Investitionsbank
des Landes
Brandenburg

ILB

Management Report 2018

Investitionsbank des Landes Brandenburg

Consolidated Management Report 2018

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I Fundamentals of the group

1. Business model of the group

1.1 Basis of business activities

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

Pursuant to the ILB law, the bank bears public-sector responsibility and guarantor's liability and is protected by a federal-state guarantee. Pursuant to its articles of association, ILB conducts its business according to commercial principles whilst at the same time respecting the common interest and strict competition neutrality. ILB and its seven subsidiaries form the ILB group. On 1 January 2018, the three previous subsidiaries BC Brandenburg Capital GmbH (BC), Seed Capital Brandenburg GmbH (SCB) and BC Venture GmbH (BCV) were merged to form KBB Kapitalbeteiligungsgesellschaft mbH (KBB). This does not have any impact on business operations. With a share of 99.9% of the group's balance sheet sum, ILB accounts for almost the entire business development of the group.

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

1.2 Mission

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

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

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

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

ILB's central goal is to ensure long-term fulfilment of ILB's business development mission pursuant to its articles of association and the ILB law. To this end, ILB will continue to optimise its range of managed business services in the coming years and to further strengthen business with ILB's own products.

- ILB is continuously expanding its function as a central business promotion institution in the management of promotion and support programmes. The aim is for ILB to bundle all tasks related to monetary support measures by the federal state, in particular, EU support measures.

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

ILB's future development will focus on increasing customer satisfaction, intensifying co-operation with the federal state and focusing more on product and process innovations.

1.4 Products and services

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

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

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

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

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

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

1.5 Declaration of Compliance

In accordance with ILB's Corporate Governance Code, the Management Board and the Administrative Board are required to report annually on corporate governance (Corporate Governance Report). The Declaration of Compliance forms an integral part of the Corporate Governance Report. The Corporate Governance Report and the Declaration of Compliance were drawn up in March 2018 and were approved by ILB's Administrative Board on 12 June 2018. ILB's Corporate Governance Code, the report on the Corporate Governance Code and the Declaration of Compliance have been published on ILB's website.

II Economic Review

1. Economic conditions in Germany

In 2018, the German economy grew for the ninth year in succession. This growth, however, was somewhat weaker than in the previous years. According to recent calculations by the Federal Statistical Office, price-adjusted gross domestic product (GDP) rose 1.5% against the previous year (2017: 2.2%, 2016: 1.9%).

Economic development was strongly driven by high domestic demand. According to the Federal Statistical Office, private consumer spending and gross fixed asset investments increased against the previous year by 1.0% and 4.8%, respectively. Government spending increased by a price-adjusted 1.1% compared to the previous year. Growth in foreign trade was weaker than in the previous year. The price-adjusted export of services rose by 2.4% (2017: 4.7%), while imports increased by 3.4% (2017: 5.2%) in the same period. The resulting negative net exports contributed 0.2 percentage points to the price-adjusted growth of gross domestic product.

Economic development in 2018 was driven by positive labour market developments. According to initial calculations by the Federal Statistical Office, the number of people in jobs in Germany increased by approx. 562,000 or 1.3% compared to the previous year. This increase results primarily from the higher number of people in jobs subject to statutory social security contributions. Taking offsetting, age-related demographic effects into account, the total number people in jobs rose from 44.3 million to 44.8 million.

In 2018, the government once again continued to pursue its course of consolidation, recording a record surplus of EUR 59.2bn. According to the Federal Statistical Office, the surplus rate totalled 1.7% in terms of price-based GDP.

The mood on capital markets changed in 2018. At the beginning of the year, economic optimism prevailed, which was also reflected in a peak in the Ifo Business Climate Index of over 105 in January. This led to widespread expectations of further rising stock markets and rising capital market interest rates in 2018. The ECB's bond purchase programme, which was partly responsible for the sharp fall in interest rates in Europe, was halved in volume at the beginning of 2018. Further reductions in bond purchases followed over the course of the year, so that from the end of 2018 only maturities will be replaced by bond purchases. This was the first step towards normalising the ECB's monetary policy, which also fuelled expectations of rising interest rates and bond yields.

A number of political events, such as the new or higher trade restrictions and protective tariffs imposed by the US, uncertainties surrounding Britain's withdrawal from the EU, the budget dispute over Italy and the paralysing migration debate, significantly dampened economic sentiment in Europe over the course of the year and led to a slowdown in growth, particularly in export-driven Germany. This led to price declines on the stock markets and the expected rise in capital market interest rates failed to materialise. At around 0.80%, 10-year swap interest rates at the end of the year were slightly below the previous year's level. Government bonds, as a particularly safe asset class, benefited more from the political uncertainties. Yields on 10-year German government bonds therefore fell by 0.30 percentage points over the course of the year to around 0.20 percentage points.

For public budgets, companies as well as private and commercial residential construction, this means a very favourable capital market environment for 2019 thanks to falling interest expenditure and low financing and investment costs.

2. Economic conditions in the federal state of Brandenburg

Since 2003, the unemployment rate in the federal state has fallen continuously. This positive development on the regional labour market was also visible again in 2018. At the end of the year under review, the average rate fell to 5.9%, the lowest level since German reunification.

At 0.7%, the increase in the total number of people in jobs was not as high as in the previous year (2017: 1.2%). While the number of people working in the services sector and manufacturing industry rose by 0.6% and 1.5%, respectively, compared to the previous year, agriculture and forestry recorded a decline of 3.7%.

According to the federal state's statistical office, Brandenburg's industrial enterprises recorded total turnover of EUR 23.9bn in 2018, an increase of 2.9% against the previous year. Domestic turnover increased by 1.3% to EUR 16.5bn while export turnover was up 6.5% to EUR 7.4bn.

According to official statistics, there was once again a positive trend in orders for 2018. Orders on hand rose by a total of 0.7% against the previous year with domestic orders down by 4.8% and foreign orders up by 9.1%.

Turnover for the construction industry increased by 1.7% in 2018, whilst order intake was up 13.7%.

According the data currently available, Brandenburg's GDP developed positively in 2018. According to the federal state's statistical office, Brandenburg's GDP was up 2.3% in the first half of 2018 compared to the first half of 2017.

3. Business development

3.1 Promotional and development business

ILB's funding and support portfolio once again met with a positive response from Brandenburg's business community, private households, municipal administrations and the housing sector. By contrast, demand for business development loans through savings banks acting as the applicants' banks in the federal state of Brandenburg has down by half compared to the previous year. In 2018, ILB pledged a total volume of EUR 1,343m.

Promotional and development business in 2018 included, for instance, the following:

- The planned volume of EUR 1,405m to be pledged for 2018 fell short by EUR 62m (4%) and thus totalled EUR 1,343m.
- Compared to the previous year, the volume pledged fell by around EUR 249m to EUR 1,592m (16%). This development is primarily due to the decline in ILB products.
- The volume of ILB products pledged totalled EUR 644m (2017: EUR 836m). The main reason for this decline is a declining volume of pledges in business with commercial banks.
- ILB's products accounted for a share of 48% in the total sum pledged in 2018.
- All the promotion areas in the field of managed activities recorded positive demand. Pledges here totalled EUR 699m.
- The volume pledged in managed activities was up EUR 93m against the budgeted figure of EUR 606m (15%).
- Compared to the previous year, the sum pledged in managed activities declined by EUR 56m (7%) (2017: EUR 755m). While pledges to promote employment rose, pledges to promote infrastructure remained stable. Pledges to promote business and housing declined in the year under review.

3.2 Earnings development

ILB and the group, which is predominantly determined by ILB, can once again look back on a successful 2018 fiscal year.

Net income from operative business was above budget. Net income before provisions for risks totalled EUR 43.0m and was hence EUR 2.7m above budget.

Net income after provisions for risks surpassed expectations and, at EUR 46.4m, was EUR 13.5m higher than budgeted for 2018. This was driven in particular by the positive development of the need for write-downs, which deviated from the budget by generating income of EUR 4.7m, while risk provisioning expenditure of EUR 6.0m was expected in the budget.

As per 31 December 2018, return on equity, a key indicator, totalled 1.15% for ILB (group: 1.15%).

4. Income, net worth and financial position

In 2018, just like in previous years, ILB accounted for 99.9% of the group's balance sheet sum. The consolidated balance sheet total of EUR 13,421.1m remains stable compared to the previous year.

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

4.1 Income situation

In 2018, ILB's annual net income totalled EUR 11.3m (previous year: EUR 11.4m), that of the group EUR 11.4m (previous year: EUR 8.6m). Consolidated net income for the year developed positively.

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

As part of the annual planning process, income and expenditure items are managed with defined budget variables. The planning variables are updated during the year and reviewed with a view to the goals set. The targets for 2018 were all surpassed. Net interest and commission exceeded expectations. Administrative expenses were slightly higher overall. Earnings before risk provisioning were thus on the whole slightly above budget.

The measure for ILB's financial success is its earnings before risk provisions and the formation of reserves. In 2018, ILB recorded a good EUR 43.0m before risk provisioning and the formation of reserves which is slightly below the previous year's level (EUR 44.4m).

In detail, development was as follows:

Net interest income totalled EUR 61.2m (previous year: EUR 61.6m) and was only slightly below the previous year's figure. This meant that net interest income remained stable despite persistently low interest rates. ILB continues to benefit from the favourable refinancing conditions on the money and capital markets. Income from interest-bearing promotional and development activities and the treasury result remained stable overall.

Net fee and commission income of EUR 49.9m (previous year: EUR 44.9m) largely results from fees for the management of promotion and support programmes. This is made up of administrative cost contributions in conjunction with the granting of loans from trust funds, the handling of promotion programmes and the management of guarantees. The increase is mainly attributable to higher income from the processing of grants.

ILB's personnel expenses totalled EUR 43.9m in 2018 (previous year: EUR 41.3m). The increase of EUR 2.6m is mainly due to collective agreement changes as of 1 January 2018 and 1 November 2018, the allocation to the provision to cover company pension obligations and a slight increase in the number of employees.

At the end of 2018, ILB employed a staff of 660 (previous year: 632) in active and passive employment.

Other administrative expenses, including depreciation, amortisation and write-downs on intangible assets and tangible assets totalled EUR 26.9m (previous year: EUR 23.2m).

Operating costs totalled EUR 20.9m and were hence above the previous year's level of EUR 18.5m largely due to higher expenditure on auditing and consulting.

At EUR 6.0m, depreciation on tangible assets was higher than in the previous year (EUR 4.7m) as depreciation of operating assets included the new administration building of ILB for a full year for the first time in 2018.

