Group Status Report for 2009

InvestitionsBank des Landes Brandenburg

The General Economic Situation

The year 2009 was characterised by a significant downswing in the world economy. The consequences of the weaker worldwide trend and the crisis in the financial markets also became apparent in the German economy. For the first time in six years the economic trend was downwards, and Germany exceeded the threshold in the Maastricht Treaty again for the first time since 2005. According to calculations by the Federal Statistical office the public budget deficit was EUR 79.3 billion, a rise of EUR 76 billion over the previous year. That is a ratio of 3.3 percent of GDP. The deficit is due firstly to a fall in revenue of 2.4 percent, and secondly to an increase in expenditure of 5.0 percent.

According to calculations by the Federal Statistical office price adjusted gross domestic product (GDP) was 5.0 lower than a year before. That was the steepest fall in postwar history. The main reason was the slump in foreign trade, which was a major driving force of growth in the German economy in previous years. Foreign trade and payments were clearly lower, and this held back the economic development. The fall was due to the strong decline in exports of 14.2 percent, price adjusted. Public consumption rose by 3.0 percent last year in real terms, but private consumer spending rose by only 0.2 percent, partly due to the end of the vehicle scrappage scheme. Production capacities were under-utilised, and this held back investment in equipment, while the empty public purse hampered construction activity. However, building renovation profited from the concentration of public funds to stimulate the economy on the renovation of buildings to reduce energy consumption.

Altogether the reductions in the gross domestic product and foreign trade expected for Germany as a whole for 2009 have been realised to a greater extent than forecast. However, instead of rising, the unemployment rate has actually fallen slightly. Economic output came from 40.3 million persons employed on average in 2009, 14,000 persons fewer than a year before. The average unemployment rate for the year was 8.2 percent

The global crisis had only a moderate effect on the economic development in Brandenburg in 2009. The gross domestic product fell by 2.1 percent in real terms from 2008, putting Brandenburg above the average of -5.0 percent for Germany as a whole.

The manufacturing industry achieved a turnover of EUR 17.6 billion in 2009, a fall of 10.2 percent from 2008. With turnover of EUR 1.5 billion in December 2009 a total of 416 industrial firms in Brandenburg employing 50 persons or more failed to achieve the same result as in December 2008 by 2.0 percent. This was due to a fall in orders received by Brandenburg industry of 7.8 percent from the previous year, as a result of the fall of 14.3 percent in demand from abroad. Other vehicle construction and the chemical industry showed falls in turnover of 23.4 and 31.7 percent respectively, but the foodstuffs industry was able to maintain the previous year's level with an increase in turnover of 0.6 percent. Metal production and processing firms showed turnover falls of 25.4 percent as a whole, but the domestic business showed a relatively strong increase of 11.3 percent.

The number of persons employed in Brandenburg was slightly above the previous year's level with an increase of around 0.8 percent. Altogether 1,056,900 persons were in employment in Brandenburg in 2009, 8,600 more than in 2008. The average unemployment rate fell in 2009 to 12.3 percent, compared with 13.0 percent in 2008.

Brandenburg's exports totalled EUR 10.7 billion, a fall of 12.2 percent in 2009 from 2008. The fall for Germany as a whole was 18.4 percent. Brandenburg is in twelfth place in Germany's exports list, and so ahead of nearly all the new Federal states. The aerospace industry made the largest contribution, followed by pharmaceutical products. The major part of the exports went to France, followed by the United States and Poland.

The Group's Earnings, Financial and Assets Situation

With moderate growth in the balance sheet total the Group again achieved a good result for the year. As in previous years it was largely determined by the result for ILB.

The Earnings Situation

The net income for the year for the Group and for ILB was EUR 5.6 million.

Interest income was increased by EUR 8.3 million from 2008 to EUR 52.0 million (ILB: 52.9 million), mainly due to the result for ILB.

Net commissions earned is mainly fees received for handling promotional programmes. It consists of contributions to the administrative costs of lending from trust funds, handling grants programmes and administering guarantees.

Altogether net commissions amounted to EUR 33.6 million (ILB: EUR 33.6 million), above the 2008 level of EUR 31.8 million. The growth of EUR 1.8 million is due to the increase in the volume of business handled.

