Investitionsbank des Landes Brandenburg

Management Report 2017

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Consolidated Management Report 2017

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I Fundamentals of the group

1. Business model of the group

1.1 Basis of business activities

Investitionsbank des Landes Brandenburg (ILB) is the central business promotion institution of the federal state of Brandenburg and in this capacity supports the implementation of business development policy in Brandenburg. The ILB law determines the framework for ILB‘s activities and forms the basis for all ILB’s business which directly or indirectly serves the implementation of the bank‘s statutory task as a business development institute. The bank is authorised to issue official administrative decisions as an approval authority. As a CRR credit institution, the bank is subject to European Banking Supervision under the responsibility of Germany’s Federal Financial Supervisory Authority (BaFin).

Pursuant to the ILB law, the bank bears public-sector responsibility and guarantor‘s liability and is protected by a federal-state guarantee. Pursuant to its articles of association, ILB conducts its business according to commercial principles whilst at the same time respecting the common interest and strict competition neutrality. ILB and its eleven subsidiaries form the ILB group. With a share of 99.9% of the group’s balance sheet sum, ILB accounts for almost the entire business development of the group.

The federal state of Brandenburg and NRW.BANK each hold a 50% stake in the bank.

1.2 Mission

As the business promotion bank of the federal state of Brandenburg, ILB supports public and private investment projects in Brandenburg in the fields of business, employment, infrastructure and housing construction, thereby promoting successful and sustainable economic development in the region.

In its capacity as an intermediary for the federal state of Brandenburg, ILB approves funds from the ERDF (European Regional Development Fund), the ESF (European Social Fund) and from the EAFRD (European Agricultural Fund for Rural Development) in the federal state of Brandenburg. The bank‘s business management duties involve a wide range of tasks, such as consultancy services, application processing, preparation of proposals for funding committees, approval and disbursement of funds, comprehensive documentation and reporting obligations, verification of fund application documentation as well as the further development of guidelines.

Furthermore, ILB is entrusted with the administration of the trust funds assigned to it by the federal state of Brandenburg and with the formation and management of special funds. In this context, the bank manages the housing assets of the federal state of Brandenburg (LWV) in trust, assumes guarantees in housing construction and manages promotional measures under the film promotion fund of the federal states of Berlin and Brandenburg.

1.3 Aims of the business activities and strategies of ILB and the group

The purpose of the business development strategy is to ensure long-term fulfilment of ILB‘s business development mission pursuant to its articles of association and the ILB law. Implementation tools include the products offered by ILB as part of its business management activities and from its own portfolio.

The key aims of ILB‘s business management can be summarised as follows.

- ILB is continuously expanding its function as the central business development institution and supports the business development policy of the federal state of Brandenburg with its banking expertise and within the scope of its overall strategy.
- ILB's central functions which the bank pursues on behalf of the federal state of Brandenburg are strengthened for this purpose. The aim is for ILB to bundle all tasks related to monetary support measures by the federal state, in particular, EU support measures.
- Increasingly complex support processes are currently vetted with a view to cost and efficiency.

The key aims of ILB's own products can be summarised as follows.

- With its own promotion programmes, ILB paves the way for the long-term and comprehensive availability of loans in the federal state of Brandenburg in order to finance investment projects in the fields of business, labour infrastructure and housing.
- In line with its own risk policy principles, ILB is continuously developing its Brandenburg loan family in order to compensate for the medium-term decline in EU and federal-state funding with its own products. One central part of this effort is continued cooperation with the applicants' banks. To finance the advantages of the Brandenburg loan family, ILB's promotion funds are formed each year from the bank's income. In this case, revenues from treasury business are the main source of financing.
- Lending business is being further developed in line with the bank's risk policy principles. The banks remains broadly positioned with regard to its customer groups and will offer new products within the scope of its risk strategy.

1.4 Products and services

ILB offers its customers grants, interest rate subsidies, loans, liability exemption, guarantees as well as venture and investment capital from funds provided by the federal state, the federal government and the European Union (EU) as well as from refinancing on the capital market.

With its equity capital firms, the bank is improving the equity situation of undertakings in the federal state of Brandenburg. The property firms not only develop property projects and rent out properties, they also promote tourism in the city of Potsdam and the establishment of companies.

Apart from distributing budget funds, the bank itself grants loans, a significant share of which is secured by first-ranking land charges or public guarantees.

ILB's core business is loan business with commercial industries – including agricultural companies – as well as loans to the federal state of Brandenburg, its municipal authorities and social institutions. ILB grants low-interest global loans to banks (applicant's bank procedure) in order to enhance the supply of loans to the commercial sector and, when necessary, also enters into syndicated loan agreements as a consortium partner. Furthermore, ILB also co-finances film productions in order to strengthen the Berlin-Brandenburg media region. Housing is another focus of the bank's loan portfolio

The bank refinances most of the funds which it needs for its tasks from the European Investment Bank (EIB), KfW Bankengruppe (KfW), Landwirtschaftliche Rentenbank (LR), the Council of Europe Development Bank (CEB) and by issuing its own promissory notes.

ILB acts as the lead institute for the savings banks in Brandenburg. In this capacity, it assists the customer support staff of savings banks in their advisory services regarding KfW products, the structuring of support funds (also as part of package financing) and the forwarding of loan applications and pledges. In this context, ILB offers training and advisory meetings to customer support staff of savings banks and provides a web-based information portal.

1.5 Declaration of Compliance

In accordance with ILB's Corporate Governance Code, the Management Board and the Administrative Board are required to report annually on corporate governance (Corporate Governance Report). The Declaration of Compliance forms an integral part of the Corporate Governance Report. In June 2017, the Management Board and the Administrative Board last issued the Corporate Governance Report and the Declaration of Compliance with ILB's Corporate Governance Code. The Corporate Governance Report and the Declaration of Compliance were drawn up in March 2017 and were approved by ILB's Administrative Board on 1 June 2017. ILB's Corporate Governance Code, the report on the Corporate Governance Code and the Declaration of Compliance were published on ILB's website.

II Economic Review

1. Economic conditions in Germany

In 2017, the German economy grew for the eighth year in succession. According to the latest calculations by the Federal Statistical Office, price-adjusted gross domestic product (GDP) grew by a good 2.2% against the previous year, a figure recorded last in 2011 (2016: 1.9%, 2015: 1.7%).

This economic development was particularly driven by strong domestic demand, which contributed 2.0 percentage points to price-adjusted GDP growth. According to the Federal Statistical Office, private consumer spending and gross plant investment increased by 2.0% and 3.0%, respectively, compared to the previous year. By contrast, government spending increased by only 1.4% on a price-adjusted basis compared to the previous year.

There was also a steep increase in foreign trade in 2017. Price-adjusted service exports were up 4.7% against the previous year, while imports increased by 5.2% over the same period. The resulting net exports contributed 0.2 percentage points to the price-adjusted growth of gross domestic product.

Economic development in 2017 was driven by positive developments on the labour market. According to initial calculations by the Federal Statistical Office, the number of people in jobs in Germany increased by approx. 638,000 or 1.5% compared to the previous year – more than at any time since 2007. This increase results from the higher number of people in jobs subject to statutory social security contributions. Taking offsetting, age-related demographic effects into account, the total number people in jobs rose from 43.6 million to 44.3 million.

Public budgets continued their consolidation course in 2017, recording a surplus of EUR 38.4bn. According to the Federal Statistical Office, the surplus rate totalled 1.2% in terms of price-based GDP.

As in previous years, interest rates on capital markets in 2017 were shaped by the ECB's monetary policy, which ensured a continuation of the low interest rate environment with its bond purchase programme and the negative interest rate on deposits. Thanks to the improved economic environment, however, the previous year's lows were not reached and interest rates were seen to move slightly upward from their low level. The ECB reacted to the improved economic environment and decided to halve the volume of bond purchases beginning in 2018. Over the course of the year, yields on 10-year German government bonds rose to 0.50% and the comparable 10-year swap rates to 0.90%. In contrast to this, short maturities on the money market remained stable in the negative interest range.

All in all, 2017 saw a very favourable capital market environment where public budgets were supported by lower interest spending while low financing costs facilitated investments and housing construction.

2. Economic conditions in the federal state of Brandenburg

Since 2003, the unemployment rate in the federal state has fallen continuously. This positive development on the regional labour market was also visible again in 2017. At the end of the year under review, the average rate fell to 7.2%, the lowest level since German reunification.

The number of people in jobs reached a new high in 2017, up 1.2% compared to 2016. This development was driven primarily by an increase in employment in the services sectors (+13,000 people in jobs).

According to the federal state's statistical office, Brandenburg's industrial enterprises recorded total turnover of EUR 23.1bn in 2017, 0.1% down against the previous year. Domestic turnover increased by 2.6% to EUR 16.2bn, export turnover decreased by 6.1% to EUR 6.8bn.

According to official statistics, there was a positive order trend for 2017 compared to the previous year. Orders on hand rose by a total of 19.7% with domestic orders up by 14.0% and foreign orders by 30.0%.

Turnover for the construction industry increased in 2017 by 3.8%, whilst order intake saw a 1.4% increase.

According the data currently available, Brandenburg's GDP developed positively in 2017. According to the federal state's statistical office, Brandenburg's GDP was up by 2.3% in the first half of 2017 compared to the first half of 2016.

3. Business development

3.1 Promotional and development business

ILB's funding and support portfolio once again met with a very positive response from Brandenburg's business community, private households, municipal administrations and the housing sector. Demand for business development loans through savings banks acting as the applicants' banks in the federal state of Brandenburg was once again high. In 2017, ILB pledged a total volume of EUR 1,592m.

Promotional and development business in 2017 included, for instance, the following:

- The volume of EUR 1,478m to be pledged for 2017 was exceeded by EUR 114m (+8%) and thus totalled EUR 1,592m.
- Compared to the previous year, the volume pledged fell by around EUR 400m to EUR 1,991m (-20%). This development is due to the decline in ILB products.
- The volume of ILB products pledged totalled EUR 836m (2016: EUR 1,454m). The main reason for this reduction is the EUR 571m in airport financing (BER) pledged in the previous year.
- ILB's products accounted for a share of 53% in the total sum pledged in 2017.
- All the promotion areas in the field of managed activities recorded positive demand. Pledges totalled EUR 755m. This marks the highest result for promotion and support in the field of managed activities over the past 10 years.
- The volume pledged in managed activities was up EUR 81m against the budgeted figure of EUR 674m (+12%).
- Compared to the previous year, the sum pledged in managed activities increased by EUR 218m (+41%) (2016: EUR 537m). Expansion of broadband (infrastructure) accounts for a large share of this figure, i.e. EUR 158m.

3.2 Earnings development

ILB and the group, which is predominantly determined by ILB, can once again look back on a successful 2017 fiscal year.

Net income from operative business developed as expected.. Net income before provisions for risks totalled EUR 44.4m and was hence EUR 0.2m above budget.

The result after risk provisioning surpassed expectations and, at EUR 42.4m, was EUR 5.9m higher than budgeted for 2017. This was driven, first and foremost, by the positive development of write-down demand which was EUR 6.5m lower than originally planned (EUR 6.3m).

As per 31 December 2017, return on equity, a key indicator, totalled 1.07% for ILB (group: 1.05%).

4. Income, net worth and financial position

In 2017, just like in previous years, ILB accounted for 99.9% of the group's balance sheet sum. With a balance sheet sum of EUR 13,540.1m, the group once again recorded a good result in 2017.

The income situation, net worth and financial position of ILB and the group are satisfactory and stable.

4.1 Income situation

In 2017, ILB's annual net income totalled EUR 11.4m (previous year: EUR 11.6m), that of the group EUR 8.6m (previous year: EUR 11.3m). In addition to the loss of EUR 0.4m recorded by subsidiary ILB Beteiligungsgesellschaft mbH, the decline in consolidated net income is mainly due to the termination of the investment agreement of group subsidiary BC Venture GmbH. In the financial year, a profit-sharing bonus of EUR 0.8m was paid to external investors. Furthermore, ILB's acquisition of the remaining shares in group subsidiary BC Brandenburg Capital GmbH had a negative impact of EUR 0.9m on the group result.

The group's income situation is determined largely by ILB. In light of ILB's dominant position in the group, separate reference to the group will only be made in the following if significant deviations exist.

As part of the annual planning process, income and expenditure items are steered with defined budget variables. The planning variables are updated during the year and reviewed with a view to the goals set. The targets for 2017 were by and large reached. Lower net fee and commission income was offset by lower administrative expenses and depreciation of tangible assets. The target figures for net interest income and income from investments were exceeded. The result before risk provisioning was thus on the whole slightly above budget.

The measure for ILB's financial success is the result before risk provisioning and the formation of reserves. In 2017, ILB recorded a good result of EUR 44.4m before risk provisioning and the formation of reserves which is close to the previous year's level (EUR 44.8m).

In detail, development was as follows:

Net interest income totalled EUR 61.2m and was up against the previous year (EUR 58.2m). This meant that net interest income increased despite persistently low interest rates which was primarily due to ILB's participation in the ECB's targeted longer-term refinancing operations. In 2016 and 2017, the ILB participated in the ECB's TLTRO (targeted longer-term refinancing operations) offer with a term of 4 years. The interest rate of this transaction is based on the net lending of the institution. ILB exceeded the conditions for new loans in the non-financial private sector as of 31 January 2018 and was thus able to realise the maximum premium in the form of a refinancing interest rate of -0.40% for 2016 and 2017 with retroactive effect from the beginning of the term.

Income from interest-bearing promotional and development activities and the treasury result remained stable.

Net fee and commission income of EUR 44.9m (previous year: EUR 45.6m) largely results from fees for the management of promotion and support programmes. This is made up of administrative cost contributions in conjunction with the granting of loans from trust funds, the handling of promotion programmes and the management of guarantees. The decline is mainly due to the scheduled decline in income from trust loans.

ILB‘s personnel expenses totalled EUR 41.3m in 2017 (previous year: EUR 38.6m). The EUR 2.7m increase still results from the takeover of 53 employees of LASA Brandenburg GmbH i. L. with effect as of 1 July 2016. Adjustments of collective agreements with effect as of 1 October 2016 also led to an increase in expenditure. With the move to the new building, employees will receive travel allowances for local public transport, which will also increase expenses.

At the end of 2017, ILB employed a staff of 632 (active and passive).

Other administrative expenses, including depreciation, amortisation and write-downs on intangible assets and tangible assets totalled EUR 23.2m (previous year: EUR 23.1m). Expenses thus remained at the previous year‘s level. However, it should be noted that from 2017 depreciation on buildings and outdoor facilities will be carried out for the first time due to the move to ILB’s new administration building. At the same time, operating costs are reduced by almost the same amount.

Operating costs thus totalled EUR 18.5m and were hence below the previous year‘s level of EUR 20.7m.

Depreciation on tangible assets totalled EUR 4.7m and was higher than the previous year‘s figure (EUR 2.4m).

The group‘s risk situation is determined largely by ILB. Itemised allowances are formed for identifiable risks in loan business, taking existing collateral into consideration. These risks are stable and at a low level, largely reflecting ILB‘s conservative risk culture. General allowances were formed to consider the development of the latent credit risk.

Fixed-asset securities are generally valued according to the less strict lower of cost or market principle. In line with the high quality of the securities held, no write-offs were required at the end of the year.

With regard to long-term loan business with fixed-interest periods of more than ten years, provident funds pursuant to section 340 f of the German Commercial Code [§ 340 f HGB] were formed in order to address the risk of statutory termination rights being exercised in this context.

