



# Consolidated Management Report 2015

Investitionsbank des Landes Brandenburg

## 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 institute 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 its 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.

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 twelve subsidiaries form the ILB group whose business is largely determined by ILB. The federal state of Brandenburg and NRW.BANK each hold a 50 % stake in the bank. ILB's equity of around EUR 484m and the group's equity of EUR 486m were formed from their own revenues.

#### 1.2 Mission

As the business development bank for the federal state of Brandenburg, ILB supports the federal state in implementing its structure and economic policy. In this capacity, it facilitates the support programmes of the federal state in the fields of business, labour, infrastructure and housing. As an intermediary, 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. In this capacity, ILB is responsible for operative execution on behalf of the ministries of 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, the bank is in charge of the administration and application of trust assets as well as the formation and administration of special funds. The bank holds the housing assets of the federal state of Brandenburg (LWV) in trust as legally dependent assets. Moreover, the bank also manages funds for undertakings in the commercial and media sectors.

#### 1.3 Products and services

ILB offers its customers low-interest loans, grants, interest rate subsidies, liability exemption, guarantees as well as venture and investment capital from funds of 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 and rent out property projects, but also promote tourism in the city of Potsdam and the establishment of companies.

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.

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. The core business includes the granting of loans to the federal state of Brandenburg, its municipal authorities and social institutions.

Loan business with commercial industries – including agricultural companies – is carried out primarily via commercial banks. ILB grants low-interest global loans to banks in order to enhance the loan supply to the commercial sector. When necessary, ILB also

enters into syndicated loan agreements as a consortium partner. 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 where ILB acts as the lead institute for the savings banks in Brandenburg. It supports 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.

## 2. 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 promotional and funding 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 land, in particular, EU support measures.

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

- With its own portfolio, ILB supports 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 risk policy, ILB is continuously developing its own portfolio (Brandenburg loan family) in order to compensate for the share of EU and federal-state funds which is set to decline in the medium term.

## II Economic Review

### 1. Economic conditions in Germany

In 2015, the German economy continued its course of strong growth and benefitted, in particular, from strong domestic demand. According to recent calculations by the Federal Statistical Office, price-adjusted gross domestic product (GDP) rose sharply by 1.7 % against the previous year and was thereby higher for the second year in succession than the average value of the last ten years. In 2014, the German economy had already recorded comparably strong growth of 1.6 %. Besides domestic consumption, capital investment and foreign trade generated positive momentum. In terms of economic sectors, particularly strong contributions to growth came from the producing industry except for the construction sector. The service sectors also developed well.

All in all, economic performance in 2015 was slightly weaker than forecast at the beginning of the year; the federal government had expected 1.8 % growth in spring.

According to the Federal Statistical Office, economic development in 2015 can be summarised as follows.

- Last year, domestic consumption grew by 1.6 percentage points and was thus almost the only driver of GDP growth.
- Despite a difficult foreign trade environment, German export business recorded positive development in 2015. However, foreign trade contributed a mere +0.2 percentage points and therefore supported GDP development to a limited extent only.
- On the other hand, contribution to growth by gross investments was slightly negative ( 0.1 percentage points).

Domestic consumption in 2015 was driven not least by positive developments on the labour market. With around 43 million people in jobs in 2015, this was the rightest level since German reunification. At the same time, 2.795 million people were unemployed, marking the lowest annual average in 24 years. Central drivers of domestic consumption were the good employment situation, strong development of incomes, low oil prices as well as low interest rates.

Public budgets continued their consolidation course in 2015 and at EUR 19.4bn recorded the highest surplus since German reunification. According to the Federal Statistical Office, the surplus rate totalled 0.6 % in terms of price-based GDP.

Although capital market interest rates were subject to a measure of fluctuation in 2015, they generally remained at a very low level. The declining trend in interest rates continued in the 1st quarter as a result of ECB's bond purchasing programme. Returns reached new all-time lows. Ten-year swap rates dropped below 0.50 % and ten-year German government bonds to even less than 0.10 %. Shorter-term German government bonds were even available at a negative return only. During the 2nd quarter, quick adjustment set in with returns rising by 0.80 % for ten-year bonds. Ten-year swap rates rose to as much as 1.30 %. The fluctuation range narrowed further during the 2nd quarter. The ECB indicated further monetary measures and expanded its bond purchasing programme at the end of the year, reducing deposit rates further to 0.30 %. Short-term interest rates fell continuously until the end of the year and also led to falling interest rates for longer terms. Ten-year swaps recorded around 1.00 % at the end of the year. This means that the financing costs for public budgets, companies and the housing sector continue to be very favourable.

## 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 also continued last year, with all districts of the federal state as well as independent cities witnessing a positive trend. The average rate for 2015 totalled around 8.7 % and thus fell to the lowest level since German reunification.

However, the rise in employment that had begun in 2014 in the federal state of Brandenburg did not continue last year. Employment declined slightly, mainly due to a decline in the producing sector in 2015. According to the Federal Statistical Office, significant increases are chiefly the result of a positive trend in financial, insurance and company services.

Developments in the processing sector in the federal state of Brandenburg fared generally well in 2015 as a whole. According to the Federal Statistical Office, Brandenburg's industrial sector recorded a slight increase in turnover of 0.6 % against the previous year, generating revenues of around EUR 23bn, also thanks to sound foreign demand (up by 8.1 %). On the other hand, domestic business turnover declined and was 2.7 % short of the previous year's level. The picture for the 2015 order intake balance is generally lacklustre compared to the previous year. With a 2.4 % decline, the trend is negative compared to the year as a whole. Order intake from foreign customers in particular declined by 9.1 %.

Turnover for the construction industry increased in 2015 by 1.4 %, whilst order intake saw a significant boost of 14.1 %.

According to the data currently available, Brandenburg's GDP developed positively in 2015. According to the Federal Statistical Office, Brandenburg's GDP grew strongly by 1.5 % in the first half of 2015. Key factors were positive impulses from the services sector as well as the processing and construction industries.

## 3. Business development

Promotion and development business:

The bank's funding and support portfolio once again met with a very positive response from Brandenburg's business community, municipal administrations and the housing sector. Demand for business development loans through savings banks acting as applicants' banks in the federal state of Brandenburg was once again high. In 2015, ILB pledged a total volume of EUR 1,454m.

Promotional and development business in 2015 can be characterised as follows:

- The volume pledged therefore increased by EUR 183m against the previous year's result (2014: EUR 1,271m; +14 %).
- This was the second highest sum pledged by ILB in the last ten years.
- In managed activities, the launch of the programmes of the new Operational Programme 2014 to 2020 was delayed both in the ERDF and in the ESF, the sums pledged nevertheless reached a level of EUR 471m, slightly less than in the previous year (2014: EUR 532m; 11 %).
- The pledged volume planned for the year 2015, i.e. a sum of EUR 1,171m, is exceeded by EUR 283m (+24 %).
- The main reason for the strong increase in volume pledged is the significant increase in ILB products to EUR 983m (2014: EUR 739m; +33 %).
- The ILB products therefore substantially overcompensated for declining managed activities.
- Managed activities business, in particular, was slow to start at the beginning of the year. The delayed approval activities in managed activities business were due to the fact that the federal state's budget was not adopted until early summer and the late coming into effect of new directives.
- A particularly strong increase in approval activities was seen during the 4th quarter. Whilst a mere EUR 143m, corresponding to 38 % of the planned volume, was pledged by 30 September 2015, this share increased to a considerable 125 % (EUR 471m) by 31 December 2015.
- In the field of ILB products, the pledge volume planned was significantly exceeded due, for instance, to a strong increase in demand for new housing. A pledging volume of EUR 983m for ILB products was achieved for the bank as a whole as per 31 December 2015.
- The share of ILB's products in the total volume pledged rose, after a temporary dip in the previous year, to currently 68 %.