The **other income from operations** is EUR 5.3 million (ILB: EUR 1.3 million), slightly below the previous year's result of EUR 5.7 million.

Expenditure on **personnel** rose by EUR 0.9 million to EUR 28.3 million (ILB: EUR 27.0 million).

The **other administrative expenditure, including depreciation and value adjustments on intangible assets and fixed assets** rose by EUR 0.5 million to EUR 16.7 million (ILB: EUR 13.0 million). No major investments were made in operating and office equipment in 2009, so that at EUR 2.5 million (ILB: EUR 1.1 million) an amount on the previous year's level is shown for depreciation on fixed assets. Expenditure on fixed assets was EUR 14.2 million (ILB: EUR 12.0 million).

The Cost/Income Ratio (CIR) was 49.0 % in the 2009 business year, after 53.1 % in 2008 (administrative expenditure in relation to the sum of interest income, net commissions earned and other income from operations.

The Group's risk situation is largely determined by ILB's position. Account has been taken of all recognisable risks in ILB's lending business with appropriate valuations and risk measures. Individual value adjustments were made for risks on loans and advances identified and quantified during the financial year, taking into account existing securities. The trend is declining. The positive development chiefly reflects the success of the bank's loan risk management. In keeping with the development in the latent loan risk an appropriate allocation was made to the global value adjustments in accordance with the principles of commercial law.

The securities treated as fixed assets are valued according to the lower of cost or market (modified). Securities treated as fixed assets that might, on a cautious consideration, be subject to lasting reduction in value were written down according to the strict lower of cost or market principle. Owing to the high quality of ILB's securities portfolio and the worldwide actions to stabilise the financial markets further lasting reductions in value are not expected.

As in previous years, EUR 2.0 million was allocated to the Fund for General Bank Risks.

In addition, further provision for general bank risks was made in 2009 to a higher amount than in previous years.

ILB again added an amount of EUR 7.5 million to the **ILB Promotional Fund** in 2009. Hence since 2006 a total of EUR 27.5 million of the bank's own funds has been made available for interest rate reductions for the ILB product family, the Brandenburg loan.

The Group's earnings position is largely determined by the results for ILB. The earnings and expenditure positions are steered through the yearly planning process with fixed budget figures. The planning data is brought up to date during the year and checked against targets. The targets for 2009 were met, and in most cases exceeded. The overall result achieved is clearly higher than the planned result.

The Financial Position

The Group's financial position is also primarily determined by ILB's position.

Funds borrowed from banks rose over the previous year by EUR 470.9 million (ILB: EUR 472.1 million), giving this item a share of 96.7 percent (ILB: 96.7 percent) in total borrowed funds, excluding liabilities on a trust basis.

The remaining borrowed funds are exclusively liabilities to customers, chiefly in connection with the promotional business on behalf of the State of Brandenburg. More than 42 percent of the customers' funds are at call or with forward contracts of up to one year.

The Group's liquidity, which is largely determined by ILB's liquidity, was always assured. The supervisory figure in 2009 was between 2.96 as minimum and 6.60 as maximum.

The Fund for General Bank Risks in accordance with § 340 g of the Commercial Code was increased to EUR 33.0 million.

The published capital and reserves now amount to EUR 218.5 million. After the decisions on the use of the profits from the years 2005 to 2008 in the Annual General Meeting on 25 January 2010 EUR 7.0 million was allocated to the statutory reserves and EUR 17.6 million is shown in the balance sheet as Other Liabilities for Dividend Payments Due. The published capital and reserves were also increased by EUR 5.6 million from the net income for 2009 and EUR 2.0 million from the allocation to the Fund for General Bank Risks in accordance with § 340g.

The bank always fulfilled the requirements on equity capital in the Solvency Regulation.

The equity capital ratio, or the overall figure under the Solvency Regulation, was between 16.2 percent and 16.5 percent in 2009.

Assets

The Group's balance sheet total rose in the 2009 financial year by EUR 579.9 million to EUR 11,879.5 million; it is determined by ILB's balance sheet total (EUR 11,854.7 million).

The volume of business, which consists of balance sheet business and contingent liabilities, administrative loans and administrative guarantees, had risen at the end of the 2009 financial year to EUR 12.3 billion.