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

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

With regard to long-term loan business with fixed-interest periods of more than ten years, provident funds pursuant to section 340 f of the German Commercial Code [§ 340 f HGB] were formed in 2018 in order to address the risk of statutory termination rights being exercised in this context.

Other operating net income, without allocations to the ILB promotional fund and to the Brandenburg fund, totalled EUR 2.8m in 2018 and was thus slightly higher than the previous year's figure of EUR 2m.

Other operating income included revenues of EUR 4.0m from the appropriate use of ERDF funds within the scope of "Brandenburg-Kredit Mezzanine". Furthermore, funds of EUR 6.4m were carried from the early-phase and growth funds as well as funds of EUR 2.1m for the micro-loan. This revenue was appropriated to the Brandenburg fund.

Other operating income also includes expenditure for earmarked funds of the ILB promotional fund of EUR 3.4m that became necessary due to funds and support pledged in 2018.

EUR 5.0m was earmarked for the ILB promotional fund in 2018. This means that since 2006, EUR 95.0m of the bank's revenues has been made available for funding and support measures within the scope of ILB's Brandenburg loan product family.

Another EUR 45.0m was allocated from current net profit to the fund for general banking risks (previous year: EUR 60.2m). In 2017, EUR 23.7m was reclassified from the contingency reserves pursuant to section 340 f of the German Civil Code [§ 340 f HGB] and allocated to the fund for general banking risks.

4.2 Net worth

ILB's balance sheet total, which accounts for 99.9% of the group's balance sheet sum, decreased in the 2018 financial year by EUR 119.1m to EUR 13,415.3m (previous year: EUR 13,533.4m). In light of ILB's dominant position in the group, separate reference to the group will only be made in the following if significant deviations exist.

The business volume, comprising business recorded in the balance sheet with current customers, contingent liabilities, other obligations, administrative loans, as well as administrative guarantees, totalled EUR 14,276.6m at the end of the financial year (previous year: EUR 14,619.2m). The group's business volume totalled EUR 14,274.5m as per 31 December 2018 (previous year: EUR 14,626.0m).

ILB's loans and advances to banks increased by 6.9% to EUR 2,507.0m (previous year: EUR 2,345.4m). These changes are mainly due to increased lending of domestic promissory note loans amounting to EUR 100.0m and the increase in the issue of call money and time deposits by EUR 70.0m. By contrast, special-purpose loans were down by EUR 28.4m as a result of repayments.

ILB's loans and advances to customers were slightly down by EUR 39.2m to EUR 4,914.5m (previous year: EUR 4,954.0m). This was particularly due to repayment of around EUR 124.0m in loan business by the State Housing Construction Fund. By contrast, municipal lending business grew. Loan business with promissory note loans and registered bonds increased by EUR 88.7m. Trust loans declined by EUR 120.8m to EUR 2,135.5m as a result of scheduled and extraordinary repayments.

Bonds and other fixed-income securities held by ILB totalled EUR 3,225.8m as per 31 December 2018 and are EUR 19.5m below last year's level.

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

ILB's other assets totalled EUR 111.5m (previous year: EUR 52.7m), including EUR 109.7m for the margin payment to central counterparties. In the consolidated balance sheet, this item also primarily includes liquid funds of EUR 44.0m held by the group's subsidiaries with banks. At the end of the 2018 financial year, the group recorded other assets totalling EUR 156.0m (previous year: EUR 82.8m).

ILB enters into derivative interest rate hedging transactions for the sole purpose of managing interest rate and currency exchange risks. The nominal volume of business as per the balance sheet key date totalled EUR 12,856.7m (previous year: EUR 12,599.5m).

4.3 Financial position

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

In the 2018 financial year, short-term funds were primarily taken out through reverse transactions, time deposits and call money transactions, mostly with domestic banks. Open-market transactions with Deutsche Bundesbank were at the same level as in 2017.

Long-term refinancing was primarily taken out through promissory note 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 fell by EUR 195.4m to EUR 9,488.2m as per 31 December 2018 (previous year: EUR 9,683.6m). Increases of EUR 160.0m in long-term refinancing were offset by lower borrowings of EUR 196.1m in call money and time deposits as well as repo transactions amounting to EUR 155.7m.

Liabilities to customers as per 31 December 2018 were up EUR 65.8m against the previous year. This increase results mainly from call money deposits totalling EUR 75.0m. Funds raised from foreign insurance companies through bond placements fell by EUR 19.5m.

Liquidity was generated in the year under review by activities on the money market and by issuing bearer bonds worth EUR 100.0m.

On the whole, off-balance sheet liabilities decreased in 2018. Liabilities in relation to guarantees and warranties were down by EUR 5.5m. There are no indications that guarantees for contingent liabilities will be called on, except for one case for which a corresponding risk provision was made. Irrevocable loan commitments declined by EUR 213.9m to EUR 653.9m as per 31 December 2018. The decline of EUR 13.1m in loans and guarantees managed for the federal state of Brandenburg results from repayments for this business field which is being reduced as planned.

The group's liquidity which is essentially determined by the ILB was secured at all times. At the end of 2018, the bank recorded more than EUR 321.1m in open loan commitments not yet called by other promotional banks.

The fund for general banking risks according to section 340g of the German Commercial Code [§ 340 g HGB] has been increased to EUR 437.4m, including EUR 368.0m which must be classified as liable core capital.

ILB's equity, including the fund for general banking risks, totalled EUR 664.9m as per 31 December 2018 (previous year: EUR 614.6m). The group's equity, including the fund for general banking risks, totalled EUR 666.2m (previous year: EUR 615.8m).

This increase is largely due to the allocation to the fund for general banking risks and to retained earnings. The appropriation to the fund for general banking risks totalled EUR 45.0m. This includes a demand-based appropriation to the ILB promotional fund with the budgeted sum of EUR 5.0m. Since 2006, EUR 95.0m of the bank's revenues has been made available for funding and support measures within the scope of ILB's Brandenburg loan product family.

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

Thousand EUR	ILB promotional fund	Brandenburg fund
Date revised last: 01 January 2018	23,523	31,213
Additions	5,000	13,977
of which:		
KBB mbH		1,103
Brandenburg Kredit Mezzanine		632
Brandenburg-Kredit Mezzanine II		3,645
BFB III early phase and growth funds		6,401
Brandenburg micro-loan		2,196
Reversals	3,357	922
of which:		
Brandenburg-Kredit Mezzanine		679
Brandenburg micro-loan		243
As per 31 December 2018	25,166	44,268

Due to the resolution regarding the appropriation of profits from 2017 adopted at the shareholders' meeting on 12 July 2018, a dividend of EUR 6.0m was distributed to the shareholders. Furthermore, EUR 5.0m was allocated to retained earnings, and EUR 0.2m was allocated to profit carried forward.

All in all, the strategic goal to strengthen equity each year by at least EUR 15.0m was clearly outperformed in 2018 with an appropriation of around EUR 35.6m.

In the 2018 financial year, the Federal Financial Supervisory Authority (BaFin) ordered as part of the Supervisory Review and Evaluation Process (SREP) that ILB maintain a total capital ratio of 8.25% above and beyond the requirements of Art. 92 CRR. In addition, an SREP stress buffer (regulatory target equity ratio) of 2.5 percentage points was established.

Following a regular review of the SREP capital determination by BaFin, ILB received an updated SREP decision in January 2019. From the 2019 financial year onwards, ILB must maintain a capital increase of 1.5 percentage points, which corresponds to a total capital ratio of 9.5%.

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

In 2018, ILB's total capital ratio under the CRR was between 16.44% and 17.61% (that of the group between 16.57% and 17.69%), well above the 8.25% requirement applicable to the bank.

In 2018, ILB's core capital ratio according to CRR ranged between 14.83% and 16.70% (that of the group between 14.95% and 16.78%).

4.4 Financial and non-financial performance indicators

In the 2018 financial year, ILB pledged promotional funds of around EUR 1.3bn for 5,210 projects, including EUR 699m for products related to managed activities for the federal state of Brandenburg and EUR 644m for ILB's own products.

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

ILB's non-financial performance indicators are mainly related to employee issues. More details can be found in our reporting on non-financial performance indicators in the Summarised Non-financial Declaration in section 4.5.

537 people were actively employed in permanent jobs on 31 December 2018 (previous year: 532). The number of employees in temporary jobs rose from 72 to 93. All in all, 17.1% of all active employees worked part-time. This figure remained unchanged against the previous year.

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

In 2018, female employees accounted for 65.1% (previous year: 66.7%) of the workforce at the end of the year. The average age of all employees was 46.5 (previous year: 47.1).

In 2018, ILB provided active support for its employees' further professional development through in-house and external training events. Seminar attendance totalled 1480 (previous year: 1016).

4.5 Summarised Non-financial Declaration

4.5.1 Classification and procedure

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

This Summarised Non-financial Declaration serves to meet the requirements of the Act to Implement the CSR Regulation (CSR-RL-UG) pursuant to sections 340i (4-5), sentence 2, in conjunction with 315b, 315c and section 340a (1a), sentence 3, in conjunction with section 289b as well as 289c to 289e of the German Commercial Code (HGB) for ILB and the group. The following disclosures are necessary to explain the course of business, the results and position of ILB and the impact of its activities on non-financial aspects.

At present, reporting is not based on national, European or international frameworks, as ILB is currently in the process of developing a sustainability programme and an appropriate international framework is to be selected in the future. In this context, ILB will also further develop the existing approach for all aspects and define control-relevant performance indicators that are not yet part of non-financial reporting.

In order to identify the most important non-financial aspects of this Summarised Non-financial Declaration, ILB conducted a comprehensive materiality analysis for the first time in 2017. As a result of this analysis, ILB has identified nine key issues that can be assigned to the following aspects: environmental matters, employee matters, social matters, respect for human rights

and the fight against corruption and bribery pursuant to section 289 c (2) of the German Commercial Code, as well as the additional aspect of information security:

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

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

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

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

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

4.5.3 Key issues

4.5.3.1 Sustainable funding and support programmes and products

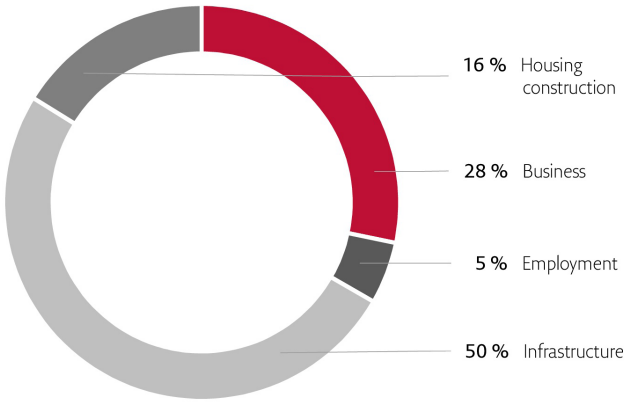
ILB's core business is to provide financial support for public and private investment projects in business, labour, infrastructure and housing. With the promotion of investment projects, ILB, as the business promotion bank of the federal state of Brandenburg, pursues the long-term goal of supporting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

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

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

In 2018, ILB approved a total of EUR 1,343m for projects by municipalities, companies, social institutions and initiatives in the federal state of Brandenburg. Of this figure, the business promotion accounted for 28%, employment promotion for 5%, infrastructure promotion for 50% and housing promotion for 16%.