Other operating net income, without allocations to the ILB promotional fund and to the Brandenburg fund, totalled EUR 2.0m in 2017 and was thus below the previous year‘s figure of EUR 2.5m. The main reasons for the decline are additional expenses in conjunction with the move to the new building and the bank‘s subsidy for the company restaurant.

Other operating income included revenues of EUR 4.0m from the appropriate use of ERDF funds within the scope of “Brandenburg-Kredit Mezzanine”. Furthermore, funds of EUR 5.7m were carried from the early-phase and growth funds as well as funds of EUR 2.1m for the micro-loan. This revenue was appropriated to the Brandenburg fund.

Other operating income also includes expenditure for earmarked funds of the ILB promotional fund of EUR 3.4m that became necessary due to funds and support pledged in 2017.

EUR 5.0m was earmarked for the ILB promotional fund in 2017. This means that since 2006, EUR 90.0m of the bank‘s revenues has been made available for funding and support measures within the scope of ILB‘s Brandenburg loan product family.

Another EUR 60.2m was allocated to the fund for general banking risks from the current result (previous year: EUR 33.7m). This figure includes reclassification of EUR 23.7m from contingency reserves to the fund for general banking risks in accordance with section 340 f of the German Commercial Code [§ 340 f HGB].

4.2 Net worth

ILB’s balance sheet total, which accounts for 99.9% of the group’s balance sheet sum, increased in the 2017 financial year by EUR 215.2m to EUR 13,533.4m (previous year: EUR 13,318.2m). In light of ILB’s dominant position in the group, separate reference to the group will only be made in the following if significant deviations exist.

The business volume, comprising business recorded in the balance sheet with current customers, contingent liabilities, administrative loans, as well as administrative guarantees, totalled EUR 13,751.4m at the end of the 2017 financial year (previous year: EUR 13,545.8m). The group's business volume totalled EUR 13,758.1m as per 31 December 2017 (previous year: EUR 13,559.9m). The difference of EUR 6.7m results mainly from bank deposits of the subsidiaries – carried under "Other assets" in the consolidated balance sheet – as well as from tangible fixed assets.

ILB's loans and advances to banks increased by 5.8% to EUR 2,345.4m (previous year: EUR 2,217.7m). This increase is mainly due to EUR 25.5m granted under the Brandenburg loans for SMEs and the forwarding of KfW loans as the forwarding institution for savings banks in Brandenburg. Furthermore, lending via domestic note loans was increased by EUR 85.0m.

There was a further increase in the cash collateral provided for bilaterally held derivative items. By contrast, global loans in business with applicants' banks fell by EUR 87.7m as a result of repayments.

ILB's loans and advances to customers were slightly down by EUR 55.2m to EUR 4,954.0m (previous year: EUR 5,009.2m). This was particularly due to repayment of around EUR 253.0m in loan business by the State Housing Construction Fund. In contrast, municipal lending business and lending for housing construction promotion grew. The issuance of domestic note loans and registered bonds kept lending business at the previous year's level. Trust loans fell by EUR 344.4m to EUR 2,256.3m as a result of scheduled and unscheduled repayments and as a result of the termination of the management of trust securities investments.

ILB's bonds and other fixed-income securities totalled EUR 3,245.3m as per 31 December 2017 and are up EUR 170.1m against the previous year.

Stocks and other variable-income securities are exclusively the shares for the special fund issued in 2014 with Union Investment Institutional GmbH which is a mixed fund that invests in European corporate bonds and which was increased by EUR 30.0m in the year under review.

ILB's other assets totalled EUR 52.7m (previous year: EUR 88.1m), including EUR 51.7m for the margin payment to central counterparties. In the group, this balance sheet item also primarily includes liquid funds of EUR 29.8m held by the group's subsidiaries with banks. At the end of the 2017 financial year, the group recorded other assets totalling EUR 82.8m (previous year: EUR 121.5m).

ILB enters into derivative interest rate hedging transactions for the sole purpose of steering interest rate and currency exchange risks. The nominal volume of business as per the balance sheet key date totalled EUR 12,599.5m (previous year: EUR 10,935.0m).

4.3 Financial position

The group's financial position is also determined almost exclusively by ILB. ILB's liabilities are secured by statutory public-sector responsibility, guarantor's liability and the liability guarantee of the federal state of Brandenburg.

In the 2017 financial year, short-term funds were primarily taken out through reverse transactions, time deposits and call money transactions, mostly with domestic banks. Funds were also taken out through open-market transactions with Deutsche Bundesbank.

Long-term refinancing was primarily taken out through bonded loans from domestic banks and global loans from the European Investment Bank (EIB), KfW-Bankengruppe, Landwirtschaftliche Rentenbank and the Council of Europe Development Bank, as well as from bond placements with domestic insurance companies.

Compared to the previous year, liabilities due to banks rose by EUR 374.7m to EUR 9,683.6m as per 31 December 2017 (previous year: EUR 9,308.9m). Whilst long-term refinancing and open-market transactions increased by EUR 845.0m, funds taken up through time deposits and call money were down by EUR 389.2m.

Liabilities to customers as per 31 December 2017 were up EUR 52.6m against the previous year. This increase results mainly from call money deposits of EUR 63.4m. Funds raised from foreign insurance companies through bond placements fell by EUR 9.0m.

Off-balance sheet liabilities increased significantly in 2017 as a whole. Liabilities in relation to guarantees and warranties increased by EUR 10.4m. There are no indications that guarantees for contingent liabilities will be called on, except for two cases for which a corresponding risk provision was made. Irrevocable loan commitments increased by EUR 517.0m to EUR 867.8m as per 31 December 2017. The decline of EUR 19.9m in loans and guarantees managed for the federal state Brandenburg results from repayments for this business field which is being reduced as planned.

The group's liquidity which is essentially determined by the ILB was secured at all times. At the end of 2017, the bank recorded more than EUR 340.2m in open loan commitments not yet called by other promotional banks.

The fund for general banking risks according to section 340g of the German Commercial Code [§ 340 g HGB] was increased to EUR 392.4m, including EUR 337.7m which must be classified as liable core capital.

ILB's equity, including the fund for general banking risks, totalled EUR 614.6m as per 31 December 2017 (previous year: EUR 549.0m). The group's equity totalled EUR 615.8m (previous year: EUR 553.5m).

This increase is largely due to the allocation to the fund for general banking risks and to retained earnings. The appropriation to the fund for general banking risks totalled EUR 60.2m. This includes a demand-based appropriation to the ILB promotional fund with the budgeted sum of EUR 5.0m. Since 2006, EUR 90.0m of the bank's revenues has been made available for funding and support measures within the scope of ILB's Brandenburg loan product family.

The table below shows the development and composition of the ILB promotional fund and of the Brandenburg fund.

Thousand EUR	ILB promotional fund	Brandenburg fund
Date revised last: 01 January 2017	21,948	22,300
Additions	5,000	11,806
of which:		
Brandenburg Kredit Mezzanine		538
Brandenburg-Kredit Mezzanine II		3,461
BFB III early phase and growth funds		5,695
Brandenburg micro-loan		2,112
Reversals	3,425	2,892
of which:		
Brandenburg-Kredit Mezzanine II		2,779
As per 31 December 2017	23,523	31,214

Due to the resolution regarding the appropriation of profits from the year 2016 adopted at the shareholders' meeting on 01 June 2017, a dividend of EUR 6.0m was distributed to the shareholders. Furthermore, EUR 5.0m was allocated to retained earnings, and EUR 0.1m was allocated to profit carried forward.

All in all, the strategic goal to strengthen equity each year by at least EUR 20m was clearly outperformed in 2017 with an appropriation of around EUR 31.2m.

The equity requirements of the German Solvability Ordinance and of the Capital Requirement Regulation (CRR) of the EU were fulfilled at all times.

In 2017, ILB's total capital ratio according to CRR ranged between 16.68% and 17.82% (that of the group: between 16.73% and 17.87%).

In 2017, ILB's core capital ratio according to CRR ranged between 14.94% and 16.08% (that of the group: between 15.00% and 16.14%).

4.4 Financial and non-financial performance indicators

In the 2017 financial year, ILB pledged promotional funds of around EUR 1.6bn for 4,190 projects, including EUR 755m for products related to managed activities for the federal state of Brandenburg and EUR 836m for ILB's own products.

The financial performance indicators relevant for ILB and the group are shown and explained in section 3.2, "Earnings development".

ILB's non-financial performance indicators are mainly related to employee issues.

532 people were actively employed in permanent jobs on 31 December 2017 (previous year: 534). The number of employees in temporary jobs rose from 67 to 72. All in all, 17.1% of all active employees worked part-time. This figure is up 1.1% against previous year's level.

28 employees were in the passive phase of semi-retirement, early retirement, parental leave or other forms of passive employment (previous year: 29 employees). The number of students (15) in cooperative study programmes was up by one against the previous year.

Female employees accounted for 66.7% (previous year: 67.1%) of the workforce at the end of the year. The average age of all employees was 47.1 years (previous year: 46.8).

In 2017, ILB provided active support for its employees' further professional development through in-house and external training events. Seminar attendance totalled 1,016 (previous year: 1,450).

4.5 Summarised Non-financial Declaration

4.5.1 Classification and procedure

Sustainable social, economic and ecological action is a principle of ILB's business activities. Sustainable action enables ILB to ensure the prerequisites for the success of its business and promotes successful and sustainable development of the people and economy in the federal state of Brandenburg. In order to live up to this claim, sustainability at ILB is a matter that falls under the responsibility of the Management Board.

This summarised Non-financial Declaration serves to meet the requirements of the Act to Implement the CSR Regulation (CSR-RL-UG) pursuant to sections 340i (4) in conjunction with 315b, 315c and section 340a (1a) in conjunction with sections 289b and 289c to 289e of the German Commercial Code (HGB) for ILB and the group. The following disclosures are necessary to explain the course of business, the results and position of ILB and the impact of its activities on non-financial aspects.

At present, reporting is not based on national, European or international frameworks. During the course of developing a sustainability programme for ILB, a suitable international framework will be selected in future.

In order to identify the main non-financial aspects of this Non-financial Declaration, ILB conducted a comprehensive materiality analysis for the first time in the 2017 reporting year. As part of this materiality analysis, ILB first compiled potential sustainability topics. For this purpose, employees from selected departments were interviewed and international standards and ratings, such as the principles of UN Global Compact and the rating of the Institute for Ecological Economic Research, were analysed.

The next step involved assessing the materiality of the topics. To this end, ILB performed a business relevance analysis, a competition analysis and an analysis of international standards and ratings. As part of the business relevance analysis, the heads of the bank's divisions evaluated the risk, efficiency and potential for growth/differentiation of the individual topics for ILB. The analyses of competition and standards/ratings identified the significance of the topics for other federal-state promotion institutions based on public sustainability reports and international standards and ratings.

As a next step, the ILB topics that resulted from the materiality analysis were prioritised in terms of business relevance in a workshop conducted with ILB's Board and division heads. Both the internal assessment from ILB's point of view and assumptions about the significance for external target groups were used to assess business relevance.

As a result, ILB has identified nine key issues that can be assigned to the following aspects: environmental matters, employee matters, social matters, respect for human rights and fight against corruption and bribery pursuant to section 289 c (2) of the German Commercial Code, as well as the additional aspect of information security:

Key issues	Reference to non-financial aspects
Sustainable promotion and support programmes and products	Environmental matters, social matters
Sustainability of the securities portfolio	Environmental matters, social matters, respect for human rights
Responsible corporate culture	Employee matters
Compatibility of career and family	Employee matters
Personnel planning and development	Employee matters
Promotion of the common good	Social matters
Combating corruption	Combating bribery and corruption
Responsible corporate management	Combating bribery and corruption
Information security	Information security (additional aspect)

No reference was made to the amounts reported in the annual financial statements and no additional notes were provided. ILB's Administrative Board commissioned the auditing firm PricewaterhouseCoopers GmbH to conduct an audit with limited assurance on the Non-financial Declaration within the scope of a business audit in accordance with auditing standard ISAE 3000 (revised).

4.5.2 Business model and risk inventory according to the Act to Implement the CSR Regulation

ILB's business model is described in section I of this Management Report.

Section III of this Management Report addresses ILB's risk management, the valuation methods applied and the relevant risks associated with ILB's business activities and relationships as well as funding and support. In net terms, no risks were identified that are very likely to have or will have serious negative effects on the material, non-financial aspects mentioned.

4.5.3 Key issues

4.5.3.1 Sustainable funding and support programmes and products

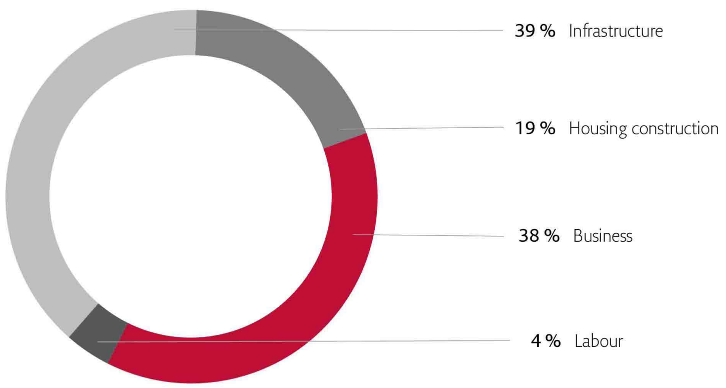
ILB‘s core business is to provide financial support for public and private investment projects in business, labour, infrastructure and housing. With the promotion of investment projects, ILB, as the business promotion bank of the federal state of Brandenburg, pursues the long-term goal of supporting both positive economic as well as ecologically and socially sustainable development in the federal state of Brandenburg and thus has an impact on environmental and social matters.

ILB‘s promotional business is based on two pillars: management of promotion and support programmes and its own business. As part of its management of promotion and support programmes, ILB handles programmes from EU, federal-government and federal-state funds on behalf of the ministries of the federal state of Brandenburg and is involved in designing the promotion and support programmes. In its own business, ILB offers funding and support products in the form of low-interest loans, liability exemption, guarantees as well as venture and investment capital.

For each of ILB‘s funding programmes and products, targets have been defined which are to be achieved by providing financial support for an investment project. In the management of promotion and support programmes, these targets are derived from the respective rules or administrative regulations of the federal state, whilst in our own business they are defined specifically for each product. When applications are submitted, ILB examines the consideration of support goals on the basis of specific funding and financing criteria.

In 2017, ILB approved a total of EUR 1,592m for projects by municipalities, companies, social institutions and initiatives in the federal state of Brandenburg. According to the following chart, the business sector accounted for 38%, employment for 4%, infrastructure for 39% and housing construction for 19%.

Breakdown of ILB’s promotional and development business according to volumes pledged (2017)



The majority of ILB‘s funding programmes and products in the four funding areas pursue social and ecological objectives in addition to economic sustainability. The ecological and social added value in the individual fields of promotion and funding can be described as follows:

In business promotion, ILB supports commercial enterprises, start-ups and freelancers as well as agricultural and media companies in their investment projects, thereby making a significant contribution to the creation and preservation of jobs. The preservation and continuation of film cultural heritage is promoted by fund approvals for Medienboard Berlin-Brandenburg GmbH and the provision of interim financing. In agriculture and forestry, ILB‘s support programmes and products contribute to nature conservation, the promotion of biodiversity as well as climate, environmental, consumer and animal protection. Promoting investment in more efficient production facilities helps to reduce energy consumption and carbon emissions.