The growth of nearly 43 percent in loans and advances to banks to EUR 1,254.3 million (ILB: EUR 1,245.3 million) is due to the interbank business, and to business with customers' banks and channelling loans.

The Group's loans and advances to customers have risen by EUR 195.9 million to EUR 4,487.6 million (ILB: EUR 4,502.0 million).

Loans on a trust basis - which form part of the assets on a trust basis - fell by EUR 103.0 million to EUR 3,536.1 million. This is due to increased redemptions with at the same time less new business.

The portfolio of bonds and other fixed interest securities totals EUR 2,417.0 million (entirely held by ILB); there is a slight rise of EUR 96.8 million.

ILB is not a commercial bank, and it has always pursued the strategy of holding securities to maturity. When the liquidity regulation came into force, replacing Principle II, ILB was no longer required to hold securities as liquidity. In view of this the bank has since 2008 assigned all its securities to Assets.

The reduction of EUR 1.3 million in Other Assets is due mainly to the difference shown in the balance sheet on 31 December 2009 on foreign currency conversions for loans taken up in US dollars (USD), which were fully secured with active interest swaps in USD. At the same time Other Liabilities were increased by EUR 5.6 million due to the difference in foreign currency conversions.

Funds borrowed from banks total EUR 7,665.8 million (ILB: EUR 7,661.7 million), a rise of EUR 470.9 million (ILB: 472.1 million) in the 2009 financial year, chiefly due to taking up long-term funding loans.

Interest swaps, foreign currency interest swaps and forward interest swaps to steer the risk of changes in interest rates through macro and micro hedging were transacted exclusively by ILB. They totalled EUR 7,269.6 million on balance sheet date.

The earnings, financial and assets situation of the Group is essentially determined by the results for ILB. The bank's earnings, financial and assets situation is satisfactory and stable.

Memo Item

No events of particular significance for the Status Report occurred after the end of the financial year 2009.

Risk Report

The Risk Situation

The risks to the subsidiaries are regarded as insignificant, so that the risk situation on Group level corresponds to that of ILB. The information in this Risk Report thus refers to ILB and it can be taken as also referring to the Group.

ILB is a specialised bank. Its risk structure results from the commission to engage in the promotional and structural policy of the State of Brandenburg. Risks are only incurred in these operations to a very limited extent. Account has been taken of all recognisable risks with the appropriate valuations and provisions.

Risk Management

The risk supervisory system is directed to the current risks of default, market prices, liquidity and operations.

The separation of functions into risk supervision and risk acceptance is carried through all the organisational levels.

The identification, assessment, control and steering of the risks on overall bank level are performed by the Controlling Department or the Loan Secretariat, while the specialised departments steer risks on operational level.

The risk controlling covers the regular supervision of the limits set by the Board of Managing Directors, and reports on the risk content and the supervisory requirements.

The risk supervisory instruments to steer the subsidiaries are adjusted to the concerns of the Group and they enable up to date observance and assessment of the risk situation. The subsidiaries are integrated in ILB's planning process. Control of the development in the subsidiaries during the year is performed by ILB's Investments and Controlling Departments. The Board of Managing Directors is informed of the development in the subsidiaries in quarterly reports on the business conditions, with analyses of any deviations from targets in the results and the risk structure. If the assessment of the risk situation shows that action is required recommendations on the way to proceed are included in the reports.

The Board of Managing Directors bears overall responsibility for the bank's risks. In accordance with the Minimum Requirements for Risk Management (MaRisk) the Board of Managing Directors informs the Risk Committee, a committee of the Board of Supervisory Directors, every quarter in writing of the bank's risk situation. ILB's risk situation is also explained to the Board of Supervisory Directors, as the controlling organ of management, at the regular board meetings.

Risk Assessment Methods

The main guideline is the risk strategy, which is derived from the business strategy. On principle ILB pursues a conservative risk policy, aiming for diversification of the various types of risk, while knowingly accepting risks and avoiding them in areas where the bank does not have core competences. The principles on the attitude to risk laid down in the risk strategy are thus the general framework for the bank's business operations.