Breakdown of ILB's promotional and development business according to volumes pledged (2018)



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

In business promotion, ILB supports commercial enterprises, start-ups and freelancers as well as agricultural and media companies in their investment projects, thereby making a significant contribution to the creation and preservation of jobs. The preservation and continuation of film cultural heritage is promoted by fund approvals for Medienboard Berlin-Brandenburg GmbH and the provision of interim financing. In agriculture and forestry, ILB's support programmes and products contribute to nature conservation, the promotion of biodiversity as well as climate, environmental, consumer and animal protection. Promoting investment in more efficient production facilities and renewable energy in private homes helps to reduce energy consumption and carbon emissions. In addition, agricultural and horticultural companies were compensated in the year under review for losses resulting from frost events and heavy, persistent rainfall in 2017.

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

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

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

With the targeted promotion of socially and ecologically sustainable investment projects, ILB made an important contribution to the sustainable development of the federal state of Brandenburg in the year under review.

4.5.3.2 Sustainability of the securities portfolio

With a sustainable investment strategy, banks can make a positive contribution to economic development, to improving social standards and protecting the environment and human rights. ILB's treasury business covers both environmental and social aspects as well as respect for human rights.

In 2014, ILB launched a special fund at Union Investment Institutional GmbH. As a long-term bond fund with a current total volume of EUR 200m (around 6% of the securities portfolio), this special fund invests in European corporate bonds. ILB has imposed non-financial exclusion criteria (ESG criteria) on the fund manager for investment decisions within the framework of the special fund. This ensures, for instance, that investments in companies that produce cluster bombs/landmines and in companies with extreme environmental scandals, human rights violations as well as child and forced labour are systematically excluded. All exclusion criteria were met in the 2018 reporting year.

With regard to the securities portfolio outside the special fund, ILB pursues a long-term, low-risk investment strategy as a sustainable promotional bank and non-trading book institution. This strategy focuses on investments in euro-denominated securities with very good credit ratings from core Europe. These include in particular covered bonds and securities eligible for refinancing with the ECB. As per 31 December 2018, ILB's securities portfolio almost exclusively comprised investment-grade securities.

The investment strategy is derived from the bank's annually drafted risk strategy. Treasury is responsible for ILB's securities portfolio and manages this within the established limits. The Risk Controlling unit monitors the bank's securities transactions and reports to the Management Board on the 15th day and at the end of each month in a trading report on developments and changes in the securities portfolio. The Management Board is closely involved in the process and decides on the introduction of limits in securities business based on analyses by front and back office.

4.5.3.3 Responsible corporate culture

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

For more than three years, ILB has been going through a process of systematic corporate culture development. The starting point was an employee survey conducted in 2015/16 in which a number of cultural development issues were identified. On the basis of these findings, ILB launched a cultural development project in 2017 with the aim of strengthening both co-operation within the company and the entrepreneurial initiative of each employee.

As part of the project, a strategic target was first developed in 2017 and the management guidelines revised. In addition, cross-divisional working groups have been set up and since then have been continuously working together autonomously on topics that affect the entire company. Since 2018, the focus of corporate culture development has been on integrating management guidelines into day-to-day work and further strengthening co-operation across different divisions. A new employee survey in 2019 will be conducted to evaluate just how effective these measures are.

4.5.3.4 Reconciling work and family life

ILB promotes a better work-life balance, because family-friendly working conditions strengthen the motivation, performance and satisfaction of employees and boost ILB's image in competition for highly qualified employees. By helping to create improved working conditions, this issue refers to the aspect of employee matters.

In the year under review, ILB was audited at the institution "berufundfamilie" and was certified for its strategically orientated, family-conscious family policy. The successful certification was based on measures already implemented in previous years. These include flexible working hours, free social counselling for employees on topics such as partnership, family and mental/physical health, and a wide range of company health management services.

As part of the certification process, a three-year target agreement was concluded in September 2018 covering eight fields of action that are designed to further the work-life balance. In accordance with this target agreement, ILB's plans for 2019 include offering advisory and placement services for families with children, strengthening family-conscious leadership and communication and information on work-life balance, and evaluating telework to identify potential for improvement. The results of the measures will be evaluated once a year in an interim report. The first interim report will be prepared in the 4th quarter of 2019.

The Management Board and HR are responsible for the further development of the reconciliation of work and family life and they are supported in this matter by the equal opportunities officer and the personnel committee.

4.5.3.5 Personnel planning and development

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

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

In the area of personnel planning, ILB is determined to ensure that staffing levels are in line with requirements in the long term. After the planning horizon for quantitative personnel planning was extended from three to six years in 2017, ILB further refined its planning in the year under review by means of scenario calculations in order to be able to react more in a more flexible manner to future developments in the corporate environment.

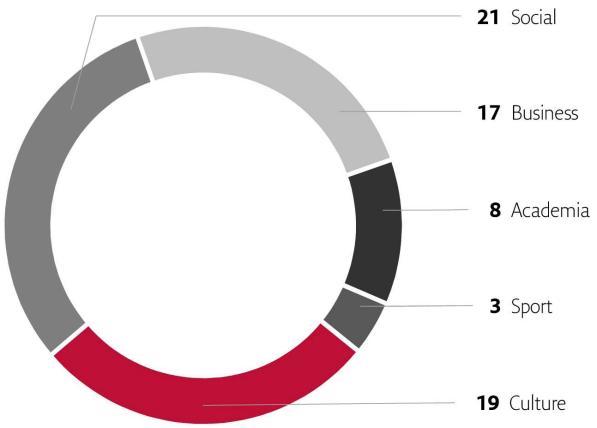
In personnel development, a concept for succession planning for key positions was developed in the year under review. This concept will better prepare high-potential employees at the company for positions that are due to become vacant in the future. In 2019, competence profiles will be developed as a basis for more targeted personnel development. Building on this, succession planning is to be further developed and the range of seminars on offer improved. Participation in seminars as a non-financial performance indicator is presented in section II.4.4 of this Consolidated Management Report.

4.5.3.6 Promotion of the common good

In accordance with the principles developed in 2018 for its commitment in Brandenburg, ILB regards it as its duty to engage in social issues in the federal state of Brandenburg beyond its promotional business and thus to have an impact on social matters.

As part of its donation and sponsoring efforts, ILB supports projects in the fields of culture, social affairs, business, sports and science. In its sponsoring activities, ILB concentrates on projects with a federal-state focus and works to achieve a balance between long-term cooperation and individual measures.

Number of projects per field of activity sponsored by ILB (2018)



In 2018, ILB supported a total of 68 projects in the federal state of Brandenburg with around EUR 290,000. Most sponsorship and donation commitments were made in the fields of culture, social affairs and business.

Long-term sponsorship activities are included in ILB's annual communication plan. Individual measures taken during the year are evaluated on the basis of a catalogue of criteria and decided by the Management Board. All commitments are summarised once a year in a report and evaluated by Communications/Funding Advisory Service and the Management Board in order to plan the following year. The report is submitted to the Board of Directors and published on ILB's website.

4.5.3.7 Fighting corruption

ILB's corporate responsibility is based on strict compliance with all laws and guidelines. ILB's compliance activities particularly focus on combating money laundering, the financing of terrorism and other criminal offences, including combating corruption in the business environment.

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

At the time of commencing work, all employees sign a protocol pursuant to section 1 of the Act on the Formal Appointment of Non-Civil Servants. This protocol explicitly refers to the relevant penal provisions (sections 331 et seqq.) and clearly informs employees of their particular responsibility.

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

The compliance officer is responsible for the suitability and effectiveness of the compliance organisation designed to prevent other criminal acts. The compliance officer reports directly to the Management Board and is not bound by instructions in the performance of these tasks. The compliance officer prepares a compliance report once a year which is handed over to the Management Board and the Administrative Board. The checks and controls carried out in accordance with the control plan showed that only a small number of measures were needed. The existing hedging measures are essentially considered to be appropriate and generally effective.

4.5.3.8 Responsible corporate management

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

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

ILB regularly reviews this Code with regard to new developments. If necessary, the Code is amended and published on ILB's website. The Management and Administrative Board report on compliance with ILB's Corporate Governance Code in the Corporate Governance Report and the Compliance Statement contained therein. The recommendations of the Code were complied with except for one fully justified deviation.

4.5.3.9 Information security

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

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

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

The Information Security Officer completed the implementation plan for the year under review in close coordination with the Compliance, Data Protection and Internal Audit functions. This work focused particularly on accompanying the current IT governance project. In 2019, the Information Security Officer will closely monitor the implementation of the information security measures resulting from the project.

III Report on forecasts, opportunities and risks

1. Risk situation

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

ILB pursues business as a special lending institution. 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 and risk management function and an internal audit function. The internal control system is made up of rules for structures and processes as well as risk management and controlling processes. Risks are identified, limited and monitored as part of risk management.

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

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

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

ILB generally pursues a conservative risk policy. The aim of this policy is to diversify between the different types of risks, i.e., knowingly accepting risks but avoiding them in areas outside the bank's core expertise. The principles concerning risk appetit 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 counterparty default risk, market price risks and operational risks.

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

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

The Board bears the overall responsibility for controlling the risks of the bank and of the institution 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. In the second quarter of 2018, ILB's business operations were audited by the Deutsche Bundesbank on behalf of the Federal Financial Supervisory Authority (BaFin) in accordance with section 44 (1) sentence 2 of the German Banking Law [KWG]. The audit focused on the correctness of the business organisation, risk management and monitoring and the procedures for determining and securing risk-bearing capacity in accordance with section 25a (1) of the German Banking Law. The audit did not make lead to any findings with serious effect. The findings will be worked through in accordance with the agreed deadlines.

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 manage 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 management measures and are limited within the scope of the risk-bearing capacity concept.

