Zürcher Kantonalbank

Half-yearly Report

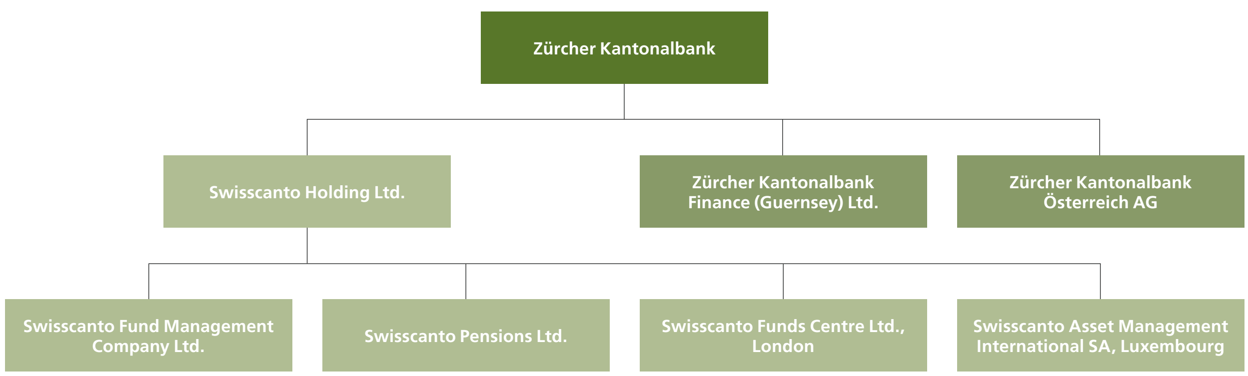
for the 2017 financial year

At a glance

About us
Zürcher Kantonalbank is an independent public-law institution of the Canton of Zurich. It fulfils a public service mandate that entails providing financial services for the public and assisting the canton in the economic, social and environmental arenas. This mandate requires the bank to be responsible in its use of natural resources and to ensure that its actions comply with the demands of social and environmental sustainability.

As a full-service bank with a strong regional anchoring as well as national and international links, Zürcher Kantonalbank has a leading position in the Greater Zurich area. It has a market penetration of around 50 percent in retail as well as corporate banking. The corporate (endowment) capital provided by the canton is a component of Zürcher Kantonalbank's equity. Should these resources prove inadequate, the canton additionally provides a guarantee for all of the bank's non-subordinated liabilities.

Scope of consolidation



About the figures:
The amounts stated in this report have been rounded. The total may therefore vary from the sum of the individual values.

The following rules apply to the tables:

0	(0 or 0.0) Figure is smaller than half the unit of account used
–	Figure not available or not meaningful
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Zürcher Kantonalbank in figures (group)

Income statement	in CHF million	1st half 2017	1st half 2016	Change 2017/2016 in %
Net result from interest operations		598	582	2.6
Result from commission business and services		378	360	4.9
Result from trading activities and the fair value option		187	183	2.1
Other result from ordinary activities		22	23	– 2.6
Operating income		1,185	1,149	3.2
Operating expenses		–706	–684	3.2
Value adjustments on participations and depreciation and amortisation of tangible fixed assets and intangible assets		–59	–65	– 9.8
Changes to provisions and other value adjustments, and losses		–4	–5	– 26.5
Operating result		417	395	5.6
Extraordinary result		7	2	233.9
Taxes		–5	–4	6.1
Group net income (result of the period)		420	393	6.9

Balance sheet (before distribution of net profit)	in CHF million	30.06.2017	31.12.2016	
Total assets		158,378	157,985	0.2
Mortgage loans		78,207	77,275	1.2
Amounts due in respect of customer deposits		81,454	80,890	0.7
Provisions		585	636	– 8.0
Equity		10,863	10,793	0.6

Key figures	in %	1st half 2017	1st half 2016
Return on equity (ROE)		8.0	7.7
Cost/income ratio (CIR) [1]		59.2	59.1
Common equity Tier 1 ratio (CET1)		15.7 [2]	15.3
Core capital ratio (Tier 1)		17.9 [2]	16.2
Total capital ratio		17.9 [2]	17.3
Leverage ratio [2]		6.9	7.1
Liquidity coverage ratio (LCR) [3]		132.0	113.7