The risk management process and responsibilities are laid down, and the basic range of instruments to assess and steer risks is also documented. The aim is to secure the bank's business position and its future success with efficient risk management. Against that background the risks are limited, depending on ILB's inclination to risk and its ability to take risks.

To calculate the bank's ability to take risks the capital available to meet risks (risk cover capital) is set against the risk capital involved in the various kinds of risk. Beside the liable equity capital, the risk cover capital also consists of the expected net income for the year after risk provision in the current year. The envisaged allocations to the other reserves from earnings and the allocations to the published and hidden reserves in accordance with §§ 340 f and g of the Commercial Code are also included in the calculation of the risk cover capital. An upper limit is set for losses to limit the overall risk for ILB, and this was fixed in accordance with the risk policy. To limit the risk potential this upper limit for loss is divided among the main types of risk to ILB. A risk inventory was carried out and the following types of risk were identified: default, market prices, liquidity and operations. No limit to count towards the upper limit for loss was set for the liquidity risks. A limit system by products/areas is used to steer risks within the above types.

To control risks the current exposure to the individual types of risk is compared with the corresponding limits. As well as the supervision of the individual limits per type of risk, the overall risk situation is appraised in relation to the utilisation of the overall bank limit, and so the bank's ability to take risks. As a guide for steering during the year the periodical annual result is also calculated, and it must not fall below a minimum figure. Quarterly reports by the Controlling Department provide the Board of Managing Directors with information on the risk situation for the entire bank, enabling them to exercise control. The supervision of the bank's ability to bear risk is supplemented by studies of the effect of crises on the markets.

For this purpose scenarios are evolved to simulate the effects of unusual but plausible events on the risk situation of the bank as a whole (stress tests).

The aim is to identify both possible events or future changes that would have a negative effect on the bank's risk situation, and ensure the bank's ability to bear risks in extreme situations as well. The analysis of the stress tests helps to ensure the stability of the bank beyond the regular course of business.

The Different Types of Risk

The Risk of Default

The risk of default is the danger that borrowers on whom the bank has claims may become insolvent and consequently cannot fulfil their contractual obligations. The risk of default covers the risks on lending and the country, counterparty and shareholder risks.

The bank's ability to bear risk of default is assessed by calculating the equity capital tied, using the offsetting procedure laid down in supervisory law in the Solvency Regulation (loan risk standard approach), and comparing this with the limit set for default risk.

The steering of default risk is oriented to the MaRisk. A limit system has been set up for individual product groups (securities, derivatives, short term interbank claims, customers' banks), and to limit the risks on these types of business volume limits have been established on borrower level (partly on the basis of loan equivalence amounts).

There are also qualitative and quantitative requirements for products and specialised departments, based on ILB's default risk strategy. The limit system is supplemented by the supervisory requirements on the limits for large loans.

The upper limit for default risks was always observed during the year under review.

The Loan Risk

ILB's core business is the promotion of public and private investment projects, mainly using funds from the budget of the State of Brandenburg, or in the low-risk procedure through customers' banks. Hence the loan risk is of only minor significance in ILB's promotional business. The bank incurs no loan risks on the assets administered on a trust basis for the State, like the State Housing Construction Fund (LWV). This is a tied State special fund which ILB handles on behalf of the Ministry of Infrastructure and Regional Planning on the basis of approved business plans and principles.

The loan risks are mainly in lending for housing construction and the commercial lending/syndicate business.

While in the housing construction loan business the demographic development and the consequently high proportion of empty housing are still causing liquidity and profitability problems for some borrowers, the risks on the commercial lending business result from the general economic development in Brandenburg. To limit these risks precisely defined minimum criteria are set for the syndicate business, especially on the standing of the borrower and the maximum amount of the loan. Sufficient provision was made for the known risks with individual value adjustments in the annual financial statements.

The strategy for dealing with risk of default, which is brought up to date each year, forms the basis of our lending business. On part-loan portfolio level it contains both the qualitative and the quantitative requirements for the lending business.

A risk report is drawn up quarterly in accordance with the requirements in the MaRisk, and this provides the information for the Board of Managing Directors and the bank's Risk Committee. As well as the account of the loan portfolio this risk report also contains an assessment of the risk of default and, if necessary, recommendations on action to steer risks.