In employment promotion, ILB, acting on behalf the federal state, supports employment, education and qualification measures as well as social partnerships. In this context, funds are made available especially in order to improve education, vocational preparation, vocational integration and training schemes for young people. Another focus is on further qualification and start-up support for the unemployed with the aim of combating poverty. Under the various support programmes, German classes are provided for refugees as well as educational and reintegration measures for prisoners. The Brandenburg social partnership guideline supports the modernisation of company work organisations towards a participatory corporate culture.

In infrastructure promotion, ILB finances infrastructure projects by municipalities, municipal special-purpose associations and municipal companies as well as by social, scientific, educational and cultural institutions. Special emphasis is placed on projects dedicated to nature conservation, preservation of environmental quality and quality of life in rural areas as well as the promotion of resource efficiency. In the field of social infrastructure, funding is provided to modernise and expand schools and to improve day-care facilities. In addition, ILB supports investments designed to improve the range of care and support services on offer.

In housing construction, ILB supports projects in the municipal, cooperative and private housing sectors as well as freehold property projects. Support is especially provided for the construction and sustainable modernisation of rented apartments offered at socially acceptable rent prices, as well as for improving the living conditions of people with severe mobility impairments. What's more, ILB offers financing for the acquisition, construction and modernisation of residential property in order to strengthen a socially stable resident structure, to establish forms of housing suitable for the elderly and families and to reduce energy consumption.

With the targeted promotion of socially and ecologically sustainable investment projects, ILB is making an important contribution to the sustainable development of the federal state of Brandenburg. With a view to the future, ILB intends to strengthen its own business, especially by the continued, extensive promotion of ecologically and socially sustainable projects.

4.5.3.2 Sustainability of the securities portfolio

Through a sustainable investment strategy, lending institutions can contribute to sustainable economic development, the protection of the environment as well as human rights and the improvement of social standards. Consequently, ILB's treasury business covers both environmental and social aspects as well as respect for human rights.

As a sustainable business promotion bank and non-trading book institution, ILB pursues a long-term, low-risk investment strategy. The focus is on investments in securities with very good credit ratings in core Europe in euros, covered bonds and securities that qualify for refinancing with the ECB. As per 31 December 2017, ILB's securities portfolio comprised exclusively investment-grade securities.

The investment strategy is derived from the bank's annually adjusted risk strategy. Treasury is responsible for and manages ILB's securities portfolio. The Risk Controlling unit monitors the bank's securities transactions and reports to the Management Board every two weeks in a trading report on developments and changes in the securities portfolio. The Management Board is closely involved in the process and decides on the introduction of limits in securities business based on analyses by front and back office.

In 2014, ILB launched a special fund at Union Investment Institutional GmbH. As a bond fund with a current total volume of 200 million euros (around 6% of the securities portfolio), this special fund invests in European corporate bonds. ILB has imposed non-financial exclusion criteria (ESG criteria) on the fund manager for investment decisions within the framework of the special fund. This ensures, for instance, that investments in companies that produce cluster bombs and landmines and in companies with extreme environmental scandals, human rights violations as well as child and forced labour are systematically excluded.

ILB uses interest income generated from the securities portfolio, for instance, to allocate funds to its promotion and support fund in line with demand. This fund is used by ILB to offer low-interest promotion and support services as part of its own business within the scope of the "Brandenburg loan" product family. The measures supported within the framework of this product family help to promote environmental protection, care and integration assistance, the creation of affordable housing and the modernisation of schools, to mention but a few.

4.5.3.3 Responsible corporate culture

A good corporate culture has a crucial effect on work satisfaction and motivation as well as the health of employees. That's why ILB attaches great importance to the positive design and continuous development of its corporate culture. This issue is related to the aspect of employee matters.

In 2017, ILB launched a cultural development project entitled “From a culture of duties and tasks to a culture of responsibility”. The core objectives of this project were to develop a vision for ILB, to revise management guidelines, improve cooperation between units and to involve employees more.

In order to achieve these goals, managers, the personnel committee, the equal opportunities officer and selected employees from HR met in six cross-divisional working groups and jointly advanced cultural development topics in workshops and discussion rounds. As a result, ILB‘s objectives and management guidelines were finalised at the end of 2017 and adopted by the Management Board. In addition, other topics that are relevant to the company as a whole, such as an agreement on teleworking, were developed and implemented across the different units.

Now that the cultural development project carried out in 2017 has successfully generated momentum for the further development of ILB‘s corporate culture, responsible and unit-spanning cooperation is to be further strengthened and expanded in the coming years.

4.5.3.4 Reconciling work and family life

ILB promotes a better work-life balance, because family-friendly working conditions strengthen the motivation, performance and satisfaction of employees and boost ILB's image in competition for highly qualified employees. In line with this mission, ILB aims to conduct an audit in 2018 on the compatibility of career and family at the “berufundfamilie” institution. By helping to create improved working conditions, this issue refers to the aspect of employee matters.

To achieve this goal, ILB has in recent years created new opportunities for more flexible working hours also in order to support employees with relatives in need of care. What's more, the bank has expanded its health-promoting offer for employees.

To make working hours more flexible, the personnel committee and the Management Board signed an agreement on teleworking in 2017. It is also possible for employees to work part-time and to take short or long-term leave of absence. The most important non-financial performance indicator in this context, i.e. the part-time ratio, is presented in section II.4.4 of this Management Report.

Since 2014, all ILB employees have been able to receive free social counselling on topics such as partnerships, family and mental/physical health. 6.9% of employees took advantage of this offer in 2017. In 2017, ILB signed a cooperation agreement with a consulting and placement agency to provide targeted support to employees with relatives in need of care.

In the area of company health management, ILB employees can use seminars such as “self and time management” and “stress management” or sports activities to keep themselves physically and mentally fit for the challenging task of reconciling work and family life. In addition, ILB organises a health fair every two years with courses on healthy diet, sport and exercise. All health services offered by ILB are evaluated annually and adjusted as required.

The Management Board and HR are responsible for developing and implementing measures to improve the compatibility of family and career and they have the support of the equal opportunities officer and the personnel committee.

4.5.3.5 Personnel planning and development

ILB's long-term success is essentially determined by the availability, skills and performance of its employees. Through effective personnel planning and development, ILB secures the qualified workforce needed now and in the future for the various functions of the Bank. This issue is related to the aspect of employee matters.

In its human resources strategy, ILB describes its central objectives for personnel planning and development. The Management Board and HR are responsible for the further development of the personnel strategy and they are supported in this matter by the equal opportunities officer and the personnel committee.

In the area of personnel planning, ILB is determined to ensure that staffing levels are in line with requirements in the long term. To achieve this, ILB extended the planning horizon for quantitative personnel planning from three to six years in 2017. In addition, ILB has further developed its annual personnel planning meetings at division manager level and its personnel controlling function.

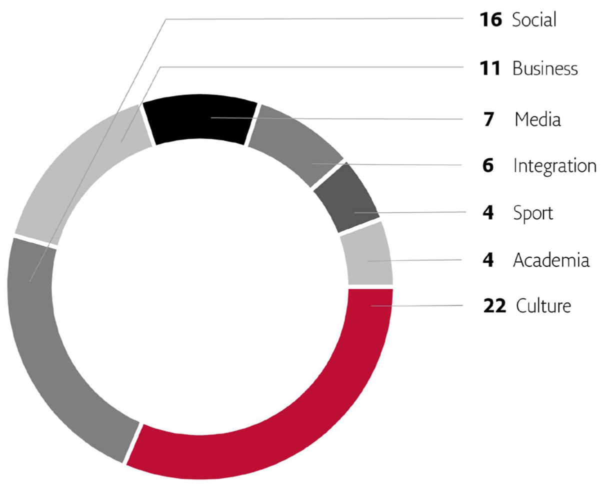
In personnel development, ILB further developed concepts to promote talent, develop management and to plan succession in the year under review. ILB plans in particular to expand and strengthen the networking of personnel development measures and to promote the management skills of selected employees. The most important non-financial performance indicator, i.e. participation in seminars, is presented in section II.4.4 of this Management Report.

4.5.3.6 Promotion of the common good

As the business promotion bank of the federal state of Brandenburg, ILB feels connected to the people in the region. ILB therefore not only assumes responsibility for Brandenburg's economic development, but is also active as a socially committed company, thus impacting social matters.

ILB is committed to public life and society in the federal state of Brandenburg and supports projects in the fields of culture, social affairs, business, media, integration, sport and science. In its sponsoring activities, ILB concentrates on projects with a federal-state focus and works to achieve a balance between long-term cooperation and individual measures.

Number of projects per field of activity sponsored by ILB (2017)



In 2017, ILB supported a total of 70 projects in the federal state of Brandenburg with around EUR 300,000. Most sponsorship and donation commitments were made in the fields of culture, social affairs and business.

With a view to social affairs, ILB supports, among others, the “Help for Families in Need” foundation. In the area of integration, sponsorship was promised to the “HelpTo” online help portal, which serves as a digital bulletin board for private individuals active in this area, welcome initiatives, communities, social institutions, companies, people seeking help and refugees.

Long-term sponsorship activities are included in ILB‘s annual communication plan. Individual measures taken during the year are evaluated on the basis of a catalogue of criteria and decided by the Management Board. The Board itself is sometimes involved in larger projects, e.g. by holding tribute speeches (Berlin-Brandenburg Innovation Award) or in the context of jury work for certain awards (e.g. the Brandenburg Future Award). All sponsorship measures are summarised once a year in a sponsorship report and evaluated by the Communications department and the Management Board in order to plan the following year.

4.5.3.7 Fighting corruption

ILB does not tolerate corruption; it is a crime that can raise doubts about the sensible use of taxpayers‘ money, especially with a view to the allocation of subsidies and it can hinder the equitable allocation of funds and lead to economic losses.

The concept for combating corruption at ILB is implemented in the policy: “Combating money laundering, financing terrorism and other criminal offences”. It presents signs of corruption and defines a general code of conduct for employees. In addition, rules are in place for the acceptance and granting of gifts and invitations. Employees are obliged to attend a training course on the “Prevention of other punishable offences”, that deals with the topic of combating corruption.

To prevent corruption in ILB‘s core business – the granting of funding and support – all employees work under the four-eyes principle. This concerns both application approval as well as the disbursement of funds and the verification of proof of use. This ensures that mutual control takes place in all steps of the process of granting funds.

The compliance officer is responsible for the adequacy and effectiveness of the compliance organisation designed to prevent other criminal acts, such as corruption. The compliance officer reports directly to the Management Board and is not bound by instructions in the performance of these tasks. The compliance officer prepares a compliance report once a year which is handed over to the Management Board and the Administrative Board. There were no findings in the year under review.

4.5.3.8 Responsible corporate management

As the business promotion bank of the federal state of Brandenburg, ILB is highly committed to implementing its business promotion policy in a responsible and transparent manner vis-à-vis the public and its clients, customers and employees and therefore impacts the aspect of combating bribery and corruption. Sound, responsible corporate governance is essential for the success, credibility and integrity of ILB.

The principles of responsible corporate management are anchored in ILB‘s Corporate Governance Code. The content and structure of the Code are based on the German Corporate Governance Code and the Corporate Governance Code of the federal state of Brandenburg. The members of ILB‘s Management and Administrative Board have laid down the requirements in their rules and regulations through corresponding resolutions and they comply with the requirements of ILB‘s Corporate Governance Code.

ILB regularly reviews this Code with regard to new developments.

If necessary, the Code is amended and published on ILB‘s website. The Management and Administrative Board report on compliance with ILB‘s Corporate Governance Code in the Corporate Governance Report and the Compliance Statement contained therein. The recommendations of the Code were complied with except for two fully justified deviations.

4.5.3.9 Information security

Information security is an essential part of ILB's business policy. ILB defines information security as the protection of data and other information of any kind and origin.

The security objectives of confidentiality, availability, integrity and authenticity are pursued in order to protect information as well as the processes and systems used to process information. In order to achieve its security objectives, ILB has implemented an information security management system (ISMS) based on the internationally recognised information security standard DIN ISO/IEC 27001, which is anchored in ILB's information security policy. Applying the methods and processes defined in the ISMS ensures transparent compliance with an appropriate level of information security at ILB. An annual ISMS implementation plan defines measures for the respective fiscal year. All ILB employees are trained in information security.

The Management Board is responsible for information security. The Information Security function at ILB is delegated to the Information Security Officer.

In the year under review, the Information Security Officer revised the information security policy and established quarterly and annual reporting. Reporting covers the effectiveness of information security and the current threat situation. The measures derived from the report will be included in the ISMS implementation plan for 2018.

III Report on forecasts, opportunities and risks

1. Risk situation

The risk at group level corresponds to that of ILB because the risks in the subsidiaries can be considered to be insignificant from a group perspective. The following information in the opportunities and risks report hence refers to ILB and can be applied to the group.

ILB pursues business as a special lending institute. The bank's risk structure results from the promotional and structure-policy tasks assigned to it by the federal state of Brandenburg. Risks are taken to a very limited extent only. All identifiable risks were taken into account through appropriate evaluation and the formation of risk provisions.

2. Risk management

Risk management considers the capability to bear risks and includes the definition of strategies as well as the establishment of an internal control system, the compliance function and an internal audit function. The internal control system is made up of rules for structures and processes as well as risk steering and controlling processes. Risks are identified, limited and monitored as part of risk management.

ILB has established an integrated strategy and planning process. Contents and processes of the strategy and target process (including the capital planning process) as well as limitation process are aligned to each other. This interaction essentially includes the process steps of planning, implementing, assessing and adapting the business and risk strategy as well as monitoring targets and analysing deviations.

The risk strategy reflects ILB's individual risk tolerance and determines the general handling of risks, forming the basis for ILB's risk structure. Guidelines and measures are laid down for identifying, steering and monitoring risks. The risk strategy is based on continuous adherence to the regulatory requirements, the law and ILB's bye-laws as well as the risk policy issued by the Management Board.

The Management Board revises and adopts the strategy as required, however, at least once a year as part of the strategy process. The Management Board communicates the risk strategy to the Risk Committee of the Administrative Board and discusses this strategy with the latter.

ILB generally pursues a conservative risk policy. The aim of this policy is to diversify between the different types of risks, i.e., knowingly accepting risks but avoiding them in areas outside the bank's core expertise. The principles concerning risk tolerance laid down in the risk strategy form the general framework for the bank's business operations.

The risk monitoring system in place is geared towards the existing risk of default, market price risks and operational risks.

Risk monitoring and risk taking are separate functions throughout all levels of the organisation. Risks are identified and assessed and the risk management and controlling processes developed further by the risk controlling/finance unit as part of the risk controlling function. The risk controlling function additionally includes the ongoing monitoring of the risk situation and risk-bearing capacity as well as reporting in line with the respective risk content and requirements under regulatory law. At operative level, risks are managed by the organisational units responsible for the respective risks.

The risk monitoring tools for steering the subsidiaries are adapted to the needs of the group and enable timely monitoring and assessment of the risk situation. The subsidiaries are integrated into ILB's planning process. The strategic shareholdings/start-up initiatives and controlling units are responsible for controlling in-year developments at the subsidiaries. Quarterly reports on economic conditions as well as target/actual deviation analyses of the result and risk structure serve to inform the Management Board of developments in shareholdings. As soon as the assessment of the risk situation shows the need for action, the reports are supplemented by proposals for further action.