Assets under management	in CHF million	30.06.2017	31.12.2016	
Total assets under management		274,519	264,754	3.7

Headcount/banking outlets	Number	30.06.2017	31.12.2016	
Headcount after adjustment for part-time employees, as at reporting date		5,115	5,173	– 1.1
Banking outlets [4]		84	89	

Rating agencies	Rating	30.06.2017	31.12.2016
Fitch		AAA	AAA
Moody’s		Aaa	Aaa
Standard & Poor’s		AAA	AAA

Scope of consolidation	Share in %	30.06.2017	31.12.2016
Zürcher Kantonalbank Finance (Guernsey) Ltd.		100	100
Zürcher Kantonalbank Österreich AG		100	100
Swisscanto Holding Ltd.		100	100

[1] Charged: Cost-income ratio (excl. changes in value adjustments for default risks and losses from interest operations).
[2] In accordance with the provisions for systemically important banks.
[3] LCR as at quarter end.
[4] Including branches of Zürcher Kantonalbank Österreich AG in Salzburg and Vienna as well as six automated banks.

Business performance

Zürcher Kantonalbank again reports an excellent result for the Group in the first half of 2017.

The group net income of Zürcher Kantonalbank was CHF 420 million in the first half of 2017 and thus exceeded the comparative period in 2016 as well as the budgeted figures.

This pleasing result is reflected in all the main income items. The result from interest operations performed positively despite a low interest rate environment and continuing negative interest rates. The result from the commission business and services as well as the results from trading activities increased compared to the comparative period. This development is to be regarded as pleasing in particular given the major challenges in the negative interest environment and the prevailing geopolitical uncertainties.

The figures are reflected appropriately in a higher return on equity amounting to 8.0 percent (1st half of 2016: 7.7 percent). The cost/income ratio remained almost unchanged at 59.2 percent (1st half of 2016: 59.1 percent).

Strengthened equity base due to new issue of Additional Tier 1 bond

At the end of May 2017, Zürcher Kantonalbank announced that it is redeeming the current Additional Tier 1 bond (AT1 bond) with contingent write-down of a nominal CHF 590 million as of 30 June 2017. A new AT1 bond of a nominal CHF 750 million with a coupon of 2.125 percent was successfully issued on the same date. The issue was met with great investor interest. This bond has a perpetual maturity, it can be terminated for the first time after 6.3 years. This new issue allowed the bank to modify the bond terms to the most recent market conditions and regulatory requirements and to further strengthen the capital base.

Due to the retained earnings at the end of 2016 and the new issue of the Additional Tier 1 bond, the further strengthened equity ratio was 17.9 percent as at 30 June 2017 compared to 17.3 percent as at 30 June of the previous year. The ratio makes evident the excellent capitalisation of Zürcher Kantonalbank.

In accordance with regulatory requirements and taking into account the countercyclical buffer, Zürcher Kantonalbank must continue to meet a total capital ratio of 14.7 percent.

The leverage ratio of 6.9 percent also continues to be well above the requirement for systemically important banks of 3.5 percent.

Top assessments by rating agencies

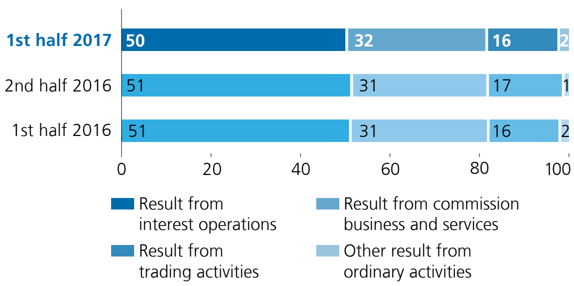
Rating agencies Fitch, Moody's and Standard & Poor's continue to accord Zürcher Kantonalbank their first-class ratings of AAA or Aaa.

Pleasing operating income

Operating income in the first half of 2017 was CHF 1.2 billion, representing an increase of CHF 36 million, or 3.2 percent, compared to the same period in the previous year.

The diversified income structure therefore continues to prove effective. With a share of 50 percent, interest operations continue to be the bank's most important income stream followed by commission business and services at 32 percent. Trading activities contributed 16 percent to operating income as the third key income stream.