Earnings development:

ILB can look back over another successful financial year. Net income after provisions for risks totalled EUR 48m. This figure is EUR 10.3m higher than the expected original figure planned and is an indicator for this positive development. This was largely due to the low level of write-downs on accounts receivable which, with a positive figure of EUR 3.7m, was significantly below budget. (EUR 5m).

Net income from operative business also developed well. Net income before provisions for risks totalled EUR 42.8m and is hence EUR 2.1m above budget. The increase in net income is due to lower administrative expenses, in particular, for material expenditure. Revenues were generally as expected in the budget.

The positive result permits the scheduled allocation of EUR 7.5m to the ILB promotional fund. Annual net income for the year after adjustments and the formation of reserves totals EUR 11.5m and is up EUR 0.1m against the previous year. Considering a planned EUR 6.0m dividend to shareholders, ILB can strengthen its equity base by almost EUR 35m so that the bank has clearly surpassed its goal for the year, i.e. to strengthen equity by at least EUR 20m.

The securities portfolio was largely left unchanged in order to achieve stable interest revenue from this business and to address regulatory requirements with a view to liquidity management in order to comply with the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR).

#### 4. Income, net worth and financial position

Just like in previous years, the group was characterised primarily by ILB and once again recorded a good profit for the year with moderate balance sheet growth.

The bank's income situation, net worth and financial position are satisfactory and stable.

#### 4.1 Income position

In 2015, ILB's annual net income totalled EUR 11.5m, that of the group EUR 13.0m.

Net interest income totalled EUR 56.8m (previous year: EUR 58.1m) and was thereby slightly above the original budget. This development is due to higher revenues from interest-earning promotional business, especially in the housing construction sector. Other interest income remained flat. Just like the rest of the financial sector, ILB is facing huge challenges due to the measures introduced in response to the financial market crisis. Direct impacts are particularly seen in conjunction with parameters in treasury activities. Persistently low interest rates put some pressure on interest income and lead to a further decline in return on equity. Negative interest rates have expanded and consolidated especially in short-term business which has led to lower margin contributions in individual cases for variable refinancing projects in existing business. At the same time, ILB also benefitted from this exceptional interest situation for short-term borrowings on the money market. By implementing the default risk strategy, ILB continued to invest liquid funds in investment-grade securities. In 2015, ILB thereby managed to counteract the erosion of margins with a largely unchanged risk structure of its securities portfolio and to stabilise contributions to profit.

Net fee and commission income 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. With EUR 40.9m in 2015, net fee and commission income was EUR 5.5m higher than in the previous year. The increase is chiefly due to new tasks assumed as part of the bank's management activities which are remunerated on the basis of the costs actually incurred by it.

ILB's personnel expenses totalled EUR 36.9m in 2015. The EUR 4.0m increase is due to salary adjustments under the collective agreement and an increase in the number of employees. In terms of quality, new ESF promotional business and the expansion of promotional business under the European Agricultural Fund for Rural Development (EAFRD) led to a significant increase in manpower demand in 2015. At the same time, the number of staff needed for the existing ERDF/EAFRD promotional programmes remains unchanged due to greater process requirements and despite declining promotional volumes. At the end of 2015, ILB employed a staff of 550. The additional 25 employees (average) are staff who were hired for new tasks.

Other administrative expenses, including depreciation, amortisation and write-downs on intangible assets and tangible assets rose by EUR 4.2m to EUR 21.7m.

Operating costs totalled EUR 20.5m and were significantly higher than in the previous year. Starting 2015, ILB is obliged to pay the European banking levy. The resultant costs were to a large extent responsible for the increase in expenditure. Further cost increases are due to the implementation of the requirements regarding processing and reporting for the new 2014 to 2020 programming period, especially for the ERDF and ESF promotional programmes. Material expenditure additionally includes the costs for the assignment of LASA employees for processing and handling employment promotion programmes.

Depreciation on tangible assets totalled EUR 1.3m and was slightly below than the previous year's figure (EUR 1.4m).

The group's risk situation is determined largely by ILB. All identifiable banking risks were taken into account through measurement valuation and risk measures. Itemised allowances for bad debts were formed, taking into account existing provisions for lending risks that were identified and quantified during the financial year. 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.

Due to the increase in long-term loan business as a result of the low interest level, tied-up contingency reserves pursuant to section 340 f of the German Commercial Code [§ 340 f HGB] were earmarked for the first time in 2015 for the statutory termination rights existing in this context.

Other operating net income, without allocations to the ILB promotional fund and to the Brandenburg fund, totalled EUR 1.8m in 2015 and was thus slightly below the previous year's figure of EUR 2.2m.

In addition, other operating income additionally includes revenues totalling EUR 3.9m from the appropriate use of ERDF funds within the scope of „Brandenburg-Kredit Mezzanine“. This revenue was appropriated to the Brandenburg fund. The Brandenburg fund is treated as a sub-item of the fund for general banking risks. The allocation of the Brandenburg fund is thus reflected by the appropriation to the fund for general banking risks of EUR 3.9m.

Other operating income also includes expenditure for earmarked funds of the ILB promotional fund of EUR 2.3m that became necessary due to funds and support pledged in 2015.

The ILB promotional fund is a sub-item of the fund for general banking risks and totalled EUR 7.5m in 2015. This means that since 2006, EUR 80.0m of the bank's revenues has been made available for funding and support measures within the scope of ILB's Brandenburg loan product family.

In order to strengthen the bank's equity position, another non-earmarked EUR 29.0m was allocated to the fund for general banking risks from the current result (2014: EUR 29.5m).

The group's income situation is determined largely by ILB. 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 set for 2015 were reached and often even surpassed. The overall profit recorded is much higher than planned. Besides ILB's result, this is mainly due to the annual result of two subsidiaries (ILB Beteiligungsgesellschaft mbH and BIOTECH CAMPUS POTSDAM GmbH) which contributed EUR 1.3m to the group's profit after consolidation.

The measure for ILB's financial success is the profit before risk provisions and the formation of reserves. In 2015, ILB recorded a good result of EUR 42.8m (group: EUR 47.0m) before risk provisioning and the formation of reserves which is only slightly below the figure for the previous year (EUR 45.3m).

## 4.2 Net worth

ILB's balance sheet total which determines the group's profit increased in 2015 by EUR 40.0m (group: EUR 36.7m) to EUR 13,662.5m (group: EUR 13,678.3) from 31 December 2014 to the balance sheet key date of 2015.

The business volume, comprising business recorded in the balance sheet with current customers, contingent liabilities, administrative loans, as well as administrative guarantees, rose to EUR 13,922.3m for ILB (group: EUR 13,938.0m) at the end of the 2015 financial year.

The small increase in ILB's loans and advances to banks by 1.1 % (group: 1.1 %) to EUR 2,315.1m (group: EUR 2,315.1) is due to the bank's Brandenburg loan and global loan and loan channelling business which increased to around EUR 57.9m. On the other hand, lending via German debenture note loans declined by around EUR 40.0m.

ILB's loans and advances to customers increased by EUR 380.2m (group: EUR 386.3m) to EUR 5,224.4m (group: EUR 5,226.0m). This was primarily due to loan business with the federal state of Brandenburg and growing housing loan business with supplementary and follow-up financing whilst receivables from the State Housing Construction Fund are declining. Trust loans – as part of trust assets – declined by EUR 320.5m to EUR 2,564.1m as a result of scheduled and extraordinary repayments.

Bonds and other fixed-income securities at ILB totalled EUR 3,055.2m as per 31 December 2015 and are EUR 149.8m below last year's level.

Stocks and other variable-income securities are exclusively the shares for the special fund issued on 1 April 2014 with Union Investment Institutional GmbH which is a mixed fund that invests in European corporate bonds.

ILB's other assets totalled EUR 75.6m (group: EUR 118.2m) including EUR 66.4m for the adjustment item for USD exchange rate differences. In the group, the balance sheet item also primarily includes liquid funds of EUR 35.3m held by the group's subsidiaries with banks.