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

Risk-bearing capacity is calculated on the basis of the determination of the risk-covering capital. The risk-covering capital determines the maximum amount of risk that can be taken by ILB. ILB determines its risk-covering 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-covering capital is made up of subscribed capital, reserves, unrestricted reserves according to section 340f and 340g of the German Commercial Code [HGB] and the net profit forecast for the year after risk provisioning and reserve formation as well as planned allocation to the ILB promotional fund. The deductions from risk-covering capital include the value of intangible assets and an amount to take into account other immaterial risks. For reasons of prudence, the amount deducted for other immaterial risks is used as a buffer. Hidden risks in the securities portfolio, including special funds, are deducted from risk-covering capital if they are substantial. The analysis is carried out separately according to its causes: hidden risks due to interest or credit spread. Since ILB examines the need to set up a provision for impending losses on a monthly basis, taking into account risk scenarios, interest rate-induced hidden risks are fully taken into account. In addition, any substantial risks resulting from credit spread changes are deducted from risk-covering capital using a rating-dependent graduated method. In addition to this, ILB can, when necessary, make use of undisclosed reserves from undervaluations in accordance with commercial law (such as unrealised gains from securities). However, these reserves are not included in the definition of risk capital because they can be subject to fluctuation and are therefore not permanent.

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

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

Depending on the amount of available risk-covering capital, the Management Board determines an maximum loss cap for the bank as a whole. This is based not just on the targets of the bank as described in its strategy and implemented in its medium-term planning, but also ILB's risk appetite and risk-bearing capacity. In line with its bye-laws, ILB generally pursues a conservative risk policy. Its risk appetite thus ranges between risk-averse and risk-neutral. The maximum loss cap at the level of the bank as a whole quantifies the risk appetite as determined by the Management Board and determines the maximum risk-covering 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.

These risk caps are the absolute limits for the different risk types and are monitored within the framework of risk control and can be broken down further depending on the structure and degree of complexity of the particular business. This can be achieved either via further limits, threshold values or bandwidths or, if the risk cannot be quantified, in the form of qualitative requirements, by defining minimum standards, etc. Monitoring of the risk-bearing capacity for the bank as a whole is thus replaced with operative management of individual risks.

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

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

The analysis of the expected net profit for the year serves to monitor the risk-covering 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-covering capital accordingly.

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

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

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

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

4. Different types of risks

Risk stock-taking is carried out within the scope of risk-bearing capacity as per 31 December of each year and as required by circumstances. Risk stock-taking as required by circumstances can, for instance, be triggered by new product introductions or

changes in environmental conditions. Based on the results of the previous year's risk stock-taking, the risks already identified are reassessed with regard to their risk relevance for ILB. Depending on their significance, they are classified as relevant or not relevant. To this end, ILB has established a quantitative materiality criterion. A risk is relevant if it is explicitly defined as such in the minimum requirements for risk management (MaRisk) or if its impact exceeds the quantitative materiality threshold for a risk to be relevant. In addition, a comparison is made with conceivable risks which are assessed to see whether they could be considered at all for ILB. The newly identified risks are then assessed in accordance with the defined materiality criterion.

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

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

The following risks are considered to be relevant for ILB:

- Counterparty 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 Counterparty default risk

The counterparty default risk is the risk of a bank's debtor becoming insolvent and consequently failing to fulfil his contractual obligations. The counterparty default risk covers lending, country, counterparty, emitter and shareholder risks.

A conservative risk policy is pursued in loan business. In commercial lending business, only borrowers with certain minimum ratings are accepted. Treasury business is conducted on the basis of individual limits that are defined, taking external ratings into account, and on the basis of the bank's own criteria and assessments. Securities business focuses on investments that should be as ECB-enabled as possible and hence be limited in terms of their risks which enable additional revenue contributions in repo business. Declining revenue contributions due to the low-interest environment are to be compensated for through portfolio diversification with new products.

A rating-based method is applied to measure the counterparty default risk for ILB's entire portfolio in analogy to the IRBA (Internal Ratings Based Approach) concept provided for in regulatory law. Internal ratings are used as a basis for the risk-sensitive evaluation of items which are then consistently integrated into ILB's risk-bearing capacity concept. Risk concentrations at borrower level are also taken into account in the portfolio. Since 30 September 2018, risk buffers have also been used to map migration and industry risks in the portfolio.

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

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

The counterparty default risk determined in this way applies to ILB's portfolio on the day of the analysis for a one-year risk horizon. The risk-bearing capacity concept requires consistent periodisation of risks. As the year progresses, the period during

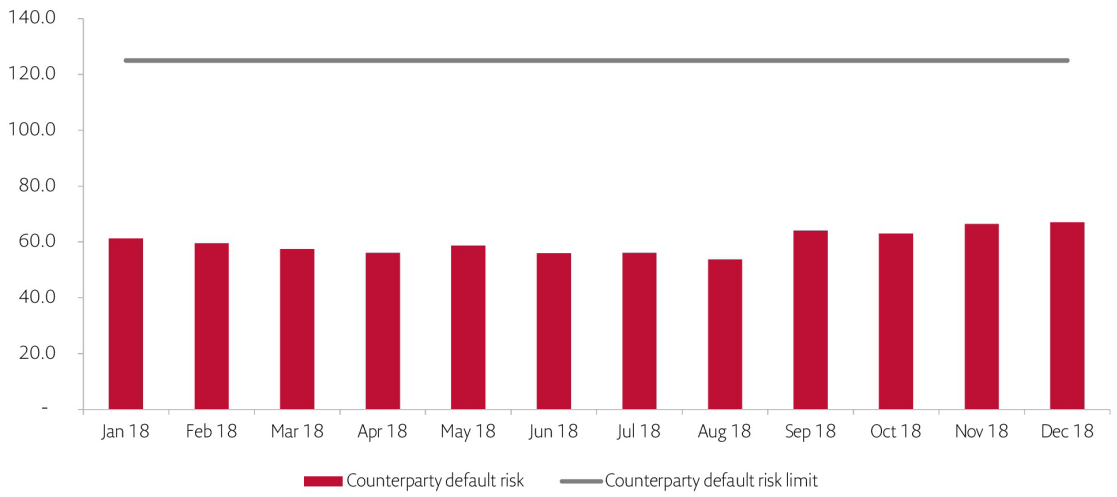
which potential risks can materialise becomes shorter. In the determination of counterparty default risks, this is achieved by scaling default probabilities. The following year is analysed on the basis of the planned stocks at the end of the year assuming an unchanged risk structure in the planning items and for the bank as a whole.

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

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

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

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



In order to ensure the comparability of risks over the course of the year, risk utilisation for the following year, i.e. 2019, is shown which refers to the one-year horizon throughout. Over the course of the year, counterparty default risks declined slightly until August 2018. This development was due to changes in risk structures and adjustments to portfolio planning. The introduction of risk buffers for migration risks and industry concentration risks of EUR 5m in each case led to an increase in risk amounts in September 2018. Other business-related changes will result in a risk utilisation of EUR 67m by 31 December 2018. Based on the limit of EUR 125m, this corresponds to a risk utilisation of 54%.

Operative counterparty 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 and commercial banks) in order to manage counterparty 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 CRR as well as compliance with the leverage ratio requirements which will come into effect in 2018. Furthermore, the rolling one-year utilisation of counterparty default risks has been limited as part of operative management.

ILB has established a working group to manage counterparty default risks. The working group is the central body that manages the bank's counterparty default risks. It advises the Management Board and prepares resolutions by the Board. The meetings are

attended by the members of the Management Board as well as the heads of the risk controlling function, treasury as well as front and back office. The working group meets regularly before the quarterly reports are due and during the course of the planning process. This body is additionally convened as required by decision-relevant issues at the chairpersons' request or in the case of important forthcoming individual decisions at the request of the manager responsible for the product area concerned.

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

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

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

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

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

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

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

At the end of each quarter, the controlling and loan secretariat functions perform a comprehensive analysis and assess the counterparty 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 counterparty default risk and, if applicable, recommends risk management measures.

In keeping with ILB's conservative risk culture, the risk structure of the bank's loan portfolio can be classified as low-risk. ILB's entire own lendings portfolio totalled EUR 12,322m as per 2018. 87% of the loans in ILB's own lending portfolio (excluding

special funds) were rated excellent (SR ratings 1-2) or collateral was provided (usually public guarantees or collateral in rem). Standardised rating procedures recognised by the regulatory authorities of Sparkassen Rating und Risikosysteme GmbH (S-Rating) are used to assess counterparty default risk at individual borrower level.

The following methods are applied:

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

For municipal loans and financial institutions, ratings are assigned in accordance with the SR system to the DSGV master scale, which is uniform for all banks. The risk classification procedure rms, developed in-house, is used for borrowers of home financing.

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

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

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

In 2014, ILB set up a special corporate bond fund (minimum rating: (investment grade) which in 2018 had a fund volume of EUR 200m.

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

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

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

4.1.2 Counterparty risk

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

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

Counterparty risk as part of counterparty default risk is generally of minor relevance at ILB. Derivatives are only used to hedge interest rate and currency risks. These transactions are generally concluded with business partners with an external minimum rating of "A".

Before the clearing obligation for standardised OTC derivatives takes effect from June 2019, ILB will clear them through central counterparties. Derivative transactions that cannot be cleared will be bilaterally collateralised on the basis of collateral annexes. Regulatory netting is carried out for portfolio business. 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 counterparty default risk is considered to be mostly secured and low.

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

4.1.3 Country risk

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

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

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

4.1.4 Shareholder risk

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

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

ILB holds shareholdings in three areas:

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

As per 31 December 2018, ILB held shares in companies with a book value of EUR 85.5m. 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 institution, ILB accepts counterparty default risks to a very limited extent only. As part of its annual planning process, the bank addresses any uncertainties regarding the development of the value of its lendings through value adjustments based on conservative estimates. Opportunities result from positive deviations of the defaults actually materialising as compared to estimates.

4.2 Market risk

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

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

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

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

The following types of market risks were identified for ILB:

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

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

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 managing the interest rate risk. The interest rate risk is covered by transactions with a direct balance sheet effect as well as swaps, forward rate agreements, swaptions and caps.

The interest rate risk is calculated and limited in the risk-bearing capacity risk by measuring the periodic interest rate change risk.

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

It must also be noted that changes in interest rates also influence the cash value of ILB's interest ledger. This influence can have a direct impact on net income if a potential reduction in cash value could necessitate a provision for anticipated losses for ILB's interest ledger. A provision must be formed if the book value of ILB's interest ledger exceeds the cash value minus future administration and risk costs. ILB takes this aspect into account when calculating the risk-covering capital.