Fig. 1: Income structure of Zürcher Kantonalbank (in %)



Solid interest result

The low interest rate environment in general and specifically the Swiss National Bank's negative interest rates remain a major challenge. The negative interest paid by Zürcher Kantonalbank to the Swiss National Bank amounted to CHF 55 million.

In the first half of 2017, Zürcher Kantonalbank was able to overcome the challenges in the negative interest rate environment with a result from interest operations of CHF 598 million, exceeding both expectations as well as the result of the comparative period (CHF 582 million). This was achieved based on the development in the mortgage lending business, which grew by 1.2 percent in the first half of 2017 in line with market growth.

Successful commission business and services

In the first half of 2017, the bank continued the positive trend in the commission business and services segment. The result from commission business and services amounted to CHF 378 million. Compared to the same period in the previous year, this represents an increase of approximately CHF 18 million, or 4.9 percent, mainly influenced by the successful securities and investment business.

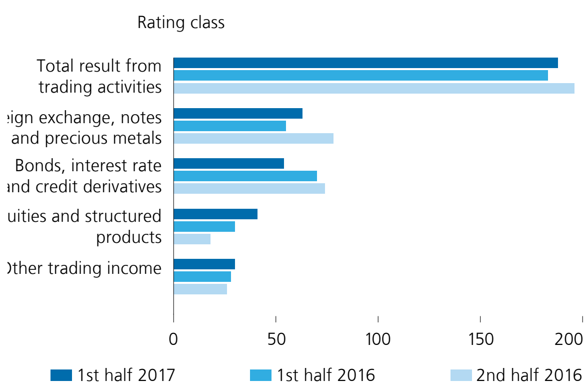
At around 80 percent, the securities and investment business remains the largest driving force with regard to income from commission business and services.

Positive trading results

The trading activities of Zürcher Kantonalbank are clearly customer focused. Market risks in the trading book (value-at-risk with a 10-day holding period) remained low at an average level of CHF 12 million, the same as the average for the first half of 2016.

The trading result performed well despite political uncertainties and not least thanks to a positive market environment. In the first half of the year, a result of CHF 187 million was achieved (1st half of 2016: CHF 183 million) with pleasing results for equities, structured products and collateral trading in particular, while eurobonds were below the level of the same period in the previous year.

Fig. 2: Trading result by segment (in CHF million)



Slightly higher operating expenses

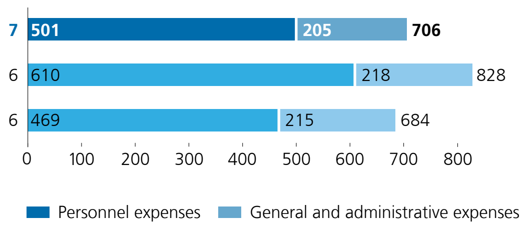
Operating expenses in the first half of this year were CHF 706 million and were thus slightly above the level of the same period in the previous year (CHF 684 million). The higher value compared to the comparative period comprises higher personnel costs (plus CHF 31 million) and general and administrative expenses that were lower by CHF 10 million.

As an important milestone, Zürcher Kantonalbank outsourced the settlement of payment transactions to Swisscom and, in March 2017, successfully started operations. The bank is therefore well equiped to meet the opportunities and challenges in the future for the progressive standardisation and digitalisation, in particular also in international payment transactions.

The canton was paid compensation of CHF 11.5 million for the first six months of 2017 for the state guarantee, which was slightly higher than in the first half of 2016 (CHF 10.5 million).

The cost/income ratio remained at around the level of the previous year at 59.2 percent (1st half of 2016: 59.1 percent).

Fig. 3: Development of operating expenses (in CHF million)[1]

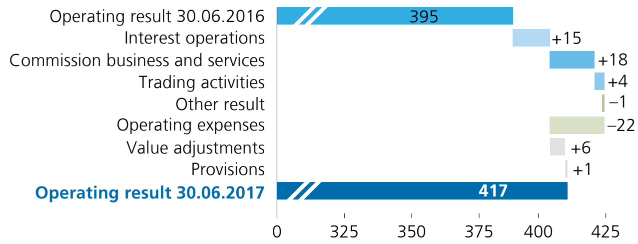


[1] The personnel expense for the second half of 2016 included a one-off provision for retirement obligations of CHF 70 million.