In keeping with ILB's conservative risk policy the risk structure of the loan portfolio can be regarded as low. The entire loan portfolio at ILB's own risk amounted to EUR 9,723 million on balance sheet date. Of this 75.0 percent has a standing rated 1, and 83.0 percent loan rating 1, which means that these commitments are of first-class standing or have full security (generally a government guarantee or material collateral).

To steer the risk of default ILB has developed an internal risk classification procedure for all the main groups of customers and products. It includes a simplified procedure for municipal loans, banks and borrowers of less than EUR 250,000. As well as the standing of the borrowers, their creditworthiness and ability to borrow the loans are also rated. For rented housing construction the loan rating process considers not only the standing of the customer but also an analysis of the location and the property and the value of the security.

Against the background of the crisis on the financial markets ILB has reappraised the business and investment strategy in its Treasury. The bank continues to pursue a conservative investment policy.

Investment decisions are made after an independent risk analysis. A condition for purchase is a minimum "A" rating by an external rating agency (Moody's, Standard & Poor's or Fitch) or an internal rating class 1. The loan risks were widely spread. Moreover, more than half the securities are mortgage bonds, state-guaranteed bonds or government bonds (around EUR 1.4 billion).

ILB's Risk Controlling Department checks the standing of the paper or the issuer for changes daily in publications. In addition to these measures the development of the yields on certain securities that are entered in a watch list is observed and compared with risk-free investments, to utilise the market valuation as an early indicator of any change in risk.

As well as limiting the purchase of securities, short-term interbank business and derivatives from individual institutes, upper limits are set per bank for loans channelled through customers' banks and global loans. The limits are set for each bank individually, based on an evaluation of its financial position, its external rating and other qualitative data. If its standing and/or external rating change an appropriate change in the limit is considered. The internal limits are reappraised each year on principle.

The regular supervision of observance of the limits is performed by our Risk Controlling Department and the specialised department.

The Counterparty Risk

The counterparty risk is the danger of incurring loss if a party to a contract defaults when claims are due to be settled (fulfilment risk) or fails to meet a payment deadline (performance risk).

ILB counters this risk by on principle only transacting commercial business with selected market partners who have a minimum “A” external rating and for whom counterparty limits have been set.

The Country Risk

The country risk is the transfer risk on cross-frontier payments caused by a country’s refusal to pay (the political risk), and its inability to pay (commercial risk).

In accordance with its promotional task ILB’s business is almost entirely in Germany and here it is concentrated in the State of Brandenburg. The bank’s foreign engagements are chiefly investments in securities, and most of these are with countries in the Eurozone. On principle only selected issuers are accepted, in keeping with ILB’s default risk strategy. Issuers outside Germany should not account for more than 50 %. Hence the country risk is only of minor significance for the bank.

The Shareholder Risk

The shareholder risk is the danger that losses may be incurred on the provision of equity capital for third parties.

In the performance of its statutory obligations ILB only holds strategic shareholdings. It acquires shareholdings principally to realise important interests of the bank or to perform structural policy tasks resulting from state policy. Essential conditions are that no other business solution is possible, the contribution is limited, appropriate influence on the company’s management can be assured and the State has given its approval.

ILB has shareholdings in three areas:

- Equity investment companies - providing equity capital for companies in the State of Brandenburg
- Property companies - developing real estate projects in the State of Brandenburg
- Others - supporting other ILB activities.

On 31 December 2009 ILB held shares in twelve companies to a book value of EUR 35.0 million. Large parts of its equity investments are secured against risk with guarantees or grants from the State of Brandenburg, so that ILB is not exposed to any potential risk on these commitments. Sufficient risk provision has been made for the risks attached to the remaining shareholdings.

The Market Risk

The market risks are the danger of negative developments for the bank on a market. As well as the risk of changes in interest rates, they include the market price risk, currency risk and other price risks.

The market risks are steered as part of our risk management, in accordance with the principles laid down in the MaRisk. ILB is classified as a non-commercial bank.

The Risk of Changes in Interest Rates

There are risks of changes in interest rates where rates are fixed for different periods in the lending and borrowing business.