The Management Board bears the overall responsibility for controlling the risks of the bank and of the institute group. In accordance with the minimum requirements for risk management, the Management Board informs the Risk Committee every quarter in writing of the bank's risk situation. Furthermore, ILB's risk situation is also explained during regular committee meetings to the Administrative Board as the control body of the Management Board.

3. Risk-bearing capability concept

In addition to defining the risk management process and responsibilities, the underlying processes and parameters that are used to measure and steer risks are also documented. The aim is to secure the bank's business and future success through efficient risk management.

In order to assess the risk profile, ILB obtains a risk overview for the bank as a whole on an annual and/or ad hoc basis as part of a risk stock-taking procedure. The major risks are the starting point for measurement and steering measures and are limited within the scope of the risk-bearing capacity concept.

Risk-bearing capacity is defined as the possibility to compensate for losses in value from the bank's own funds. ILB consistently applies the period-based going-concern approach for its risk-bearing capacity concept. For this purpose, risk capital is determined on the basis of the profit and loss account/balance sheet and compared to the degree of actual risk in the form of negative deviations from the expected result under commercial law. The risk-bearing capacity according to the going-concern approach is ensured if the available risk capital is greater than or equal to the total actual risk. This approach is designed to ensure that the institute can continue operating in conformity with the requirements of regulatory laws even if all items of the risk capital used to cover risks and identified as risk-prone were lost as a result of these risks actually materialising.

Risk-bearing capacity is calculated on the basis of the determination of the risk capital. The risk capital determines the maximum amount of risk that can be taken by ILB. ILB determines its risk capital on the basis of the profit and loss account/balance sheet, by drawing up its balance sheet according to the rules of the German Commercial Code [HGB]. Accordingly, the risk cover capital is made up of its subscribed capital, reserves, unrestricted reserves according to section 340f and 340g of the German Commercial Code [HGB] and the net profit forecast for the year after risk provisioning and reserve formation as well as planned allocation to the ILB promotional. In addition to this, ILB can, when necessary, make use of undisclosed reserves from undervaluations in accordance with commercial law (such as unrealised gains from securities). However, these reserves are not included in the definition of risk capital because they can be subject to fluctuation and are therefore not permanent. Intangible assets and, if necessary, expenses for the formation of provisions for impending losses on the interest book as well as significant hidden charges in the investment portfolio are taken into account as deductions.

ILB determines the available risk capital on the basis of its risk capital. In this case, the regulatory capital required for going-concern purposes, including the SREP markup and capital buffers, is deducted from the risk capital. Until the SREP markup for each institution is determined, the capital requirement from the “general regulation: equity requirements for interest rate risks” is considered in the banking book. Within the scope of the risk-bearing capacity concept, the available risk capital is the maximum sum available to cover risks.

As part of medium-term planning, the capital demand that will be needed in order to ensure the bank‘s risk-bearing capacity and to comply with regulatory requirements is determined over a period of 5 years. The capital planning process considers future changes in the bank‘s own business activities and its relevant environment as well as the impact of unfavourable developments. Possible adverse developments are considered in addition to expected ones. The aim is to enable counter-measures at an early point in time in order to secure ILB‘s capital demand even under unfavourable conditions. For capital planning purposes, the three-year medium-term planning period is additionally expanded by a two-year forecast horizon.

Depending on the amount of available risk capital, the Management Board determines an maximum loss cap for the bank as a whole. This is based not just on the targets of the bank as described in its strategy and implemented in its medium-term planning, but also ILB‘s risk tolerance and risk-bearing capacity. In line with its bye-laws, ILB generally pursues a conservative risk policy. Its risk tolerance thus ranges between risk-averse and risk-neutral. The maximum loss cap at the level of the bank as a whole quantifies the risk tolerance as determined by the Management Board and determines the maximum risk capital which is to be applied at the level of the bank as a whole in order to cover all major risks. The loss cap thereby serves to limit ILB‘s total risk In line with the planned utilisation and ILB‘s strategic orientation, the sum available under the maximum loss cap is then allocated to the major risk types. A risk buffer is maintained as part of the loss cap in order to cover risks which, although they are classified as minor, are to be considered within the scope of the risk-bearing capacity calculation. From 2018, the amount for other immaterial risks will be deducted directly in the calculation of risk capital. The risk caps are the absolute limits for the different risk types and are monitored within the framework of risk control and can be broken down further depending on the structure and degree of complexity of the particular business. This can be achieved either via further limits, threshold values or bandwidths or, if the risk cannot be quantified, in the form of qualitative requirements, by defining minimum standards, etc. Monitoring of the risk-bearing capacity for the bank as a whole is thus replaced with operative steering of individual risks.

The risk level (risk amount) is measured in the risk-bearing capacity concept on the basis of the profit and loss account in line with the period-based approach. This means that the impact of potential risks on certain items of the profit and loss account is analysed. The risk amount is defined as the negative deviation of the profit contribution of the profit and loss account within the risk horizon. A uniform confidence level of 99.0% is used in this context in as far as the model permits this. The basis in each case are the latest extrapolations for the end of the year, related to the current year and the following year. The following year is analysed in order to comply with the regulatory requirement for a period-spanning perspective. By mapping the current year and the following year, ILB thereby applies two review periods in its risk-bearing capacity concept.

Risk-bearing capacity is determined and verified for the bank as a whole on a monthly basis by comparing the actual utilisation rates of the individual risk types to the corresponding individual limits and the maximum loss cap on the level of the bank as a whole. The relevant escalation procedures applicable when defined alert thresholds are reached are applied to the different risk types for the bank as a whole. It is assumed that all the risks add up. Diversification effects which reduce risks are not considered.

The analysis of the expected net profit for the year serves to monitor the risk capital. In this context, quarterly extrapolation is carried out in order to examine whether the intended net profit for the year after risk provisioning will be achieved. Risks that have materialised during the year are considered in the extrapolation and reduce the available risk capital accordingly.

Quarterly reports are a control instrument that also informs the Management Board of the bank's overall risk situation. Risk-bearing capacity analyses are supplemented by examining the impact of shaky market developments. For this purpose, scenarios are developed to simulate the effects of unusual, yet plausible, events on the bank's overall risk situation (stress tests). A special stress test is the annual simulation of the impact of a severe economic downturn.

The aim is to identify possible events or future changes that would have a negative effect on the bank's risk situation and its risk-bearing capacity. The analysis of the stress tests helps to warrant the bank's stability beyond the regular course of business.

Furthermore, the bank's risk-bearing capacity is tested using so-called "inverse stress tests". Taking the result of the impossibility to continue ILB's current business model as the basis, this stress test is used to model events that can cause such a condition. The aim is to identify strategically difficult situations which could threaten the institute's existence on a stand-alone basis, i.e., without statutory public-sector responsibility, guarantor's liability and the liability guarantee of the federal state of Brandenburg.

Monitoring of the risk-bearing capacity is supplemented by risk steering at an operational level as well as monitoring of compliance with regulatory requirements. Deviating risk quantification methods are sometimes used in this context. Steering at an operational level is in line with the risk-bearing capacity concept and the limits determined there. The limits of the risk-bearing capacity concept and the limits of operational steering must be adhered to at the same time.

4. Different types of risks

Risk stock-taking is carried out within the scope of risk-bearing capacity as per 31 December of each year and as required by circumstances. Risk stock-taking as required by circumstances can, for instance, be triggered by new product introductions or changes in environmental conditions. Based on the results of the previous year's risk stock-taking, the risks already identified are reassessed with regard to their risk relevance for ILB. Depending on their significance, they are classified as relevant or not relevant. To this end, ILB has established a quantitative materiality criterion. A risk is relevant if it is explicitly defined as such in the minimum requirements for risk management (MaRisk) or if its impact exceeds the quantitative materiality threshold for a risk to be relevant. In addition, a comparison is made with conceivable risks which are assessed to see whether they could be considered at all for ILB. The newly identified risks are then assessed in accordance with the defined materiality criterion.

The result of risk stock-taking is transferred to a risk matrix in which all significant risks are identified. The results derived are documented in separate evaluations for risk stock-taking. The result of risk stock-taking is presented to the Management Board by the head of the risk controlling function in order to assess the overall risk profile and is centrally stored in the Controlling unit.

The risks identified as material in risk stock-taking are generally included in the risk-bearing capacity concept.

The following risks are considered to be relevant for ILB:

- Default risk
- Market price risk
- Liquidity risk
- Operational risk

Concentration risks, in particular, revenue concentration, are considered as part of the stock-taking process. The relevant risks identified during the stock-taking process are monitored and managed by the risk management process in accordance with the principles and loss caps determined as part of the risk strategy.

4.1 Default risk

The risk of default is the risk that a bank‘s debtor becomes insolvent and consequently fails to fulfil his contractual obligations. The risk of default covers lending, country, counterparty, emitter and shareholder risks.

A conservative risk policy is pursued in loan business. In commercial lending business, borrowers with certain minimum ratings are accepted. Treasury business focuses on investments that should be as ECB-enabled as possible and hence be limited in terms of their risks which enable additional revenue contributions in repo business. Declining revenue contributions due to the low-interest environment are to be compensated for through portfolio diversification with new products.

A rating-based method is applied to measure default risk for ILB‘s entire portfolio in analogy to the IRBA ((Internal Ratings Based Approach) concept provided for in regulatory law. Internal ratings are used as a basis for the risk-sensitive evaluation of items which are then consistently integrated into ILB‘s risk-bearing capacity concept. Risk concentrations in the portfolio are also taken into account.

With this method, the decline in value of ILB’s portfolio caused by defaulting debtors can be assessed which statistically will not be exceeded in 99.0% of all possible cases (Value at Risk (VaR) with a confidence level of 99.0%). This total portfolio loss represents the risk amount for default risks and can also be split up into sub-portfolios and/or portfolio items for steering purposes.

Application of this method is not possible in the case of sub-portfolios of a minor volume. If the items concerned are subject to a default risk, they are then valued according to the credit risk standardised approach as provided for by the regulator.

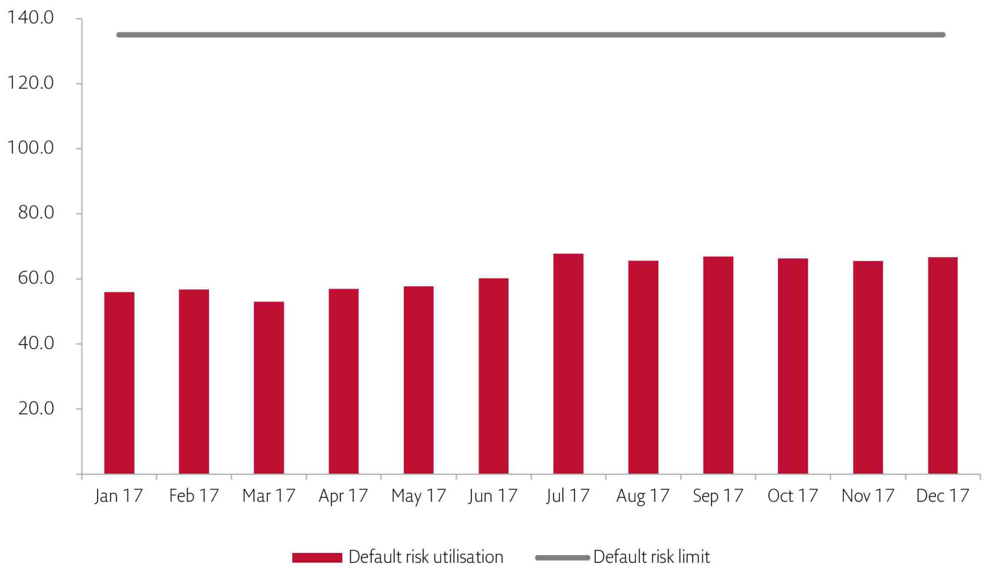
The default risk determined in this way applies to ILB‘s portfolio on the day of the analysis for a one-year risk horizon. The risk-bearing capacity concept requires consistent periodisation of risks. As the year progresses, the period during which potential risks can materialise becomes shorter. In the determination of default risks, this is achieved by scaling default probabilities. The following year is analysed on the basis of the planned stocks at the end of the year assuming an unchanged risk structure in the planning items and for the bank as a whole.

Default risks are reflected in the valuation result of the profit and loss account. As part of planned risk provisioning, the planned net profit for the year and therefore the entire risk capital are burdened accordingly. Risks that have materialised during the current year are represented by itemised allowances or write-offs to the lower going-concern value, direct write-downs or provisions and are also reflected in the latest extrapolation of net income for the year. Planned and actual default risks are therefore already included in the planned net profit for the year and reduce the risk capital.

Any default risks over and above this within the meaning of a loss for the portfolio as a whole must be covered by available risk capital and are limited (risk utilisation amounting to the unexpected loss).

Risk utilisation for default risks is represented by the following curve over the year:

Development of default risk as per the relevant date for the one-year horizon (in million EUR)



In order to ensure the comparability of risks over the course of the year, risk utilisation for the following year, i.e. 2018, is shown which refers to the one-year horizon throughout. Starting from a risk utilisation of EUR 56m at the beginning of the year, utilisation declined slightly by the end of the first quarter. This can be attributed to the establishment of the rating system of Sparkassen Rating- und Risikosysteme GmbH (SR). The replacement of the previously used internal rms risk classification methods leads to a reduction in overexposure. This systematic effect of the reduction in risk amounts due to the introduction of the SR system can be regarded as having ended in March 2017. At this point in time, an exposure of only EUR 50m (mainly in the home portfolio) was measured using the rms method. Risk utilisation in the further course of 2017 was affected by the effects of individual rating changes in ILB's portfolio. Since the third quarter, utilisation has remained constant, with risk-increasing and risk-reducing effects offsetting each other. At the end of 2017, utilisation of the limit of EUR 135 million for the following year totalled 49%.

Operative default risk management is based on the minimum requirements for risk management (MaRisk) and is carried out in a portfolio and risk-orientated manner. Limit systems have been set up for country risks and product groups (securities, derivatives, money market paper, repo transactions, commercial banks) in order to steer default risks. In order to restrict risks with these transactions, limits have been set up on borrower level. The limit system is supplemented by regulatory requirements regarding large exposure limits, the CRR as well as compliance with the leverage ratio requirements which will come into effect in 2018. Furthermore, the rolling one-year default risk utilisation has been limited as part of operative management.

ILB has established a working group to steer default risks. The working group is the central body for steering the bank‘s default risks. It advises the Management Board and prepares resolutions by the Board. The meetings are attended by the members of the Management Board as well as the heads of the risk controlling function, treasury as well as front and back office. The working group meets regularly before the quarterly reports are due and during the course of the planning process. This body is additionally convened as required by decision-relevant issues at the chairpersons‘ request or in the case of important forthcoming individual decisions at the request of the manager responsible for the product area concerned.

The monthly "ILB risk report" compiles the most important implications of default risks according to the bank‘s risk-bearing capacity.

The default risk cap was adhered to at all times during the year under review.

4.1.1 Loan risk

ILB’s core business is the promotion of public and private investment projects, mainly using funds from the budget of the federal state of Brandenburg or through customer banks.

The bank does not bear any loan risks for the assets managed on a trust basis for the federal state, such as the State Housing Construction Fund (LWV), a special-purpose federal-state fund managed by the bank on the basis of approved budgets and management principles on behalf of the Brandenburg Ministry for Infrastructure and Regional Planning.

The sub-strategy for default risks is updated each year and forms the basis for lending. This strategy contains the guidelines of lending business and, at a sub-loan portfolio level, the qualitative and quantitative requirements for lending.