Higher operating result

The positive development in earnings was able to offset the slightly higher operating expenses, which resulted in an operating result of CHF 417 million. Compared to the first half of 2016, this represents an increase of around CHF 22 million, or 5.6 percent.

Fig. 4: Development of the operating result (in CHF million)



Decrease in the net creation of value adjustments and provisions

Zürcher Kantonalbank assesses credit default risks as well as all other identifiable risks on a continuous basis. Where necessary, the bank creates corresponding value adjustments and provisions.

The net creation of value adjustments for default risks and losses from interest operations in the amount of CHF 7 million was at a low level and even less than in the comparative period (1st half of 2016: CHF 10 million). The same applies to the changes in the provisions amounting to CHF 4 million (1st half of 2016: CHF 5 million).

Value adjustments on participations and depreciation and amortisation of tangible fixed assets and intangible assets also declined and amounted to CHF 59 million (1st half of 2016: CHF 65 million). This figure also includes the regular depreciation of goodwill from the acquisition of the Swisscanto Group.

Excellent half-year result

In summary, in the first half of 2017 Zürcher Kantonalbank achieved very good group net income in excess of the same period in the previous year of CHF 420 million and, thanks to the higher operating income, clearly exceeded expectations without any notable extraordinary income items.

Stable total assets

As at 30 June 2017, total assets increased negligibly by around 0.2 percent compared to 31 December 2016, to CHF 158.4 billion.

Overall, the balance sheet structure was also stable. Mortgage loans of CHF 78.2 billion still representing the largest balance sheet item on the assets side, while customer deposits amounting to CHF 81.5 billion continued to dominate liabilities. Zürcher Kantonalbank's refinancing situation therefore remains comfortable.

High liquidity cushion

As of the middle of the year, liquid assets, primarily comprising deposits with the Swiss National Bank, amounted to CHF 36.1 billion compared to CHF 35.3 billion at the end of December 2016.

These deposits serve to meet liquidity requirements, which are particularly high for systemically important banks such as Zürcher Kantonalbank.

Growth in mortgage lending at market level

The total of mortgage loans increased by CHF 0.9 billion in the first six months of 2017 and by 1.2 percent respectively (1st half of 2016: 2.4 percent). This growth reflects the current market situation. The share of fixed mortgages was around 76 percent, similarly to 31 December 2016.

The quality of the lendings remains Zürcher Kantonalbank's top priority. This is why the affordability calculation is based on an imputed mortgage rate of 5 percent even in the current low interest rate environment.

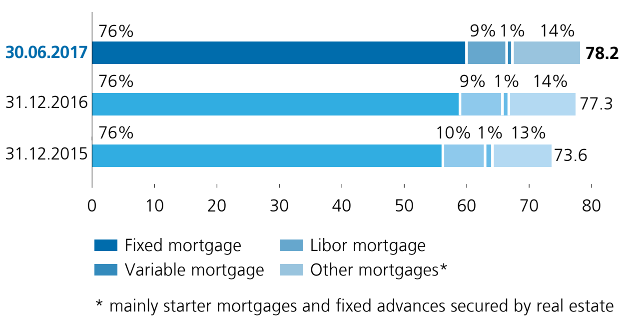


Fig. 5: Fixed and variable mortgages (in % and in CHF billion)

Slightly higher customer deposits

Customer deposits comprise money in saving accounts and in investment form as well as other liabilities to customers. As at 30 June 2017, these amounted to CHF 81.5 billion compared to CHF 80.9 billion at the end of 2016. This corresponds to an increase of 0.7 percent.

Increase in assets under management

Assets under management grew by CHF 9.8 billion in the first half of 2017, to CHF 274.5 billion.

Capital adequacy and liquidity disclosures

The capital adequacy and liquidity disclosures are posted in a separate report on the internet at www.zkb.ch («Disclosures»).

Outlook

Thanks to its highly diversified business model and its client proximity, Zürcher Kantonalbank has a positive outlook for the second half of 2017 and expects the environment to remain demanding and competitive. Despite excellent economic fundamentals, geopolitical uncertainties must continue to be expected. Nevertheless, Zürcher Kantonalbank is confident that it will generate another respectable result in the second half of 2017 as well, given the current business conditions.

