2017

Annual Report · Short Version

Aargauische Kantonalbank

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This unaudited short version of the annual report is not a complete annual report. It is a translation of select segments of the original German annual and the pillar 3 report for information purposes only.

In the event of variances, the German version shall take precedence over the English translation. You can find the full German annual and pillar 3 report at www.akb.ch for additional information.

CEO Dr. Pascal Koradi (l.)
Chairman of the Board of Directors Dieter Egloff (r.)

FOREWORD

Company, Legal Status and Bank Headquarters
Aargauische Kantonalbank (AKB) was founded in 1913 as an autonomous institution under public cantonal law and is protected by law. The canton guarantees all debts of the Bank. AKB provides comprehensive banking services for private individuals, companies and communities. The Bank's headquarters are located in Aarau and the business area is predominantly limited to the canton of Aargau and the bordering regions with 31 branch offices located across the canton. There is a branch in Olten for the Olten-Gösgen-Gäu region, in addition to an ATM in Egerkingen.

Clients as the focal point
Aargauische Kantonalbank employs around 800 people day after day. The intensity of their involvement does not depend on whether they are in direct contact with customers or whether they perform their duties "behind the scenes". In everything we do, in everything we plan: the focus is always on our customers. They form the core of our actions. We encapsulate this deliberate focus in the term "client centricity". In addition, we are pursuing "omnichanneling" as a second strategic direction. Our clients can use our range of solutions via integrated channels. In 2017, we created the organisational conditions allowing us to consistently focus on the requirements and needs of our clients.

Organisation follows strategy
The new organisational structure of AKB was established on 15 May 2017. Adapted to the requirements of client centricity and omnichannelling as well as to strengthen the private and corporate customer business, it now comprises the five divisions: "Corporate Governance", headed by Dr. Pascal Koradi, CEO; "Private Clients & Private Banking", headed by René Chopard, Deputy CEO; "Corporate Clients & Institutional Banking", headed by Patrick Küng; "Client Solutions", headed by Dieter Widmer; "Loans, Finance & BI", headed by Stefan Liebich.

With Patrick Küng an eminently qualified person with a wealth of experience in the SME sector was appointed to the Executive Management of Aargauische Kantonalbank. In the wake of restructuring, the previous Head of "Services & Logistics", Dr. Karsten Kunert, retired from the Executive Management and from AKB. The Board of Directors expresses its gratitude for his many years of commitment to AKB.

The Board of Directors and the Executive Management of Aargauische Kantonalbank are satisfied that they have set the course for a successful further development of the bank with the strategic and operational realignment of the organisation.

On a successful course
With an annual profit of CHF 145.6 million, we seamlessly build on the good results of previous years in 2017. The highest growth in customer funds over the last five years was CHF 1.0 billion. We see this as a strong vote of confidence in the security and consistency of our Bank, but also as a sign that we will be even more successful "setting standards" for our clients. Our successful activities in the financial year 2017 were also reflected in the cumulative client volume, consisting of loans, client funds and securities holdings. It increased by CHF 3.0 billion to a total of CHF 49.2 billion.

Values count
AKB is an attractive employer in the canton of Aargau and in the bordering area Olten-Gösgen-Gäu. The fact that we do not just attach importance to figures is shown by our employee surveys, which we conduct every year. Total employee satisfaction for 2017 is 92%. We promote and give concrete expression to our corporate culture in a very conscious manner. Our cooperation is based on our defined core values of trust, respect, responsibility, flexibility and openness.

Thank You
On behalf of the Board of Directors and the Executive Management of Aargauische Kantonalbank, we would like to thank our clients, our stakeholders from business and politics, and our business partners for the trust they have placed in us over the past year. We would also like to extend our sincere thanks to our employees, who wholeheartedly ensure on a daily basis that Aargauische Kantonalbank can act as a successful bank, as an attractive employer and, ultimately, as a decisive financial partner for its clients.

Dieter Egloff
Chairman of the Board of Directors

Dr. Pascal Koradi
CEO

AT A GLANCE

in CHF million	2016	2017	Change in %
Income statement			
Net result from interest operations	268.9	255.3	– 5.1
Result from commission business and services	59.0	62.3	5.7
Result from trading activities and the fair value option	51.0	61.9	21.3
Other result from ordinary activities	5.1	6.7	32.6
Operating income	**383.9**	**386.2**	**0.6**
Personnel expenses	– 106.7	– 112.4	5.4
General and administrative expenses	– 70.2	– 74.6	6.2
of which compensation for the state guarantee	– 10.7	– 11.1	4.0
Operating expenses	**– 176.9**	**– 187.0**	**5.7**
Value adjustments on participations and depreciation and amortisation of tangible fixed assets and intangible assets	– 10.5	– 10.0	– 4.7
Changes to provisions and other value adjustments, and losses	– 1.5	0.7	– 150.5
Operating result	**195.1**	**189.9**	**– 2.7**
Extraordinary income	7.5	6.2	– 18.1
Extraordinary expenses	–	–	n. a.
Changes in reserves for general banking risks	– 45.9	– 38.1	– 17.1
Taxes	– 14.5	– 12.3	– 15.0
Profit	**142.2**	**145.6**	**2.4**
Appropriation of profit			
Allocation to statutory retained earnings reserve	45.5	49.6	9.0
Distribution to the canton	99.0	96.0	– 3.0

in CHF million	31.12.2016	31.12.2017	Change in %
Balance sheet			
Total assets	**25 245.5**	**26 961.3**	**6.8**
Loans to customers	**20 842.8**	**21 826.2**	**4.7**
Amounts due from customers	1 282.3	1 017.5	– 20.7
Mortgage loans	19 560.5	20 808.7	6.4
Funds due to customers	**16 310.5**	**17 312.6**	**6.1**
Amounts due in respect of customer deposits	16 250.7	17 270.0	6.3
Cash bonds	59.7	42.6	– 28.7
Net equity before distribution of net profit	**2 187.7**	**2 272.4**	**3.9**
Business Volume			
Client Assets [1]	22 449.1	24 217.3	7.9
Net new money	1 126.0	1 516.3	34.7
Client Volume [2]	46 152.6	49 174.2	6.5
Personnel [3]	**Jobs**	**Jobs**	
FTE (full-time equivalent)	676.3	693.2	2.5
of which apprentices/trainees	40.2	38.5	– 4.2

in %	2015	2016	2017	strategic targets
Key figures				
Return on Equity (ROE) [4]	10.2	9.5	8.9	7–8
Total Capital Ratio incl. national countercyclical buffer [5]	16.2	16.2	16.1	15.8–16.2
National countercyclical buffer ratio	0.9	1.0	1.0	
Total Capital Ratio according to Pillar 3 [6]	17.1	17.2	17.1	
Leverage Ratio [7]	8.0	8.1	7.9	
Cost-income Ratio [8]	46.3	46.1	48.4	50–55

in CHF 1000	2015	2016	2017
Assets per employee	35 218	37 329	38 894
Operating income per employee	544	568	557
Operating expenses per employee	252	262	270
Operating result per employee	287	288	274

[1] Basis: deposits and assets under management, since 2017 exclusive corporate assets.
[2] Basis: client assets, corporate assets and loans to customers.
[3] FTE (full-time equivalent) is shown as part-time adjusted, apprentices, trainees and employees in the trainee pool are counted as 50%.
[4] Calculation Return on Equity: Operating result / Average net equity.
[5] Eligible capital to risk-weighted assets ratio according to Art. 42 para. 2 CAO.
[6] See Pillar 3 Report at www.akb.ch.
[7] Ratio of core capital (Tier 1) to total engagement for the leverage ratio (assets, derivate engagements, securities financing transactions engagements and other off-balance-sheet positions).
[8] Calculation of cost-income Ratio: Operating expenses (incl. compensation for the state guarantee) / Operating income (incl. changes in value adjustments for default risks and losses from interest operations).

COMMENTARY ON BUSINESS PERFORMANCE

Aargauische Kantonalbank (AKB) once again unveiled an extremely good operating profit for 2017. Total assets increased by 6.8% and amounted to CHF 27.0 billion at the end of 2017. With operating income of CHF 386.2 million, it reached a record high, and the operating result of CHF 189.9 million almost seamlessly matches the results of the two previous years. The Board of Directors proposes profit distribution to the canton of Aargau of CHF 96.0 million.

Balance Sheet

At the end of 2017, total assets stood at CHF 27.0 billion, up CHF 1.7 billion or 6.8% on the previous year. In addition to the increase in liquid assets, the main driver for the growth on the assets side of the balance sheet was the granting of mortgages. On the liabilities side, amounts due in respect of customer deposits and bond issues rose accordingly.

Assets

There was a marked increase in loans to customers of CHF 1.0 billion or 4.7%. With a total volume of CHF 21.8 billion of customer loans, the cantonal bank made a sustainable contribution to the economy in its business area.

Mortgage loans, the most important area of lending with a share of 77.2% of total assets, posted a net gain of CHF 1.3 billion or 6.4% to a total of CHF 20.8 billion. With this growth AKB was able to further strengthen its strong market position which has been continuously expanded in recent years. The continued low interest rates during the reporting year prompted clients to take out mainly fixed-rate and money-market mortgages. At the end of the year the breakdown of mortgage loans was as follows: 67% fixed-rate mortgages, 32% money-market mortgages and 1% variable rate mortgages.

Besides the mortgage business, AKB's core business areas are loans to SMEs and the public sector and issuing construction loans. The balance sheet item "Amounts due from customers" decreased by the net amount of CHF 264.8 million or 20.7% to CHF 1.0 billion during the reporting year. The persistently low interest rate phase with negative interest rates on customer deposits as well as the good liquidity position have prompted corporate customers to lower the use of approved credit limits. In addition, around half of the decrease is attributable to a reclassification from the balance sheet item "Amounts due from customers" to the "Mortgage loans" balance sheet item.

Liabilities

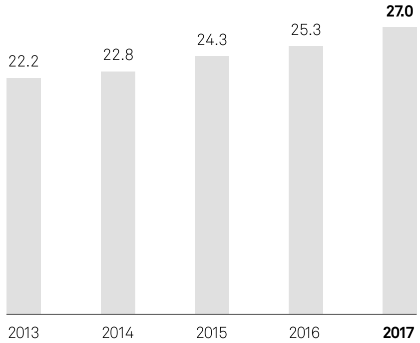
Like customers loans, customers funds also grew by CHF 1.0 billion or 6.1% in the year under review. It is the highest growth of the last five years. We view this as a strong vote of confidence in the security and reliability of our Bank, but also as a sign that we are "setting standards" for our clients.

The balance sheet item "Amounts due in respect of customer deposits" increased by the net amount of CHF 1.0 billion or 6.3% to CHF 17.3 billion during the reporting year. This growth was mainly in our product offering universal accounts. One reason for this pleasing increase in the funds entrusted to us is likely to be in the decision by AKB not, to a large extent, to pass on negative interest rates to savings and universal

27.0 bn

Balance Sheet Total

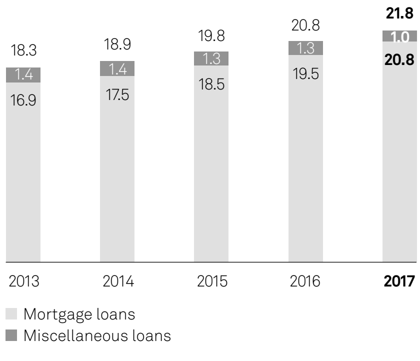
in CHF bn



21.8 bn

Customer Loans

in CHF bn



accounts. Commitments from client deposits made up 64.1% of total assets as at the end of 2017.

As our clients did not want to lock themselves in for the long term with interest rates at persistently low levels, the volume of cash bonds mostly lost significance with residual balance sheet items of CHF 42.6 million.

There was an increase in client assets (deposits and assets under management, without corporate assets) in the reporting year of CHF 1.8 billion or 7.9% to CHF 24.2 billion. This pleasing increase also had an impact on net new money adjusted for performance, which in the year under review posted an inflow of CHF 1.5 billion.

AKB took advantage of this period of low interest rates to increase its long-term funding in the form of bond issues and central mortgage institution loans. These items under liabilities increased by CHF 385.7 million to CHF 4.2 billion (previous year: + CHF 578.3 million).