Loan risks result from treasury business, housing loans, syndicated loans in the commercial sector, infrastructure loans as well as business with applicants’ banks. In transactions with applicants’ banks, loans are passed on to the final borrower‘s bank without any risk on the part of ILB with regard to the default risk of the final borrower. In the case of such bank-to-bank loans, ILB bears the default risk of the applicant‘s bank which is additionally secured by the possibility to take recourse to the final borrower.

Risks from off-balance sheet transactions consist primarily of irrevocable loan commitments and contingent liabilities in the form of risk sub-participations in syndicated loan business.

In order to limit risks from loan business, precisely defined criteria are in place for these transactions, especially with regard to the borrower‘s creditworthiness, collateral and maximum loan sum (commercial syndicated loans only). Sufficient provision in the form of itemised allowances for bad debts has been made in the annual accounts to cover known risks.

Due to inter-state fiscal adjustment, the law on general fiscal adjustment with municipalities and the municipal associations in the federal state of Brandenburg as well as the “debt brake” laid down in the constitution, ILB still does not foresee any default risk in public-sector loan business as the bank‘s largest loan sub-portfolio.

Default risks are monitored by the back office/loan management unit. Risk controlling calculates limit utilisation on a quarterly basis and informs back office/loan management and subsequently the respective product areas. Back office/loan management evaluates the risk and, when necessary, draws up suitable recommendations for action.

At the end of each quarter, the controlling and loan secretariat functions perform a comprehensive analysis and assess the default risk for the bank as a whole for business involving loans guaranteed by ILB. The result of this analysis forms part of risk reporting to the Group Board and the risk committee of the Administrative Board. Besides presenting the loan portfolio, the risk report also assesses the default risk and, if applicable, recommends risk steering measures.

In keeping with ILB’s conservative risk culture, the risk structure of the bank‘s loan portfolio can be classified as low-risk. ILB‘s entire own lendings portfolio totalled EUR 12,505m as per 2017. More than 99% was rated as per the relevant date on the basis of the new rating system of Sparkassen Rating und Risikosysteme GmbH (S-Rating). 87% of the loans in ILB’s own lending portfolio (excluding special funds) were rated excellent (SR ratings 1 2) or collateral was provided (usually public guarantees or collateral in rem). The assessment of default risks at the level of the individual debtors was introduced gradually starting in 2015 by applying standardised, regulator-approved rating methods of S-Rating.

The following methods are applied:

- Sparkassen-Immobiliengeschäftsrating (SIR) mainly in real estate customers/leasehold property business
- Sparkassen-Standardrating (STR) mainly in commercial and public customer business.
- KundenKompaktRating (KKR) mainly for borrowers in non-risk-relevant lending business of the business areas of economy, infrastructure financing and residential construction (real estate financing/rented apartments).

Simplified procedures are applied in the case of municipal loans, financial institutions and debtors where ILB’s own exposure is less than EUR 750,000.

The risk classification methods are applied on a regular basis and/or as required in loan approval and loan monitoring processes,

The business and investment strategy in treasury is subject to an ongoing, risk-orientated analysis and adaptation process which ensures ILB's conservative investment policy.

Investment decisions are made after an independent risk analysis. Purchases are contingent upon a minimum “A” rating of the security concerned by an external rating agency (Moody's, Standard & Poor's or Fitch). An external minimum BBB rating was accepted for a limited part of the portfolio. Unsecured bonds are purchased subject to volume and term limitation, depending on the external rating. The loan risks were widely spread.

In 2014, ILB set up a special corporate bond fund (minimum rating: investment grade) with a volume that was successively increased in 2017 by EUR 30m to EUR 200m.

Controlling checks publications on a daily basis for changes in the standing of securities and/or issuers. In addition to these measures, the development of yield markups for securities on a watchlist is monitored and compared with risk-free investments in order to utilise the market's assessment as an early indicator of any change in risk.

The bank has specific limits in place for the purchase of securities, money market paper and derivatives as well as upper limits for each bank for loans channelled through customer banks, individual refinancing projects and global loans. The limits are set for each bank separately, based on an evaluation of its financial position, its external rating and other qualitative data. If the standing and/or external rating changes, appropriate adjustment of the limit is considered. Internal limits are generally reviewed once a year.

Controlling and the specialist unit regularly check adherence to the limits.

4.1.2 Counterparty risk

Counterparty risk is the risk that a party to a contract defaults when claims are due to be settled (fulfilment risk) or that a party fails to meet a payment deadline (performance risk).

In order to counter this risk, ILB generally conducts commercial business with selected market partners only who have a minimum external “A” rating according to the second-best rule. Counterparty limits are in place for these market partners.

Counterparty risk as part of default risk is generally of minor relevance at ILB. Within the scope of the European Market Infrastructure Regulation (EMIR), ILB started performing derivative transactions (mostly interest rate hedging swaps) in 2015 via a central counterparty and intermediate clearing brokers. Due to the protection mechanisms resulting from this regulation, such as a default management process, a margin process, margin calculation methods as well as general risk control methods of the central counterparties, the default risk is considered to be mostly secured and low.

As existing business is phased out and cleared new business and/or business with bilateral collateral is developed, counterparty risk for derivatives will decline.

4.1.3 Country risk

Country risk includes the credit and market risk of a country. It represents the risk of partial or complete default with contractual interest and redemption payments by borrowers of the country concerned and the risk of a loss of value of securities and derivatives which depend on the country's market parameters.

In accordance with its promotional task, ILB's business is conducted almost entirely in Germany and more specifically in the federal state of Brandenburg. Existing foreign commitment is based almost exclusively on investment in securities from countries of the European Union (except special funds) and most of these in euro zone countries. In line with the counterparty risk sub-strategy, only selected debtors are generally accepted. German issuers should account for at least 40%.

The country risk outside Germany is limited by country caps. These caps are determined on the basis of external ratings, as well as the gross debt and GDP of the country in question. The country limits are checked during the year with a view to their suitability on the basis of early warning indicators. In order to avoid risk clusters, separate limits are determined for country risks and included in the respective limits.

4.1.4 Shareholder risk

Shareholder risk is the risk that losses may be incurred due to the provision of equity for third parties.

In the performance of its statutory obligations, ILB holds strategic shareholdings only. It acquires shareholdings primarily in order to pursue important interests of the bank or to assume tasks resulting from federal state structure policy. ILB also provides national co-financing as part of EU financing instruments.

ILB holds shareholdings in three areas:

- Equity investment companies - Provision of equity for companies in the federal state of Brandenburg
- Property companies - Property development in the federal state of Brandenburg
- Others - Supporting other ILB activities

As per 31 December 2017, ILB held shares in companies with a book value of EUR 71.8m. Large parts of ILB's equity investments are secured by guarantees or financed by grants from the federal state of Brandenburg, so that ILB is not exposed to any potential loss from these commitments. Sufficient risk provision has been made for the risks attached to the remaining shareholdings.

4.1.5 Opportunities

In line with its mission as a business promotion institute, ILB accepts default risks to a very limited extent only. As part of its annual planning process, the bank addresses any uncertainties regarding the development of the value of its lendings through value adjustments based on conservative estimates. Opportunities result from positive deviations of the defaults actually materialising as compared to estimates.

4.2 Market risk

Market risk is generally the risk which negative developments on a market can pose to the bank. Market risks include interest rate risks as well as the exchange rate risk, currency risk and other price risks.

In order to fulfil its promotional and structure-policy tasks for the federal state of Brandenburg, ILB must carry out typical banking business, such as:

- Loan business with small volumes and varying terms
- Prefinancing until refinancable lot sizes are reached at acceptable prices
- Adherence to offer deadlines in customer loan business and the resultant market price fluctuations
- Investment of free liquidity necessary due to the delayed application of funds in loan business (such as EIB refinancing) on money and capital markets in conformity with general market conditions

The resultant term and deadline mismatches lead to market price risks under unfavourable market conditions characterised by high volatility and market distortions. This can have an adverse impact on ILB's revenue situation.

The following types of market risks were identified for ILB:

- Interest change risk
- Market price risk
- Currency risk
- Risk from implicit and explicit options (caps, swaptions)

Market risks are steered by Risk Management based on the minimum requirements for risk management. ILB is classified as a non-trading book institute.

4.2.1 Interest rate risk

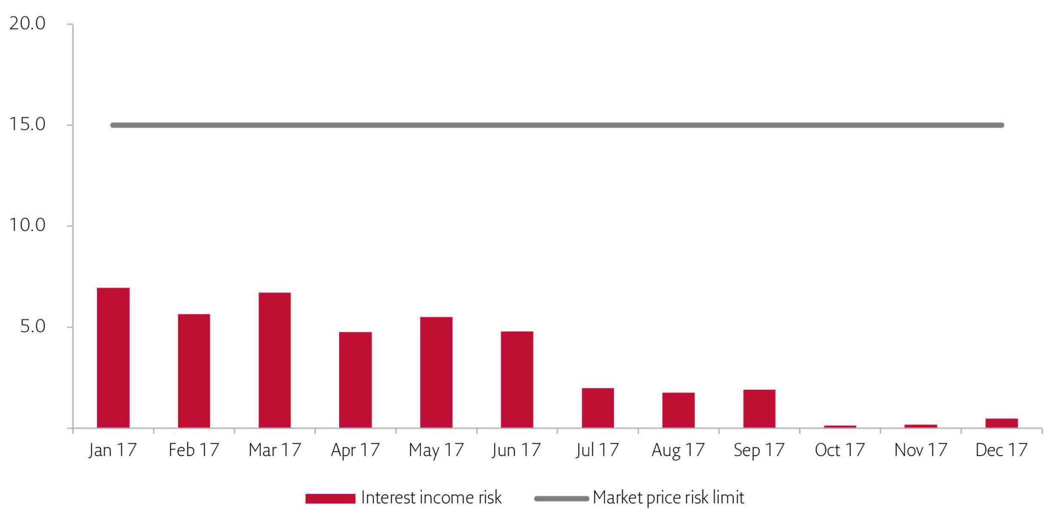
Interest rate risks exist for ILB with a view to different fixed-interest rate periods in lending and borrowing business. ILB‘s transformation function in conjunction with interest rate change risks is geared towards ensuring a long-term and stable contribution towards the bank‘s net interest income. Treasury is responsible for steering the interest rate risk. The interest rate risk is covered by transactions with a direct balance sheet effect as well as swaps, forward rate agreements, swaptions and caps.

The interest rate risk is calculated and limited in the risk-bearing capacity risk by measuring the periodic interest rate change risk. From the perspective of the profit and loss account, interest changes have a direct impact on interest income. The risk is defined here as the negative deviation between forecast and actual interest income. The last day of the current year and the last day of the following year are considered here. Interest changes particularly affect variable-interest business as a result of interest rate adjustment and the terms and conditions of new business. These influences are quantified by analysing the impact of potential interest rate developments. The basis for this is the interest rate trend according to latest forecasts which is varied within the scope of scenario analyses. The scenarios applied are derived from history and are expected to represent interest rate developments in all possible directions (parallel shifts, rotation, etc.).

It must also be noted that changes in interest rates also influence the cash value of ILB‘s interest ledger. This influence can have a direct impact on net income if a potential reduction in cash value could necessitate a provision for anticipated losses for ILB‘s interest ledger. A provision must be formed if the book value of ILB‘s interest ledger exceeds the cash value minus future administration and risk costs. Expected provisions for impending losses are deducted directly from risk capital.

Risk utilisation for interest rate risks is represented by the following curve over the year:

Development of interest rate risk as per the relevant date for the one year horizon (in million EUR)



In order to ensure the comparability of risks over the course of the year, risk utilisation for the following year, i.e. 2018, is shown which refers to the one-year horizon throughout. The limit of EUR 15m was adhered to at all times during the year under review, with maximum utilisation for the following year, i.e. 2018, totalling EUR 7m. In the third and fourth quarters of 2017, periodic interest rate risks for 2018 decreased. Fluctuations during the course of the year are mainly due to changes in short-term cashflow structures which are primarily influenced by interest rate fixings in variable-interest business. The long-term cashflow structure of this investment is orientated towards the benchmark structure set for strategic reasons and is therefore relatively stable. Accordingly, the fixed interest rates and dates of future fixed interest rates on the assets and liabilities side in the short-term area and the yield curves existing at these points in time have a significant impact on periodic interest rate risks.

In addition to monitoring the periodic interest rate risk in risk-bearing capacity, operative interest rate risk management is carried out by ILB by valuating the cash value of the payment flows of all transactions with interest rate change relevance. This addition enables adequate operative management combined with consistent consideration of interest rate risks in the risk-bearing capacity analysis. In determining risk, the bank considers all interest-bearing items in the interest ledger up until their respective fixed-interest period. ILB does not have any variable-capital products with an indefinite term in its books. This means there is no need to integrate maturity scenario models into the bank's interest ledger. The effects of implicit options from customer business are taken into account depending on the respective interest rate scenarios.

The software used at ILB permits integrated interest ledger management. Besides period-based measurement of the interest rate risk in order to calculate risk bearing capacity, operative measurement of the cash value of interest rate risks is also possible in this way. The transfer of profit and loss for the period to cash-value based presentation is thus possible with a single steering system.

The amount of the maximum interest rate risk to be taken is limited via the value-at-risk (VaR) on the basis of the "modern historical simulation" and a holding time of one month in line with the requirements of the periodic view. This is based on the impact which real changes in interest rates observed over a 10-year period have on the bank's interest ledger cash value by reference to 2,500 historical interest rate curves. In order to prevent one-sided historical trends, yield curve developments are also mirrored. The bank has determined a 99% confidence level as the parameter.

Since the reporting date of 31 December 2016, additional regulatory requirements have resulted from the general ruling on capital requirements for interest rate risks. The equity requirement is derived here from the ratio between the cash value impact of the Basel II interest rate shock and the regulatory total risk amount. The Basel II interest rate shock reflects the present value effects of an ad hoc interest rate shift of 200 bps.

Besides limiting interest rate risks, the efficiency of the open items entered through matching maturities is measured and steered by reference to a benchmark. The aim is to optimise ILB's opportunities-to-risk ratio in accordance with this benchmark and by observing a specified tolerance band.

In order to assess the impact of extraordinary market changes on the interest rate risk, hypothetical extreme or worst case interest rate scenarios are additionally simulated.

This means that the limits determined by the Management Board in order to limit interest rate risks were adhered to at all times during the 2017 financial year.

ILB determines the forecast quality of the model applied to measure risks by back-testing as of the report dates. To this effect, the value losses (VaR) are compared to the value losses actually incurred. The cash value changes were found to be below VaR on all the relevant dates tested. The back-testing results show that ILB's risk model sufficiently considers interest rate risks.

The interest rate risk is supervised by Risk Controlling/Finance. On every trading day, the value at risk, the requirement from the general regulation and the benchmark lever are determined and checked for adherence to limits as part of operative management. The monthly risk report submitted to management by the head of risk controlling contains details of the interest rate risks taken from the perspective of operative management and with a view to risk-bearing capacity. Furthermore, extreme and worst-case scenarios are simulated in order to assess the impacts of extraordinary market changes on the interest rate risk.

When limits are exceeded, the Risk Controlling/Finance function immediately informs the Management Board and the Treasury function.

The report on the interest rate risk also contains the regulatory indicator concerning the impact of a standardised interest rate shock and the resultant equity requirements for interest rate risks.