Group income statement

in CHF million	1st half 2017	1st half 2016	Change	Change in %
Result from interest operations				
Interest and discount income	776	718	58	8.1
Interest and dividend income from financial investments	25	30	−5	−16.5
Interest expenses	−196	−156	−40	25.5
Gross result from interest operations	605	592	13	2.2
Changes in value adjustments for default risks and losses from interest operations	−7	−10	2	– 23.1
Subtotal net income from interest operations	598	582	15	2.6
Result from commission business and services				
Commission income from securities and investment activities	394	379	15	4.0
Commission income from lending activities	26	26	−0	– 0.6
Commission income from other services	68	62	5	8.7
Commission expenses	−109	−106	−3	2.6
Subtotal result from commission business and services	378	360	18	4.9
Result from trading operations and the fair value option	187	183	4	2.1
Other result from ordinary activities				
Result from the disposal of financial investments	0	0	0	391.8
Income from participations	14	12	3	23.4
– of which from equity-consolidated participations	2	0	2	–
– of which from other non-consolidated participations	13	12	1	10.1
Result from real estate	4	5	−1	−18.2
Other ordinary income	4	8	−3	– 43.8
Other ordinary expenses	−1	−1	1	– 60.7
Subtotal other result from ordinary activities	22	23	−1	– 2.6
Operating income	1,185	1,149	36	3.2
Operating expenses				
Personnel expenses	−501	−469	−31	6.7
General and administrative expenses	−205	−215	10	– 4.6
Subtotal operating expenses	−706	−684	−22	3.2
Value adjustments on participations and depreciation and amortisation of tangible fixed assets and intangible assets	−59	−65	6	– 9.8
Changes to provisions and other value adjustments and losses	−4	−5	1	−26.5
Operating result	417	395	22	5.6
Extraordinary income	7	3	4	154.3
Extraordinary expenses	−0	−1	1	– 98.7
Taxes	−5	−4	−0	6.1
Group net income (result of the period)	420	393	27	6.9

Group balance sheet

before distribution of net profit

in CHF million	30.06.2017	31.12.2016	Change	Change in %
Assets				
Liquid assets	36,059	35,336	723	2.0
Amounts due from banks	5,036	5,364	–328	– 6.1
Amounts due from securities financing transactions	14,260	14,889	–629	– 4.2
Amounts due from customers	7,436	7,509	–74	– 1.0
Mortgage loans	78,207	77,275	931	1.2
Trading portfolio assets	9,135	9,472	–337	– 3.6
Positive replacement values of derivative financial instruments	1,514	1,933	–419	– 21.7
Other financial instruments at fair value		20	–20	–100
Financial investments	4,539	4,156	383	9.2
Accrued income and prepaid expenses	527	360	167	46.4
Non-consolidated participations	182	179	4	2.0
Tangible fixed assets	785	804	–18	– 2.3
Intangible assets	153	168	–15	– 8.7
Other assets	545	520	25	4.7
Total assets	158,378	157,985	393	0.2
Total subordinated claims	162	181	–20	– 10.8
– of which subject to mandatory conversion and/or debt waiver	53	44	10	22.2
Liabilities				
Amounts due to banks	32,422	34,137	– 1,715	– 5.0
Liabilities from securities financing transactions	5,111	5,084	27	0.5
Amounts due in respect of customer deposits	81,454	80,890	564	0.7
Trading portfolio liabilities	2,048	2,656	–608	– 22.9
Negative replacement values of derivative financial instruments	1,357	1,551	–195	– 12.5
Liabilities from other financial instruments at fair value	3,058	3,100	–42	– 1.4
Cash bonds	209	235	–26	– 11.1
Bond issues	10,908	9,329	1,579	16.9
Central mortgage institutions loans	9,162	8,384	778	9.3
Accrued expenses and deferred income	556	683	–126	– 18.5
Other liabilities	645	506	138	27.3
Provisions	585	636	–51	– 8.0
Bank's capital	2,425	2,425		
Retained earnings reserves	8,026	7,686	340	4.4
Foreign currency translation reserves	–7	–8	1	– 9.9
Group net income (result of the period)	420	691	–271	– 39.2
Equity	10,863	10,793	70	0.6
Total liabilities	158,378	157,985	393	0.2
Total subordinated liabilities	1,473	1,298	175	13.5
– of which subject to mandatory conversion and/or dept waiver	1,473	1,298	175	13.5
Off-balance-sheet transactions				
Contingent liabilities	3,975	4,483	–508	– 11.3
Irrevocable commitments	7,926	7,506	420	5.6
Obligations to pay up shares and make further contributions	233	233	–0	– 0.0
Credit commitments				