Income Statement
AKB's net result from its interest operations (which is its strongest earnings pillar with a share of around 66%) was CHF 255.3 million, a decrease of CHF 13.6 million or 5.1% less than in the previous year. Gross result from interest operations was once again weighed on by the current low interest rate environment and stood at CHF 241.9 million, CHF 6.7 million or 2.7% lower than in the previous year despite expansion in the balance sheet. As in the previous year, the earnings item “Changes in value adjustments for default risks and losses from interest operations” produced an earnings surplus of CHF 13.4 million. Since the rise in releases of impairments in the previous year amounted to CHF 20.3 million, this item shows a decrease in earnings of CHF 6.9 million.

Earnings from the commission business and services increased slightly by CHF 3.3 million or 5.7% to a total of CHF 62.3 million in the reporting year. The pleasing development of the financial markets has prompted our clients to become more active again in the investment business, resulting in a CHF 2.2 million or 5.0% increase in commission income from securities trading and investment activities to CHF 46.4 million.

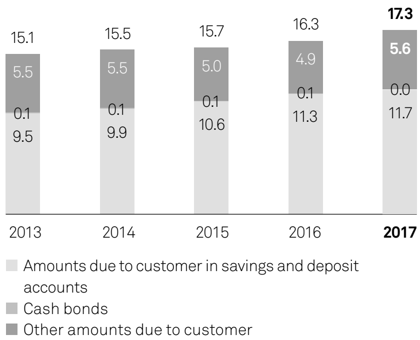
Earnings from the trading business enjoyed another rise in the reporting year of CHF 10.9 million or 21.3% to CHF 61.9 million. The increase is based on systematic use of the opportunities by Treasury, arising from the large interest rate differential between the Swiss franc and major currencies.

The earnings item “Other result from ordinary activities” increased from CHF 5.1 million to CHF 6.7 million. The increase was due to income from disposals of financial assets and investment income.

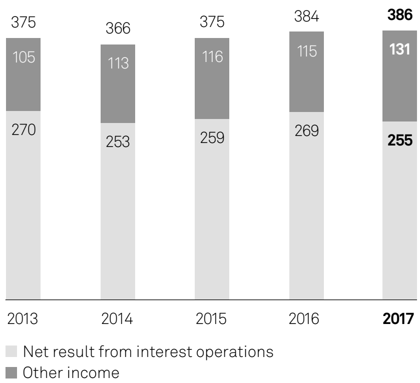
Total operating income of CHF 386.2 million was achieved, an increase of CHF 2.3 million or 0.6% on the previous year, representing a record high for the past years.

Operating expenses rose in the reporting year by CHF 10.1 million or 5.7% to CHF 187.0 million. Personnel expenses increased by CHF 5.8 million,

17.3 bn
Customer Funds
in CHF bn



386 m
Operating Income
in CHF m



or 5.4%, to CHF 112.4 million, primarily due to the increase in the number of employees and adjustments in personnel expenses. General and administrative expenses of CHF 74.6 million were CHF 4.4 million or 6.2% higher than the previous year. This increase was mainly driven by the bank's digital evolution and investment in the branch network.

The payment of the state guarantee to the canton of Aargau is also an integral part of the general and administrative expenses. This levy is governed under § 5 paragraph 2 of the Aargauische Kantonalbank Act. It amounts to 1% of the required capital according to the banking and stock exchange regulations, which for the reporting year results in a payment of CHF 11.1 million (previous year: CHF 10.7 million).

The changes in operating income and operating expenses were also reflected in the cost-income ratio which increased during the reporting year from 46.1% to 48.4%. It is therefore still well below the long-term maximum of 55% set by the owner.

Value adjustments on participations and depreciation and amortisation of tangible fixed assets amounted to CHF 10.0 million, 4.7% or CHF 0.5 million less than in the previous year. This item comprises CHF 0.3 million of impairments on participations and CHF 9.7 million of writedowns on tangible fixed assets, of which CHF 3.3 million were incurred on bank premises, CHF 0.8 million on other premises and CHF 5.6 million on other tangible fixed assets (predominantly furnishings, equipment, hardware and software).

The earnings item "Changes to provisions and other value adjustments, and losses" produced an expense of CHF 0.7 million in the reporting year on the back of reversals of released provisions (previous year expenses CHF 1.5 million).

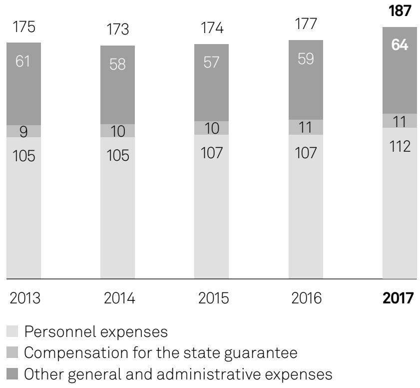
Earnings from operating activities are shown under the income statement item "Operating result". This came in at CHF 189.9 million, CHF 5.2 million or 2.7% below the previous year's level of CHF 195.1 million and is the third best result in the Bank's history. Return on equity based on the operating result was 8.9% (previous year: 9.5%) and so significantly higher than the strategic objective of 7.0–8.0%.

Extraordinary income stood at CHF 6.2 million, compared with the CHF 7.5 million of the previous year. This earnings item mainly includes the second earn-out payment in the reporting year from the sale of the holding in Swisscanto Holding AG to Zürcher Kantonalbank in 2015.

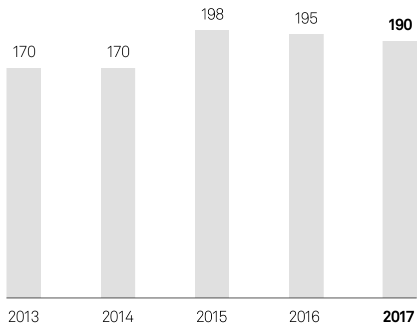
To further increase risk-bearing own funds, the net amount of CHF 38.1 million (previous year: CHF 45.9 million) was transferred from the income statement to the reserves for general banking risks. This allocation helped ensure that, despite the significant balance sheet growth, the total capital ratio at 16.1% at the end of 2017 was in the upper range of the target ratio of 15.8%–16.2% according to the ownership strategy.

The tax expenses of CHF 12.3 million includes CHF 10.5 million (previous year: CHF 12.7 million) of income taxes in favour of the local communities of AKB in the canton of Aargau. These taxes are attributable to the profit dis-

187 m
Costs
in CHF m



190 m
Operating Result
in CHF m



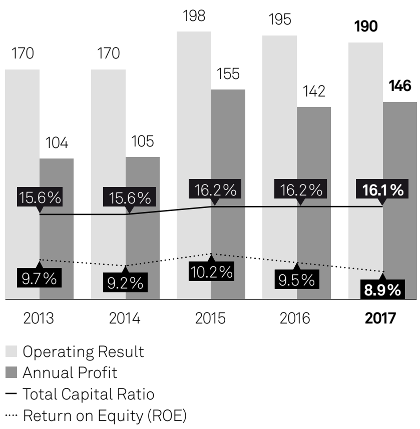
tribution to the canton of Aargau. Since the tax expense from the previous year included additional charges for the profit distribution from the 2015 annual financial statement, the tax expense in the income statement for 2017 shows a decrease of 15.0%.

AKB reported a profit for the year of CHF 145.6 million, an increase of CHF 3.5 million or 2.4% on the previous year (CHF 142.2 million). The smaller allocation to reserves for general banking risks and the lower tax expense more than offset the lower operating result and extraordinary income.

The company's profit before a change in the reserves for general banking risks was CHF 183.7 million compared to CHF 188.1 million in the previous year, which is CHF 4.4 million or 2.3% less.

Appropriation of Profit
The Board of Directors proposed to the Executive Council a profit distribution to the canton of Aargau of CHF 96.0 million and an allocation to the statutory retained earnings reserve of CHF 49.6 million. Details on profit distribution can be found on page 24.

Operating Result, Annual Profit, Total Capital Ratio and Return on Equity (ROE)
in CHF m



MANAGEMENT REPORT

DEVELOPMENT OF BUSINESS ENVIRONMENT

The development of exchange rates and the surprisingly positive economic momentum in the European Union dominated Switzerland's economic development last year. The Swiss franc started against the euro in 2017 at a level of around 1.07 francs per euro. From mid-April, however, the Swiss franc continued to weaken to a level of 1.17 francs per euro. Surprisingly for the financial markets, the exchange rate was able to consolidate at this level; and this without significant support measures by the Swiss National Bank. By contrast, there was little movement in the domestic interest rate level, which remained largely in negative territory. The noticeable increase in longer-term interest rates at the end of 2016 following the election of Donald Trump as US President continued only moderately. Within a year, interest rates only rose by around 0.125%, with pronounced sideward movements. This, even though the global economy has developed extremely positively. Not surprisingly, the money market interest rate changed practically nothing. The 3-month Libor interest rate managed by the Swiss National Bank remained at –0.75%. This environment had an effect on the real economy.

Boost for the real economy

At the beginning of 2017, the rate of inflation, measured in terms of consumer prices was again above 0% for the first time after two years in negative territory. Since then, the rate of inflation has slowly but steadily increased, coming to just under 1% at the end of the year. Thus, the at times accentuating fears of deflation have been eliminated. The appreciable devaluation of the Swiss franc – especially against the euro, but also against most other major trading currencies – significantly improved the competitiveness of export-oriented companies during the course of the year. The positive global economic development in general, and especially in the eurozone, also provided additional impetus, as demand for Swiss goods and services continued to rise. Not only the export sectors such as medical technology, the pharmaceutical sector or specialty chemicals with their typical unique selling points and high quality standards benefited from this. The classic export goods from the watchmaking, mechanical engineering, metalworking and electrical industries also managed to recover steadily over the course of the year, albeit only slightly. The retail sector close to the border also benefited from the fact that the price differential with its competitors in neighbouring countries declined.

Liquidity boosts stock markets

There were no significant changes in the share price compared to the previous year in the financial industry. The third year of negative interest rates meant that pricing in the mortgage business was further complicated. In Pensions, the consequences of a negative risk-free interest rate in the form of a further decline in interest on pension assets and further falls in conversion rates became more apparent.

Negative yields and the still extremely generous injections of liquidity to the financial markets via all major central banks resulted in a further inflow of capital to the global stock exchanges. The increase in global growth momentum, especially in emerging markets, and the associated increased earnings expectations at companies boosted equity markets around the world. Last year, the Swiss stock market rose by a respectable 12.8%, as measured by the Swiss Market Index (SMI).

Signs of a slowdown on the Real Estate Market

The Swiss real estate market is showing increasing signs of saturation. The continuing high level of construction activity in 2017 ran up against in a decline in demand. Vacancy rates have increased significantly, especially in the rental sector. The persistent trend towards less dynamic increases in prices of single-family homes and owner-occupied homes (more pronounced in the latter case) continued. Commercial real estate also showed a further increase in empty space. Retail space in particular was less in demand due to the transfer of sales activities to the online arena.

STRATEGIC PRIORITIES/ACTIVITIES

Key figures

In accordance with the financial objectives of the Executive Council's Ownership Strategy, the Board of Directors and the Executive Management have defined the following strategic key figures for the strategic orientation in 2016–2020 of Aargauische Kantonalbank:

Strategic key figures	Target Value	2016	**2017**
Return on Equity (ROE)	7–8%	9.5%	**8.9%**
Cost-income Ratio	50–55%	46.1%	**48.4%**
Total Capital Ratio[1]	15.8–16.2%	16.2%	**16.1%**

[1] Ratio of eligible capital (net capital requirement for national countercyclical buffer) to risk-weighted positions pursuant to Art. 42 para. 2 CAO.

Aargauische Kantonalbank has kept its total capital ratio at a constant level in recent years. The company has thus, measured against the 12% capital ratio required by the regulator, a very solid capital base: it is around 34% above the minimum requirement. The results of our ordinary capital planning and stress scenarios show that Aargauische Kantonalbank, even taking into account a substantial economic downturn, would still have intact capital adequacy and could ensure compliance with capital requirements at all times.

Strategic directions
We focus on the two strategic directions of “customer centricity” and “omnichannelling” and measure them using key figures. The first measure, which takes into account the number of principal banking relationships, shows a positive development of around 2% for 2017. We have succeeded in significantly increasing our footprint in the canton of Aargau.
A second measure of user behaviour was established in the year under review: Here it will be decisive whether and how our clients use our Bank's digital and analogue contact points.