Prepayments and accrued income include, besides disagio from refinancing loans taken out with KfW, primarily agio in accruals and deferrals for loans taken out and for registered securities.

Interest swaps and cross-currency interest rate swaps as well as forward interest swaps and swap transactions were also taken out exclusively by ILB in order to steer interest rate risks through macro and micro hedges totalling EUR 9,675.2m as per the balance sheet date.

### 4.3 Financial position

Net worth is also determined chiefly by ILB.

In the 2015 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 66.7m to EUR 9,278.7m (group: EUR 9,278.7m) as per 31 December 2015. Time deposits, call money and reverse transactions increased by EUR 424.3m, whilst a smaller amount of EUR 359.8m was taken up through long-term refinancing and open-market transactions.

Liabilities to customers increased by EUR 133.5m as per 31 December 2015 against the previous year. This increase is mainly due to the German government's time deposit of EUR 132.0m. Besides an increase in call money deposits by EUR 91.1m, seven new note loans totalling EUR 69.5m were taken up at German insurance companies. At the same time, eight note loans totalling EUR 145.5m expired. The group's liabilities, which are entered into by the bank, are secured by statutory public-sector responsibility, guarantor's liability and the liability guarantee of the federal state of Brandenburg.

Off-balance sheet liabilities declined in 2015 as a whole. Liabilities in relation to guarantees and warranties increased by EUR 10.6m. 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 also increased by EUR 6.7m to EUR 301.1m as per 31 December 2015. The reduction in administrative loans and guarantees by EUR 37.9m is in line with repayments in business managed on behalf and account of the federal state of Brandenburg for which new business is no longer foreseen.

The group's liquidity which is essentially determined by the bank was secured at all times. At the end of 2015, the bank recorded more than EUR 495.3m in loan commitments which were either open or 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 298.6m, including EUR 262.0m which must be classified as liable core capital. Another EUR 16.43 concerned the Brandenburg fund and the remaining EUR 20.3m for the earmarked ILB promotional fund.

Equity and the fund for general banking risks totalled EUR 509.8m (group: EUR 514.6m) including EUR 36.6m for the promotional funds. This increase is largely due to the allocation to the fund for general banking risks and to retained earnings.

Due to the resolution regarding the appropriation of profits from the year 2014 adopted at the shareholders' meeting on 13 May 2015, dividends of EUR 6.0m were distributed, EUR 5.0m was allocated to retained earnings, and EUR 0.1m was allocated to profit carried forward.

The equity requirements of the regulatory German Solvency Regulation and of the CRR were fulfilled at all times.



In 2015, ILB's total capital ratio according to CRR ranged between 14.06 % (group: 14.18 %) and 14.83 % (group: 14.94 %).

In 2015, ILB's common equity and also its core capital ratio according to CRR ranged between 12.38 % (group: 12.49 %) and 13.19 % (group: 13.30 %).

ILB's return on equity as a key indicator totalled 1.25 % (group: 1.25 %) as per 31 December 2015. This figure is calculated by the total return on capital formula from the ratio between profit and interest on borrowings vs total capital, consisting of equity and debt.

#### 4.4 Financial and non-financial performance indicators

ILB and LASA Brandenburg GmbH pledged funds of around EUR 1.5bn for 4,309 projects, including EUR 470.9m for managed activities and EUR 983.3m for ILB's own products.

A good profit of EUR 42.8m (group: EUR 47.0m) before risk provisioning and reserve formation was achieved in 2015, slightly below previous year's level (EUR 45.3m).

The strategic goal to strengthen equity each year by accumulating profits of at least EUR 20m was clearly outperformed with around EUR 34.5m in 2015.

The profit for 2015 enables the demand-conforming volume of the ILB promotional fund up to the targeted maximum sum of EUR 7.5m.

487 people were employed in permanent jobs on 31 December 2015 (previous year: 473). The number of employees in temporary jobs rose from 42 to 49. 18.7 % of these employees worked part-time; this figure is 0.5 % below the previous year's level.

14 employees were in the passive phase of semi-retirement, early retirement, parental leave or other forms of passive employment (previous year: 19). The number of students (14) in co-operative study programmes remained flat against the previous year.

The share of female employees fell slightly from 67.4 % to 67.2 % at the end of 2015. The average age of all employees was 46.1 years.

In 2015, ILB provided active support for its employees' further professional development through in-house and external training events. Seminar attendance totalled 1,074 (previous year: 798).

### III Events after the balance-sheet date

No events of significant importance for the management report took place after the conclusion of the 2015 financial year.

### IV 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 as well as the planning and limitation processes 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 culture determined 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 culture. 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 capability 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/management 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 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 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 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 capability concept.

Risk-bearing capability is defined as the possibility to compensate for value loss from the bank's own funds. Effective as of 1 January 2015, a revised risk-bearing capability concept has been applied which includes, in particular, an adjustment of risk measurement methods. ILB consistently applies the period-based going-concern approach for its risk-bearing capability 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 capability in the going concern is ensured if the available risk capital  $\geq$  total actual risk. This approach is designed to ensure that the institute can continue operating in conformity with the requirements of bank 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 capability 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 g of the German Commercial Code and the net profit forecast for the year after risk provisioning and reserve formation as well as planned allocation to the ILB promotional fund minus intangible assets. 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 significant fluctuation and are therefore not permanent.

ILB determines the available risk capital on the basis of its risk capital by subtracting from the risk capital the regulatory capital required under pillar I for going-concern purposes. Within the scope of the risk-bearing capability 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 future in order to ensure the bank's risk-bearing capability 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 adverse 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 upper loss limit 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 capability. In line with its bye-laws, ILB generally pursues a conservative risk culture. Its risk tolerance thus ranges between risk-averse and risk-neutral. The total 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 in the form of available risk cover is maintained in order to cover risks which, although they are classified as minor, are to be considered within the scope of the risk-bearing capability calculation. 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.

The risk level (risk amount) is measured in the risk-bearing capability 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 so. In order to determine its risk-bearing capability, ILB examines the impact of the negative deviations on profit under commercial law within the risk horizon. 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 considering the current year and the following year, ILB thereby applies two steering groups in its risk-bearing capability concept.

Risk-bearing capability 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 total 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 Board of the bank's overall risk situation. Risk-bearing capability 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). The stress tests are also used to analyse the effects of a major economic downturn.

The aim is to identify both possible events or future changes that would have a negative effect on the bank's risk situation and its risk-bearing capability. 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 capability 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 capability 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 capability concept and the limits determined there. The limits of the risk-bearing capability concept and the limits of operational steering must be adhered to at the same time.

#### 4. Different types of risks

ILB performs annual and demand-driven risk stock-taking. Demand-driven risk stock-taking can, for instance, be triggered by new product introductions or changes in the general environment. Risk stock-taking serves to identify ILB's overall risk profile. During risk stock-taking, the respective risk managers examine the different risk types in terms of their relevance for ILB and classify these risks accordingly as being relevant or not relevant.

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 default risk 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 and shareholder risks.

A conservative risk culture is pursued in loan business. 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.

Within the scope of adjusting ILB's risk-bearing capability concept, the method for determining default risk was completely revised. Since 1 January 2015, a rating-based method has been 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 and external ratings are used as a basis for the risk-sensitive evaluation of items which are then consistently integrated into ILB's risk-bearing capability concept. Risk concentrations in the portfolio are also taken into account.

With this method, it is possible to estimate ILB's portfolio loss that will not be exceeded in 99.0 % of cases (value-at-risk(VaR) with a confidence level of 99.0 %). This total portfolio loss represents the risk utilisation for default risks and can also be split up into sub-portfolios and/or items for steering purposes.

This method cannot be applied to sub-portfolios of minor importance (this applies to assets representing less than 1 % of total assets). 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.