ILB steers the risk of interest rate changes through the payments flows on all transactions where interest rate changes are relevant. The maximum risk of interest rate changes that may be accepted is fixed using the value at risk (VaR) system based on the modern historical simulation. The historical simulation is based on about 5,400 past interest curves from 1 January 1988. As parameter the bank has set a confidence level of 99 % for rates held for three months. To enable the effects of extraordinary market changes on the risk of interest rate changes to be estimated additional extreme or worst case scenarios are also simulated.

To measure the quality of the forecast provided by the risk assessment model used ILB carries out back testing, in which the forecast value at risk (VaR) is compared with the losses actually incurred. On all the sample days tested the changes in cash value established were below the VaR. The results of the back testing show that ILB's risk model does take sufficient account of the market risks.

As well as limiting the risk of changes in interest rates the efficiency of the open positions entered into through matching maturities is measured and steered by comparison with a benchmark. The aim is to optimise ILB's opportunities/risk ratio in accordance with that benchmark.

The risk of changes in interest rates is supervised by our Risk Controlling Department. The Board of Managing Directors receives a monthly risk report on the risks of interest rate changes to which the bank is exposed. Decisions on how to position the bank in regard to risks of interest rate changes are then taken in the Management Board meetings on the basis of these reports. Possible measures are discussed and their effect on the risk of interest rate changes and the efficiency of the cash flow examined.

The limits laid down by the Board of Managing Directors to restrict the risk of changes in interest rates were always observed in the 2009 financial year.

In 2009 software to enable integrated steering of the bank's interest rate exposure was introduced in ILB. After a successful one-year test phase in parallel operation the productive operation began on 1 January 2010. As well as measuring the cash value of the risk of interest rate changes the new software makes period-oriented steering of the interest rates exposure possible on profit and loss basis. In future it will be possible to use a steering system to transfer the cash earned into a profit-and-loss oriented statement of results, for interest income planning and for balance sheet prognoses on the basis of a fully automated supply of data from the SAP system.

The Market Price Risk

On principle ILB buys securities with the intention of holding them to maturity (long-term portfolio). So if it is certain that the full value will be redeemed fluctuations in market prices do not cause lasting loss. Hence the market price risk is not a significant risk for ILB.

The Currency Risk

Transactions in foreign currencies are fully secured immediately after completion using foreign currency interest swaps, so that ILB incurs no currency risks on these transactions.

Other Price Risks

During the period under review ILB held no shares. Hence the bank is not exposed to risks of changes in share prices or other price risks.

The Liquidity Risk

In general the liquidity risk means the risk that the bank may not be able to meet payment obligations in full when they become due.

ILB's Treasury Department steers the bank's liquidity through its daily transactions. Funds are raised and invested on the basis of the expected inflows and outflows of payments to meet the bank's contractual obligations and in accordance with the reports by the specialised departments. By the nature of its operations ILB has a high share of payments flows that are fixed and can therefore be planned.

The liquidity risk is supervised by the Finance and Accounting Department. The Board of Managing Directors receives monthly statements showing that the liquidity principle has been observed. The liquidity risk is also assessed by comparing the bank's need for funds with its potential to raise funds (the liquidity reserve), with a one-year horizon for the forecast. Moreover, the effects of potential liquidity shortfalls are examined in various scenarios, taking into account internal and external factors that affect ILB's ability to meet its payments obligations. If fixed limits are exceeded appropriate measures, depending on the amount needed, are taken to improve the liquidity situation. The results are presented to the Board of Managing Directors monthly.

The Liquidity Risk in the Narrower Sense

To ensure that it can meet its payment obligations at all times ILB 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 the European Central Bank. With the implementation of the MaRisk amendment ILB also has a lasting reserve of liquidity, that is judged to be sufficient, in the form of securities eligible as collateral at the central bank. This enables the bank to meet additional need for liquidity (for a one-year period) that can arise under stress conditions. Hence, ILB has an extensive refinancing potential that will enable it to generate sufficient liquidity, even in extreme situations and largely independent of the general market situation. The shortage of funds on the money market caused by the financial markets crisis did not have negative effects on ILB's provision with liquidity.

In the past financial year the bank was always able to provide itself with sufficient liquidity, both on the interbank market and through open market transactions. In addition, ILB has signed contracts with German and European promotional banks to secure long-term funding.