4.2.2 Market price risk

ILB is classified as a non-trading book institute. This means that the bank does not actively trade any securities, fund shares, currencies, derivatives or raw materials in order to generate profit. This means that there are no market price or other price risks (for instance, in conjunction with foreign currency, precious metals, etc.).

ILB generally buys securities with the intention of holding them until final maturity (long-term portfolio). The investment horizon of the special fund is also orientated towards the long term. ILB therefore carries all securities and the special fund as investment holdings. The securities and the special fund are valued according to the diluted lower of cost or market principle, so that market price changes do not affect ILB's valuation result. As long as full redemption is secured, market price fluctuations will not lead to lasting losses. The market price risk is hence not one of ILB's major risks. Against this background, market price risks are not limited and counted towards the bank's total limit.

ILB's current plans for the special fund up until 2019 provide for the reinvestment of profits, so that there is no distribution risk.

Market price changes of securities are monitored by ILB in order to assess risks from a possible reduction of the refinancing potential of open-market securities and to identify market price changes which could suggest latent credit risks. Significant hidden charges would have to be included in the risk-bearing capacity analysis as a deduction from risk capital.

4.2.3 Currency risk

Transactions in foreign currencies are fully secured immediately on closing through foreign currency interest swaps so that ILB does not incur any currency risks in conjunction with these transactions.

4.2.4 Implicit options

Implicit options in the interest ledger are rights of customers having contractual extraordinary redemption rights as well as termination rights pursuant to the German Civil Code [BGB]. This is an option or right which the customer has, but not an obligation to effect extraordinary redemption payments. This right is a risk for ILB. Each time such an option is exercised, this constitutes a deviation from regular redemption payments and has implications especially for net interest income, cash value and the interest rate risks measured. In the current period of low interest rates, customers increasingly ask for and agree upon long-term, fixed-interest periods which are subject to statutory termination rights pursuant to section 489 of the German Civil Code [§ 489 BGB]. The implicit options resulting from these transactions are fully included and monitored in the interest ledger management. A limit system ensures that risk is kept below the materiality threshold.

4.2.5 Other price risks

During the period under review, ILB did not hold any shares and was hence not exposed to any share price and other price risks.

4.2.6 Opportunities

ILB's transformation function in conjunction with interest rate change risks is geared towards ensuring a long-term and stable contribution towards the bank's net interest income. ILB therefore accepts interest rate risks to a limited extent only. This means that the volume of both risks and opportunities is generally limited. Additional opportunities arise if the interest structure becomes steeper with persistently low money market interest rates. ECB forecasts and the current economic situation suggest that the low-interest phase will continue. The general conditions for matching maturities are therefore seen to be positive and stable for the future.

Changes in the price of securities held in ILB's portfolio (market price risks) have no impact on the bank's net income situation since the bank is planning to hold these securities for a long term. No risks from market price fluctuations means that there are no opportunities either.

4.3 Liquidity risk

Liquidity risks can be distinguished in two dimensions. Liquidity risk in the narrower sense typically refers to the risk that the bank may not be able to meet payment obligations in full when they become due (illiquidity risk). However, there is also a liquidity spread risk (liquidity risk in the broader sense). This risk materialises when the bank, as a result of a change in its own credit standing, can obtain the required funds only subject to changed terms and conditions.

ILB is generally risk-averse with regard to liquidity risks. However, liquidity transformation is permitted in order to differentiate contributions to profit on condition that liquidity is ensured at all times.

4.3.1 Liquidity risk in the narrower sense (illiquidity risk)

The following types of illiquidity risks were identified for ILB:

- Refinancing risk: Follow-up refinancing risk due to different capital commitment periods on the assets and liabilities sides of the balance sheet.
- Maturity risk: Delayed repayment in loan business
- Call risk: immediate utilisation of open payment obligations, unexpected withdrawal of deposits
- Market value risk: value losses of open-market assets that can be used for refinancing purposes

Maturity risks and call risks are of minor importance at ILB. There is no passive call risk because ILB is not engaged in deposit business.

ILB's Treasury steers the bank's liquidity through its daily transactions. Funds are raised and invested on the basis of expected incoming and outgoing payments in order to meet the bank's contractual obligations and in accordance with the reports by the specialised departments. In line with its operations, ILB has a high share of payment flows that are fixed and can therefore be planned.

Due to the different nature of the risks compared to the period risk-bearing capacity calculation, illiquidity risk is measured and managed on the basis of a comparison of the refinancing demand with the existing refinancing potential in a dedicated steering process. The focus is on warranting liquidity at all times.

In order to ensure that ILB can meet its payment obligations at all times, the bank has money market lines available with commercial banks and a portfolio of securities, loans and advances that can be used in open-market transactions for short-term funding through Deutsche Bundesbank and/or the European Central Bank or through repo transactions. ILB has a sufficient, sustainable liquidity reserve in the form of securities eligible as collateral at the central bank. This liquidity reserve enables the bank to cover additional liquidity requirements which may arise under stress conditions. This means that ILB has an extensive refinancing potential that enables it to generate sufficient liquidity, even under extreme circumstances and largely independent of the general market situation. If fixed limits are exceeded, appropriate measures are introduced in order to improve the liquidity situation depending on its severity. Risk Controlling/Finance is responsible for monitoring and issues a monthly risk report as part of monthly risk reporting to the Management Board. Reporting on the short-term liquidity situation is supplemented by a long-term forecast over a 10-year period as well as a report on compliance with the regulatory liquidity indicators.

In order to measure the liquidity risk, ILB uses software that enables integrated interest rate and liquidity risk management. The effects of changes in business can hence be evaluated on a budget and actual basis from a revenue, interest risk and liquidity risk perspective.

In the year under review, ILB was always able to provide itself with sufficient liquidity, both on the interbank market and through repo transactions. ILB has also signed contracts with German and European development banks to secure long-term refinancing options. During the course of the year 2017, ILB's unused liquidity potential was at all times sufficient. It was at no time necessary to resort to the liquidity reserve.

The regulatory liquidity requirements in their current version were met with a substantial buffer: According to the monthly regulatory reporting, the liquidity coverage ratio, which represents the short-term liquidity risk, ranged between 248% and 1,707% (required: minimum of 80%) during the financial year.

4.3.2 Liquidity risk in the broader sense (liquidity spread risk)

Even when liquidity is maintained, liquidity costs constitute a risk. Given an incomplete match between the maturities of incoming and outgoing funds, there is a risk that follow-up business will be subject to higher refinancing costs should ILB's creditworthiness decline (expansion of the liquidity spread). When ILB's liquidity spreads increase, the existing refinancing gap must be closed at higher cost. This risk is reflected in the period-related risk analysis by declining net interest income.

The bank's liabilities are secured by statutory public-sector responsibility, guarantor's liability and the liability guarantee of the federal state of Brandenburg.

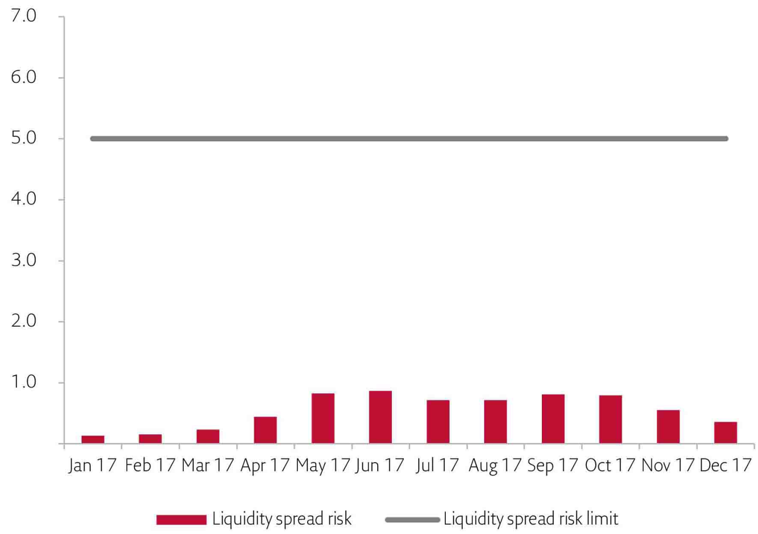
ILB is hence able to obtain liquidity at competitive terms because counterparties regard its creditworthiness to be comparable with that of the federal state of Brandenburg.

The bank hence expects to be generally able to obtain refinancing at prime terms in the future.

The impact of a potential and realistic increase in liquidity spread is considered to be low. However, the risk-bearing capacity concept includes a model for quantifying this risk type. On the basis of historical changes in ILB's liquidity spreads, this model simulates the impact of potential increases in refinancing costs on net interest income for the current and for the next year. Since 1 January 2017, a separate limit has been allocated to the liquidity spread risk as part of the maximum loss cap. Monitoring is carried out on a monthly basis and is integrated into the risk report for the bank as a whole as well as the monthly risk report.

Risk utilisation for liquidity spread risks is represented by the following curve over the year:

Development of liquidity spread risk as per the relevant date for the one year horizon (in million EUR)



In order to ensure the comparability of risks over the course of the year, risk utilisation for the following year, i.e. 2018, is shown which refers to the one-year horizon throughout. The limit of EUR 5m for the liquidity spread risk was adhered to at all times during the year under review, with maximum utilisation for the following year, i.e. 2018, totalling EUR 1m. The fluctuations in the liquidity spread risk are related to the development of the short-term refinancing requirements and can be considered to be non-critical with a view to their absolute amount.

4.3.3 Opportunities

Thanks to its status as a promotional bank and the liability guarantee of the federal state of Brandenburg, ILB is in a position to refinance its activities at favourable terms and conditions on the money and capital markets. As already seen when financial markets were tight, additional opportunities result from a further reduction of the bank's own risk spread whilst at the same time expanding the refinancing spread in the finance environment.

4.4 Operational risk

Operational risk (OpRisk) is the risk of losses due to the unsuitability or failure of internal procedures, people and systems or due to external factors.

ILB cannot rule out operational risks as part of its business. Risks that would jeopardise the continued existence of the bank are generally avoided, or appropriate provision is made by passing on the risks (for example through insurance) or reducing the risks (through damage prevention measures).

ILB strives to diversify its risk and revenue profile further by continuing existing and taking over new managed activities in conjunction with the deliberate taking of operational risks.

ILB uses an integrated IT system based on SAP. Operational risks are therefore managed and minimised, amongst other things, on the basis of IT systems with comprehensive checks and controls as well as connections to management systems with special monitoring, steering and information logic.

An information security management system (ISMS) is at the heart of IT governance. This ISMS is the basis for standards and responsibilities for the management of authorisations, change processes, IT security and contingency plans, events and problems. Risks remaining despite comprehensive IT risk management processes are addressed as part of operational risk within the scope of the risk-bearing capacity.

The loss potential from operational risks is not quantified in detail for management purposes at ILB. Risk reporting addresses losses resulting from operational risks in the form of damage or losses when such losses exceed the threshold relevant for reporting. Qualitative management is carried out according to the following approach: The method employed to manage operational risks is backed by transparent communication and documentation throughout the bank. Avoiding operational risks is always a top priority for ILB.

In order to manage operational risk, ILB has established an OpRisk controlling function to co-ordinate the entire management of operational risks. OpRisk controlling belongs to the bank's Risk Controlling/Finance function. All queries regarding the bank's operational risks are generally forwarded to this organisational unit. Furthermore, responsibility for partial risks has also been assigned within the bank. Those in charge of partial risks ensure that these are suitably assessed and that measures are initiated according to the risk type concerned. This takes place as part of the annual risk stock-taking procedure, regular evaluation of risk indicators as well as membership in the expert committee. The expert committee meets twice a year and addresses damage/risk cases reported for the previous six months. Furthermore, useful information for OpRisk controlling and its further optimisation is discussed. These meetings are attended by those in charge of partial risks as well as employees from exposed organisational units at the bank where indications of operational damage/risks could become apparent: risk controlling, customer accounting, compliance and internal auditing.

As part of risk stock-taking for operational risks, the Controlling unit provides standardised questionnaires to those responsible for sub-risk. These questionnaires serve as a basis for carrying out assessments for various event categories with regard to the probability of occurrence and the extent of damage. In addition, a self-assessment is carried out that involves all departments and staff departments. The quantitative and qualitative evaluation did not reveal any unexpected risks. ILB has basically implemented general control systems, such as the four-eyes principle or competence rules, written procedures as well as a cautious risk policy. This reduces the risk of loss, a fact that is also reflected by occurrence probabilities which are mostly rated "very low" to "low" as well as loss levels which are also rated "very low" to "low" in most cases. Concepts for IT security and contingency plans are additionally in place.

The specific problems of the areas are known. Suitable measures are taken and/or developed. No new risks or risks not discovered by measures have been identified.

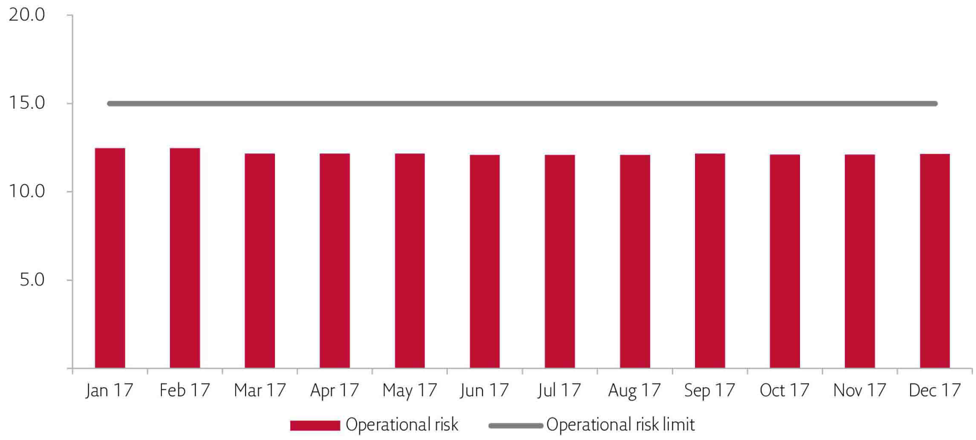
In addition to its risk stock-taking, ILB regularly compiles information on operational risks and damage. Each employee must carefully monitor their environment for operational risks and damage cases. Generally speaking, the "discoverer" of a risk or damage case is obliged to report this to the respective head of their organisational unit who is responsible for identifying operational risks and reporting damage cases, i.e. passing these on to OpRisk Controlling. ILB records risks and damage in an event database, and analyses its operational risk using risk inventories, risk maps or risk indicators in order to identify potential damage at an early point in time. These instruments already consider stress test requirements in that they include scenarios describing the possible occurrence of operational damage. Every six months, all members of ILB's management analyse and report on the risk potential of their areas as part of the operational risk controlling process. This helps the bank in its efforts to better handle and identify operational risks.

The Management Board is informed of any cases of damage in ad-hoc reports. OpRisk Controlling additionally informs the Management Board of the risk situation in its quarterly reports.

In order to map operational risks within the scope of the bank's risk-bearing capacity, the loss potential is determined using the calculation method according to the base indicator approach pursuant to the CRR and therefore on a generalised basis. In order to ensure the consistent integration of the risk-bearing capacity concept, distribution assumptions are made in order to adapt the risk measurement method to a confidence level of 99.0%. Linear distribution of the risks over the year is assumed, so that the risks are also linearly allocated to the periods on a pro-rata temporis basis. The calculation is carried out each month on the basis of the extrapolated result for the current year. The analysis of the current year's risk-bearing capacity includes operational risks already carried in the profit and loss account as expenditure so that the extrapolated net income for the year and hence risk capital are reduced.