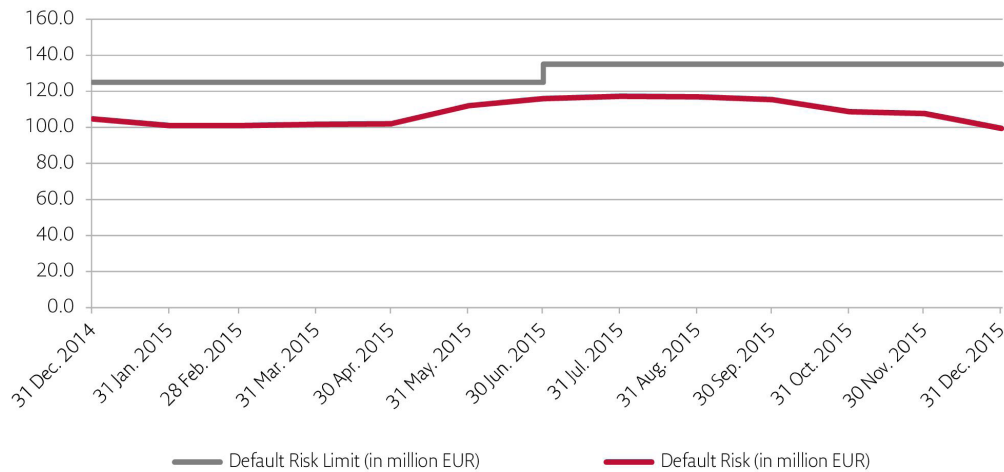
The default risk determined in this way applies to ILB's portfolio on the day of the analysis for a one-year risk horizon. The risk-bearing capability concept requires consistent periodisation of risks. In the analysis of the current year until its end, the period during which potential risks can materialise 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.

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 and/or direct write-downs 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 for default risks is represented by the following curve over the year:

### Default risk (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. 2016, is shown which refers to the one-year horizon throughout. Starting from a utilisation of EUR 105m at the beginning of the year, default risk rose to EUR 117m by the middle of the year. Reasons for this increase are the change in risk structure due to rating changes and, in particular, the increase in new business volume. In this context, the default limit was raised from EUR 125m to EUR 135m effective as per 1 July 2016. Taking the development of business into account, it was thereby possible to secure sufficient leeway for new loan business for 2015. Utilisation drops to EUR 99m by the end of the year. Besides a number of redemption payments and maturities in loan business, this decline is particularly due to the establishment of new risk classification methods in customer business where the estimated default probabilities are significantly lower than the levels previously forecast. This leads to a better internal risk structure.

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 limit risks with these transactions, limits have been set up at borrower level. The limit system is supplemented by regulatory requirements regarding large exposure limits, the capital ratios according to the CRR as well as compliance with the leverage ratio requirements which will come into effect in 2018.

A working group to steer default risks was established in 2015. The working group is the central body for steering the bank's default risks. It advises the Board of Management and prepares resolutions by the Board of Management. The quarterly meetings are attended by the members of the Board of Management 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 „Report on default risks for the bank as a whole“ compiles the most important implications of default risks according to the bank's risk-bearing capability.

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. On tranche loan level, this strategy contains both qualitative and quantitative requirements for lending.

Loan risks result from housing loan, commercial loan and/or syndicated as well as applicants' bank business. In transactions with applicant's 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 commercial syndicated loan business.

In order to limit risks from housing loan as well as commercial loan and syndicated loan business, precisely defined criteria are in place for these transactions, especially with regard to the borrower's creditworthiness, collateral and maximum loan sum (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 draws up suitable recommendations for action.

At the end of each quarter, the controlling and back office 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 portfolio of its own lendings in 2015 totalled EUR 11,713m as per the balance-sheet date. 56.2 % of the loan portfolio without special funds (EUR 11,562m) belonged to credit class 1 and therefore featured impeccable creditworthiness. A total of 64 % of the loan portfolio is collateralised (usually public guarantees or collateral in rem).

In order to steer default risk, ILB applies an internally developed risk classification method for all main groups of customers and products. It includes a simplified method for public-sector loans, banks and borrowers with an own involvement of less than EUR 250,000. In 2015, the introduction of the standardised rating methods of Sparkassen Rating und Risikosysteme GmbH began for ILB's most important customer groups. By the end of 2016, the new method will be used to rate customers.

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 a 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 of EUR 100m which was increased to EUR 150m in 2015.

Controlling checks publications on a daily basis for changes in the standing of securities 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 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 is developed, counterparty risk for derivatives will decline in the future.

#### 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 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 2015, ILB held shares in companies with a book value of EUR 65.7m. 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, the 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
- share price risk
- currency risk
- implicit options

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.

In the revised risk-bearing capability concept, the calculation of the interest rate risk was changed from the value-orientated approach using value at risk to periodic determination. As of 1 January 2015, the interest rate risk is therefore quantified as the net interest income risk in the risk-bearing capability analysis.

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. 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 necessitates 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. 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 shifted 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.).

The software used at ILB permits integrated interest ledger management. Besides period-based measurement of the interest rate risk, the cash value of interest rate risks can also be measured. The transfer of profit and loss for the period to cash-value based presentation on the basis of data automatically supplied from SAP is now possible with a single steering system.

In addition to monitoring the periodic interest rate risk in risk-bearing capability, 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 capability 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 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. The bank has determined a 99 % confidence level as the parameter.

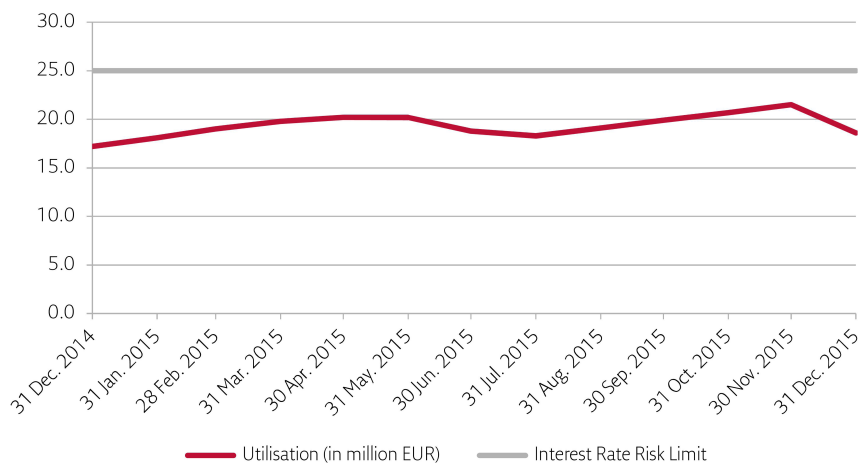
Besides this value-at-risk-based measurement of interest rate risks, regulatory requirements dictate yet another steering parameter. If the so-called Basel-II interest rate shock of 200 base points leads to a cash value loss in the interest ledger of more than 20 % of the relevant equity, an institute is then classified as an „institute with increased interest rate risks“. These institutes must then demonstrate to the regulator that the increased interest rate risks are tolerable within the scope of risk-bearing capability which is to be warranted via an „extended test criterion“. This criterion is also limited at ILB.

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.

The VaR development in 2015 is shown below on the basis of the one-month holding period:

#### Interest rate risk (in million EUR)



During the course of the year, the utilisation of the interest rate risk increased from EUR 17.2m to up to EUR 21.5m. ILB considers the general conditions for matching maturities to be positive and stable in 2015. Against this background and considering risk-bearing capability, matching maturities were expanded in order to utilise the opportunities offered by matching maturities as part of the bank's sub-strategy for market price risks. This is also reflected by the utilisation of the Basel-II interest rate shock which was higher than 20 % in 2015 for the first time, taking the restrictions of the „extended test criterion“ into consideration. This means that the limits determined by the Board in order to limit interest rate risks were adhered to at all times during the 2015 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 the Risk Controlling/Finance function. On every trading day, the value at risk, the extended test criterion 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 capability. 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 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.

#### 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.

In its current medium-term planning, ILB considers the reinvestment of profits in the special fund so that there is currently 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.