Ownership strategy for the AKB
The goals formulated in the ownership strategy for Aargauische Kantonalbank in accordance with the requirements of the cantonal constitution and the AKB law, the objectives of cooperation with the canton and the financial targets regarding own funds, growth and earnings were achieved. The cost-income ratio (inclusive of the payment of the state guarantee) was 48.4%, well below the long-term maximum of 55%.

“AKB – Setting Standards”
With our “AKB – Setting Standards” vision as our guiding principle, we seek to inspire our clients and sustainably increase the company value, taking into account the performance mandate. We also want to be an attractive employer and our processes should be simple, fast and effective.

Further development of overall bank strategy
In 2017, we dedicated ourselves to the development of key strategic projects, the development of sub-strategies for each business area and the development of sub-strategies for functional support.

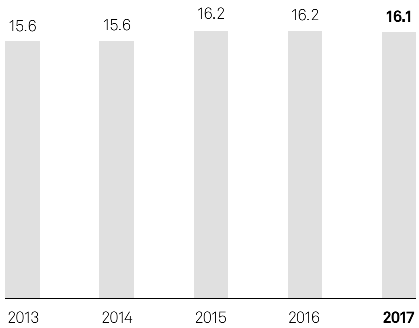
The key projects served primarily to develop the necessary (data) bases for the development of the sub-strategies. The resulting strategic initiatives and projects now have to be implemented in productive environments in 2018.

New member of the Executive Management
On 15 May 2017 Patrick Küng was appointed member of the Executive Management of Aargauische Kantonalbank. The 43-year-old finance specialist and corporate client specialist, a highly trained and extremely experienced person, bears the responsibility for Corporate Banking & Institutional Banking, which was newly established in 2017.

Patrick Küng joined AKB in October 2016. Previously, he worked for many years in a senior position at another banking institution in the SME sector. As a result, he is familiar with the SME landscape, its needs as well as challenges.

Key Strategic Projects
Within the strategic key project “primary and secondary organisation”,

16.1 %
Total Capital Ratio
in percent



we have consistently adjusted the organisation of AKB to the overall bank strategy defined in 2016. With the new structure, which was established on 15 May 2017, our focus is more closely on clients and their needs. You can choose how to contact us: In a branch, by telephone, online or mobile. Thus, they use the advantages of omnichannelling across all business units.

In the key project “Brand Promise” we have collected the opinions and input of both internal and external persons. Both clients, employees, interns and non-clients have gathered in round tables for an in-depth exchange of views. Together they worked out what makes Aargauische Kantonalbank stands out, the characteristics its brand embodies today and where there is potential for development in order to strengthen its positioning for the future. The insights will be incorporated in the strategic brand management and communication strategies of 2018.

Substrategies for Business Areas and Functional Support
In 2017, we developed the sub-strategies for the Private Clients, Private Banking, Corporate Clients and Institutional Banking segments.

Process optimisation, the expansion of omnichannelling and the development of digital solutions in the web environment were the focus of the sub-strategy “Functional Support Digitalisation”. In 2017, among others, we successfully introduced the new client portal. At the heart of the portal is the integrated AKB Financial Assistant (Personal Finance Management PFM), which gives users access to their personal finances at any time and from anywhere.

The merging of the analogue and digital worlds, the exploitation of the opportunities offered by digitalisation and the optimisation of further processes through new technologies are topics that will continue to preoccupy us intensively in 2018 in all strategic deliberations and the resulting operational implementation.

CORPORATE BANKING & INSTITUTIONAL BANKING

With the strategic change of direction in mid-May 2017, Aargauische Kantonalbank focused more closely on the needs of clients and established a separate business unit for corporate banking under the supervision of Patrick Küng. The intention is to increase the footprint as SME bank in our economic area.

Reliable partner in a challenging market environment
Geopolitical, cyclical and structural uncertainties also dominated 2017. The financial year continued to be characterised by low interest rates and a slightly weaker Swiss franc - a plus for all export-oriented companies. Added to this was the rapid change brought about by digitalisation. New business models are being created, previous framework conditions are no longer valid. A rethink is required.

In 2017, too, we supported our clients with our bespoke knowledge, commitment, tailored services and fair conditions.

Encouraging growth in the corporate client business
We operate the regional corporate client business at our seven regional offices as well as directly at our 31 branches. Presence and proximity are important to us. Only in this way can we anticipate the specificities of the regional economy and efficiently support our SME clients. Despite the challenging market environment, we can look back on a very successful year. Our corporate banking business grew significantly and we also managed to increase the number of clients. In both assets and liabilities, we achieved very encouraging growth and were able to report increased income, which was broadly diversified and distributed among all units.

Aargau's SMEs in good shape
The SMEs in the canton of Aargau and in the Olten-Gösgen-Gäu region were in good shape in 2017. In a stable domestic economy and thanks to the weakened Swiss franc, the tense situation of export-oriented companies has eased. The real estate market caused us more concern. Construction activity remained high, despite increased vacancies in flats in the cantons of Aargau and Solothurn. Therefore, we were very selective when it came to the financing of investment properties. We continue to scrutinise the market situation and in particular the regional and local conditions.

Large companies implemented safeguards
Pleasing trends were also reported in business with major clients. 2017 was still dominated by low interest rates. This situation continuously influenced the chosen financing mix of the companies. Liquidity has been secured in the medium to long term, and our clients have opted for long-term maturities for financing as far as possible. The exchange rate against the euro eased over the course of the year,

leading to improved order books and growth for export-oriented companies. In particular, companies that produce their products in Switzerland and export to the euro countries have benefited. The annual average price of just under CHF 1.11 in 2017 was only marginally higher than the previous year, with growth of around 2%. The actual impact on the 2017 year-end figures remained negligible.

Successful year for institutional investment clients
The segment of our institutional investment clients can look back on a very successful year. Net inflows in securities holdings, including asset management assets, reached a record high, while liabilities were neutral. The positive developments on the financial markets in the 2017 investment year also had a positive effect on the existing securities portfolio. However, the challenges in the prevailing low interest rate environment are unlikely to diminish in the coming years. Accordingly, professional advice as well as innovations relating to investment business will continue to gain in importance.

Expansion of the Corporate Finance offering
Our consulting services for SMEs were in high demand in 2017. As a result, we further expanded our offering in the Corporate Finance segment and strengthened the segment in the last quarter of 2017 by engaging a dedicated corporate finance specialist. We also focused on succession planning in the reporting year. Our aim was and is to offer our clients a comprehensive service at all business stages – from start-up to succession planning.

Successful events for SMEs
With annual events we promote regular dialogue with and among our clients. We create suitable platforms for the exchange of knowledge, networking and positioning of companies in the canton of Aargau. For example, we welcomed 700 guests on 30 November 2017 in Brugg-Windisch to our 7th construction and economic conference. Just as successful was the event bestowing the Aargau business awards on the best cantonal SMEs held for the 11th time on 27 April 2017. The event, which was organised in cooperation with the Aargau Trade Association, has become well-established in the canton of Aargau and is enjoying great popularity. Another highlight was the investor conference in the Aargau Culture and Conference House on 19 October 2017. Two Aargau startups presented themselves in search of investors. It is wonderful that there have been lively discussions between founders and investors in 2017 with prospects for various forms of cooperation.

Investing in Training and Continued Development
Training and continued development are highly valued at AKB and are indispensable for our client partners as well as for our specialists. In 2017, for example, we invested in intensive specialist and management training. In 2017, our approximately 60 employees from Corporate Banking & Institutional Banking took part in over 400 internal and external training days. We also attach great importance to the training of young professionals. Thus, 26 apprentices were taken on in our business last year and were able to acquire valuable skills in our corporate client teams for their future training.

Outlook
Our clients are at the very heart of what we do. We want to further expand our position as an SME bank in 2018 and will focus our business model even more on the needs of our clients. We are investing in digitalisation and expanding our online channels.

“We are investing in digitalisation and expanding our online channels.”

Our clients are free to choose when and via which channel they would like to contact us. At the same time, we set ourselves the goal of providing our clients with more time for personal discussions through efficiency improvements and process optimisations. Even in a digitally oriented world, personal contacts and encounters continue to form the basis for successful business relationships.

PRIVATE CLIENTS & PRIVATE BANKING

The 2017 financial year was characterised by numerous challenges and demanded a lot from us. Within the Bank, the main focus was on the reorganisation of the business units. Thus, for the first time, we report here as the new Private Clients & Private Banking division. External factors that were of concern to us were the consistently very low interest rates, accompanied by a challenging but encouraging investment environment. Under these conditions, the Private Clients & Private Banking division had a very successful year. This is not least because the employees have dedicated themselves with a great deal of commitment to AKB and its clientele.

Development of business volume
Demand for residential property and mortgage financing remained high in 2017. At all 31 locations we achieved very strong growth in the lending business. Aargauische Kantonalbank thus confirmed its leading role in the cantonal mortgage business.

At the same time, the volume of liabilities also developed very favourably. We are perceived as a safe, reliable and trustworthy partner. This is encouraging, but there were also some challenges for our Bank in the current low interest rate environment. However, with timely and far-sighted decisions, these difficulties could be arranged in favour of the bank and thus also for the benefit of the clients. This included, for example, not passing on negative interest rates to our private clients and investing millions in the expansion and conversion of our local locations.

Our clients took advantage of the positive investment environment, which was generally positive throughout the year. The development in custody account volumes held by private clients was very satisfactory. In Private Banking, a lot of profit-taking was realised and, as a result, the volume growth did not quite live up to expectations.

Stable operating income
The constant high pressure on the margins weighed on the yield in interest margin. But even with indifferent income, the price sensitivity of our clients became more apparent, which led to further pressure on margins. Thanks to volume growth, however, overall operating income in the Private Clients segment remained stable.

Responsibility and risk awareness
Knowing that the AKB is doing well only when Aargau's economy and population are doing well, we fulfilled our mandate as an economy-boosting bank in our area of activity in 2017 with our transparent credit policy. At the same time, AKB's consistently cautious risk policy ensured that, despite the high level of growth, no excessive risks of loss were entered into. This is reflected not least in the fact that more impairments were reversed than were newly created.

Products, services and fees
In an environment that is increasingly regulated and continues to create new formal requirements, our goal in the reporting year was to present our clients with a clearly structured, clearly arranged product range. We still refrain from obliging them to select product packages (package solutions). Our clients appreciated the flexibility to decide for themselves which products and services they wanted to use. They could, for example, set their own budget. With good value account products, a transparent price structure in the investment business and customised conditions in financing, we provide a fair pricing model which is tailored to the particular circumstances and needs of the clients. This enabled us to increase the number of clients serviced by 2.388 to 93.204.

Client centricity and feedback culture
The needs and requirements of our clients are at the centre of all our decisions and activities. With our established consulting concept, we place them at the heart of our actions. We see ourselves as bridge builders between the needs of our clients and the solutions we offer them. We also see ourselves as a partner who acts with respect and esteem towards the clientele. These characteristics were also appreciated in the reporting year and rewarded with confidence. The number of customers for whom we are their principal bank increased by 2 percent in 2017.

Not only externally, but internally we attach great importance to respectful interaction and have set ourselves the goal of expanding our internal feedback culture. With the launched “Constructive Feedback Culture” initiative, we support our employees in expressing their opinions, being authentic and providing feedback independent of the hierarchical level. That benefits us and our clients too: We want to continue to improve and provide them with optimal solutions at all stages of their lives, so that they can count on Aargauische Kantonalbank as a reliable partner in all financial matters.

Client Focus and Dedication to Service
Long-standing and trusting relationships with our clients are an important key to success. Therefore, we aim to fill vacancies with internal candidates whenever possible. This is for the benefit of our clients, who can rely on long-term and tailor-made business relationships with their clients and partners.

“That's why we will continue to modernise our existing branch network.”

We firmly believe that proximity to clients is an important factor in our success in 2017. For this reason, we also invested in client focus and dedication to service last year.

The regional location of Zofingen was completely reorganised and adapted to the changing needs and increased expectations of our customers. All previous investments in our locations have paid off. That's why we will continue to modernise our existing branch network and open new offices.