In addition to monitoring the periodic interest rate risk in risk-bearing capacity, operative interest rate risk management is carried out by ILB by valuating the cash value of the payment flows of all transactions with interest rate change relevance. This addi-

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

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

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

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

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

This means that the limits determined by the Management Board in order to limit interest rate risks were adhered to at all times during the 2018 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.

In addition to this absolute and relative value at risk-based management of interest rate risks, the regulatory requirements result in a further absolute management measure, the so-called Basel II interest rate shock. The quantification of the Basel II interest rate shock also forms the basis for determining the interest rate risk component used to determine ILB's SREP premium.

The interest rate risk is supervised by the Risk Controlling/Finance function. On every trading day, the Basel II interest rate shock and the benchmark lever are determined within the scope of operative management of the value at risk and are checked for compliance. 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 Management Board and the Treasury function.

4.2.2 Market price risk

ILB is classified as a non-trading book institution. This means that the bank does not actively trade any securities, fund shares, currencies, derivatives or raw materials in order to generate profit. 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, Changes in market value therefore have no impact on ILB's valuation result, provided that no permanent impairments can be assumed.

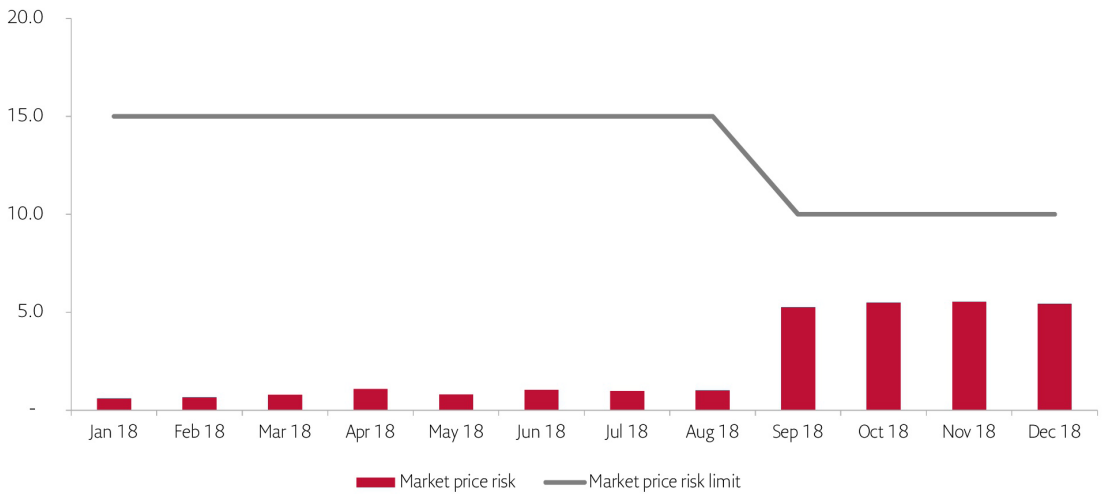
ILB takes a differentiated approach in its consideration of risks arising from credit spread changes in the periodically oriented risk-bearing capacity:

hidden risks from credit spread changes as per the balance sheet date are already taken into account as a deduction in a rating-related procedure when determining risk-covering capital. In addition, there is a risk that the credit spreads in the investment portfolio may change during the period under review. In order to determine this risk, ILB does not currently have a separate model but has analysed the potential effects of credit spread changes on the basis of a scenario analysis. Based on the results of this analysis, ILB has taken into account the credit spread risk in the form of a risk buffer amounting to EUR 4m since 30 September 2018 as the utilisation of market price risks in its risk-bearing capacity. The risk buffer is not periodised.

Changes in the market price of securities are also observed by ILB and seen as an early warning indicator. This means that risks resulting from a possible reduction in the refinancing potential of open-market securities can be assessed and latent credit risks can be identified.

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

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



In order to ensure the comparability of risks over the course of the year, risk utilisation for the following year, i.e. 2019, is shown which refers to the one-year horizon throughout.

Until August 2018, the limit for market price risks was only utilised by the periodic interest rate risk. The interest rate risk is consistently at a low level of no more than EUR 1.5m. Fluctuations during the course of the year are mainly due to changes in short-term cashflow structures which are primarily influenced by interest rate fixings in variable-interest business. The long-term cashflow structure of this investment is orientated towards the benchmark structure set for strategic reasons and is therefore relatively stable. Accordingly, the fixed interest rates and dates of future fixed interest rates on the assets and liabilities side in the short-term area and the yield curves existing at these points in time have a significant impact on periodic interest rate risks.
As part of the adjustments to the risk-bearing capacity concept as of 30 September 2018, the limit for market price risks was reduced from EUR 15m to EUR 10m and the risk buffer for credit spread risks is also offset against this limit.

All in all, it should be noted that the limit for market price risks was adhered to at all times and that 54% of capacity was utilised at the end of 2018.

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 Option risk

In principle, options come in different forms (explicit and implicit options) and in different products. An option refers to the right of a party to execute a certain action (e.g. early redemption) whereby the business partner is obliged to follow this action. Options can lead to risks, especially if obligations arise for ILB (writer of an option).

Explicit options include, in particular, options from customer business where customers are entitled but not obliged under their (loan) contract to terminate the contract or make an unscheduled repayment. As a matter of principle, ILB does not enter into such agreements. In exceptional cases, special repayment agreements are conceivable. However, the total volume of lending here is insignificant, and new business is virtually non-existent. There are currently no plans to issue redeemable bearer bonds, so there is no risk of redemption. Therefore, the risk from explicit options in customer business is insignificant.

On the other hand, these may be options that are part of a financial product. These include caps, floors and swaptions. All such financial instruments held by ILB are primarily used for hedging – such as securities without call rights – and are fully integrated into the bank's management systems and therefore do not have to be monitored separately as a separate risk category.

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

4.2.5 Other price risks

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

4.2.6 Intra-risk concentrations

Interest rate risk may include risk concentrations that rise from an accumulation of open positions in individual maturity bands due to strong changes in interest rates in these maturity segments. Open positions in long-term maturity segments have a particularly negative impact on the interest rate risk, because the longer the fixed-interest maturities, the greater the effects of interest rate changes on the present value. The interest rate risk is distributed relatively evenly across the maturity bands. Monitoring of the remaining risk concentration is considered to be manageable. A reduction in concentration is possible at any time by concluding corresponding derivative transactions. Due to the benchmark-orientated investment strategy, there is no need for additional management of risk concentrations in the interest rate risk.

Market-value risk at ILB consists of the risk of price losses on assets that can be valued at market prices and losses in the interest book. Risk concentration means that ILB's securities portfolio consists of bonds with the highest collateral requirements that lose value in the event of a general rise in interest rates or a rise in the liquidity or credit spread. This has a direct impact to the extent that it reduces the value of collateral for ILB's refinancing possibilities. A lower market value thus leads to lower collateral potential for open-market and repo transactions. In addition to securities, ILB also has KEV-eligible receivables as open-market

material in its portfolio. A risk concentration with regard to market-value risks within the framework of open marketable collateral is therefore not ascertainable. Risk concentrations in the market-value risk must therefore be classified as insignificant.

4.2.7 Opportunities

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

Changes in prices in ILB's securities portfolio (price risks) have no direct impact on the bank's earnings due to ILB's intention to hold its securities permanently, nor do price changes create any direct opportunities for ILB.

4.3 Liquidity risk

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

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

4.3.1 Liquidity risk in the narrower sense (illiquidity risk)

The following types of illiquidity risks were identified for ILB:

- Refinancing risk: Follow-up refinancing risk due to different capital commitment periods on the assets and liabilities sides of the balance sheet.
- Maturity risk: Delayed repayment in loan business
- Call risk: immediate utilisation of open payment obligations, unexpected withdrawal of deposits
- Market-value risk: value losses of open-market assets that can be used for refinancing purposes
- Market-liquidity risk (danger of not being able to sell positions at the planned time or only at a discount)
- Intra-risk concentration (danger of concentration of liquidity potential)

Maturity risks and call risks are of minor importance at ILB. The passive call risk is eliminated as ILB does not engage in any deposit-taking business and even the bearer bonds issued have neither premature buyback options. The market-value risk is of secondary importance for ILB due to the high diversification of open marketable assets.

ILB has a long-term refinancing plan in place to ensure liquidity. In 2018, the bank issued its own bearer bonds for the first time. Issue planning is included in the refinancing planning and supplements it in terms of diversifying sources of refinancing. The focus of refinancing sources continues to be on bank refinancing. If, nevertheless, the issue of bearer bonds leads to cluster risks, it can be assumed that any resulting refinancing gaps can be closed due to ILB's high credit standing and the existing well-diversified refinancing possibilities and liquidity potential; this risk is assessed as being low.

ILB's Treasury manages the bank's liquidity through its daily transactions. Funds are raised and invested on the basis of expected incoming and outgoing payments in order to meet the bank's contractual obligations and in accordance with the reports by the

specialised departments. In line with its operations, ILB has a high share of payment flows that are fixed and can therefore be planned.

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

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

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

In the year under review, ILB was always able to provide itself with sufficient liquidity, both on the interbank market and through repo transactions. In the 2018 financial year, ILB issued its first bearer bond, thus broadening its refinancing base further. ILB has also signed contracts with German and European development banks to secure long-term refinancing options. During the course of the year 2018, ILB's unused liquidity potential was at all times sufficient. It was at no time necessary to resort to the liquidity reserve.

The regulatory liquidity requirements in their current version were met with a substantial buffer: According to the monthly regulatory reporting, the liquidity coverage ratio, which represents the short-term liquidity risk, ranged between 581% and 1,342% (required: 100%) during the financial year.

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

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

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

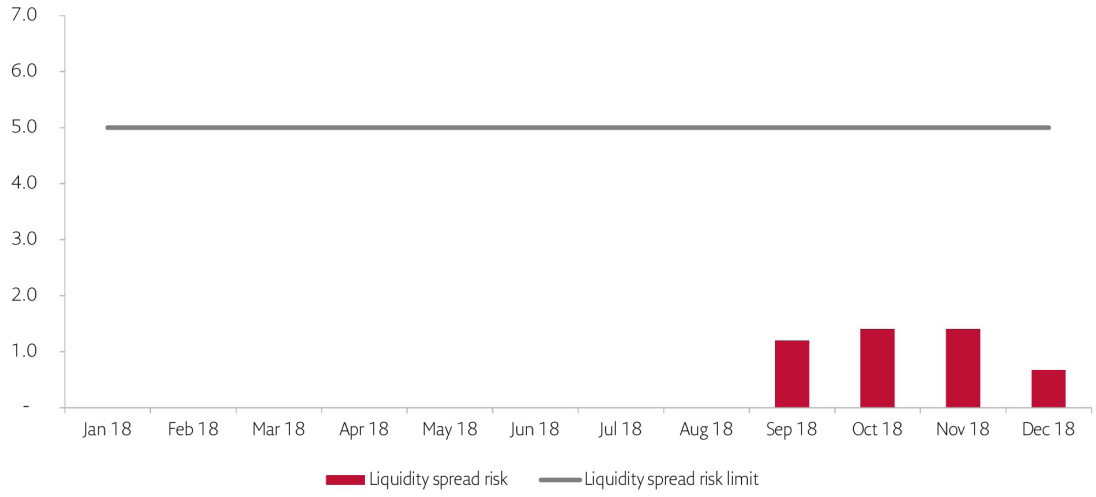
ILB is hence able to obtain liquidity at competitive terms because counterparties regard its creditworthiness to be comparable with that of the federal state of Brandenburg.