Group statement of changes in equity

in CHF million	Bank's capital	Profit reserves	Group net income	Foreign currency reserves	Total equity
Total equity as at 1 January 2016					
Opening amount	2,425	8,012		–8	10,429
Impact of restatement					
Capital increase					
Capital reduction					
Increase in scope of capital consolidation					
Decrease in scope of capital consolidation					
Other contributions / other capital paid in					
Reclassifications					
Currency translation effect				–0	–0
Distribution of profit		–326			–326
Revaluation adjustments not affecting net income		0			0
Other allocations to (transfers from) the other reserves					
Group net income (result of the period)			691		691
Total equity as at 31 December 2016	2,425	7,686	691	–8	10,793

in CHF million	Bank's capital	Profit reserves	Group net income	Foreign currency reserves	Total equity
Total equity as at 1 January 2017					
Opening amount	2,425	8,376		–8	10,793
Impact of restatement					
Capital increase					
Capital reduction					
Increase in scope of capital consolidation					
Decrease in scope of capital consolidation					
Other contributions / other capital paid in					
Reclassifications					
Currency translation differences				1	1
Distribution of profit		–351			–351
Revaluation adjustments not affecting net income		0			0
Other allocations to (transfers from) the other reserves					
Group net income (result of the period)			420		420
Total equity as at 30 June 2017	2,425	8,026	420	–7	10,863

Condensed notes

Changes to the accounting and valuation principles

No changes were made to the accounting and valuation principles in the first half of 2017.

For more details on the applicable accounting and valuation principles, please refer to the Annual Report 2016.

Factors affecting the half-year result 2017

Despite the improvement in the global economy, the political uncertainty significantly characterised the financial markets in the first half of 2017. Initially, the elections in Europe had a negative impact on investor sentiment. This uncertainty mainly manifested itself in the bond rates – the equity markets, in contrast, largely continued to climb. According to expectations, the American central bank increased its key interest rates twice in the first half of the year whilst the European Central Bank continued on its expansive path. As a consequence, the monetary policy of the Swiss National Bank remained unchanged. At times she intervened overtly and extensively on the foreign exchange market. After the elections in France, the situation on the financial markets eased noticeably, i. e. the flight to safety was no longer the focus. The EUR/CHF exchange

Extraordinary income and expenses

in CHF million	1st half 2017	1st half 2016
Extraordinary income		
Reversal of impairment on other participations	5	0
Income from sale of other real estate / bank premises	2	2
Income from sale of participations		0
Other	–0	0
Total	7	3
Extraordinary expenses		
Losses from sale of other real estate / bank premises		0
Loss from the sale of participations		
Other	0	1
Total	0	1

In the financial year, no hidden reserves or reserves for general banking risks were reversed and no significant freed-up value adjustments and provisions were recorded.

Events occurring after the date of the interim financial statements

No material events affecting the net assets, financial position and results of operations of the group occurred between the date of the interim financial statements and the date on which the report was published.

Contact

Information

Should you require further information about Zürcher Kantonalbank, the following offices will be pleased to assist:

Retail customers
+41 (0)844 843 823
info@zkb.ch

Private Banking
privatebanking@zkb.ch

Corporate customers
+41 (0)844 850 830
info@zkb.ch

Financial Institutions & Multinationals
+41 (0)44 292 87 00
international@zkb.ch

Media
+41 (0)44 292 29 79
medien@zkb.ch

Further contact details can be found at www.zkb.ch

Imprint
Published by Zürcher Kantonalbank, Bahnhofstrasse 9, CH-8010 Zurich, +41 (0)44 293 93 93
Concept and layout by Partner & Partner AG, Winterthur