However, we make client focus a reality, not only in physical locations, but also by expanding our digital services. The technical and social developments and possibilities motivate us to offer our clients not only physical locations but also other communication channels that are more or less open at all times. Omnichannelling is becoming the norm in the financial industry. In this context, the AKB portal launched in autumn 2017 was a special milestone. Clients can clearly visualise their personal financial situation with the online portal and have it under control at all times. It also enables the secure exchange of documents, data and e-mails with the Bank.

Further training for employees

The mutual respect, the reliability of AKB as a business partner and employer as well as the solidity are important reasons why we can count on many very long-standing employees. This is for the benefit of our clients. However, we can only meet their expectations if our employees meet a high professional and personal standard. In 2017, too, we invested a great deal in the initial and further training of our client partners. Providing internal specialist and management training as well as promoting young professionals has proven to be particularly valuable. These training courses are tailored precisely to our needs and guarantee targeted continued development. We also attach great importance to team events. These promote team spirit, cohesion within the team and interdisciplinary understanding.

Looking to the future

The financial year 2018 will demand a lot from us. Growing competition in the financial services market and technological development require us to constantly review and constantly adapt our processes and offerings. At the same time, clients' expectations of us and our products continue to increase. The fair and transparent client relationship will continue to be at the focal point of our company, accompanied by professional advice and support, true client focus, swift business transactions, individual product selection and correct risk assessment. Aargauische Kantonalbank's clients can rest assured that we will be working hard for them in the future too.

CLIENT SOLUTIONS

As part of the realignment of the primary organisational structure, the Client Solutions segment was created. In addition to trading, asset management and the bancassurance business, this segment also brings together those units that ensure processing and support in the trading and investment business as well as client data and payment transactions. In addition, the client solutions segment is also responsible for the entire infrastructure of AKB, for example for construction activities and building security.

More revenue in the trading business

Trading activities were dominated in the past year by the noticeable devaluation of the Swiss franc and by the extraordinary positive development on the stock markets. In particular, the rapid and surprisingly sustained rise in the Swiss franc against the euro from the middle of the year led to significantly increased intentions to buy by our clients. Thanks to their many years of experience in foreign exchange, our client partners were able to comprehensively recognise the specific needs of our clients and identify appropriate solutions.

The almost unchanged expansive injections of liquidity by the most important central banks meant that funds continued to flow into the stock markets in the past year as well. Nevertheless, the surprisingly strong price gains ultimately spurred the purchase of shares throughout the year and led to a pleasing increase in revenue from brokerage fees.

Good performance for investment business

The positive sentiment on the equity markets not only led to an increase in trading activities, but also led to a pleasing increase in deposit volumes and assets under management. Our portfolio management took advantage of the good market situation and achieved an above-average performance in the individual investment strategies. Assets under management exceeded the threshold of CHF 5 billion, both through the acquisition of new institutional funds and the expansion in private client business. Our many years of proven asset management and the attractive market environment enabled our client partners to increase the number of asset management mandates by more than 12 percent compared to 2016.

Strong Demand for Advice in Bancassurance

The services in bancassurance in the areas of taxes, finance and estate planning and occupational pensions were in high demand. With the help of comprehensive analyses of the individual financial situations, the specialised staff at AKB were able to provide their clients with optimal advice for the future. The affinity of our clients with AKB was further solidified and led to an expansion in the business volume.

New competence sector for products and services

The newly created Segment and Product Management sector serves the comprehensive and all-round support of all front-line units with product and specialist issues. It plays an important role in our client-centric Bank. In addition to the prompt and competent answering of inquiries from clients, it is also dedicated to the further development of our products and services. Thanks to a well-balanced range of services, combined with the positive development of our cooperation with Leonteq in the area of structured products, we achieved encouraging growth of 10% in custody account volumes.

Efficiency and security for client data and processing

Through the newly created Client Data and Payment Transactions sector, we ensure that client data is of the highest quality while maintaining all security-relevant requirements. This means that traditional payment services can be offered efficiently, reliably and quickly at the highest level. Processing and settlement for all investment and trading activities of AKB and its clients takes place in the second new sector, the Trade Support Centre. Through the organisational and spatial consolidation of the processing departments, synergies can be exploited to enable even more efficient and secure settlement of trading and investment transactions. We managed to further improve various settlement processes and increase quality. As part of our processing sub-strategy, the foundation has been laid for digitalisation to be driven by processes that are consistent and free of media disruption, thereby further relieving the client areas of administrative tasks.

Full-scale construction work

In 2017 we were challenged with relocations related to the reorganisation and demanding construction and infrastructure projects. The largest construction project was realised with the refurbishment of our regional office in Zofingen. In addition to structural and building law requirements, the renovation of the building also had to meet the Bank's internal strategic requirements for digital meeting zones in the client areas. The completion and reopening of the regional office is scheduled for the first quarter of 2018. The infrastructure of our data centres was also renewed last year, which has increased operational reliability and demonstrably reduced energy consumption.

LENDING, FINANCE AND BUSINESS INTELLIGENCE

As part of the reorganisation in 2017, we created the Lending, Finance and Business Intelligence segment. The entire IT services of our Bank have been transformed into this newly created segment and consequently the horizontalisation of IT processes has been consistently pursued. Also new are the Treasury functions in Lending, Finance and Business Intelligence, which are part of the Bank's core functions.

Further development of reporting platforms

In 2017, the Controlling sector focused on the further development of the reporting platform and the controlling instruments. On the one hand, we created the basis for covering future reporting requirements. On the other hand, predictive analytics should explore ways to use unstructured data to identify and exploit business opportunities and effectively support the sales organisation. At the same time, we have developed a cockpit for operational bank management that enables a menu-driven, integrated view of strategic and operational metrics.

In 2017, we completed basic work on the design of a modular price offer (risk-adjusted pricing). In parallel to repositioning the Treasury functions, we have developed the corresponding sub-strategy and defined its conceptual orientation.

VARIOUS IT ISSUES

Avaloq Major Release

After four months of preparation and extensive testing, we successfully launched a new major release of our Avaloq core banking system on 17 April 2017. In addition to many technical adjustments, the new release brought enhancements in the areas of loans, investments and payments.

Introduction of Skype for Business
With the introduction of Skype for Business we have set a milestone in the field of IT infrastructure. The telephone system, which was over 10 years old, has been replaced by a modern, software-based solution. New functions and headsets will facilitate communication and enable collaboration across devices. In addition to pure telephony, Skype for Business enables additional services such as team or conference meetings. Around 90 participants can now take part in training courses or cross-location meetings via Skype at the same time.

Digital workplace
Digital support during the consultation process and future-oriented forms of work require mobile and consistently well-connected workplaces. With the piloting of the Digital Workplace (DAP) under Windows 10 and Office 365, we created the technical and infrastructural prerequisites during the reporting year for the roll-out in 2018. Mobile Surface devices optimally support our employees. Selected cloud services enable them to work virtually anywhere and at any time they choose.

New server systems for a high-performance infrastructure
Maintaining and developing a high-performance and secure IT infrastructure is one of the core tasks within our Bank. For the new AKB website, which was set up in 2017, and the newly implemented "My AKB" client portal, 25 new server systems were put into operation in Swisscom's data centres.

New ATMs for new notes
The introduction of the new 20 and 10 notes as well as the merging of the bank's own services with the interbank services of SIX led in 2017 to the most extensive innovations in the area of ATM banking. Some of the AKB ATMs were definitely outdated. We started the modernisation process in 2017 by replacing the old machines with state-of-the-art ATMs. This will persist into 2018 and 2019.

PERSONNEL

An Attractive Employer
AKB was a significant employer in the canton of Aargau in 2017 with 789 employees. Of these, 78 are apprentices, who are treated conscientiously and with great care and support. We have addressed and anchored the values of our corporate culture with various activities.

The employee survey from mid-year on cultural values highlights the fact that a very high number of employees identify with AKB. At the consolidated company level, the feedback is very positive. Lower-ranking assessments were recorded and processed for individual divisions. The staff turnover rate fell to 4.7% (net fluctuation) in 2017 and reflects the high level of employee loyalty to AKB.

Changes in Staffing Levels
Headcount is listed as an FTE value (full-time equivalent), which means that employment relationships are converted to the corresponding full-time level of employment (i.e.100%). "Employees in training" includes apprentices and trainees.

2017	
Employees	711
Headcount	693.2
Employees in training	78

Employer Responsibility
The sub-strategy Human Resources was developed in a heterogeneous project group. It addresses many new regulations that clearly help us as an attractive employer and express our responsibility to our employees. As part of strategic initiatives, approaches are further processed and implemented. This affects all topics of the HR value-added chain.

We have revised our approach to the development and selection of subject matter experts and executives at the executive level. Since then, several candidates have gone through this process. Their development was determined based on the respective report. We are pleased to note that this new mode provides very good, reliable results.

To promote individual development, we have re-issued the regulations for external continued development. In particular, the flexibility in implementation was taken into account for the employees.

"The issue of gender diversity was prioritised."

The issue of gender diversity was prioritised. Thus, since 2017, all full-time jobs without a weighty counter-argument are consistently advertised and filled with an 80–100% workload.
We ensure long-term professional development opportunities are available at AKB as follows:
- Internal and external management and professional training for employees and managers

- Individual development via access to the getAbstract database for all employees
- Personnel selection and promotion based on clearly defined, objective decision criteria
- Use of level-oriented selection tools in the recruitment of new employees and the development of internal employees
- Conscious consideration of internal employees in filling vacancies
- Remuneration based on a neutral and analytical job evaluation
- Manager appraisal: managers receive structured feedback from employees annually.

MARKETING AND SPONSORSHIP

New brand promise

The brand AKB is a strong brand and thus a valuable asset of our Bank. It has stood for trust, quality and reliability for more than 100 years. Maintaining our brand is the core element of our brand management with the aim of further improving the positioning and attractiveness of AKB. In 2017, we created a new, ambitious brand promise: "In the right place". It should and can at once evoke associations and expectations. Our stakeholders have chosen the right partner in AKB with their needs, wishes and plans, are always welcome and in good hands. They are in the right place in all respects!

Commitments to Culture, Sport and Society

Through sponsorship, AKB actively participates in cultural, sporting and community life in its economic area. In 2017, we engaged in a variety of events, creating an emotional connection to the AKB brand. The AKB Roadrunner concerts, the international music festival Lenzburgiade, the Aargau company award as well as the construction and business conference and the wetland trips in cooperation with the Naturama are some examples of our multifaceted commitment. Aargauische Kantonalbank has also been the main sponsor of FC Aarau women since the 2017 season.

By awarding financial contributions to non-profit institutions, associations and organisations we support a variety of tasks and projects for the benefit of people, nature and the environment. Our commitments and events can be found at akb.ch/sponsoring.

OUTLOOK

The Economic Outlook

The current year will continue to be shaped by political decisions and events. Although most of the geopolitical risks (Syria, Turkey, Iran, Saudi Arabia, etc.) are largely ignored by the financial markets, the announcement by the United States that it intends to relocate its embassy from Tel Aviv to Jerusalem has caused concern. Furthermore, there is a growing trend towards protectionist attitudes by many governments, which will have a lasting impact on global trade. The current US policy will be reassessed by voters in the midterm elections at the end of 2018. The European agenda is dominated by the ongoing Brexit negotiations and new elections are also pending in Germany (possibly) and in Italy. Current events have developed a certain habit effect, could well be underestimated and ultimately cause more unrest – especially in the financial markets. The US economy will continue to play an important role economically, even if the actions taken by President, Donald Trump, are not always immediately clear. Nonetheless, the US President had succeeded in implementing one of his election promises by the end of 2017, the passage of his promised tax reform. However, while some of the desired expansionary effect of this tax reform will fizzle out, it comes at a time when the US economy is already in full swing and the labour market seems completely saturated. What is clear, however, is that the US debt ratio will continue to rise due to the expected massive tax shortfalls. Thanks to low inflation expectations, the expected US rate hikes could therefore be less rapid than forecast. In Europe, too, monetary policy is becoming less expansionary than before.

> "The upswing in Europe is broad-based and is being driven by all the major countries."