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

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

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

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



In order to ensure the comparability of risks over the course of the year, risk utilisation for the following year, i.e. 2019, is shown which refers to the one-year horizon throughout. The limit of EUR 5m for the liquidity spread risk was adhered to at all times during the year under review, with maximum utilisation for the following year, i.e. 2019, totalling EUR 1.4m. Up until August 2018, a model was used that is based on ILB's liquidity cash flow profile as per the reporting date. On this basis, there were no liquidity spread risks for the subsequent year 2019, as ILB had a liquidity surplus for this period. The risk measurement method was changed in September 2018: ILB now also takes planned new business into account when measuring the liquidity spread risk, resulting in positive risk amounts. All in all, liquidity spread risks continue to be a minor risk.

4.3.3 Opportunities

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

4.4 Operational risk

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

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

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

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

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

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

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

As part of risk stock-taking for operational risks, the Controlling unit provides sub-risk questionnaires to those responsible for sub-risks. These questionnaires are used to assess various scenarios with regard to the probability of their occurrence and the extent of damage. In addition, self-assessments are carried out by the heads of all departments and staff units.

ILB has basically implemented general control systems, such as the four-eyes principle or competence rules, written procedures as well as a cautious risk policy. This reduces the risk of loss, a fact that is also reflected by occurrence probabilities which are mostly rated "very low" to "low" as well as loss levels which are also rated "very low" to "low" in most cases. Concepts for IT security and contingency plans are additionally in place. The specific problems of the areas are known. Suitable measures are taken and/or developed. No new risks or risks not discovered by measures have been identified.

In addition to its risk stock-taking, ILB regularly compiles information on operational risks and damage. Each employee must carefully monitor their environment for operational risks and damage cases. Generally speaking, the "discoverer" of a risk or damage case is obliged to report this to the respective manager of their organisational unit who is then responsible for identifying operational risks and reporting damage cases, i.e. passing these on to OpRisk Controlling. ILB records risks and damage in an event database, and analyses its operational risk using risk inventories, risk maps or risk indicators in order to identify potential damage at an early point in time. These instruments already consider stress test requirements in that they include scenarios describing the possible occurrence of operational damage.

The Board receives ad hoc reports informing them of losses in excess of EUR 50,000 or risks of particular significance to ILB and a high probability of consequential losses. In addition, OpRisk Controlling informs the Board on a monthly basis about current risks and losses as part of the risk report. Each quarter, this report contains a more detailed assessment of ILB's operational risks.

In order to map operational risks within the scope of the bank's risk-bearing capacity, the loss potential is determined using the calculation method according to the base indicator approach pursuant to the CRR and therefore on a generalised basis,. In order to ensure the consistent integration of the risk-bearing capacity concept, distribution assumptions were made up until August 2018 in order to adapt the risk measurement method to a confidence level of 99.0%. Since September 2018, the ILB

has refrained from scaling the confidence level due to a lack of distribution assumptions that can be validated. The calculation is carried out each month on the basis of the extrapolated result for the current year. The analysis of the current year's risk-bearing capacity includes operational risks already carried in the profit and loss account as expenditure so that the extrapolated net income for the year and hence risk covering capital are reduced.

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

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

In order to ensure the comparability of risks over the course of the year, risk utilisation for the following year, i.e. 2019, is shown which refers to the one-year horizon at all times. The limits for operational risks of EUR 15m (until 31 August 2018) and EUR 20m (from 30 September 2018) were consistently adhered to. The development of the operational risk amount remains very constant due to the calculation method and the stable results forecast for ILB. The parameter adjustment as per 30 September 2018 and the waiver of the scaling of the confidence level led to a systematic increase in the measured risk amounts. As per the reporting date, 83% of the current limit of EUR 20m was utilised.

The loss events and risk events identified in 2018 did not reveal any risks that could jeopardise the bank's existence and their impact was far below the risk utilisation assumed within the scope of the risk-bearing capacity.

4.4.1 Operating risk

Minor risks are taken when justified from a commercial perspective. ILB counters these 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.

4.4.2 Legal risk

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

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

4.4.3 Model risk

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

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

4.4.4 Reputational risk

Reputational risk includes the risk of negative economic consequences as a result of damage to the company's reputation. In principle, ILB's activities as a promotional bank are also exposed to a reputational risk, since events within ILB may also result in a loss of reputation. In order to effectively counter reputational risks, an early warning system has been established at ILB. A watchlist is used to identify and analyse business transactions that are of significance for ILB's business policy. In addition to preventive measures, ILB also has internal structures in place to respond quickly and appropriately to emerging reputational risks in individual cases.

5. The risk situation in summary

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

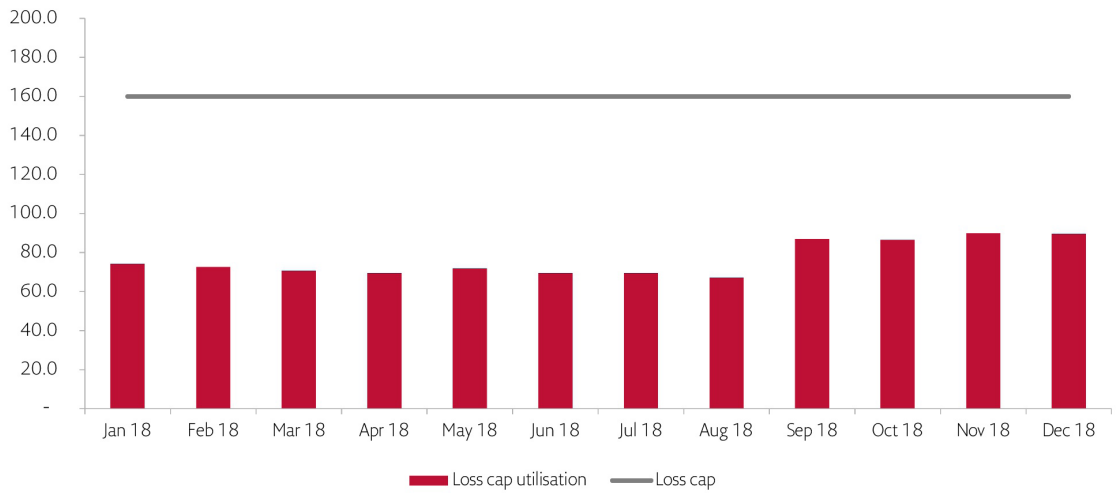
The maximum loss cap thus serves to limit the overall risk for ILB and must be complied with both in the current and the following year.

The following table shows the development of the upper loss limit and the limits for individual risks since the last reporting date.

In million EUR	31 Dec. 2017	1 Jan. 2018 - 31 Aug 2018	30 Sept. 2018 -31 Dec. 2018
Counterparty default risk limit	135	125	125
Market price risk limit	15	15	10
Liquidity spread risk limit	5	5	5
Operational risk limit	15	15	20
Limit of other individual risks	10	-	-
Loss cap	**180**	**160**	**160**

The maximum loss cap in the year under review is EUR 160m. The 2018 risk strategy reduces the limit for this type of risk by EUR 10m, from EUR 135m to EUR 125m as a result of parameter adjustments to the counterparty default risk, and the limit for other individual risks of EUR 10m is no longer applicable because the amount for other individual risks is deducted from risk-covering capital. As per 30 September 2018, adjustments were made to ILB's risk-bearing capacity concept and risk measurement methods. In this context, the allocation of the upper loss limit to the individual risk types was recalibrated. The limit for operational risks was increased from EUR 15m to EUR 20m and, at the same time, the limit for market price risks was reduced by EUR 5m, from EUR 15m to EUR 10m.

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



In order to ensure the comparability of risks over the course of the year, total risk utilisation for the following year, i.e. 2019, is shown which refers to the one-year horizon throughout. The limit to ILB's risk items laid down in the loss cap amounting to EUR 160m was adhered to at all times during the 2018 financial year.

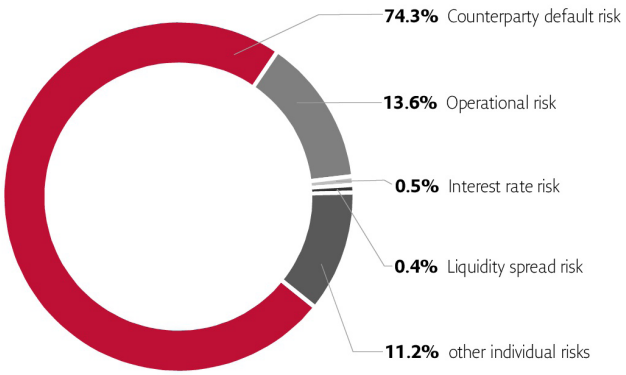
Up until August 2018, risk utilisation tended to decline between EUR 74m (January 2018) and EUR 67m (August 2018). This decline is mainly due to lower counterparty default risk forecasts.

In September, a significant and systematically justified increase in the utilisation of the upper loss limit can be seen, which is attributable to various modelling aspects. The risk amounts taken into account rose particularly due to the establishment of the risk buffers for sector and migration risks (counterparty default risk), the introduction of the risk buffer for credit spread risks (market price risk), the inclusion of new business in the measurement of the liquidity spread risk and the decision not to scale the confidence level for operational risks.