#### 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 which the customer has, i.e. the right, but not the obligation to effect extraordinary redemption payments. This right is a risk for ILB. Each time the 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 this 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]. Inclusion of implicit options in interest ledger management was therefore considered in the year under review and will be carried out in 2016.

#### 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.

#### 4.2.5 Opportunities

ILB's transformation function in conjunction with interest rate 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 for a longer period of time. 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). On the other hand, a liquidity spread risk exists if the bank can obtain necessary funds only at a higher cost (also a component of refinancing risk, liquidity risk in the broader sense).

ILB is generally risk-averse with regard to liquidity risks. However, liquidity transformation is permitted in order to differentiate contributions to profit subject to the restriction 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
- 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 refinancing potentials with open-market assets

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.

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 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. Due to the different nature of the risks, 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 rather than on covering a loss by risk capital.

The liquidity risk is supervised by the Risk Controlling/Finance function. Monthly evaluations inform the Board about compliance with the regulatory liquidity ratios. Furthermore, a dedicated management process limits the liquidity risk by comparing the bank's refinancing requirement with its refinancing potential and taking a reasonable liquidity reserve over a one-year forecast period into account. The liquidity reserve is also designed to cover the liquidity requirement even under stress conditions over this one-year forecast period. Moreover, the effects of potential liquidity bottlenecks are examined in various scenarios as a result of internal and external factors that influence ILB's ability to meet its payments obligations. If fixed limits are exceeded, appropriate measures are introduced in order to improve the liquidity situation depending on its severity. The results are presented to the Board each month. Reporting on the short-term liquidity situation is supplemented by a long-term forecast over a 10-year period.

In order to measure the liquidity risk, ILB uses a 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. The bank has also signed contracts with German and European development banks to secure long-term refinancing options. During the course of the year, ILB's unused liquidity potential was at all times sufficient. It was at no time necessary to resort to the liquidity reserve.

The currently valid regulatory liquidity requirements were fulfilled with a substantial buffer, with the liquidity coverage ratio in 2015 ranging between 2.4 and 5.7 (required minimum of 1). In 2015, the liquidity coverage ratio ranged between 1.7 and 5.5 (required minimum of 0.6 from October 2015).

#### 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 at all times 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 quantified as low. However, the risk-bearing capability 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. Risk utilisation is counted towards the limit for other individual risks. Monitoring is carried out on a monthly basis and is integrated into the risk report for the bank as a whole.

#### 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 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.

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 appointed an OpRisk manager who co-ordinates the entire management of operational risks. The OpRisk manager belongs to the bank operations 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 a risk stock-taking procedure every six months, 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 management 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, back office, compliance and internal auditing. Prior to the expert committee meeting, the heads of areas and divisions at ILB are contacted. The aim is to address operational risks/damage in their areas of responsibility over the past six months. Feedback is mandatory.

ILB regularly compiles information on operational risks and damage. Each employee must also 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 the OpRisk manager. ILB records damage, for example, in a damage 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 operational risk management. This helps the bank in its efforts to better handle and identify operational risks.

The board is informed of any cases of damage in ad-hoc reports. The OpRisk manager additionally informs the board of the risk situation in its annual reports.

In order to map operational risks within the scope of the bank's risk-bearing capability, 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 capability 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 on the basis of the extrapolated result on a monthly basis for the current and for the next year. The analysis of the current year 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.

#### 4.4.1 Operating risk

Minor risks are taken when justified from a commercial perspective. ILB counters these operating 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 is building a new administration building in Potsdam's inner city which is due to be completed at the end of 2016. This new building project is of considerable relevance for the bank. With this in mind, the project is managed throughout its term by a dedicated organisational unit (ILB new building unit) and the services of external experts. Internal processes and reporting ensure that the board is informed in due time. Although ILB recognises this project as a certain risk, this is considered to be manageable in its totality and with a view to its impact on the bank's risk-bearing capability.

#### 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.

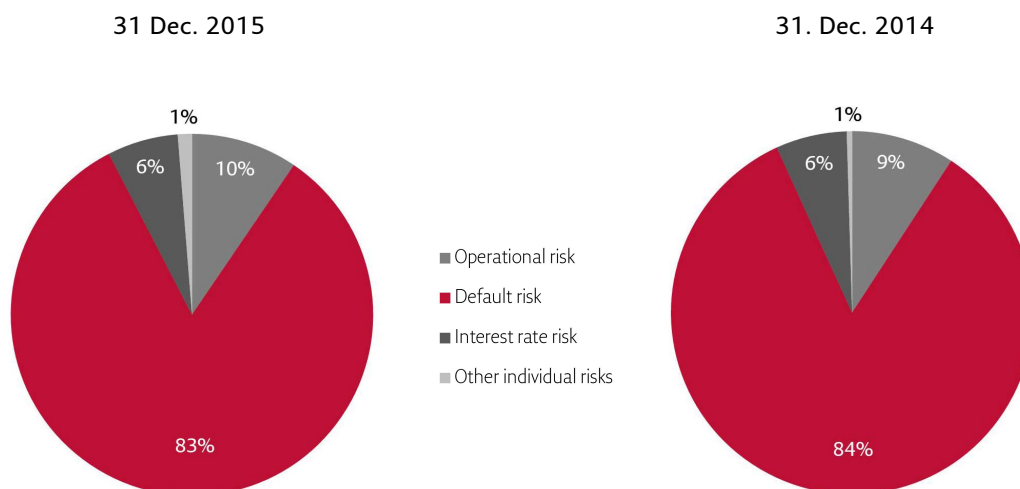
#### 4.4.3 Model risk

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.

During the risk stock-taking procedure for 2015, the model risk was identified as another relevant sub-risk type of operational risk. ILB counters this risk through a conservative approach for determining risk capital without consideration of diversification effects as well as through the timely performance of back-tests for the risk types.

### 5. The risk situation in summary

As per 31 December 2015, the bank's overall risk compared to the analysis time in 2014 was distributed to the different types of risk according to their respective shares in the bank's overall risk exposure:





The comparison of the percentages of the individual risk times with the figures for the previous year does not show any major change in the composition of the overall risk profile.

The market price risk reached a share of 6 % in ILB's overall risk. This reflects interest rate risks resulting from matching maturities. The increase by 1 percentage point against the previous year reflects the moderate expansion in matching maturities.