Nevertheless, the first rate hikes are unlikely to occur this year. The upswing in Europe is broad-based and is being driven by all the major countries. Nonetheless, the basic problems remain in the former crisis countries. Many of these countries are currently benefiting from a veritable tourism boom and higher consumption rates, which are often financed by increased private debt. In addition, the current year will be influenced by the Brexit negotiations. For Great Britain, access to the European single market is of great importance. Recently, however, the European negotiating delegation has shown a tough attitude towards the wishes of the United Kingdom. The emerging economies are enjoying pleasing economic momentum. Higher energy prices have meanwhile led Russia and Brazil out of recession. India and China will continue to account for a higher overall share of global growth. The five-year plan adopted by the Government of China also places special emphasis on promoting quality sustainable growth. China's goal of becoming the most important global industrial nation is drawing ever closer.

Despite persistently high geopolitical uncertainties, the Swiss economy will benefit from the positive development in the European Union and the encouraging weakening of the Swiss franc. However, domestic demand continues to suffer from low migration figures and increasing online trade. Nevertheless, the easing on the currency front should, however, ensure that shopping tourism does not expand further. Tourism could also increase this year due to currency effects. High export expectations and the renewed increase in the investment propensity of domestic enterprises should ensure sustained economic momentum in Switzerland. All in all, the rate of growth in 2018, measured in terms of gross domestic product, could well rise to just over 2%.

Outlook for AKB

We expect Aargauische Kantonalbank to have a good financial year 2018. The economic area of Aargau is in robust shape. The broadly diversified sector mix among companies and the attractive location quality of the canton are likely to outweigh any possible slight signs of a slowdown in the real estate sector. Our client portfolio has a balanced composition with adequate risk exposure and further growth potential. We are therefore optimistic that we can sustainably achieve further expansion of our position as the leading regional bank.

BALANCE SHEET

before appropriation of profit

in CHF 1000	31.12.2016	31.12.2017	Change in %
Assets			
Liquid assets	2 607 560	3 102 410	19.0
Amounts due from banks	344 008	470 001	36.6
Amounts due from customers [1]	1 282 315	1 017 482	– 20.7
Mortgage loans	19 560 492	20 808 730	6.4
Trading portfolio assets	111 267	116 366	4.6
Positive replacement values of derivative financial instruments	122 099	121 255	– 0.7
Financial investments	1 087 780	1 199 734	10.3
Accrued income and prepaid expenses	20 887	20 198	– 3.3
Participations	15 669	15 712	0.3
Tangible fixed assets	64 306	61 527	– 4.3
Other assets	29 151	27 903	– 4.3
Total assets	**25 245 534**	**26 961 318**	**6.8**
Total subordinated claims	11 182	3 713	– 66.8
of which subject to mandatory conversion and / or debt waiver	–	–	n. a.
Liabilities			
Amounts due to banks	2 461 195	2 858 045	16.1
Liabilities from securities financing transactions	130 000	–	– 100.0
Amounts due in respect of customer deposits	16 250 737	17 270 041	6.3
Negative replacement values of derivative financial instruments	127 299	102 709	– 19.3
Liabilities from other financial instruments at fair value	114 155	112 604	– 1.4
Cash bonds	59 732	42 596	– 28.7
Bond issues and central mortgage institution loans	3 787 373	4 173 110	10.2
Accrued expenses and deferred income	83 477	83 518	0.0
Other liabilities	5 321	7 774	46.1
Provisions	38 526	38 473	– 0.1
Reserves for general banking risks	1 232 500	1 270 600	3.1
Bank's capital	200 000	200 000	–
Statutory retained earnings reserve	610 480	655 980	7.5
Profit carried forward	2 568	239	– 90.7
Profit	142 171	145 629	2.4
Total liabilities	**25 245 534**	**26 961 318**	**6.8**
Total subordinated liabilities	–	–	n. a.
of which subject to mandatory conversion and / or debt waiver	–	–	n. a.
Off-balance-sheet transactions			
Contingent liabilities	180 015	266 102	47.8
Irrevocable commitments	815 237	810 540	– 0.6
Obligations to pay up shares and make further contributions	48 458	48 458	–
Credit commitments	–	–	n. a.

[1] This balance position shows a decrease of CHF 265 millions. Where of CHF 135 millions are due to a re-balancing from mortgage loans. Without this re-balancing the decrease would be –11.3%.

INCOME STATEMENT

in CHF 1000	2016	2017	Change in %
Result from interest operations			
Interest and discount income	292 044	286 327	– 2.0
Interest and dividend income from financial investments	9 271	8 737	– 5.8
Interest expense	– 52 723	– 53 211	0.9
Gross result from interest operations	**248 592**	**241 853**	**– 2.7**
Changes in value adjustments for default risks and losses from interest operations	20 281	13 422	– 33.8
Subtotal net result from interest operations	**268 873**	**255 275**	**– 5.1**
Result from commission business and services			
Commission income from securities trading and investment activities	44 207	46 437	5.0
Commission income from lending activities	3 839	3 829	– 0.3
Commission income from other services	15 490	16 432	6.1
Commission expense	– 4 555	– 4 376	– 3.9
Subtotal result from commission business and services	**58 981**	**62 322**	**5.7**
Result from trading activities and the fair value option	**50 997**	**61 861**	**21.3**
Other result from ordinary activities			
Result from the disposal of financial investments	983	2 251	129.0
Income from participations	1 386	1 862	34.3
Result from real estate	1 977	1 990	0.7
Other ordinary income	1 018	755	– 25.8
Other ordinary expenses	– 314	– 160	– 49.0
Subtotal other result from ordinary activities	**5 050**	**6 698**	**32.6**
Operating income	**383 901**	**386 156**	**0.6**
Operating expenses			
Personnel expenses	– 106 654	– 112 404	5.4
General and administrative expenses	– 70 222	– 74 606	6.2
of which compensation for the state guarantee	– 10 707	– 11 139	4.0
Subtotal operating expenses	**– 176 876**	**– 187 010**	**5.7**
Value adjustments on participations and depreciation and amortisation of tangible fixed assets and intangible assets	– 10 491	– 9 999	– 4.7
Changes to provisions and other value adjustments, and losses	– 1 459	737	– 150.5
Operating result	**195 075**	**189 884**	**– 2.7**
Extraordinary income	7 529	6 164	– 18.1
Extraordinary expenses	–	–	n. a.
Changes in reserves for general banking risks	– 45 939	– 38 100	– 17.1
Taxes	– 14 494	– 12 319	– 15.0
Profit	**142 171**	**145 629**	**2.4**

APPROPRIATION OF PROFIT

in CHF 1000	2016	2017	Change in %
Appropriation of profit			
Profit	142 171	145 629	2.4
Profit carried forward	2 568	239	−90.7
Distributable profit	**144 739**	**145 868**	**0.8**
Allocation to statutory retained earnings reserve	45 500	49 600	9.0
Distribution to the canton	99 000	96 000	−3.0
Profit carried forward	**239**	**268**	**12.1**

Appropriation of Profit
The Board of Directors propose an appropriation of profit of CHF 96.0 million to the canton of Aargau as owner of Aargauische Kantonalbank.

Total Compensation to the Canton of Aargau

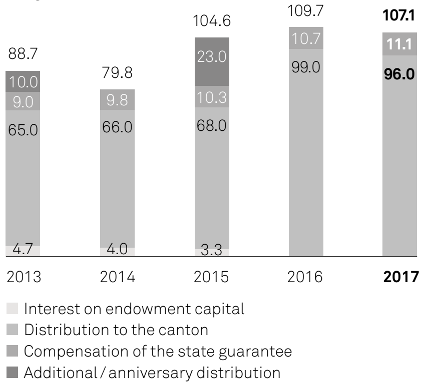
in CHF 1000	Value 2016	**Value 2017**
Distribution to the canton	99 000	**96 000**
Compensation of the state guarantee	10 707	**11 139**
Total compensation	109 707	**107 139**

Inclusive of the payment of the state guarantee of CHF 11.1 million, the canton of Aargau receives from the 2017 annual accounts total compensation of CHF 107.1 Million, compared to CHF 109.7 million in the previous year.

Taking into consideration the interest on the endowment capital, the compensation for the state guarantee, the profit distribution and the increase in the Bank's equity, AKB has created added value for the canton of around CHF 1.7 billion in the last 10 years.

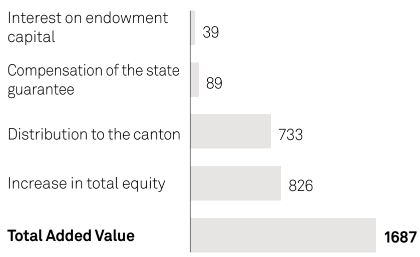
107.1 m

Total Compensation to the Canton
in CHF m



1687 m

Added Value for Canton (2008–2017)
in CHF m



CASH FLOW STATEMENT

in CHF 1000	2016 Cash in-flow	2016 Cash out-flow	2017 Cash in-flow	2017 Cash out-flow
Cash flow from operating activities (internal financing)	**77 577**		**79 588**	
Result of the period	142 171		145 629	
Change in reserves for general banking risks	45 939		38 100	
Value adjustments on participations, depreciation and amortisation of tangible fixed assets and intangible assets	10 491		9 999	
Provisions and other value adjustments	1 459		105	3 051
Change in value adjustments for default risks and losses		20 281	6 749	19 673
Accrued income and prepaid expenses		2 549	689	
Accrued expenses and deferred income		5 291	41	
Previous year's interest on endowment capital		3 362		
Previous year's distribution to the canton		91 000		99 000
Cash flow from shareholder's equity transactions				
Endowment capital				
Cash flow from transactions in respect of participations, tangible fixed assets and intangible assets		**9 764**		**7 263**
Participations	141	4 979		336
Real estate	780	408		1 330
Other tangible fixed assets		5 298		5 597
Cash flow from banking operations		**51 654**	**422 525**	
Medium and long-term business (> 1 year)		**101 974**		**258 268**
Amounts due to banks		136 306	40 000	
Amounts due in respect of customer deposits		31 851	67 299	
Cash bonds	140	30 514	610	17 746
Bonds	766 273	450 000	718 915	302 178
Central mortgage institution loans	272 000	10 000		31 000
Amounts due from banks	20 750		2 750	
Amounts due from customers		15 728	24 128	
Mortgage loans		554 579		645 580
Financial investments	67 841			115 466
Short-term business	**50 320**		**680 793**	
Amounts due to banks		126 558	356 850	
Liabilities from securities financing transactions				130 000
Amounts due in respect of customer deposits	634 103		952 005	
Negative replacement values of derivative financial instruments		35 081		24 590
Liabilities from other financial instruments at fair value	24 810			1 551
Other liabilities		206	2 453	
Amounts due from banks	103 420			128 743
Amounts due from customers		20 428	254 363	
Mortgage loans		484 322		600 499
Trading portfolio assets		25 034		5 099
Positive replacement values of derivative financial instruments	2 395		844	
Financial investments		41 736	3 512	
Other accounts receivable	18 957		1 248	
Liquidity		**16 159**		**494 850**
Liquid assets		16 159		494 850
Total	**77 577**	**77 577**	**502 113**	**502 113**

STATEMENT OF CHANGES IN EQUITY

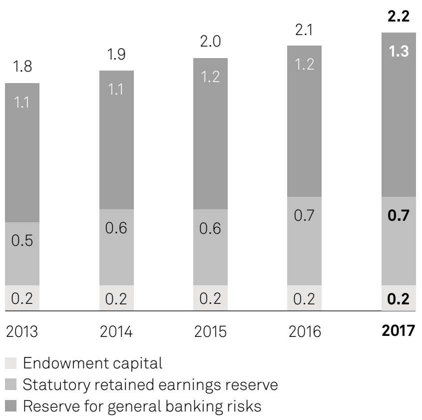
in CHF 1000	Bank's capital	Statutory retained earnings reserve	Reserve for general banking risks	Profit carried forward	Profit	Total
Equity as of 31.12.2016	**200 000**	**610 480**	**1 232 500**	**2 568**	**142 171**	**2 187 719**
Dividends and other distributions						
Distribution to the canton					– 99 000	– 99 000
Other allocations to (transfers from) the reserves for general banking risks			38 100			38 100
Other allocations to (transfers from) the other reserves		45 500		– 2 329	– 43 171	–
Profit					145 629	145 629
Equity as of 31.12.2017	**200 000**	**655 980**	**1 270 600**	**239**	**145 629**	**2 272 448**

The change in equity after the appropriation of profit is presented for the last five years as follows:

2.2 bn

Equity in Accordance with Appropriation of Profit

in CHF bn



RISK MANAGEMENT

In connection with its business model and its strategic orientation, AKB is largely exposed to credit risks, market risks, liquidity risks, operational risks (including IT risks) as well as compliance risks.
For AKB, risk management is a process in which all relevant risks with a potential negative impact on the Bank are systematically identified, analysed, assessed, managed and monitored. This process is supported by appropriate organisational structures as well as methods, tools, and guidelines.