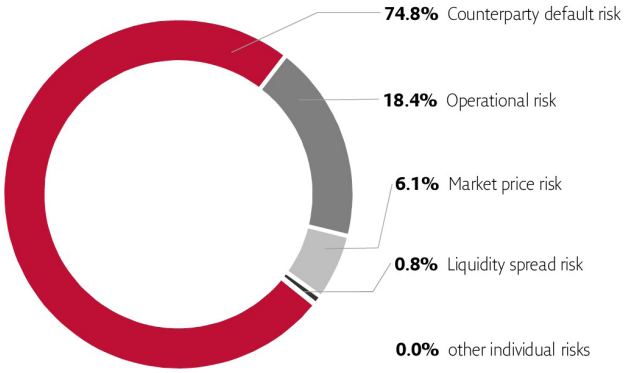
Over the course of the year, a maximum utilisation of the upper loss limit of 56% was observed. The risks taken were hence consistent with ILB's risk strategy. Utilisation generally corresponded with the bank's willingness to take risks as laid down in its risk strategy.

Share of risk types in the total utilisation of the upper loss limit in a key date comparison for the respective subsequent year

31 December 2017



31 December 2018



Default risk, which accounts for 74.8% of the overall utilisation of the maximum loss cap, continues to be the most important risk. This is in line with ILB's business model and its focus business promotion tasks.

The loss potential from operational risks calculated as a lump sum accounted for 18.4% of ILB's total risk, with the absolute risk amount and the proportionate utilisation rising compared with the previous year as a result of the decision not to scale the confidence level.

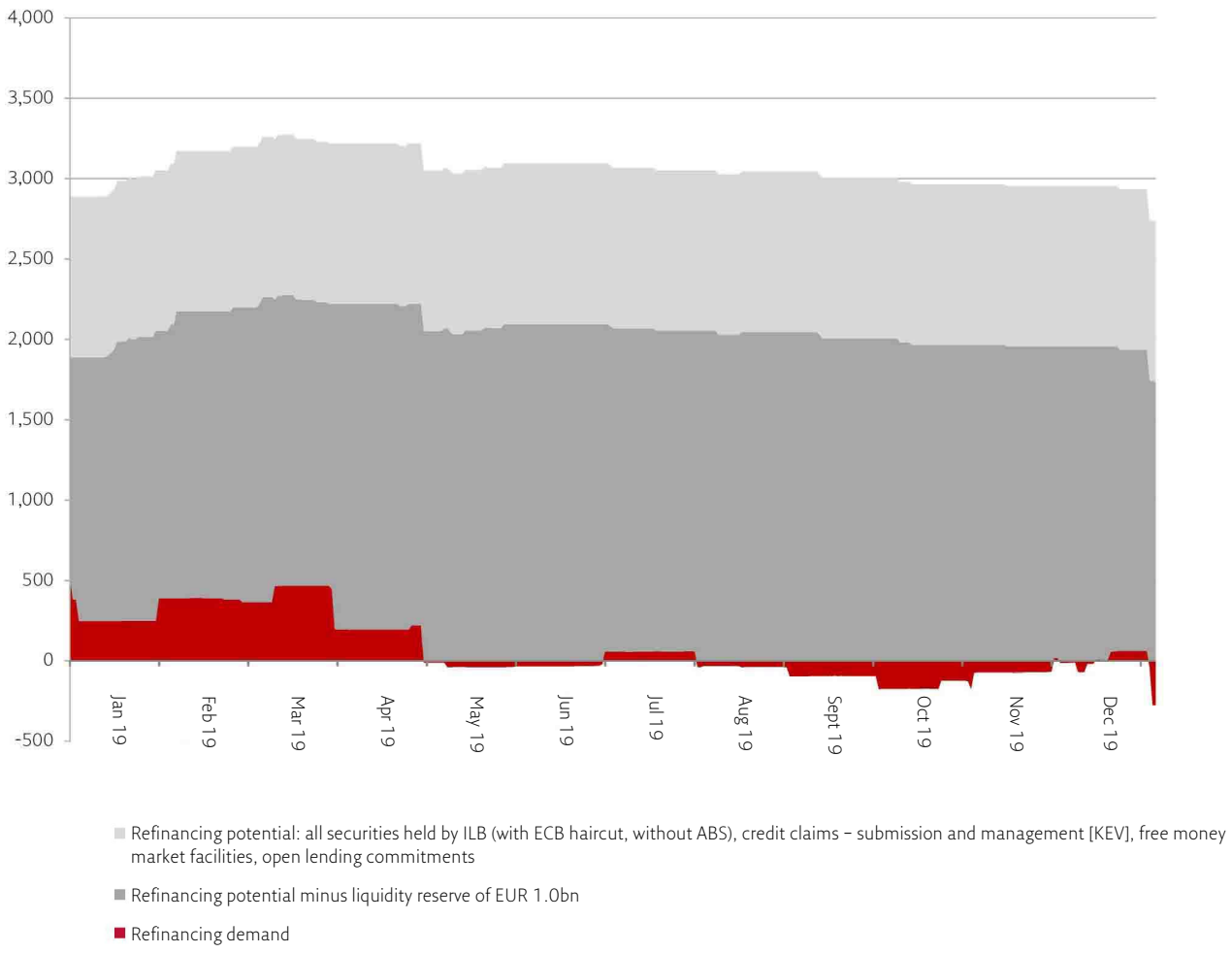
The market price risk, consisting of interest rate risk and credit spread risk, accounts for 6.1% of overall risk utilisation. Due to the inclusion of credit spread risks since 30 September 2018, this share has increased compared to the previous year.

The liquidity spread risk appears to remain of secondary importance due to the low level of utilisation. However, utilisation of these risk types depends on the respective cash flow and business structures on the reporting date and on new transactions planned, which is why the periodic effects of the risks may vary.

Since 2018, the amount for other individual risks in the amount of EUR 10 million has been deducted from risk cover capital and - in contrast to the previous year – is not offset against the upper loss limit.

The following diagram illustrates the liquidity risk within the meaning of the bank's illiquidity risk as per 31 December 2018, which is limited by a dedicated management process by comparing the bank's refinancing requirement with its refinancing potential:

Normal scenario (volume in million EUR)



Refinancing demand never exceeded the refinancing potential. Refinancing demand accounted for a maximum of 17% of the refinancing potential. The extrapolation suggests that ILB has a sufficiently large liquidity buffer which is made up of an unused refinancing potential of at least EUR 2.3bn. The liquidity reserve of EUR 1.0bn is not used. Liquidity is thus assured for the entire 2019 year and the survival horizon is at least one year.

IV Outlook

1. Economic factors

The German economy continues to grow. In its annual economic report for 2019, the German government forecasts 1% growth in price-adjusted gross domestic product and a 4.9% decline in unemployment in 2019. However, risks from the non-economic environment are likely to slow the pace of growth in 2019.

The ECB's bond purchase programme expired in 2018, but maturities of the purchased bonds will continue to be reinvested in the bond market. As a result, the Central Bank has not yet withdrawn any liquidity from the capital markets. The ECB has signalled its intention to keep the key interest rate stable for a considerable period of time even after bond purchases have ended. An initial increase in the key interest rate is not expected until the second half of 2019 at the earliest. In view of the current political uncertainties (Brexit, tariff restrictions between the US, the EU and China) and the associated economic effects, the long-awaited normalisation of key interest rates may also be delayed. However, a strong and rapid rise in interest rates is not expected due to the anchoring of key interest rates and current economic prospects.

The economic situation in Brandenburg is also expected to remain good in 2019. However, the end of the boom phase is already in sight: The economic climate index of the Berlin and Brandenburg Chamber of Industry and Commerce fell by four points to 134 points at the start of 2019, having already fallen by one point in the autumn.

In Brandenburg, around 96% of the companies surveyed rated the current business situation as "good" or "satisfactory". Around 87% of these companies assume that business in 2019 will be "more favourable" or "more stable". Business expectations have been clouding over since the summer of 2018.

13% of the companies surveyed expect a "less favourable" business situation. The shortage of skilled labour remains the key challenge for the regional economy. In addition, the economic policy environment has deteriorated.

Summing up, the report from the beginning of 2019 shows the following further results for the federal state of Brandenburg:

- Stable investment climate: Around 79% of companies are planning to invest in 2019. Around 91% of these investing companies are expecting investment volumes either to increase (41%) or at least to remain flat (50%).
- Unchanged employment expectations: 26% of the companies surveyed are planning to create new jobs in 2019. 62% of companies are expecting employment to remain flat, with 12% expecting layoffs.

2. Major influences

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

Promotion and development business:

- In the positive economic environment currently forecast for the federal state of Brandenburg, ILB is expecting a pledged volume of at least EUR 1,000m for 2019 including at least EUR 550m for products related to managed activities for the federal state of Brandenburg and EUR 450m for ILB's own products. ILB's promotion and development business in 2019 will be influenced to a large extent by the transposition of the directives within the scope of the current EU programming period.

Market environment:

- After the ECB ended its bond purchases, risk premiums rose slightly. Nevertheless, the measures maintained by the ECB will ensure a sustained low-interest environment and thus continue to support economic growth in Europe.

Regulatory framework conditions:

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

Liquidity situation:

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

3. Development of income situation and net worth

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

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

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

Item	2018 Thousand EUR	Plan 2019 Thousand EUR	Change in %
Net interest income	61,232	57,751	-5.7
Net commission income	49,870	49,786	-0.2
Other operating income*	2,661	2,482	-6.7
Personnel expenditure	43,946	44,145	0.5
Material expenditure	20,868	20,970	0.5
Depreciation on operating equipment	5,983	5,162	-13.7
Earnings before risk provisioning/reserve formation	**42,966**	**39,742**	**-7.5**
Value adjustment of receivables	2,753	-4,561	-265.7
Valuation result of securities	1,987	-4,697	-336.4
Allocation to provident funds	-1,099	-1,400	27.4
Earnings after risk provisioning	**46,607**	**29,084**	**-37.6**
Formation of reserves	-30,300	-13,000	-57.1
Allocation to ILB promotional fund	-5,000	-5,000	0.0
Net profit for the year	**11,307**	**11,084**	**-2.0**

* Other taxes included

ILB expects the income situation and net worth to remain satisfactory in 2019.

Earnings before risk provisioning and the formation of reserves is to total around EUR 39.7m in 2019 and will therefore be EUR 3.2m below the previous year's figure. Lower administrative expenses will not be able to fully compensate for a decline in income, especially in net interest income.

Net interest income of EUR 57.8m will continue to account for the greatest share in ILB's revenues. While the net interest income of the specialist departments will essentially remain stable, lower overall net interest income is to be expected due to the decline in treasury earnings. This decline is due to the persistently low level of interest rates, which not only affects income from new business and the simultaneous expiry of high-interest portfolio business, but also the return on ILB's equity.