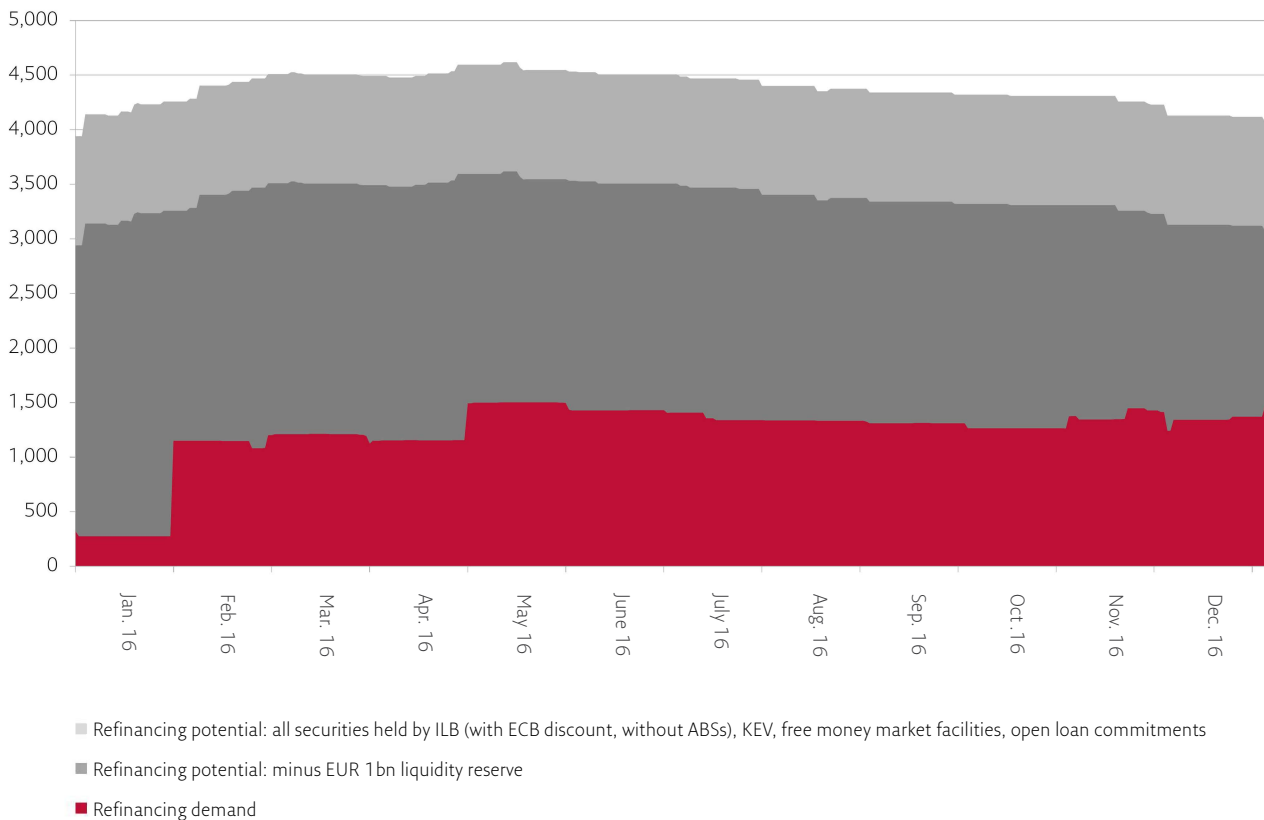
The default risk accounts for 83 % and hence remains the greatest share. Compared to 31 December 2014, this represents a decline of 1 percentage point.

The potential loss from operational risks calculated as a whole using the base indicator method according to CRR accounted for 10 % of ILB's overall risk for the year 2015 (previous year: 9 %).

The share of other risks totals 1 % and is unchanged against the previous year. In this item, ILB considers the risk of being forced to refinance itself at less favourable conditions only (liquidity spread risk). In light of ILB's excellent refinancing conditions, this item is of minor relevance only.

The following diagram illustrates the liquidity risk within the meaning of the bank's illiquidity risk as per 31 December 2015, which is limited by a dedicated management process by comparing the bank's refinancing requirement with its refinancing potential.

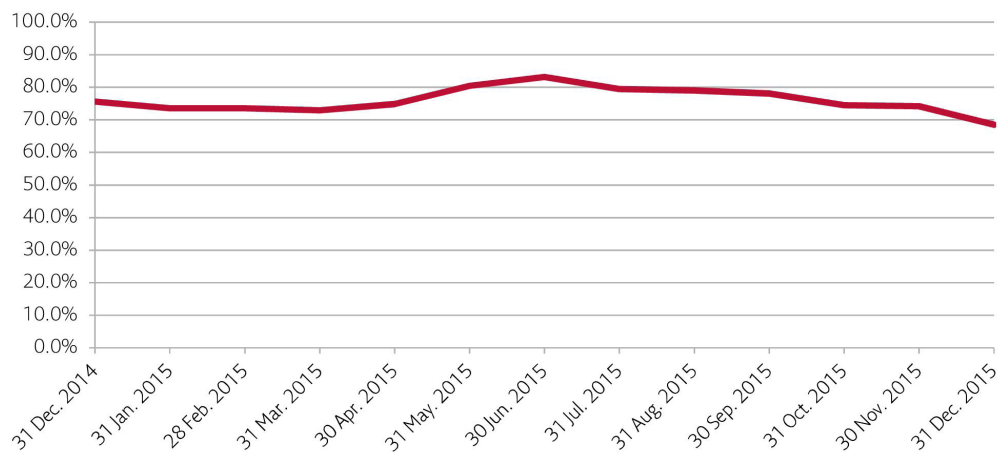
#### Normal scenario (volume in million EUR)



Refinancing demand never exceeds the refinancing potential. Refinancing demand accounts for a maximum of 36 % of the refinancing potential. ILB has a sufficiently large liquidity buffer which is made up of an unused refinancing potential of at least EUR 3.6bn. The liquidity reserve of EUR 1.0bn is not used. Liquidity is therefore ensured.

Utilisation of the loss cap limit for the bank as a whole increased from 76 % to 83 % during the first half of the year. With the increase in the limit for default risks as per 31 July 2015, utilisation fell by 4 percentage points against the previous month. Utilisation totals 69 % at the end of 2015. Besides a number of redemption payments and maturities in loan business, this decline is particularly due to the establishment of new risk classification methods in customer business where the estimated default probabilities are significantly lower than the levels previously forecast. This leads to a better internal risk structure.

#### Limit utilisation for the risk of the bank as a whole



The limit to ILB's risk items laid down in the loss cap was adhered to at all times during the 2015 financial year. The risks taken were hence consistent with ILB's risk strategy. Utilisation generally corresponds with the bank's willingness to take risks as laid down in its risk strategy.

## V Outlook

### 1. Economic factors

Germany's economic situation in 2015 was characterised by solid growth that was driven mainly by domestic consumption. According to calculations by the Federal Statistical Office, gross domestic product increased against the previous year by a price-adjusted 1.7 %.

Irrespective of a fragile international environment, the German government's annual economic report for the year 2016 expects to see this economic growth continue and forecasts another 1.7 % growth of gross domestic product for the current year too. The German government believes that continued layoffs in 2016 in conjunction with significantly rising incomes will form the basis for continued momentum for Germany's national economy.

ILB does not expect a significant increase in interest rates in 2016, not least due to the ECB's bond purchase programme which will continue at least until the end of March 2017.

Positive economic development can also be expected for the federal state of Brandenburg in 2016. The latest 2016 economic report issued at the beginning of the year by the working group of the Berlin and Brandenburg Chambers of Industry and Commerce drew a generally optimistic picture of the economic situation in the region. According to the report, the economy in the federal states of Berlin and Brandenburg remained unaffected by the latest turbulences on the stock exchanges and growth warnings in emerging economies. The economic climate index for the region currently totals 135 points – an all-time high since the beginning of the time series in 1995.

According to the working group, the very good mood among companies in the Berlin-Brandenburg region at the beginning of the year is due to the currently very good business climate. Although most companies expect business momentum to continue in the coming months, they do not expect economic pace to step up further. According to the chambers, the economy in the Berlin-Brandenburg region has been growing since the beginning of 2016 and promises a certain measure of stability. Key risks for economic development are sluggish growth of the global economy as well as public debt in European countries.

To sum up, the report shows the following results for the federal state of Brandenburg:

- At present, around 20 % of companies in the federal state of Brandenburg are expecting positive business growth whilst 63 % expect business to remain constant.
- A positive factor is that regional companies demonstrated greater willingness to invest at the beginning of the year. Around 32 % of companies investing are planning to increase their expenditure. Only around 13 % of the companies polled are expecting investment to decline.

## 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 1.0bn for the current year. ILB's promotion and development business in 2016 will be strongly influenced by the implementation of directives to implement the operational programmes of the new EU programming period.

Designation procedure:

- The designation procedure for the ERDF is expected to be completed by 30 June 2016. ILB expects that this will proceed as planned and that it will be confirmed as an intermediate body for the ERDF.
- No concrete timelines have been determined so far for the ESF and THE INTERREG. ILB expects that the designation procedure for the ESF and the INTERREG will be completed by the end of 2016.
- The fund-spanning review of IT systems will probably take place between 1 July 2016 and 30 September 2016. The result will depend to a large extent on input from the ERDF as the administrative body which will form the basis for the interface between ILB and the administrative authorities, i.e. ERDF, ESF and INTERREG. The last input for ILB is scheduled to be completed in September 2016.