I. Risk governance structure
The Bank's risk governance is based on the concept of the Three Lines of Defence.

Ultimate responsibility for risk management rests with the Board of Directors. It is responsible for the regulation, establishment and monitoring of effective risk management and overall risk management. To this end, it adopts the framework concept of bank-wide risk management.

The Audit and Risk Committee of the Board of Directors assists the Board of Directors in assessing and monitoring the functionality and appropriateness of internal control and/or the internal control system, bank-wide risk management and compliance.

The Executive Management is responsible for the operational business in accordance with the framework concept for bank-wide risk management. It must specify, set up and implement appropriate processes for identifying, assessing, managing, monitoring and controlling the risks taken by the Bank.

The overall company's risk management builds on three independent lines of defence below corporate governance:

1. Line of defence of risk responsibility, risk assumption and control:
The specific risk assumption is delegated by the Executive Management to the operational units by means of guidelines and instructions subject to clearly defined specifications and risk limits. In some significant types of risk, risk assumption is also delegated to defined internal committees (e.g. Liquidity & ALM Committee). As Risk Officers, these operational bodies or committees are responsible for the assessment, management, control and reduction of risks.

2. Line of defence of risk monitoring and control:
The independent and centralised CRO Risk & Compliance sector, under the direction of the Chief Risk Officer (CRO), is responsible for the comprehensive and systematic monitoring and reporting of both individual and aggregated exposures to all material types of risk. The CRO Risk & Compliance sector is part of the Corporate Governance department. The CRO is thus subordinated to the Chief Executive Officer and has direct access to the operational management, the Audit and Risk Committee and the Board of Directors. The sector forms the Bank's second line of defence and includes the Bank's independent control bodies with the functions of risk control, compliance and IT security.

The CRO Risk & Compliance sector issues various specific reports on the exposures and development of the risk situation for each major type of risk.
In addition, it prepares a quarterly comprehensive and consolidated risk report covering all material risk categories for the attention of the Executive Management, the Audit and Risk Committee and the Board of Directors. In addition, the CRO immediately triggers the defined escalation and emergency procedures for significant risk-relevant developments. In any case, this includes violations of prescribed risk tolerances, risk limits and/or thresholds.

3. Line of defence of independent "Assurance":
The independent internal auditing department, which is independent of the Executive management, assists the Board of Directors in the performance of its senior management function. In this role, it assesses the Bank's risk management, control and governance processes.

II. Framework for bank-wide risk management
The Bank has a framework for bank-wide risk management specified by the Board of Directors. This consists of the internal regulations on risk policy, the risk policy guidelines of the Board of Directors and the specific internal regulations issued for the main types of risk.

The risk policy is limited to the definition of principles for the individual risk types, the delegation of authority, methodological and organisational standards as well as reporting and financial reporting.

The main risk types are limited in the risk policy parameters by the Board of Directors. Based on the risk profile and risk-bearing capacity of the Bank, these guidelines define the risk tolerance of the Bank as a whole and the main types of risk to be complied with. The risk policy guidelines are reviewed annually and are continuously monitored. The defined risk tolerances are set up so that even in the case of a cumulative exhaustion they do not compromise the continued existence of the bank.

The specific implementation rules regarding the tasks, competencies and responsibilities as well as the principles of identification and evaluation, limitation and control, monitoring and reporting are ultimately contained in the specific internal regulations on the main types of risk.

The annual reassessment of the risk policy, the risk policy guidelines as well as the final assessment and approval of the systematic risk analysis took place for the last time at the meeting of the Board of Directors on 26 October 2017.

A. Credit risks
An integral part of the framework for bank-wide risk management are the credit regulations, which establish the regulatory framework for all banking transactions that generate credit risks for the Bank. At the implementation level, the credit regulations are supplemented by various directives and process descriptions, which act on both the process and product levels. The regulatory principles and guidelines in lending and the market area are detailed further in the credit policy and are restricted further depending on the current risk assessment of the market and economic environments.

Credit risks are restricted by limits, quality requirements (e.g. minimum rating), fixed cover margins (reductions on eligible collateral) and guidelines for risk diversification. When granting loans and other exposures with default risks, creditworthiness and solvency are assessed using uniform criteria. There is a multi-level, risk-based allocation of responsibilities, which regulates both ordinary credit competencies and special and tolerance competencies. Individual competency at client partner level exists only within defined loan-to-value and income limits on standardised mortgage lending for owner-occupied properties as well as up to a defined maximum amount. All remaining credit transactions must be substantively assessed and approved by the central credit committee, which is separate from the market-oriented units.

The units responsible for acquiring and servicing customers are completely separate from the loan processing and credit administration. The credit risk monitoring at the portfolio level is carried out by the CRO Risk & Compliance sector, which is independent of the sales organisation and monitors the development of the credit portfolio in various ways. Appropriate methods and models are used to assess credit risks periodically and/or on an ad hoc basis. The objective of credit monitoring at the portfolio level is to identify at an early stage existing and/or potential credit risks due to concentrations, interdependencies or influences of significant market developments and to assess and demonstrate their impact on the overall risk tolerance, risk limits and/or thresholds.

The Executive Management, the Audit and Risk Committee and the Board of Directors are each sent reports on the specific credit risk analyses. In addition, the risk assessment of the entire loan portfolio is reported in detail quarterly. To measure and manage default risk, the Bank classifies its loans according to a rating system. The system is used to ensure the uniform assessment of default risks and to determine the expected losses which the Bank will incur in lending. This component is used for the risk-based definition of credit conditions and thereby directly influences the conclusion of credit transactions.

Methods used to identify default risks and to determine impairment requirements:
Additionally to the IT-based rating system, credit monitoring is based on defined early warning indicators (maturing resubmissions, overruns, interest arrears, impairments, etc.), which point to a deterioration in credit quality as early as possible and ensure the timely introduction of corrective measures.

The Bank attaches great importance to the consistent management of problem exposures and loss positions. The Special Financing sector monitors in particular the “watch list” positions and provides support for positions that are impaired or non-performing, either on its own or together with the account manager of the sales organisation.

The sector is also responsible for the management and the rapid re-sale of properties foreclosed on by the Bank.

Receivables for which the Bank considers it unlikely that the borrower will be able to fully comply with its future obligations are considered at risk. Client commitments are classified as at risk at the latest when the contractual payments (principal, interest and/or commission) are 90 days or more overdue and when there is evidence that the borrower (taking account of coverage income) cannot comply at all or in full with its future obligations.

Loans at risk are valued individually and the impairment is covered by specific valuation allowances. The impairment is the difference between the receivable's carrying amount and the estimated recoverable amount, taking into account the counterparty risk and the net proceeds from the sale of any collateral. In determining the net proceeds of collateral, all holding costs such as interest, maintenance and sales costs, etc. up until the estimated time of sale, as well as any applicable taxes and fees, are deducted.

As it uses a well-developed range of tools for the early detection of receivables at risk, AKB does not create additional impairments to cover existing latent default risks in the client portfolio on the date of valuation. However, it estimates future unexpected losses at overall portfolio level. This serves as the basis for the calculation of capital allocation to reserves for general banking risks in the lending business in accordance with the concept of "risk provisioning".

The concept of "risk provisioning" is used for risk prevention and anticipation of future unexpected losses from the trade receivables. Depending on the provision situation, the aim of "risk provisioning" is to create additional, voluntary reserves for future loan defaults or to use these reserves to cover losses in the case of special events. The calculation is based on the average of the actual credit loss ratios incurred over the past 10 years. The difference between the calculated loss ratios and the actual specific valuation allowances booked in the year under review is credited to or debited from the separately reported "risk provisioning" account under the balance sheet item "Reserves for general banking risks". The annual addition or release is made via the income statement item "Changes in reserves for general banking risks". After the addition of CHF 9 million in the reporting year, risk provisioning stood at CHF 222 million as at the end of the year.

As part of the annual capital planning, stress losses were calculated in the loan portfolio according to defined default scenarios. The aim of the scenarios is to show the effects of a real estate price collapse or a macroeconomic recession on the loan portfolio.

In capital planning, the effects of the losses based on the stress scenarios on the capital situation are shown. The results show that when entering a series of very high credit losses which affect the entire banking industry equally, the bank itself would still have an intact equity ceiling, so the ordinary course of business could be guaranteed in compliance with the capital adequacy requirements.

1. Client Loans

The core business of AKB is the granting of mortgages and other mortgage-backed loans.

To determine the maximum amount of property financing, the following factors are decisive: collateral values internally defined by the Bank for each property type and the financial viability of the borrower and the observance of amortisation principles. The criteria to be applied in each case are set out in the current credit policies and also take into account the assessment of the property market.

For loans with securities as collateral, the internal loan regulations contain guidelines on the assets accepted as securities and their collateral values. The guidelines are further restricted using risk-based criteria by currency, issuer domicile, stock exchange, tradeability and diversification and are reviewed periodically.

Alongside the mortgage business and securities collateral-secured loans for private clients, the Bank's operations include commercial lending, primarily to companies based in the market territory.

Valuation of Collateral:

To value property, AKB employs experts to support the client partners and the approval entities in technical matters, decisions and judgements. The guidelines for valuing all kinds of property are subject to binding regulations. A client partner can determine "standard transactions" under their own authority using a set of estimation tools. Properties which do not meet the defined parameters for standard transactions are assessed exclusively by real estate experts. The real estate experts are based in a central unit independent from the front office.

For the great majority of standard transactions, either a hedonic model for owner-occupied homes and single-family homes, or a capitalisation rate model for simple residential and commercial buildings is used. Both estimation tools are integrated into the lending process, which guarantee an efficient and consistent evaluation.

In the case of poor creditworthiness an additional liquidation value is calculated.

The value of securities collateral is monitored daily. If the collateral values fall below the loan exposure amount, the outstanding amount needs to be reduced or additional collateral put up. In exceptional market conditions or in the case of increasing cover deficit, the collateral is realised and the loan closed out.

For commercial loans, the relevant evaluation criteria are mainly future earnings outlook, market position, the assessment by management and financial ability to repay the loan on schedule. Unsecured major exposures are restricted by limits at individual and total exposure level. Additionally, guidelines and benchmarks exist at the overall portfolio level.

2. Credit risks from trading
Responsibilities and technical tasks related to credit risks from trading, including the internal standards for the application of risk mitigation techniques, are set out in the loan regulations and at the instruction level. The counterparty risks in the interbank business as well as in positions towards central counterparties are limited by a limit system. Limits must be approved by the competent approval entities at the request of the operational units in the trading department in accordance with the allocation of authority. The approval entities are completely separate from the units making the request. The adequacy of the limits is checked at least once per year or if particular events occur. To reduce wrong-way risks, care is taken to ensure appropriate diversification.

Compliance with limits is monitored daily by the CRO Risk & Compliance sector and is reported on a monthly basis. Furthermore, each quarter the Audit and Risk Committee and the Board of Directors are informed about limit compliance, risk assessment and particular findings.

AKB conducts interbank business primarily for liquidity management and handling of client orders (international payments).

This involves short-term money market deposits and transfers from domestic and foreign banks.

3. Country Risk
Country risks are limited by the Board of Directors through predetermined thresholds based on rating category. Within these thresholds, the competent credit committee places additional limits in the form of individual limits per country. The CRO Risk & Compliance sector monitors compliance with country limits. Exposures in risk countries are assessed at least twice a year for traceability and impairments made if necessary.

B. Market Risk
Market risks describe the risk of losses arising due to changes in market prices (equities, exchange rates, interest, commodities and property) and factors influenced by market prices (e.g. volatility and correlations). We differentiate between three sub-risk categories: Market risk in the trading book, interest-change risk and other market risks.