ILB assumes that the low interest rate environment will either continue in 2019 or will only slowly normalise. Negative interest rates on money markets and long-term capital market rates of close to 1.5% are therefore expected to continue up until the end of the year. ILB will benefit from this trend in the short term in the form of favourable refinancing conditions with variable-interest borrowings. Benefits due to negative interest rates can still be realised in this context. Furthermore, the interest situation also enables positive effects from matching maturities. This measure moderately counteracts the long-term negative effects of low interest rates. In the long term, however, the negative effects will predominate. The narrowing of spreads as a result of the ECB's securities purchasing programme and the falling interest rate on equity, caused by the low interest rate environment, has put pressure on treasury's contribution to earnings.

The possible effects of strong ad-hoc changes in the planned interest curve of up to two percentage points for the following year were simulated as part of scenario analyses. Net interest income planned for 2019 will accordingly move within a band from EUR 53m to EUR 74m. Net interest income will respond negatively to a steep increase in the entire interest rate structure. Compared to initial planning, persistently low money market rates and steeper interest rates or further base lending rate reductions can be seen to have a very positive impact. The changes in interest rates assumed are extreme scenarios which are unlikely to occur. For more moderate interest rate scenarios, the budget estimate for 2019 is essentially confirmed.

Net fee and commission income is another major factor that influences earnings and is likely to total EUR 49.8m in 2019, thus remaining stable at around the same level as last year (EUR 49.9m). Net fee and commission income largely results from fees for the management of promotion and support programmes. Around a fifth of this income is from administrative cost contributions in conjunction with the granting of loans from trust funds and around three quarters from the handling of promotion programmes and a small amount from the management of guarantees, loan processing and other services.

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

Other operating income in 2019 is expected to amount to EUR 2.5m, almost matching the previous year's level of EUR 2.7m.

Administrative expenses (personnel, material expenditure and depreciation on operating equipment) are expected to total EUR 70.3m and thus slightly down by EUR 0.5m against the previous year. Following the elimination of one-off effects in 2018, a moderate increase of EUR 0.2m is expected for personnel expenditure. In 2019, EUR 26.1m is earmarked for material expenditure and depreciation on operating equipment, i.e. EUR 0.7m less than the actual figure from 2018. Depreciation on ILB's fixed assets is expected to amount to EUR 5.2m in 2019, EUR 0.8m less than in 2018. The reason for this decline is the expiry of depreciation on investments in conjunction with the implementation of the e-file project. Planning for 2019 assumes ma-

terial expenditure of EUR 21m. The figure is thus at the previous year's level. Most of ILB's administrative expenditure is subject to long-term fixed rates. Deviations from planning may occur if the actual expenses for projects involving the use of external services do not correspond to the planned expenses.

Based on the loss expected, the 2019 budget includes an amount of EUR 4.6m for value adjustments of receivables.

Securities held by the bank are valued according to the diluted lower of cost or market principle. According to the principle of prudence, potential valuation demand for securities totalling E0.7m is considered as an expected loss. In addition, a risk buffer of EUR 4m p.a. is recognised as an expense for latent migration risks in the securities portfolio. Altogether, a negative valuation result of EUR 4.7m is expected here.

In order to consider implicit options due to statutory termination rights within the scope of loan business, EUR 1.4m is allocated to provident funds, corresponding to the same amount as in the previous year.

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

ILB's result will continue to be stable and satisfactory in 2019, 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 2019. Considering current planning, ILB will probably achieve its goal of strengthening its equity by EUR 15m once again in 2019.

According to the 2019 budget, the balance sheet total for 2019 will be in the order of around EUR 13.3bn.

By the end of 2019, the number of employees will probably increase once again slightly. The share of female employees and the share of part-time employees will remain largely unchanged. The same applies to the share of temporary employees.

The number of employees in the passive phase of semi-retirement, early retirement, parental leave or other forms of passive employment is expected to remain unchanged against the previous year.

The number of students in cooperative study programmes is set to rise to 16.

The range of further education courses will continue to be expanded in terms of content, with the number of seminar participants remaining at the same level.

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

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

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

The annual and consolidated financial statements are prepared by the Risk Controlling/Finance function and set up by the Management Board. The Administrative Board elects an Audit Committee from among its members. According to the busi-

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

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

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

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

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

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

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

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

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

Potsdam, 29 March 2019

The Board of Investitionsbank des Landes Brandenburg

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

Annual Balance Sheet as of 31 December 2018

Investitionsbank des Landes Brandenburg

Assets	EUR	EUR	31 Dec. 2017 Thousand EUR
1. Cash			
a) Cash in hand	1,782.99		3
b) Balances with central banks	130,885,466.51		296,789
of which:		130,887,249.50	296,792
at Deutsche Bundesbank EUR 130,885,466.51 (previous year: EUR 296,789,000)			
3. Loans and advances to banks			
a) Payable on demand	142,938,587.85		139,316
b) Other loans and advances	2,364,025,012.58		2,206,123
		2,506,963,600.43	2,345,439
4. Loans and advances to customers		4,914,490,354.43	4,954,009
of which:			
Secured by liens EUR 796,140,244.77 (previous year: EUR 792,653,000)			
Public-sector loans EUR 2,927,508,264.68 (previous year: EUR 3,133,420,000)			
5. Bonds and other fixed-income securities			
b) Bonds and notes			
ba) Issued by public institutions	1,572,159,570.60		1,823,526
of which:			
eligible as collateral at Deutsche Bundesbank EUR 1,482,921,775.89 (previous year: EUR 1,819,462,000)			
bb) from other issuers	1,653,665,618.77		1,421,802
of which:		3,225,825,189.37	3,245,328
eligible as collateral at Deutsche Bundesbank EUR 1,542,538,550.40 (previous year: EUR 1,405,153,000)			
6. Stocks and other variable-income securities		199,796,639.65	199,790
7. Shareholdings		30,000.00	30
8. Shares in affiliated companies		85,434,046.61	71,833
9. Trust assets		2,135,492,192.05	2,256,330
of which:			
Trust loans EUR 2,135,329,492.25 (previous year: EUR 2,251,867,000)			
Securities held in trust EUR 0.00 (previous year: EUR 0.00)			
11. Intangible assets			
b) Acquired concessions, industrial property rights and similar rights and values as well as licenses thereto		1,133,443.19	2,476
12. Tangible assets		93,875,249.36	97,332
14. Other assets		111,503,978.87	52,659
15. Prepaid expenses		8,831,040.73	11,346
Total assets		13,414,262,984.19	13,533,364

Liabilities	EUR	EUR	EUR	31 Dec. 2017 Thousand EUR
1. Liabilities to banks				
a) Payable on demand		13,841,252.47		9,990
b) With an agreed term or notice period		9,474,314,209.11		9,673,580
			9,488,155,461.58	9,683,570
2. Liabilities to customers				
b) Other liabilities				
ba) Payable on demand		247,404,074.90		162,780
bb) With an agreed term or notice period		606,263,826.54		625,094
			853,667,901.44	787,874
3. Securitised liabilities				
a) Bonds issued			100,000,000.00	0
4. Trust liabilities			2,135,492,192.05	2,256,330
of which:				
Trust loans EUR 2,135,329,492.25 (prev. year: EUR 2,251,867,000)				
Securities held in trust EUR 0.00 (previous year: EUR 0.00)				
5. Other liabilities			64,626,760.95	75,487
6. Deferred income			71,354,214.02	77,026
7. Provisions				
a) Provisions for pensions and similar obligations		2,100,392.00		1,581
c) Other provisions		8,748,344.15		12,397
			10,848,736.15	13,978
8. Special item for investment allowances			25,214,309.67	24,500
11. Funds for general banking risks			437,434,400.29	392,436
12. Equity				
a) Subscribed capital		110,000,000.00		110,000
c) Revenue reserves				
ca) Statutory reserve	11,000,000.00			11,000
cd) Other retained earnings	95,000,000.00			90,000
		106,000,000.00		101,000
d) Net retained profit		11,469,008.04		11,163
			227,469,008.04	222,163
Total liabilities and shareholders' equity			13,414,262,984.19	13,533,364
1. Contingent liabilities				
b) Liabilities in relation to guarantees and warranties			49,893,669.17	55,426
2. Other obligations				
c) Irrevocable loan commitments			653,935,507.10	867,834
3. Administration loans			56,485,380.66	61,638
4. Administration guarantees			93,052,893.07	100,968

The annual financial statements of ILB for 31 December 2018 were prepared according to the relevant regulations of the German Commercial Code (HGB). the Regulations on the Accounting of Banks and Financial Institutions (RechKredV) and the German Stock Corporation Act (AktG),

Profit and Loss Account for the period 1 January to 31 December 2018

Investitionsbank des Landes Brandenburg

	EUR	EUR	EUR	1 Jan.–31 Dec. 2017 Thousand EUR
1. Interest income from				
a) lending and money market transactions	153,817,819.75			160,073
minus negative interest from money-market transactions	1,096,756.06			323
	152,721,063.69			
b) fixed-income securities and debt register claims	51,243,348.36			34,927
		203,964,412.05		194,677
2. Interest expenditure				
Interest expenditure from banking business		148,912,867.84		141,130
minus positive interest from banking business		6,180,175.63		8,064
		142,732,692.21		133,066
			61,231,719.84	61,611
4. Revenues from profit pools, profit and partial profit transfer agreements			0.00	481
5. Fee and commission income		50,297,043.86		46,012
6. Fee and commission expenses		426,747.14		1,151
			49,870,296.72	44,861
8. Other operating income			15,942,934.82	15,034
10. General administrative expenses				
a) Expenditure on personnel				
aa) Wages and salaries	36,714,962.39			34,816
ab) Social security contributions and expenditure on pensions and other benefits				
of which for pensions:				
EUR 414,706.00 (previous year: EUR 136,000)	7,231,501.69			6,442
		43,946,464.08		41,258
b) Other administrative expenses		20,867,950.53		18,541
			64,814,414.61	59,799
11. Depreciation, amortisation and write-downs on intangible assets and tangible assets			5,982,518.40	4,696
12. Other operating expenses			3,993,751.37	4,656
14. Revenues from additions to receivables and certain securities as well as the reversal of provisions in loan business			1,037,344.30	20,167
16. Revenues from additions to investments, shares in affiliated companies and securities treated as fixed assets (previous year: depreciation)			3,091,063.40	-1,360
18. Allocations to the fund for general banking risks			44,998,332.40	60,188
19. Net income from ordinary activities			11,384,342.30	11,455
21. Extraordinary expenses			0.00	43
24. Other taxes			78,074.99	31
27. Net income for the year			11,306,267.31	11,381
28. Profit brought forward from the previous year			162,740.73	18
32. Appropriation to retained earnings				
a) to the statutory reserve			0.00	236
34. Net retained profit			11,469,008.04	11,163

The annual financial statements of ILB for 31 December 2018 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),