Market environment:

- The current measures by the European Central Bank (ECB) to boost economic development in Europe lead to persistently low interest rates and hence at times to insufficient risk premiums on markets for fixed-interest securities.

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 („BASEL IV“) and consequently high investment costs for the necessary IT infrastructure.

Liquidity situation:

- The bank obtains short-term liquidity from the ECB (European Central Bank)/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.

Administration building:

- In 2016, ILB will implement further measures to build a new administration building at the Babelsberger Straße site. The investment costs will not affect the federal state budget nor will they impact the bank's funding and support activities.

### 3. Development of income situation and net worth

The group's future income situation and net worth will continue to depend heavily on ILB. Since 1 January 2014, LASA Brandenburg GmbH has been part of the ILB group. ILB together with LASA Brandenburg GmbH performs employment promotion measures on behalf of the Ministry of Labour, Social Affairs, Women and Families of the federal state of Brandenburg. On 1 July 2016, the LASA employees will be integrated and the related personnel expenditure will become ILB's expenses. In line with the agreed form of remuneration of activities on a cost basis, no major effects on net income will be seen at both ILB and group level.

ILB's liquidity is ensured thanks to its excellent refinancing possibilities. ILB has signed long-term contracts with German and European development banks to secure refinancing. The refinancing basis will be broadened by placing note loans and registered bonds with institutional investors. ILB can also obtain additional liquidity at short notice from the ECB and/or Bundesbank. It also raises money unsecured as time deposits and call money.

The increasingly restrictive regulatory conditions (Basel III) may in the longer term result in implications for ILB's equity. In order to achieve the planned business development, ILB will continue to accumulate profits in order to strengthen its equity. It is planned to accumulate profits of at least EUR 20m 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 their implementation.

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	2015 Thousand EUR	Plan 2016 Thousand EUR	Change in %
Net interest income	58,642	57,594	-1.8
Net commission income	40,907	46,787	14.4
Other operating income *	1,820	2,035	11.8
Personnel expenditure	36,858	38,795	5.3
Material costs	20,451	23,503	14.9
Depreciation, operations area	1,285	1,973	53.5
<b>Result before risk provisioning/reserves</b>	<b>42,775</b>	<b>42,145</b>	<b>-1.5</b>
Value adjustments of receivables	3,716	-5,000	-234.6
Valuation result of securities	2,469	-757	-130.7
Allocation to provident funds	-946	-1,000	5.7
<b>Result after risk provisioning</b>	<b>48,014</b>	<b>35,388</b>	<b>-26.3</b>
Formation of reserves	-29,000	-19,000	-34.5
Allocation to ILB promotional fund	-7,500	-5,000	-33.3
<b>Net profit for the year</b>	<b>11,514</b>	<b>11,388</b>	<b>-1.1</b>

\* including net extraordinary income, other taxes

ILB expects the income situation and net worth to remain satisfactory in 2016.

Profit before risk provisioning and the formation of reserves is planned to total around EUR 42.1m in 2016 and will therefore be only insignificantly lower than in the previous year.

Net interest income will continue to account for the greatest share in ILB's revenues. In 2016, this is likely to total EUR 57.6m and will therefore be slightly lower than in the previous year. In light of the step-up in ECB's expansionary monetary policy, the bank expects that the very low interest level will continue in 2016.

Just like the rest of the financial sector, ILB is facing huge challenges due to the low-interest environment with interest rates already significantly below zero. A direct impact can be seen especially on the parameters in treasury, so that treasury business is expected to contribute a lower share to net interest income.

Interest income from promotional and development business is expected to remain stable. The bank's existing business and its newly created products will contribute to this stability. Possible effects of extreme changes in the interest curve on the following year were simulated as part of scenario analyses. Net interest income planned for 2016 will move accordingly within a band from EUR 59.8m to EUR 49.6m. Net interest income will show a strongly negative response to a steep increase in the entire interest rate structure. Positive effects compared to the initial planning can be seen in continuously low money market rates and steeper interest rates or further base lending rate reductions. The changes in interest rates assumed are extreme scenarios which are unlikely to occur. The assumptions made for 2016 are confirmed for the majority of the interest scenarios.

Net fee and commission income is becoming increasingly important for net income and is likely to total EUR 46.8m in 2016, i.e. around EUR 5.9m higher than in 2015. Net fee and commission income largely results from fees for the management of promotion and support programmes. One quarter of this income is from administrative cost contributions in conjunction with the granting of loans from trust funds and almost three quarters from the handling of promotion programmes and a small amount from the management of guarantees and loan processing. The increase in net fee and commission income is particularly due to the expansion of business as a result of the expansion of employment promotion and EAFRD measures.

ILB, in its capacity as a central funding and support platform for the federal state of Brandenburg, will enter into further management agreements with the federal state. According to the fee structure based on the refunding of costs actually incurred,

which prevails in this business field, no major positive or negative deviations of net commission income from the figures planned are to be 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 used. As part of a scenario simulation, a decline in fees of EUR 0.5m was assumed.

Other operating net income in 2016 will probably total EUR 2.0m compared to EUR 1.8m in 2015.

Administrative expenses (personnel, material expenditure and depreciation on operating equipment) will probably increase in 2016 by EUR 5.7m to EUR 64.3m. Besides increased material expenditure due to IT adjustment projects, projects driven by regulatory requirements and the planned move to the new administration building, this increase is also due to higher personnel costs. The increase in personnel costs is particularly due to ILB taking over the LASA GmbH employees effective as of 1 July 2016 and new employees hired to fill vacancies. Another driver of this increase is the takeover of new tasks as part of employment promotion and EAFRD measures. However, these increases go hand in hand with revenues from cost refunds. Since 2015, ILB has been obliged to pay the European banking levy which means higher expenditure and cannot be compensated for by revenues. According to internal estimates, EUR 1.5m in conjunction with the payment of the bank levy as part of the European Settlement Mechanism was taken into account for 2016. Positive and negative deviations from the budget can result especially from deviations of the actual bank levy amount compared to the internal estimate.

The 2016 budget includes a flat EUR 5.0m as a cautious estimate of 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 2.0m is additionally considered in view of persistent uncertainty regarding the development of the government debt crisis. A negative valuation result of EUR 0.8m is expected in total for the year 2016.

In order to consider implicit options due to statutory termination rights within the scope of loan business, a sum of EUR 1.0bn is allocated to provident funds, corresponding to the same amount as in the previous year.

Net income for the year is 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 20m once again in 2016.

According to the 2016 budget, the balance sheet total will be in the order of around EUR 13.3bn.

The planned integration of permanent LASA GmbH employees as of 1 July 2016 will have a significant impact on ILB's headcount.

By the end of 2016, the number of employees will probably grow to 570 with the share of part-time employees remaining constant. At the same time, the share of female employees will increase by around 1 %. The number of fixed-term employees will increase slightly. The same applies to the average age of the workforce which is expected to increase by around 0.5 years.

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 co-operative study programmes will remain flat against the previous year.

The bank will continue its professional development offering at the same high level.

## VI 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 Corporate Steering. 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 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 management 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 eleven affiliated companies on a fully consolidated basis.

Receivables and liabilities as well as expenses and revenues are fully consolidated in line with the relevant provisions of the German Commercial Code. Consolidation in the consolidated financial statements is carried out by the Risk Controlling/Finance function on the basis of the annual financial statements of the consolidated companies. This function is also responsible for the entire bookkeeping, accounting of annual financial statements, adjustment of the companies to be consolidated to the accounting rules applicable to ILB and uniform valuation throughout 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 writing in manuals and procedures in its written rules which are updated on a regular 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 for the related risks 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 about the results of the audit soon after they become available.