Operational risk utilisation is represented by the following curve over the year:

Development of the operational risk development as per the relevant date for the one year horizon (in million EUR)



In order to ensure the comparability of risks over the course of the year, risk utilisation for the following year, i.e. 2018, is shown which refers to the one-year horizon at all times. The limit of EUR 15m for operational risks was adhered to at all times, with the maximum utilisation volume reaching a level of EUR 12.5m. Due to the calculation method and the stable results forecast for ILB, the risk amount remains very constant over time.

The loss events and risk events identified in 2017 did not reveal any risks that could jeopardise the bank's existence and their impact was far below the risk utilisation assumed within the scope of the risk-bearing capacity.

4.4.1 Operating risk

Minor risks are taken when justified from a commercial perspective. ILB counters these operational risks with a suitable system of internal control. Furthermore, sufficient insurance has been taken out to cover any damage that may occur.

A business impact analysis served as a basis for a contingency manual for all areas of ILB. This manual documents measures to maintain critical bank processes in extreme situations.

ILB has built a new administration building in Potsdam's inner city. This new building project was of considerable relevance for the bank. With this in mind, the project was managed throughout its term by a dedicated organisational unit (ILB new building unit) and with the services of external experts. Internal processes and reporting ensured that the Management Board was informed in due time. With the relocation of the bank on 2 May 2017, the project was successfully completed according to plan.

4.4.2 Legal risk

Legal risks exist with a view to the material effect of agreements, decisions, powers of attorney/powers of representation as well as compliance with formal requirements, especially with regard to new legislation and court decisions.

ILB counters these legal risks by using standardised documents which are approved by the Legal function and continuously updated. Furthermore, the legal department is also involved at an early stage in any decisions that may commit or favour the bank.

4.4.3 Model risk

The model risk is the risk which a bank could suffer as a result of decisions made primarily on the basis of the results of internal models and which are incorrect in terms of development, implementation or application.

ILB counters this risk through a conservative approach for determining risks without consideration of diversification effects as well as through the timely performance of validation measures and checks of the measuring methods for the risk types.

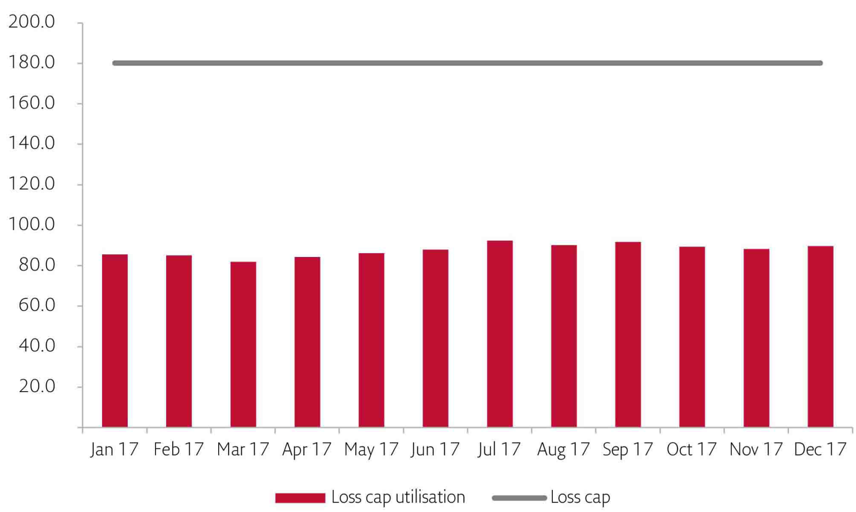
5. The risk situation in summary

The maximum loss cap at the level of the bank as a whole quantifies the risk tolerance as determined by the Management Board and determines the maximum risk capital which is to be applied at the level of the bank as a whole in order to cover all major risks.

The maximum loss cap thus serves to limit the overall risk for ILB and must be complied with both in the current and the following year.

The maximum loss cap is EUR 180m. The 2017 risk strategy sets a separate limit of EUR 5.0m for liquidity spread risks. To facilitate this, the maximum loss cap was raised from EUR 175m to EUR 180.0m with effect as of 1 January 2017. In 2017, the limit for other individual risks amounting to EUR 10m is fully included in risk utilisation.

Development of the loss cap utilisation as per the relevant date for the one year horizon (in million EUR)



In order to ensure the comparability of risks over the course of the year, total risk utilisation for the following year, i.e. 2018, is shown which refers to the one-year horizon throughout. The limit to ILB's risk items laid down in the loss cap amounting to EUR 180m was adhered to at all times during the 2017 financial year. In the course of 2017, utilisation was relatively constant between EUR 82m or 46% (March 2017) and EUR 92m or 51% (July 2017).

The risks taken were hence consistent with ILB‘s risk strategy. Utilisation generally corresponded with the bank‘s willingness to take risks as laid down in its risk strategy.

Default risk, which accounts for 74.3% of the overall utilisation of the maximum loss cap, continues to be the most important risk. This is in line with ILB’s business model and its focus business promotion tasks.

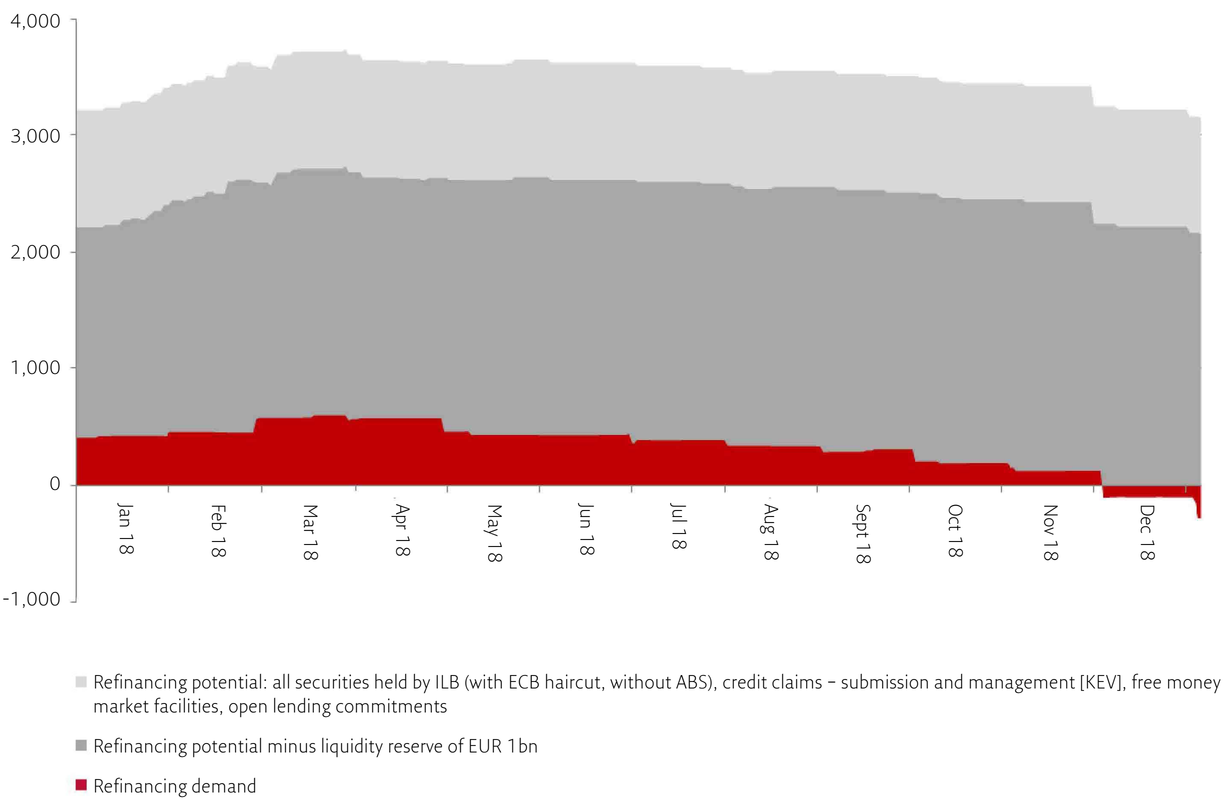
The loss potential from operational risks was determined on a general basis and accounted for 13.6% of ILB’s total risk, with the absolute risk amount remaining almost flat against the previous year.

Based on the 2017 risk strategy, the sum of other individual risks amounting to EUR 10m is included in the utilisation of the maximum loss cap. At the end of 2017, this corresponds to 11.2% of the risk utilisation in 2018.

On the reporting date, the interest rate risk and the liquidity spread risk appear to be of minor significance due to the low utilisation of capacity. However, utilisation of these risk types depends heavily on the respective cash flow and business structures on the reporting date, which is why the periodic effects of the risks may vary. For this reason and due to the relevance of other risk dimensions (cash value, solvency), ILB attaches great importance to the management of liquidity and interest rate risks.

The following diagram illustrates the liquidity risk within the meaning of the bank‘s illiquidity risk as per 31 December 2017, which is limited by a dedicated management process by comparing the bank‘s refinancing requirement with its refinancing potential:

Normal scenario (volume in million EUR)



Refinancing demand never exceeded the refinancing potential. Refinancing demand accounted for a maximum of 16% of the refinancing potential. The extrapolation suggests that ILB has a sufficiently large liquidity buffer which is made up of an unused refinancing potential of at least EUR 2.8bn. The liquidity reserve of EUR 1.0bn is not used. Liquidity is thus assured for the entire 2018 year and the survival horizon is at least one year.

IV Outlook

1. Economic factors

Germany's economic situation in 2017 was characterised by strong growth that was driven mainly by domestic consumption and investments. According to calculations by the Federal Statistical Office, gross domestic product increased against the previous year by a price-adjusted 2.2%.

The German government expects the good economic situation to continue in 2018. In its annual economic report for 2018, the German government forecasts 2.4% growth in price-adjusted gross domestic product for the current year. The expansion of the German economy will benefit especially from a friendlier global economic climate.

ILB expects the income situation and net worth to remain the same in 2018. The bond purchase programme will continue at a reduced volume until September, when it is expected to expire. The ECB has signalled its intention to keep the key interest rate stable for a considerable period of time even after bond purchases have ended. A first hike in rates is therefore not expected until 2019. Low interest rates will therefore continue to support good economic development in Germany and the euro zone. Due to this positive development, interest rates are expected to rise further for longer maturities. However, a strong and rapid rise in interest rates is not expected due to the anchoring of key interest rates.

Positive economic development can also be once again expected for the federal state of Brandenburg in 2018. The latest 2018 economic report issued at the beginning of the year by the working group of the Berlin and Brandenburg Chambers of Industry and Commerce drew an optimistic overall picture of the economic situation in the region. According to the report, the economy in Berlin-Brandenburg was found to be doing extremely well at the beginning of the year despite global political risks. The business climate index retained its high level of 138 points. The economic survey shows a stable, mild economic climate for the economy as a whole.

Around 97% of the companies surveyed rated the current business situation as "good" or "satisfactory", with around 91% expecting "rather favourable" or "rather constant" business for the current year. The shortage of skilled labour remains the key challenge for the regional economy.

Summing up, the report from the beginning of 2018 shows the following further results for the federal state of Brandenburg:

- A good investment climate: Around 82% of companies are planning to invest in 2018. Around 89% of these investing companies are expecting investment volumes either to increase (37%) or at least to remain flat (52%).
- Positive employment expectations: 27% of the companies surveyed are planning to create new jobs in 2018. 60% of companies are expecting employment to remain flat, with 13% expecting layoffs.

2. Major influences

ILB considers the following influence factors to be essential for its business activities:

Promotion and development business

- In the positive economic environment currently forecast for the federal state of Brandenburg, ILB is expecting a pledged volume of at least EUR 1,400m for the current year, including at least EUR 600m for products related to managed activities for the federal state of Brandenburg and EUR 800m for ILB's own products. ILB's promotion and development business in 2018 will be influenced to a large extent by the transposition of the directives within the scope of the current EU programming period.

Market environment:

- The ongoing measures by the European Central Bank (ECB) and the resultant low interest rate environment continue to boost economic growth in Europe. Low interest rates and low risk premiums for fixed-interest securities are maintaining pressure on the bank's net interest income.

Regulatory framework conditions:

- Regulatory obligations within the scope of CRR as well as successively stricter provisions for internal risk management by banks mean more demanding requirements for ILB's equity. Against this background, the bank is working to increase its relevant equity from its own revenues.
- ILB expects regulatory requirements to be further expanded and consequently high investment costs for the necessary IT infrastructure.

Liquidity situation:

- The bank obtains short-term liquidity from the ECB (European Central Bank) and/or the Bundesbank through securitised borrowings in the form of repo transactions as well as open-market transactions. It also raises money unsecured as time deposits and call money. In light of ILB's good refinancing possibilities, it boasts a comfortable liquidity situation.
- The bank sources long-term financing mainly from national and supranational business development banks (KfW, European Investment Bank, Landwirtschaftliche Rentenbank, Council of Europe Development Bank) and through note loan and registered bond issues. Access to these refinancing sources will also be possible in the future. The refinancing basis is to be broadened by issuing listed bearer bonds.
- ILB's refinancing demand can be covered at all times taking current developments into account.

3. Development of income situation and financial position

The group's future income situation and net worth will continue to depend heavily on ILB.

The increasingly restrictive regulatory conditions (Basel III/SREP) may have implications for ILB's equity in the long term. In order to achieve the planned business development, ILB will continue to accumulate profits in order to strengthen its equity. Profits of at least EUR 15m are to be accumulated in order to strengthen equity.

The new debt and liquidity ratios implemented under Basel III, especially the leverage ratio, liquidity coverage ratio and the net stable funding ratio, will be monitored with a view to their possible impact, and measures will be taken in time for the implementation of the corresponding standards.

The chart below illustrates the planned development of ILB's net income without compensatory entries from the ILB promotional fund and from the Brandenburg fund.

The new debt and liquidity ratios implemented under Basel III, especially the leverage ratio, liquidity coverage ratio and the net stable funding ratio, will be monitored with a view to their possible impact, and measures will be taken in time for the implementation of the corresponding standards.

The chart below illustrates the planned development of ILB's net income without compensatory entries from the ILB promotional fund and from the Brandenburg fund.

Item	2017 Thousand EUR	Plan 2018 Thousand EUR	Change in %
Net interest income	61,611	61,049	-0.9
Net commission income	44,861	47,253	5.3
Other operating net income *	2,444	1,950	-20.2
Personnel expenditure	41,258	42,837	3.8
Material costs	18,541	20,706	11.7
Depreciation, operations area	4,696	6,404	36.4
Profit before risk provisioning/reserve formation	**44,421**	**40,305**	**-9.3**
Value adjustment of receivables	259	-5,410	-2,188.8
Valuation result of securities	-1,353	-549	-59.4
Allocation to provident funds	-946	-1,200	26.8
Result after risk provisioning	**42,381**	**33,146**	**-21.8**
Formation of reserves	-26,000	-17,000	-34.6
Allocation to ILB promotional fund	-5,000	-5,000	0.0
Net profit for the year	**11,381**	**11,146**	**-2.1**

* including net extraordinary result, other taxes , income from partial profit transfer agreements

ILB expects the income situation and financial situation to remain satisfactory in 2018.

Profit before risk provisioning and the formation of reserves is to total around EUR 40.3m in 2018 and will therefore be EUR 4.1m below the previous year's figure. A stable earnings situation is confronted by rising administrative expenses.