1. Market Risk in the Trading Book
Financial instruments that are held for the Bank's own account for resale in order to exploit short-term price and interest rate fluctuations are assigned to the trading book and measured on a fair value basis using daily market prices. These positions are actively managed within the defined risk tolerance and risk limits exclusively by the trading desks “Forex”, “Equity” and “Interest”. The Bank also acts as issuer of certificates. The underlying assets or securities of the certificates are held in the trading portfolio as a hedged item.

The concrete tasks, competencies and responsibilities as well as the principles of identification and evaluation, limitation and control, monitoring and reporting of the Bank's trading activities are regulated in the internal trading regulations. Entering into risks from proprietary trading is specified in detail in and regulated by the internal trading guidelines and dealer-specific instructions. With the exception of self-issued certificates, AKB does not engage in any market-making activities.

Derivative financial instruments may be used in currency, interest and securities trading for the Bank's own or a third-party account. Both standardised and OTC instruments are used.

Risk is limited by Value at Risk limits (VaR), position and daily loss limits.

The risk tolerance for the entire trading book (currency, securities and interest) is determined as VaR limits by the Board of Directors and its adequacy is verified at least annually. At Executive Management level, the risk tolerance is allocated to the individual trading desks “Forex”, “Equity” and “Interest” as VaR risk limits. Daily monitoring of the VaR limit is carried out by CRO Risk & Compliance sector which is an independent unit of the trading department. Daily reports on the utilisation of the VaR limit are sent to the competent department manager and managers of each trading desk, on a monthly basis to the Executive Management and on a quarterly basis to the Audit and Risk Committee and the Board of Directors.

For the monitoring and reporting of market risks in the trading book, the CRO Risk & Compliance sector has a dedicated IT system that derives the trading book positions directly from the core system of the Bank, evaluates them independently and calculates the limit utilisation.

The position and daily loss limits are allocated by the relevant department managers per trading desk or per trader and monitored by the respective manager of the corresponding trading desk. The position limits restrict the exposure for each dealer and are designed to protect to the Bank from excessive exposure. The daily loss limits are intended to restrict short-term losses due to large market fluctuations and prevent the Bank from exceeding its risk tolerance and/or VaR risk limits through an accumulation of realised and unrealised losses.

2. Interest Rate Risk

It is the aim of interest rate risk management to reduce any margin pressure from changes in market prices and client behaviour, strengthen the solvency of the Bank and thus safeguard the stability of the equity through optimal balance sheet structure management. Asset and liability management is based on the internal regulations for liquidity and the asset and liability management. The regulations define principles, responsibilities and competencies.

The “Liquidity & ALM Board” (LAB) is the strategic decision-making committee for monitoring and managing interest rate risks, within the framework of the competencies and limits set by the Board of Directors. The LAB meets monthly and delegates certain well-defined tasks, competencies and responsibilities to the “Liquidity & ALM Committee” (LAC). The LAB comprises the members of the Executive Management and the advisory members of the LAC. The operational unit “Treasury” implements the strategic decisions of the LAB. CRO Risk & Compliance conducts the supervision/monitoring of the implementation of strategic decisions by the LAB and its compliance with the limits, independently from the operational units. It is also responsible for the monthly risk reporting to the LAC and LAB and quarterly reporting to the Audit and Risk Committee and the Board of Directors.

The management of interest rate risks is based on the present value method and focuses on limiting the negative impact in the net present value of equity and the income effect.

To calculate the present value of equity, fixed interest rate products are divided according to their maturity and variable interest rate products are replicated on the basis of their remaining lifetime. Replication is based on the need to reproduce, as accurately as possible, changes in client interest rates using changes in market interest rates, i.e. to achieve an optimum ratio between risk (interest rate risk) and income (margin). The optimum ratio is calculated with the aid of the efficient frontier method, which originates from portfolio theory. The entire equity complex is treated as non-interest sensitive and is not replicated. Replication is reviewed annually for its effectiveness.

Interest rate risks are monitored on the basis of static (sensitivity, market value of equity, VaR) and dynamic calculations (simulations of possible market scenarios). The Bank manages the interest rate risks through on-balance sheet measures. The LAB conducts hedging depending on the assessment of interest rate risk.

Interest rate risks are limited by the risk tolerance specified by the Board of Directors using a sensitivity limit and a VaR limit.

Simulations are carried out periodically to determine future trends in the Bank’s earnings from interest operations. Both the value effect and income effect are measured here.

The market value of equity is stressed monthly by means of five different changes in the yield curve. The LAB is informed monthly of the scenarios used and the resulting changes in value.

Future potential changes in the interest balance (income effect) are stressed several times a year using various scenarios. These include both different changes in the yield curve and client behaviour, which can, depending on the interest rate environment, lead to massive shifts in capital. The interest balance calculated is based on a dynamic change in interest-bearing positions and the market environment. The results are discussed in the LAB and brought to the attention of the Audit and Risk Committee as part of the quarterly reporting.

For the monitoring and reporting of interest rate risks as well as for the calculation of key figures and the implementation of stress scenarios, the CRO Risk & Compliance sector has a dedicated IT system that derives the balance sheet data directly from the bank's core system.

Business policy on the use of derivative financial instruments:
The instruments used for balance sheet management serve mainly to hedge interest rate and foreign currency risks in the banking book. Interest rate swaps and cross-currency swaps are also primarily used. Credit derivatives are not used.

Micro-hedges are predominantly used for hedging. Selected and clearly identified, interest rate-sensitive client receivables or liabilities are hedged (either individually or grouped together) over the entire remaining period as underlying assets here. Macro-hedges are also occasionally used alongside to hedge sensitivity in a specific maturity bracket.

The objectives and strategies of hedges between the hedging instrument and the hedged item are documented in each case upon conclusion of the derivative hedging transactions.

The effectiveness of the hedging relationship is reviewed periodically by the independent CRO Risk & Compliance sector. It monitors whether the sensitivity of the hedging transactions exceeds the sensitivity of the allocated underlying assets by more than 20 percent. The hedging transaction must always reduce the sensitivity of the underlying assets overall.

Hedges where the criteria of effectiveness are no longer met are compared with the non-effective portion of a commercial transaction and the effect from the ineffective portion is booked under income from trading activities. In the reporting year there were no hedges that were not effective or not fully effective.

3. Other Market Risks
A VaR limit is in place to limit other market risks, which consist in particular of position risks from equity securities and from foreign currency positions.

C. Liquidity Risk
The primary objective of liquidity management is to ensure the ongoing solvency of the Bank at all times, particularly during bank-specific and/or market-wide periods of stress.

The principles, responsibilities and competencies for managing liquidity risks are defined in a specific set of internal regulations.

The LAC is responsible for the central management of tactical liquidity. The LAC reports directly to the LAB committee. The LAC meets twice monthly and, among other duties, is responsible for developing and fleshing out strategies for managing liquidity risk and the liquidity reserves.

The central operational unit Treasury implements the tactical decisions of the LAC and safeguards and manages intraday or short-term liquidity. The CRO Risk & Compliance sector conducts the supervision and monitoring of the implementation of tactical decisions by the LAC and its compliance with the limits, independently from the operational units. It is also responsible for daily liquidity reporting to Treasury and monthly risk reporting to the LAC and the LAB.

The Audit and Risk Committee and the Board of Directors is updated quarterly on the changes in liquidity risk.

Operational measurement and management of liquidity risks is based on a daily liquidity schedule, which compares the expected cash inflows and outflows in a normal market phase. The liquidity schedule therefore shows the time horizon over which the Bank is still liquid or viable.

Liquidity risks are monitored on the basis of both static and dynamic calculations (including simulations of possible stress scenarios).

Liquidity risks are limited by rules governing the maintenance of liquidity reserves (e.g. on quality and diversification) and guidelines on the financing structure (e.g. on counterparties, maturity bands and currencies). In addition, the Board of Directors limits liquidity risk by setting the liquidity risk tolerance.

The liquidity risk tolerance defines the minimum time horizon, which must be continually maintained in a given stress scenario. Both institution-specific events and the effects of a global economic crisis are considered as stress scenarios.

In order to promptly detect risks in a liquidity position and potential funding options for the Bank, it has defined appropriate early warning indicators and set out potential emergency procedures with potential response measures. The defined early warning indicators are continuously monitored.

D. Operational Risk
Operational Risk Management (OpRisk) is part of the independent risk control

function CRO Risk & Compliance under the supervision of the Chief Risk Officer (CRO). The risk control function is responsible for the design, implementation and maintenance of an effective and efficient operational risk framework and ensures the full and systematic monitoring and reporting of operational risk. In 2017, the concept of the Three Lines of Defence was refined and implemented. The focus here was on the comprehensive assumption of individual responsibility by the profit-oriented business units for the risks that arise within their business and infrastructure areas as well as on the controls to be set up by them.

AKB defines operational risks as the risk of losses arising as a result of inadequate or failed internal procedures, people or systems or as a result of external events. Included are all legal risks, including fines from regulators and settlements. Strategic risks and reputational risks as secondary risks have an indirect effect on operational risks. These are an integral part of the operational risk management.

AKB defines operational risk management as a comprehensive process. The focus is on the risk-oriented protection of persons, services, information and assets of the individual departments as well as the maintenance and restoration of critical business processes in an operational emergency.

The principles, responsibilities and competencies for the management of operational risks and designing the internal control system (ICS) are defined in a specific set of internal regulations. This also defines an escalation process for results that exceed the expected scope.

The risk tolerance for operational risks is limited annually by the Board of Directors with appropriate early warning indicators. The Executive Management further limits these by defining suitable thresholds or limits. Compliance with the defined thresholds and limits is subject to periodic monitoring.

Any violations of the limits will be remedied promptly with targeted measures.

The basis for the management of operational risks is the inventory of inherent operational risks at the level of the Bank as a whole, which is dynamically tracked by the CRO Risk & Compliance sector. For the identification and assessment of operational risks, AKB uses numerous instruments (including periodic risk and control assessments, continuous recording of loss events, approval process for the introduction of new or major adjustments to existing products, activities, processes or systems). Within the framework of so-called risk and control assessments, for example, the operational risks of each business are assessed on a bottom-up basis on the basis of a defined methodology. The operational risks identified are systematically categorised and prioritised.

Both internal and external operational risk events are recorded, assessed and analysed in order to identify the reasons for their occurrence and to close potential gaps in the internal control system.

Operational risks are reduced by an effective and suitable internal control system (ICS). Internal control is designed so that processes run as intended and in compliance with applicable regulations. The starting point for designing the internal control system is a systematic risk analysis. Systematic risk analysis is the result of a comprehensive and systematic process to assess the overall risks to which the Bank is exposed. By doing so, the Board of Directors ensures that all significant risks in the Bank are recorded, limited and monitored. It is also used as a basis for the regular review of the adequacy and effectiveness of the internal controls.

Tiered according to the level of risk relevance, AKB's internal monitoring system differentiates between key, managerial and other controls. The key controls are of elevated risk relevance, geared towards covering the risks which are significant from the perspective of the entire company. The Bank uses an ICS tool for documenting, monitoring and evaluating the adequacy and effectiveness of the internal monitoring system.

The adequacy and effectiveness of the internal controls are assessed once a year by the department managers and documented in a report. Another essential criterion of the assessment is the up-to-dateness of the internal control system. The assessment is also the basis for defining and carrying out any necessary corrective actions. To reduce risk, specific insurance policies are also used. The entire insurance portfolio of AKB is reviewed annually by an external insurance broker, discussed with the Bank or approved by the Executive Management.

Potential information security risks are managed on the basis of regular threat assessments. It will provide adequate and effective security measures to protect information and infrastructures in terms of confidentiality, integrity, availability and traceability.

For business-critical processes, precautions have been taken in the context of Business Continuity Management (BCM). In this context AKB takes recognised standards into account. The relevant principles, responsibilities and procedures for BCM are defined in a specific set of internal regulations.

The Audit and Risk Committee and the Board of Directors are updated quarterly on the development of early warning indicators, the assessment of the operational risks and the development of the operational risk profile (including the information security risks). Reporting includes the results of significant internal and relevant external operational risk events.

In addition, the CRO produces an annual report for the Board of Directors, the Audit and Risk Committee and the Executive Management on the assessment of the internal monitoring system of the Bank. This report also includes the findings and developments of the risk situation in the areas of operational risk, information security and Business Continuity Management (BCM).

E. Compliance Risk

Compliance risk refers to any legal, reputational and loss risks which may arise from the violation of legal or professional standards or ethical principles. The principles, responsibilities and competencies for the compliance risks are defined in a specific set of internal regulations.