Potsdam, 21 March 2016

The Board of Investitionsbank des Landes Brandenburg

Tillmann Stenger  
Chairman of the Board

Jacqueline Tag  
Member of the Board

Gabriela Pantring  
Member of the Board



## Consolidated Balance Sheet as per 31 December 2015

### Investitionsbank des Landes Brandenburg

Assets	Thousand EUR	Thousand EUR	31 Dec. 2014 Thousand EUR
<b>1. Cash</b>			
a) Cash in hand	8		8
b) Balances with central banks	<u>9,695</u>		<u>8,807</u>
of which:		9,703	8,815
at Deutsche Bundesbank EUR 9,695,000 (previous year: EUR 8,807,000)			
<b>2. Loans and advances to banks</b>			
a) Payable on demand	27,305		25,680
b) Other loans and advances	<u>2,287,824</u>		<u>2,263,060</u>
		2,315,129	2,288,740
<b>3. Loans and advances to customers</b>		5,225,992	4,839,646
of which:			
Secured by liens EUR 738,064,000 (previous year: EUR 534,913,000)			
Public-sector loans EUR 3,576,017 (previous year: EUR 3,506,159,000)			
<b>4. Bonds and other fixed-income securities</b>			
a) Bonds and notes			
aa) Issued by public institutions	1,622,943		1,816,817
of which:			
eligible as collateral at Deutsche Bundesbank EUR 1,618,861,000 (previous year: EUR 1,816,817,000)			
ab) from other issuers	<u>1,432,215</u>		<u>1,388,129</u>
of which:		3,055,158	3,204,946
eligible as collateral at Deutsche Bundesbank EUR 1,405,579 (previous year: EUR 1,371,679,000)			
<b>5. Stocks and other variable-income securities</b>		149,878	99,899
<b>6. Shareholdings</b>		19,840	23,021
<b>7. Shares in affiliated companies</b>		170	170
<b>8. Trust assets</b>		2,723,002	3,052,348
of which:			
Trust loans EUR 2,564,113 (previous year: EUR 2,884,570,000)			
Securities held in trust EUR 148,600,000 (previous year: EUR 156,584,000)			
<b>9. Intangible assets</b>			
a) Acquired concessions, industrial property rights and similar rights and values as well as licenses thereto		2,351	670
<b>10. Tangible assets</b>		48,691	37,869
<b>11. Other assets</b>		118,176	54,574
<b>12. Prepaid expenses</b>		10,206	30,944
<b>Total assets</b>		<u>13,678,296</u>	<u>13,641,642</u>

Liabilities	Thousand EUR	Thousand EUR	Thousand EUR	31 Dec. 2014 Thousand EUR
<b>1. Liabilities to banks</b>				
a) Payable on demand		3,932		119,909
b) With an agreed term or notice period		<u>9,274,804</u>		<u>9,092,289</u>
			9,278,736	9,212,198
<b>2. Liabilities to customers</b>				
a) Other liabilities				
aa) Payable on demand		239,854		148,741
ab) With an agreed term or notice period		<u>765,794</u>		<u>723,570</u>
			1,005,648	872,311
<b>3. Trust liabilities</b>			2,723,002	3,052,348
of which:				
Trust loans				
EUR 2,564,113 (previous year: EUR 2,884,570,000)				
Securities held in trust				
EUR 148,600,000 (previous year: EUR 156,584,000)				
<b>4. Other liabilities</b>			24,116	4,443
<b>5. Prepaid expenses</b>			88,830	8,577
<b>6. Provisions</b>				
a) Provisions for pensions and similar obligations		1,353		1,094
b) Provisions for taxation		0		0
c) Other provisions		<u>10,274</u>		<u>7,460</u>
			11,627	8,554
<b>7. Special item for investment allowances</b>			31,740	13,753
<b>8. Fund for general banking risks</b>			298,592	260,465
of which:				
Brandenburg fund				
EUR 16,335,000 (previous year: EUR 12,422,000)				
ILB promotional fund				
EUR 20,258,000 (previous year: EUR 15,043,000)				
<b>9. Equity</b>				
a) Subscribed capital		110,000		110,000
b) Retained earnings				
ba) Statutory reserve	10,185			9,610
bb) Other retained earnings	<u>80,000</u>			<u>75,000</u>
		90,185		84,610
c) Net retained profit		14,938		13,474
d) Shares held by external parties		<u>882</u>		<u>909</u>
			216,005	208,993
<b>Total liabilities and shareholders' equity</b>			<b><u>13,678,296</u></b>	<b><u>13,641,642</u></b>
<b>1. Contingent liabilities</b>				
a) Liabilities in relation to guarantees and warranties			37,166	26,558
<b>2. Other obligations</b>				
a) Irrevocable loan commitments			301,835	295,087
<b>3. Administration loans</b>			84,007	114,351
<b>4. Administration guarantees</b>			138,554	146,085

The annual financial statements of ILB for 31 December 2015 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).

## Consolidated Profit and Loss Account for the period 1 January to 31 December 2015

### Investitionsbank des Landes Brandenburg

	Thousand EUR	Thousand EUR	Thousand EUR	1 Jan. - 31 Dec. 2014 Thousand EUR
<b>1. Interest income from</b>				
a) lending and money market transactions	156,216			173,264
minus negative interest from money-market transactions	<u>18</u>			0
	156,198			
b) fixed-income securities and debt register claims	<u>59,899</u>			<u>61,729</u>
		216,097		234,993
<b>2. Interest expenditure</b>				
Interest expenditure from banking business		159,574		177,368
minus positive interest from banking business		<u>1,684</u>		<u>59</u>
		<u>157,890</u>		<u>177,309</u>
			58,207	57,684
<b>3. Current revenue from</b>				
a) shareholdings			3,408	1,037
<b>4. Fee and commission income</b>		41,349		35,716
<b>5. Fee and commission expenses</b>		<u>462</u>		<u>280</u>
			40,887	35,436
<b>6. Other operating income</b>			14,059	11,289
of which:				
Brandenburg fund EUR 3,913,000 (previous year: EUR 5,330,000)				
<b>7. General administrative expenses</b>				
a) Expenditure on personnel				
aa) Wages and salaries	31,061			27,961
ab) Social security contributions and expenditure on pensions and other benefits	<u>5,797</u>			<u>4,930</u>
of which for pensions: EUR 156,000 (previous year: EUR 74,000)				
		36,858		32,891
b) Other administrative expenses		<u>25,703</u>		<u>19,215</u>
			62,561	52,106
<b>8. Depreciation, amortisation and write-downs on intangible assets and tangible assets</b>			2,636	2,790
<b>9. Other operating expenses</b>			2,722	4,888
of which:				
ILB promotional fund EUR 2,285,000 (previous year: EUR 4,322,000)				

	Thousand EUR	Thousand EUR	Thousand EUR	1 Jan. - 31 Dec. 2014 Thousand EUR
10. Amortisation and write-downs on accounts receivable and certain securities as well as additions to reserves in loan business			819	2,711
11. Amortisation and write-downs on shareholdings, shares in affiliated companies and securities treated as fixed assets			2,377	0
12. Revenue from additions to investments, shares in affiliated companies and securities treated as fixed assets			0	4,716
13. Allocations to the fund for general banking risks			<u>38,128</u>	<u>38,008</u>
of which:				
Brandenburg fund EUR 3,913,000 (previous year: EUR 5,330,000)				
ILB promotional fund EUR 7,500,000 (previous year: EUR 7,500,000)				
14. Results from ordinary activities			7,318	9,659
15. Taxes on income and profits			-11	-4
16. Other taxes not reported under item 9			-56	-57
17. Income from loss transfer agreements			5,805	2,693
18. Profits transferred as a result of a profit pool, a profit and partial profit transfer agreement			0	350
19. Expenditure related to the increase in liabilities reduced during previous years			0	283
20. Extraordinary expenses			<u>43</u>	<u>44</u>
21. Net income for the year			13,013	11,614
22. Profit brought forward from the previous year			2,474	2,410
23. Appropriation to retained earnings				
a) to the statutory reserve			576	571
24. Shares of external shareholders in net income			<u>27</u>	<u>21</u>
25. Net retained profit			<u>14,938</u>	<u>13,474</u>

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