The Refinancing Risk

ILB's liabilities are secured by the government guarantees (the "Anstaltslast" and "Gewährträgerhaftung") that are laid down in law, and by the guarantee from the State of Brandenburg. Hence the bank is able to obtain liquid funds at any time at competitive conditions, as for counterparties its standing is comparable with that of the State of Brandenburg.

In view of this the bank expects to be able to obtain funding at first-class conditions in future too.

The Operational Risk

The operational risk (OpRisk) is the danger of losses due to the unsuitability or failure of internal procedures, systems and people, or to external factors; strategic risks and risks to the bank's reputation are excluded.

ILB cannot exclude operational risks from its business activities. On principle, major risks that would jeopardise the continued existence of the bank are avoided, or appropriate provision is made by passing on the risks (for example through insurance), or to reduce the risks (by damage prevention measures).

The procedure to manage operational risks is supported by transparent communication and documentation throughout the bank. Avoiding risks is always the main concern at ILB.

ILB regularly compiles information on operational risks and damage. For example, it holds a data bank on cases of damage, and the operational risk is analysed using risk inventories, maps and indicators, to enable potential risks to be recognised at an early stage. The use of these instruments in itself requires stress tests, as it includes scenarios showing the possible occurrence of operational damage. The bank's management staff consider the risk potentials in their field of operation quarterly, as part of the OpRisk management process, and report. This helps to sensitise the bank in recognising and dealing with operational risks.

In 2009 the functions, business processes and relevant risks of fraud throughout the bank were classified. The results are shown annually in the Fraud Risk Assessment.

The Commercial Risk

Minor risks are accepted in consideration for profitability. ILB counters these commercial risks with an appropriate internal control system. Sufficient insurance has also been obtained to cover any damage that might be incurred.

In 2009 an Emergency Handbook covering every area of ILB's operations was drawn up on the basis of a Business Impact Analysis. It documents measures to be taken to maintain the crucial banking processes in emergency situations.

The Legal Risk

There are legal risks in the material validity of contracts, approvals, authorisations/powers of attorney and the observance of formal requirements, especially new laws and jurisdiction.

ILB counters these legal risks by using standardised documents that are approved by the bank's Legal Department and continuously brought up to date. The bank's Legal Department is also involved at an early stage in decisions that can entail legal obligations or be advantageous for the bank.

Until 09.12. 2009 ILB's shareholders were the State of Brandenburg, NRW.BANK and Landesbank Berlin AG (LBB). In proceedings against the State of Brandenburg and ILB as co-debtors LBB had applied to the Administrative Court for payment of a disputed amount on the basis of the balance sheet price. The State of Brandenburg and ILB regarded the claim as inadmissible and totally unjustified. The case went on for several years, but it was brought to conclusion when LBB withdrew its suit and signed a share transfer agreement with the State of Brandenburg. Since 10.12.2009 ILB's shareholders are the State of Brandenburg and NRW.BANK, each with 50 %. ILB's share capital is unchanged at EUR 110.0 million. Never at any time did the legal proceedings have negative effects on ILB's business activities.

Summary of the Risk Situation

On 31 December 2009 the different types of risk accounted for the following percentages of the overall risk to the bank:

The risk of default constituted the major part at 80 percent.

The market price risk accounted for 13 percent of ILB's overall risk. This reflects the risks of changes in interest rates on matching maturities. The efficiency of the opportunity/risk ratio that results from matching maturities is optimised through benchmark steering.

The potential loss from operational risks calculated using the base indicator approach in Basel II accounts for 7 percent of the overall risk to ILB for the year 2009.

A comparison of the risks incurred with the total risk cover capital shows a risk coefficient of 41.0 percent at the end of 2009. This corresponds to the bank's readiness to take risk as laid down in its risk strategy, and it also reflects responsible handling of the risk cover capital. The conservative risk assessment methods deliberately chosen by ILB overstate the risk on overall bank level, and they do not take into account correlation effects between the various types of risk that can reduce risk. These factors, and the risk cover capital, which was not all made available for risks as the overall bank risk was limited, form an adequate buffer that can deal with extraordinary situations as well.