Compliance with legal, regulatory, professional or internal regulations is monitored by the independent compliance function within the CRO Risk & Compliance sector.

Compliance activities relate in particular to combating money laundering, preventing insider dealing, complying with banking and stock exchange law, observing product distribution rules, monitoring the risks from cross-border client transactions, avoiding conflicts of interest and ensuring the tax transparency of the client funds deposited with AKB.

Compliance annually reviews the compliance risk inventory, which it uses to draw up a plan of action. Compliance risks identified are managed and limited through the issue of directives, tailored operational systems and processes, employee training and downstream, independent monitoring and controls. The Compliance unit also advises the Executive Management and employees on compliance-related issues.

SIGNIFICANT EVENTS AFTER THE BALANCE SHEET DATE

No significant events occurred after the reporting date that have a significant influence on the financial position and financial performance of the Bank as at 31st December 2017.

COMPOSITION/PRESENTATION OF ELIGIBLE REGULATORY CAPITAL

in CHF 1000		Net figures (after transitional arrangements have been taken into account) [1] 31.12.2016	Net figures (after transitional arrangements have been taken into account) [1] 31.12.2017
Common equity (CET1)			
1	Issued and paid-in capital, fully eligible	200 000	200 000
2	Retained earnings reserve / reserves for general banking risks / profit carried forward	1 888 719	1 976 448
6	**= Common equity Tier 1 before regulatory adjustments**	**2 088 719**	**2 176 448**
	Adjustments to common equity Tier 1		
8	Goodwill	–	–
19	Other qualified participations in the financial sector (amount above threshold 2) (CET1 instruments)	–	–
28	**= Total regulatory adjustments to CET1**	**–**	**–**
29	**= Common equity Tier 1 (net CET1)**	**2 088 719**	**2 176 448**
44	**= Additional Tier 1 capital (net AT1)**	**–**	**–**
45	**= Tier 1 capital (net Tier 1)**	**2 088 719**	**2 176 448**
58	**= Tier 2 capital (net T2)**	**–**	**–**
59	**= Regulatory capital (net T1 & T2)**	**2 088 719**	**2 176 448**
60	Total risk-weighted assets	12 178 238	12 731 580
Capital ratios			
61	CET1 ratio (item 29, in % of risk-weighted assets)	17.2%	17.1%
62	T1 ratio (item 45, in % of risk-weighted assets)	17.2%	17.1%
63	Regulatory capital ratio (item 59, in % of risk-weighted assets)	17.2%	17.1%
64	CET1 requirements in accordance with the Basel minimum standards (minimum requirements + capital buffer + counter-cyclical buffer) (in % of risk-weighted assets)	6.1%	6.7%
65	of which, capital buffer in accordance with Basel minimum standards (in % of risk-weighted assets) [2]	0.6%	1.3%
66	of which, countercyclical buffer in accordance with the Basel minimum standards (in % of risk-weighted assets) [3]	1.0%	1.0%
68	CET1 available to meet minimum and buffer requirements as per the Basel minimum standards, after deduction of the AT1 and T2 requirements met by CET1 (in % of risk-weighted assets)	13.7%	13.6%
68a	CET1 total requirement target in accordance with Annex 8 of the CAO plus the countercyclical buffer (in % of risk-weighted assets)	8.8%	8.8%
68b	CET1 available (in % of risk-weighted assets)	13.0%	12.9%
68c	T1 total requirement in accordance with Annex 8 of the CAO plus the countercyclical buffer (in % of risk-weighted assets)	10.6%	10.6%
68d	T1 available (in % of risk-weighted assets)	14.8%	14.7%
68e	Total requirement for regulatory capital as per Annex 8 of the CAO plus the countercyclical buffer (in % of risk-weighted assets)	13.0%	13.0%
68f	Regulatory capital available (in % of risk-weighted assets)	17.2%	17.1%
Amounts below the thresholds for deduction (before risk-weighting)			
72	Non-qualified participation in the financial sector	13 636	13 636
73	Other qualified participations in the financial sector (CET1)	1 501	1 501
Applicable caps on the inclusion of items in T2			
77	Cap on inclusion of valuation adjustments in T2 in the context of the SA-BIS approach	140 638	146 837

[1] Figures for capital are net values in accordance with the definitive Basel III provisions. AKB chose not to make use of the transitional provisions under Art. 137–142 CAO, which allow a gradual introduction of the new regulations.
[2] Based on the transitional provisions (Art. 144 CAO), the capital buffer specified in Art. 43 CAO for 2016 is 0.625 % and for 2017 1.25 %.
[3] Based on Art. 44 CAO the Swiss Federal Council has been requested by the Swiss National Bank to activate the countercyclical buffer. It was set at 2% as of 30th June 2014 for the risk-weighted assets on mortgage lending for the financing of residential property in Switzerland.

INFORMATION ABOUT THE LEVERAGE RATIO

Leverage Ratio: comparison of accounting assets versus Leverage Ratio exposure measure

	in CHF 1000	31.12.2016	31.12.2017
1	Total assets as per published financial statements	25 245 534	26 961 318
2	Adjustment for investments in banking, financial, insurance or commercial entities that are consolidated for accounting purposes but outside the scope of regulatory consolidation (margin nos. 6-7 FINMA Circ. 15/3), as well as adjustment for assets deducted from Tier 1 capital (margin nos. 16-17 FINMA Circ. 15/3)	–	–
3	Adjustment for fiduciary assets recognised on the balance sheet for accounting purposes, but excluded from the Leverage Ratio exposure measure (margin no. 15 FINMA Circ. 15/3)	–	–
4	Adjustment for derivative financial instruments (margin nos. 21-51 FINMA Circ. 15/3)	– 45 499	– 21 112
5	Adjustment for securities financing transactions (SFTs) (margin nos. 52-73 FINMA Circ. 15/3)	19	–
6	Adjustment for off-balance-sheet items (margin nos. 74-76 FINMA Circ. 15/3)	683 725	768 921
7	Other adjustments	–	–
8	**Leverage Ratio exposure**	**25 883 779**	**27 709 127**

Leverage Ratio: Detailed illustration

	Balance sheet exposures in CHF 1000	31.12.2016	31.12.2017
1	On-balance sheet items (excluding derivatives and SFTs, but including collateral)	25 123 436	26 840 063
2	Assets that must be deducted in determining the eligible Tier 1 capital (margin nos. 7 and 16-17 FINMA Circ. 15/3)	–	–
3	**Total on-balance sheet exposures within the Leverage Ratio framework, excluding derivatives and SFTs**	**25 123 436**	**26 840 063**
	Derivatives		
4	Replacement values associated with all derivatives transactions, including those with CCPs, taking into account the margin payments received and netting agreements in accordance with margin nos. 22-23 and 34-35 FINMA Circ. 15/3	37 235	48 934
5	Add-on amounts for PFE associated with all derivatives transactions (margin nos. 22 and 25 FINMA Circ. 15/3)	39 364	51 209
6	Gross up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the operative accounting framework (margin no. 27 FINMA Circ. 15/3)	–	–
7	Deduction of receivables assets for cash variation margin provided in derivatives transactions, in accordance with margin no. 36 FINMA Circ. 15/3	–	–
8	Deduction relating to exposures to QCCPs if there is no obligation to reimburse the client in the event of the QCCP defaulting (margin no. 39 FINMA Circ. 15/3)	–	–
9	Adjusted effective notional amount of written credit derivatives, after deduction of negative replacement values (margin no. 43 FINMA Circ. 15/3)	–	–
10	Adjusted effective notional offsets of bought/written credit derivatives (margin nos. 44-50 FINMA Circ. 15/3) and add-on deductions for written credit derivatives (margin no. 51 FINMA Circ. 15/3)	–	–
11	**Total derivative exposures**	**76 599**	**100 143**
	Securities financing transaction exposures		
12	Gross SFT assets with no recognition of netting (except in the case of novation with a QCCP as per margin no. 57 FINMA Circ. 15/3) including sale accounting transactions (Margin no. 69 FINMA Circ. 15/3), less the items specified in margin no. 58 FINMA Circ. 15/3)	–	–
13	Netted amounts of cash payables and cash receivables relating to SFT counterparties (margin nos. 59-62 FINMA Circ. 15/3)	–	–
14	CCR exposure for SFT assets (margin nos. 63-68 FINMA Circ. 15/3)	19	–
15	Agent transaction exposures (margin nos. 70-73 FINMA Circ. 15/3)	–	–
16	**Total securities financing transaction exposures**	**19**	**–**
	Other off-balance-sheet exposures		
17	Off-balance-sheet exposure at gross national amounts before application of credit conversion factors	3 358 319	3 470 691
18	Adjustments for conversion to credit equivalent amounts) (Margin nos. 75-76 FINMA Circ. 15/3)	– 2 674 594	– 2 701 770
19	**Total off-balance-sheet items**	**683 725**	**768 921**
	Eligible capital and total exposures		
20	Tier 1 capital (margin no. 5 FINMA Circ. 15/3)	2 088 719	2 176 448
21	Total exposures (sum of Rows 3, 11, 16 and 19)	25 883 779	27 709 127
	Leverage Ratio		
22	**Leverage Ratio (margin nos. 3-4 FINMA Circ. 15/3)**	**8.1%**	**7.9%**

INFORMATION ABOUT THE LIQUIDITY COVERAGE RATIO (LCR)

		1. Quarter 2017		2. Quarter 2017		3. Quarter 2017		4. Quarter 2017	
	in CHF 1000 (monthly average)	Unweighted values	Weighted values	Unweighted values	Weighted values	Unweighted values	Weighted values	Unweighted values	Weighted values
A.	**High-quality liquid assets (HQLA)**								
1	**Total high-quality liquid assets (HQLA)**	**3 339 648**	**3 294 998**	**3 591 111**	**3 545 981**	**3 581 382**	**3 530 989**	**3 852 287**	**3 798 368**
B.	**Cash outflows**								
2	Retail deposits	12 270 048	1 069 689	12 087 822	1 062 974	11 316 343	998 389	11 587 656	1 024 242
3	of which, stable deposits	4 855 227	242 761	4 748 648	237 432	4 476 219	223 811	4 566 789	228 339
4	of which, less stable deposits	7 414 821	826 928	7 339 174	825 542	6 840 125	774 578	7 020 867	795 903
5	Unsecured wholesale funding	3 131 584	2 068 513	3 179 275	2 110 383	3 176 011	2 085 494	3 360 029	2 138 431
7	of which, non-operational deposits (all counterparties)	3 131 584	2 068 513	3 179 275	2 110 383	3 176 011	2 085 494	3 360 029	2 138 431
10	Other outflows	2 161 376	1 310 725	2 521 075	1 635 823	2 733 979	1 837 492	2 517 125	1 662 640
11	of which, outflows related to derivative exposures and other transactions	1 182 249	1 149 761	1 525 208	1 484 652	1 708 136	1 682 669	1 519 659	1 508 572
13	of which, outflows related to committed credit and liquidity facilities	979 127	160 964	995 867	151 171	1 025 843	154 823	997 466	154 068
14	Other contractual funding obligations	160 688	52 933	287 103	83 794	299 477	116 536	101 231	28 993
15	Other contingent funding obligations	190 140	9 507	215 437	10 772	233 629	11 681	258 444	12 922
16	**Total cash outflows**	**17 913 836**	**4 511 367**	**18 290 712**	**4 903 746**	**17 759 439**	**5 049 592**	**17 824 485**	**4 867 228**
C.	**Cash inflows**								
18	Inflows from fully performing exposures	546 804	298 666	651 279	416 754	652 497	442 667	348 252	217 744
19	Other cash inflows	1 190 391	1 190 391	1 461 824	1 461 824	1 688 609	1 688 609	1 480 966	1 480 966
20	**Total cash inflows**	**1 737 195**	**1 489 057**	**2 113 103**	**1 878 578**	**2 341 106**	**2 131 276**	**1 829 218**	**1 698 710**
	Adjusted Values								
21	Total high-quality liquid assets (HQLA)		3 294 998		3 545 981		3 530 989		3 798 368
22	Total net cash outflow		3 022 310		3 025 168		2 918 316		3 168 518
23	Liquidity Coverage Ratio (LCR)		109.0%		117.1%		121.0%		119.9%

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