Net interest income of EUR 61.0m will continue to account for the greatest share in ILB's revenues. Despite the still difficult market environment, ILB expects net interest income for 2018 to reach the same level as the previous year. The results recorded by both the departments and treasury remained level against the previous year.

ILB expects the easy money policy to continue in 2018. A low-interest environment with negative interest rates on money markets and long-term capital market rates of close to 1.0% are therefore expected. ILB will benefit from this trend in the short term in the form of favourable refinancing conditions with variable-interest borrowings. Benefits due to negative interest rates can be realised in this context. Furthermore, the interest situation also enables positive effects from matching maturities. This measure moderately counteracts the long-term negative effects of low interest rates. In the long term, however, the negative effects will predominate. The narrowing of spreads as a result of the ECB's securities purchasing programme and the falling interest rate on equity, caused by the low interest rate environment, has put pressure on treasury's contribution to earnings.

The possible effects of extreme ad hoc changes in the planned interest curve of between one and four percentage points for the following year were simulated as part of scenario analyses. Net interest income planned for 2018 will range between EUR 53.0m and EUR 85.5m. Net interest income shows a negative response to a steep increase in short-term interest rates or a steep increase in the entire interest rate structure. Compared to initial planning, persistently low money market rates and steeper interest rates or further base lending rate reductions can be seen to have a very positive impact. The changes in interest rates assumed are extreme scenarios which are unlikely to occur. For more moderate interest rate scenarios, the budget estimate for 2018 is essentially confirmed.

Net fee and commission income is becoming increasingly important for net income and is likely to total EUR 47.3m in 2018, i.e. around EUR 2.4m higher than in 2017. Net fee and commission income largely results from fees for the management of promotion and support programmes. Close to one quarter of this income is from administrative cost contributions in conjunction with the granting of loans from trust funds and around three quarters from the handling of promotion programmes and a small amount from the management of guarantees, loan processing and other services. The increase in net fee and commission income is mainly due to the launch of various promotional programmes in grant processing, which are mainly settled within the scope of cost reimbursement.

ILB's planning foresees the gradual decline of funds available to the federal state of Brandenburg up until 2020. In this context, revenues from the processing of grant programmes are expected to decline in the future. As the central promotional platform for the federal state of Brandenburg, ILB aims to enter into further management agreements with the federal state in order to partially compensate for the aforementioned trend. Increasingly complex promotion processes are also currently vetted with a view to cost and efficiency. In line with the prevailing cost reimbursement structure in this business segment, declining revenues are offset by correspondingly lower processing costs, so that no significant negative effects on ILB's result are expected. On the other hand, revenues are generated from loans granted in the past from trust funds in housing and from ongoing fee payments on the basis of foreign exchange. Due to the continued low interest level, additional extraordinary redemption payments cannot be ruled out above and beyond the special redemption payments already included in the planning scenario. A scenario simulation suggests a decline in fees of EUR 0.5m.

Other operating net income in 2018 will probably total EUR 2.0m compared to EUR 2.4m in 2017. In 2017, this includes once-off income from a partial profit transfer.

Administrative expenses (personnel, material expenditure and depreciation on operating equipment) are likely to increase in 2018 by EUR 5.5m to EUR 69.9m. A moderate increase of EUR 1.6m is expected for personnel expenditure, primarily due to wage/salary increases. In 2018, EUR 27.1m is planned for material expenditure and depreciation on operating equipment, i.e. EUR 3.9m more than the actual figure from 2017. Depreciation on buildings as well as facilities and equipment will increase as planned following the commissioning of the new ILB building on 1 May 2017 due to the full-year effect in 2018. The main reasons for the increase in material expenditure are the expected, increasing external costs for managing specialist applications and basic operations as well as IT consultancy services needed in conjunction with projects driven by regulatory requirements. Most of ILB's administrative expenditure is subject to long-term fixed rates. Deviations from budget can result from deviations in actual project costs compared to planned retainers of external service providers. In line with cautious planning principles, however, opportunities here outweigh potential risks.

Based on the loss expected, the 2018 budget includes an amount of EUR 5.4m for value adjustments of receivables.

Securities held by the bank are valued according to the diluted lower of cost or market principle. According to the principle of prudence, potential valuation demand for securities totalling EUR 0.7m is additionally considered as an expected loss. Altogether, a negative valuation result of EUR 0.5m is recorded here.

In order to consider implicit options due to statutory termination rights within the scope of loan business, EUR 1.2m is allocated to provident funds, corresponding to the same amount as in the previous year.

Net income for the year is mainly planned at the same level as last year.

ILB's profit will continue to be stable and satisfactory in the year to come, creating the basis for further successful business by the bank to the benefit of the federal state of Brandenburg. In light of this, ILB plans to step up the ILB promotional fund in order to offer attractive loan products by drawing on its own revenues. In line with demand, a sum of EUR 5m is planned for the ILB promotional fund for the following year. Considering current planning, ILB will probably achieve its goal of strengthening its equity by EUR 15m once again in 2018.

According to the 2018 budget, the balance sheet total will be in the order of around EUR 13.3bn.

By the end of 2018, the number of employees will probably increase once again slightly. The share of female employees and the share of part-time employees will remain largely unchanged. We expect to see an increase in the share of fixed-term employees.

The number of employees in the passive phase of semi-retirement, early retirement, parental leave or other forms of passive employment is expected to increase slightly.

The number of students in cooperative study programmes will remain flat against the previous year.

The professional development offering will be continued at the same level.

V System of internal control and risk management for the accounting process

The system of internal control for accounting includes, in particular, organisational rules for structures and processes with clear differentiation between areas of responsibility as well as processes, methods and measures to ensure the correctness and reliability of internal and external accounting.

Accounting-related business transactions are mostly handled by the respective units and departments. ILB‘s Board is responsible for the design and effectiveness of a reasonable system of internal control for accounting. Risk Controlling/Finance is responsible for implementation in cooperation with Bank Operations and Board/Strategy. The respective areas are responsible for complete and correct recording and for performing and documenting the necessary related controls. The Risk Controlling/Finance function is in charge of accounting rules, posting methods, balancing and definition of valuation rules. The Risk Controlling/Finance function is responsible for transaction-independent valuation and result determination.

The annual and consolidated financial statements are prepared by the Risk Controlling/Finance function and set up by the Management Board. The Administrative Board elects an Audit Committee from among its members. According to the business rules, the tasks of the Finance Committee include, but are not limited to, resolutions regarding accounting, the selection and monitoring of the necessary independence of the auditor, the appointment of the auditor, the determination of key audit tasks and fee agreements. The Audit Committee also supervises the accounting process as well as the effectiveness of the risk management system, especially the internal control system and internal auditing. The Audit Committee controls the prompt elimination by the Management Board of points of criticism identified by the auditor. ILB‘s general meeting approves the annual and consolidated financial statements pursuant to its articles of association. The auditor attends the discussions of the Administrative Board and of the committees regarding the annual and consolidated financial statements and reports on the key results of his audit. The auditor is elected by the general meeting at the recommendation of the Administrative Board/Audit Committee.

The consolidated financial statements include ILB and ten affiliated companies on a fully consolidated basis.

The consolidated financial statement is carried out by the Risk Controlling/Finance function on the basis of the annual financial statements of the consolidated companies. Receivables and liabilities as well as expenses and revenues are fully consolidated in line with the relevant provisions of the German Commercial Code. This function is also responsible for the entire bookkeeping, preparation of annual financial statements as well as adjustment to the accounting and valuation rules applicable to the entire group.

In light of the business model of ILB and its affiliated companies to pursue tasks in the public interest, a more in-depth analysis of the market compliance of transactions with related persons was not carried out.

ILB‘s accounting process has been laid down in manuals and procedures in its written rules which are updated on a continuous basis.

In the standardised management and monitoring process for new products and processes, the Risk Controlling/Finance function is responsible, amongst other things, for the accounting-related analysis and the assessment of risks related to new products in order to ensure adequate presentation in the books.

In addition to the minimum requirement of the four-eyes principle, the use of standard software, which is protected against unauthorised use by competence-related authorisations, is another key element of the system of internal control for accounting. The functions and organisation of the market areas are separate from the areas responsible for handling, supervision, control and accounting.

The internal control systems of the accounting processes are identical for ILB and its consolidated subsidiaries.

The functioning of the accounting-related internal control system is monitored by the Internal Audit function in the form of regular, process-independent audits according to the minimum requirements for risk management (MaRisk) published by the Federal Financial Supervisory Authority (BaFin). The Management Board and the Administrative Board are informed promptly and regularly about the results of the audit.

Potsdam, 21 March 2018

Management Board of Investitionsbank des Landes Brandenburg

Tillmann Stenger	Jacqueline Tag	Kerstin Jöntgen
Chairman of the Board	Member of the Board	Member of the Board

Annual Balance Sheet as of 31 December 2017

Investitionsbank des Landes Brandenburg

Assets	EUR	EUR	31 Dec. 2016 Thousand EUR
1, Cash			
a) Cash in hand	2,866.49		5
b) Balances with central banks	296,789,329.21		10,964
of which:		296,792,195.70	10,969
at Deutsche Bundesbank EUR 296,789,329.21 (previous year: EUR 10,964,000)			
2. Loans and advances to banks			
a) Payable on demand	139,316,233.81		39,698
b) Other loans and advances	2,206,122,471.99		2,178,022
		2,345,438,705.80	2,217,720
3. Loans and advances to customers		4,954,009,267.56	5,009,173
of which:			
Secured by liens EUR 792,652,986.61 (previous year: EUR 776,468,000)			
Public-sector loans EUR 3,133,419,711.89 (previous year: EUR 3,607,949,000)			
4. Bonds and other fixed-income securities			
a) Bonds and notes			
aa) Issued by public institutions	1,823,525,890.97		1,579,006
of which:			
eligible as collateral at Deutsche Bundesbank EUR 1,819,462,319.41 (previous year: EUR 1,574,934,000)			
ab) from other issuers	1,421,802,247.20		1,496,173
of which:		3,245,328,138.17	3,075,179
eligible as collateral at Deutsche Bundesbank EUR 1,405,153,313.37 (previous year: EUR 1,455,051,000)			
5. Stocks and other variable-income securities		199,789,639.65	169,833
6. Shareholdings		30,000.00	30
7. Shares in affiliated companies		71,832,912.33	62,443
8. Trust assets		2,256,330,151.17	2,600,729
of which:			
Trust loans EUR 2,251,867,451.37 (previous year: EUR 2,414,068,000)			
Securities held in trust EUR 0.00 (previous year: EUR 181,814,000)			
9. Intangible assets			
a) Acquired concessions, industrial property rights and similar rights and values as well as licenses thereto		2,476,242.04	3,451
10. Tangible assets		97,332,098.16	70,320
11. Other assets		52,658,474.51	88,069
12. Prepaid expenses		11,345,746.77	10,291
Total assets		13,533,363,571.86	13,318,207

Liabilities	EUR	EUR	EUR	31 Dec. 2016 Thousand EUR
1. Liabilities to banks				
a) Payable on demand		9,989,648.90		125,978
b) With an agreed term or notice period		9,673,580,448.02		9,182,928
			9,683,570,096.92	9,308,906
2. Liabilities to customers				
a) Other liabilities				
aa) Payable on demand		162,780,172.12		99,624
ab) With an agreed term or notice period		625,093,637.10		635,703
			787,873,809.22	735,327
3. Trust liabilities			2,256,330,151.17	2,600,729
of which:				
Trust loans EUR 2,251,867,451.37 (previous year: EUR 2,414,068,000)				
Securities held in trust EUR 0.00 (previous year: EUR 181,814,000)				
4. Other liabilities			75,486,821.15	13,337
5. Prepaid expenses			77,026,098.31	80,447
6. Provisions				
a) Provisions for pensions and similar obligations		1,581,164.00		1,402
b) Other provisions		12,397,099.37		9,277
			13,978,263.37	10,679
7. Special item for investment allowances			24,499,523.10	19,752
8. Fund for general banking risks			392,436,067.89	332,248
9. Equity				
a) Subscribed capital		110,000,000.00		110,000
b) Retained earnings				
ba) Statutory reserve	11,000,000.00			10,763
bb) Other retained earnings	90,000,000.00			85,000
		101,000,000.00		95,763
c) Net retained profit		11,162,740.73		11,018
			222,162,740.73	216,782
Total liabilities and shareholders‘ equity			13,533,363,571.86	13,318,207
1. Contingent liabilities				
a) Liabilities in relation to guarantees and warranties			55,426,285.08	44,989
2. Other obligations				
a) Irrevocable loan commitments			867,834,304.15	350,818
3. Administration loans			61,638,379.27	67,675
4. Administration guarantees			100,967,947.48	114,870

The annual financial statements of ILB for 31 December 2017 were prepared according to the relevant regulations of the German Commercial Code (HGB), the Regulations on the Accounting of Banks and Financial Institutions (RechKredV) and the German Stock Corporation Act (AktG).

Profit and Loss Account for the period 1 January to 31 December 2017

Investitionsbank des Landes Brandenburg

	EUR	EUR	EUR	1 Jan.–31 Dec. 2016 Thousand EUR
1. Interest income from				
a) lending and money market transactions	160,072,985.26			161,742
minus negative interest from money-market transactions	322,824.10			54
	159,750,161.16			
b) fixed-income securities	34,927,232.99			41,476
		194,677,394.15		203,164
2. Interest expenditure				
Interest expenditure from banking business		141,129,782.34		150,893
minus positive interest from banking business		8,063,704.24		5,948
		133,066,078.10		144,945
			61,611,316.05	58,219
3. Revenues from profit pools, profit and partial profit transfer agreements			480,729.60	0
4. Fee and commission income		46,012,091.53		46,018
5. Fee and commission expenses		1,150,958.84		375
			44,861,132.69	45,643
6. Other operating income			15,034,159.13	10,939
7. General administrative expenses				
a) Expenditure on personnel				
aa) Wages and salaries	34,815,795.11			32,707
ab) Social security contributions and expenditure on pensions and other benefits				
of which for pensions:				
EUR 136,474.00 (previous year: EUR 7,000)	6,442,193.18			5,861
		41,257,988.29		38,568
b) Other administrative expenses		18,541,045.33		20,698
			59,799,033.62	59,266
8. Depreciation, amortisation and write-downs on intangible assets and tangible assets			4,695,888.73	2,390
9. Other operating expenses			4,656,336.36	4,190
10. Revenues from additions to receivables and certain securities as well as the reversal of provisions in loan business (previous year: amortisation)			20,166,525.70	-5,489
11. Amortisation and write-downs on investments, shares in affiliated companies and securities treated as fixed assets (previous year: revenues)			1,359,820.04	-1,846
12. Allocations to the fund for general banking risks			60,188,062.53	33,656
13. Results from ordinary activities			11,454,721.89	11,656
14. Extraordinary expenses			42,693.00	43
15. Other taxes			30,970.33	55
16. Net income for the year			11,381,058.56	11,558
17. Profit brought forward from the previous year			18,416.37	38
18. Appropriation to retained earnings				
a) to the statutory reserve			236,734.20	578
19. Net retained profit			11,162,740.73	11,018

The annual financial statements of ILB for 31 December 2017 were prepared according to the relevant regulations of the German Commercial Code (HGB), the Regulations on the Accounting of Banks and Financial Institutions (RechKredV) and the German Stock Corporation Act (AktG).