The limit to ILB's risk position laid down in the maximum set for loss was always observed in the 2009 financial year. The risks entered into were thus always in accordance with ILB's approach to risk. The results of the stress tests show that ILB's ability to bear risk is not in jeopardy, even should extraordinary events occur. The bank's ability to bear risks is assured.

Outlook

The Economic Situation

The European Commission has based its prognosis on the assumption that the crisis will continue. For Germany the Federal Government is expecting the difficult economic situation to persist. At EUR 80.2 billion for 2010 the Federal Government has decided on the highest level of new borrowing in the history of the Federal Republic, with the overall public deficit expected to be 5.5 percent of GDP. It is to be gradually reduced in the following years. From the year 2013 the Maastricht threshold is to be observed again.

The Deutsches Institut für Wirtschaftsforschung (DIW) is expecting quarter-on-quarter growth of only 0.2 percent in GDP for the first quarter of 2010. After the stagnation at the end of 2009 it is evident that a further upswing is by no means certain and the increase in economic activity will probably only be slight.

The hope is that some growth can be made up in the second quarter. Lasting stimulus is expected from exports, and a rise in German exports of up to 10 percent is expected for 2010 as a whole. Our export-dependent industry can profit from the improvement in the world economy. Industrial production and the retail trade are showing an increasing trend in economic activity. After exports investment in equipment is also increasing, while the propensity to invest in construction is clearly more restrained. The stimulus from the Federal Government's cyclical programmes is not enough to compensate for the downswing in commercial building following the crisis. For 2010 a fall in turnover of 1.5 percent is expected. In private consumer spending, on the other hand, stagnation is becoming evident, and the housing market is also showing little movement.

The labour market is proving more robust than expected. The Federal Employment Agency (BA) currently assumes a maximum of 3.8 million job-seekers in 2010. This is due to the improvement in the order situation. Many companies are reported to be stepping up production again, and there are no signs of mass redundancies. The situation on the labour market remains difficult in the new Federal states, where the unemployment rate is still almost double that in the old Federal states.

It may be assumed that the economic situation will stabilise in the State of Brandenburg in 2010, analogous to the development on Federal level.

Major Influences

Against the background of the financial markets crisis and the recession public financing instruments are playing an increasingly important role. The financial markets crisis has not had negative effects on ILB's promotional business. The bank is still meeting with growing demand for promotional loans from the savings banks and commercial banks for their customers in Brandenburg.

The bank's volume of promotion increased by around 50 percent in 2009, owing to some large-scale individual projects. ILB is expecting the volume of promotion in its future operations to return to the level of previous years.

Apart from this it may be assumed that the financial markets crisis will also increasingly affect the real economy in Brandenburg. A possible increase in defaults by borrowers from ILB has already been taken into account in planning the bank's risk provision.

On ILB's liquidity situation it can be stated that the need for funding can in future be met, also taking into account current developments. No liquidity problems are evident in ILB owing to the bank's excellent funding possibilities. ILB has signed long-term funding contracts with German and European promotional banks; it also has the possibility of obtaining short-term liquidity at any time through the ECB/Deutsche Bundesbank.

The Development of the Earnings and Financial Position

In future, too, the Group's earnings and financial situation will largely depend on ILB's position. The planning for the 2010 and 2011 financial years is optimistic. ILB is expecting the earnings and financial situation to remain stable as a whole for the next two years.

Interest income on the promotional business is regarded as stable.

The bank's stock of business and its new products will both contribute to this. For the rest, interest income depends on the development on the money and capital markets.

Net commissions earned will remain on a high level. As a major services enterprise ILB will continue to conclude contracts to handle business for the State of Brandenburg.

Owing to the high quality of ILB's securities portfolio further re-evaluation is not at present indicated.

The net income for the year is planned to be on the level of the previous year.

The result for the Group will be stable and satisfactory in future, too, and provide the basis for further successful business operations to the benefit of the State of Brandenburg. Against this background ILB intends to make further allocations to the ILB Promotional fund in order to offer loans at favourable terms with the use of its own earnings. For the next few years an annual allocation to the ILB Promotional Fund of at least the same amount as last year, EUR 7.5 million, is planned.

Potsdam, 26.03.2010

Klaus-Dieter Licht Jacqueline Tag