple risk-weighted approach or the IMA	801	791	64
6	**CCR**	**490**	**486**	**39**
7	of which: Mark to market	293	283	23
8	of which: Original exposure	–	–	–
9	of which: Standardised approach	–	–	–
10	of which: Internal model method (IMM)	–	–	–
11	of which: Risk exposure amount from contributions to the default fund of a CCP	0	0	0
12	of which: CVA	197	203	16
13	**Settlement risk**	**–**	**–**	**–**
14	**Securitisation exposures in the banking book (after the cap)**	**–**	**–**	**–**
15	of which: IRB approach	–	–	–
16	of which: IRB supervisory formula approach	–	–	–
17	of which: Internal assessment approach (IAA)	–	–	–
18	of which: Standardised approach	–	–	–

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€ mn		RWAs 31 Mar 2020	RWAs 31 Dec 2019	Regulatory capital requirements 31 Mar 2020
19	**Market risk**	**48**	**61**	**4**
20	of which: Standardised approach	48	61	4
21	of which: IMA	–	–	–
22	**Large exposures**	**–**	**–**	**–**
23	**Operational risk**	**1,236**	**1,489**	**99**
24	of which: Basic indicator approach	29	44	2
25	of which: Standardised approach	1,207	1,445	97
26	of which: Advanced measurement approach	–	–	–
27	**Amounts below the thresholds for deduction (subject to 250 % risk weight)**	**425**	**385**	**34**
28	**Floor adjustment**	**–**	**–**	**–**
29	Total	11,463	11,195	917

Regarding the causes of RWA changes during the first quarter of 2020, reference is made to the explanations in the previous chapter ”Regulatory Capital Structure and Capital Ratios”.

RWA Developments and Regulatory Capital Requirements for AIRBA Exposures

The table EU CR8 provides an overview of the RWA changes and the associated causes to be analysed since 31 December 2019. The starting and end balances represent the sums of figures disclosed in lines 4 and 5 of table EU OV1 for the respective reporting date. IRBA exposures subject to counterparty credit risk were not taken into account for this purpose.

EU CR8: RWA flow statements of credit risk exposures under the IRB approach

€ mn		a RWA amounts	b Regulatory capital requirements
1	**Position as at 31 December 2019**	**8,179**	**654**
2	Asset size	23	2
3	Asset quality	516	41
4	Model updates	–	–
5	Methodology and policy	–	–
6	Acquisitions and disposals	–	–
7	Foreign exchange movements	-31	-2
8	Other	–	–
9	Position as at 31 March 2020	8,686	695

Besides exposures from new business originated, the changes reported in line 2 also include RWA changes from existing exposures – where we also include investments and other non-credit related assets, except for changes purely related to exchange rate fluctuations, which are presented separately in line 7.

Line 3 reports changes in risk-weighted exposures resulting from changed borrower probabilities of default or loss given default. This is also a reflection of the increased uncertainty about the economic outlook worsened since the COVID-19 outbreak, which impacts different valuation parameters.

Line 4 does not show any changes; this is due to the fact that no new models for estimating risk parameters were implemented, nor were any adjustments made to internal models already approved during the period under review.

Line 5 only requires disclosure of any changes resulting from a changed RWA calculation methodology – for example, where exposures previously subject to the CRSA are being included under the Advanced IRB Approach. No such changes applied as at the reporting date.

Line 6 does not show any changes, due to the fact that Aareal Bank did not acquire any new investments (or disposed of any existing investments) outside the regulatory scope of consolidation, which need to be included as RWAs in the reporting pursuant to sections 10 and 10a of the KWG.

No figures are shown in line 8 since we were able to assign RWA changes within Aareal Bank Group to the aforementioned categories.

Leverage Ratio

The Leverage Ratio is calculated taking into account the regulatory scope of consolidation, based on Delegated Regulation (EU) 2015/62.

€ mn	31 Mar 2020
Tier 1 capital	2,541
Total exposure measure	39,314
Leverage Ratio (%)	6.5

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