SEMI ANNUAL REPORT
2016

DEXIA KOMMUNALBANK DEUTSCHLAND AG

DEXIA KOMMUNALBANK DEUTSCHLAND DKD

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OVERVIEW OF DEXIA KOMMUNALBANK DEUTSCHLAND

1 Key balance sheet positions

in EUR million	30.06.2016	31.12.2015
Assets		
Loans to public sector entities	15,156.1	15,730.2
Other loans and advances to banks and non-bank customers	6,878.0	5,926.5
Securities	8,501.1	9,353.0
Equity and liabilities		
Pfandbriefe	18,599.0	19,678.6
Other liabilities to banks and non-bank customers	10,931.4	10,433.0
Equity	654.4	657.7
Balance sheet total	**30,900.7**	**31,395.4**

2 Key profit and loss account positions

in EUR million	30.06.2016	30.06.2015
Net interest and commission income	16.8	26.6
Administrative expenses (incl. depreciation)	–16.9	–12.3
Risk provisioning incl. result of financial investments	–3.4	–156.2
Profit/loss	–3.4	–141.9

3 Other disclosures

	30.06.2016	30.06.2015
Employees (average number)	80	79
Cost-income ratio as %	100.7	46.1

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EXECUTIVE BODIES OF THE BANK

SUPERVISORY BOARD

Claude Piret
Member of the Management Board of Dexia S. A. with responsibility for assets
Executive Vice President of Dexia Crédit Local S. A.
Chairman

Benoît Debroise
Member of the Management Board of Dexia S. A. with responsibility for funding and markets
Member of the Management Board of Dexia Crédit Local S. A. with responsibility for funding and markets
Deputy Chairman

Eric Bouthors
Bank employee of Dexia Kommunalbank Deutschland AG

Stefanie Gregorius
Bank employee of Dexia Kommunalbank Deutschland AG

Véronique Hugues
Chief Financial Officer and Member of the Management Board of Dexia S. A. with responsibility for finance
Executive Vice President of Dexia Crédit Local S. A.

Jürgen Jung
Consultant
(since July 1, 2016)

Dr Dirk Hoffmann
Lawyer and consultant
(until June 30, 2016)

MANAGEMENT BOARD

Friedrich Munsberg
Member of the Management Board with responsibility for markets
Chairman

Laurent Fritsch
Member of the Management Board with responsibility for back-office functions

TRUSTEE

Werner Graf
Retired Bundesbank director

Victor von Bothmer
Lawyer

INTERIM MANAGEMENT REPORT

BASIC INFORMATION

Profile of the Dexia Group

The Dexia Group is a European banking group which has pursued the orderly resolution of its assets since the end of 2011. The Belgian and French governments have owned 94.4 % of the Group since the end of 2012, when they made a EUR 5.5 billion capital injection.

The Dexia Group's orderly resolution plan, which was approved by the European Commission in December 2012, aims to avoid the Group's bankruptcy and liquidation which, given the Group's residual size, might destabilise the entire European banking sector.

As a 'significant bank' within the meaning of the SSM Framework Regulation, the Dexia Group has been under the direct prudential supervision of the European Central Bank within the framework of the Single Supervisory Mechanism (SSM) since November 4, 2014. The Group's parent company, Dexia S. A., is a public limited company (société anonyme) and financial holding company governed by Belgian law, whose shares are listed on Euronext Brussels and Paris as well as the Luxembourg Stock Exchange.

The Dexia Group has discontinued its commercial activities and is pursuing the orderly resolution of its remaining assets. The Group's financial structure is not comparable to that of other banks in resolution due to its sizable asset portfolio and long-dated maturity profile. Its financial structure also includes a significant volume of off-balance sheet transactions for hedging against fluctuations in interest and exchange rates.

As of June 30, 2016, the Dexia Group's asset portfolio consisted of 89 % investment grade assets, which reflects Dexia Crédit Local's former status as a leader in the local public and project finance sectors, with a primary focus on local public entities in Europe and the United States and, to a lesser extent, European sovereigns and project finance. The Dexia Group's remaining assets, which have relatively low credit spreads, were primarily booked between 2006 and 2008. Since the Group's portfolio is hedged against rate movements, the sale of assets may require unwinding the hedges, which could prove to be expensive.

At the end of June 2016, the Dexia Group's balance sheet totalled EUR 236 billion and off-balance sheet commitments stood at EUR 363 billion. In order to protect the Group's capital base, its resolution will be managed over the long term. It will rely on an opportunistic asset sale strategy, aimed at reducing concentration risks of credit exposures. As such, the orderly resolution plan provides for the gradual resolution of the Bank's assets to around EUR 91 billion by 2020.

The Dexia Group finances itself mainly through the issuance of government guaranteed debt and secured funding. As of June 30, 2016, its Common Equity Tier 1 ratio (CET1 ratio) amounted to 15.0 %.

Dexia Crédit Local is the Dexia Group's main operating entity and benefits from a funding guarantee, up to a maximum amount of EUR 85 billion, provided by the governments of Belgium, France and Luxembourg, to allow for the execution of the orderly resolution plan. Dexia Crédit Local is based in France, where it holds a banking licence, with branches in Ireland and the United States and subsidiaries in Germany, Spain, Italy, the United Kingdom and Israel. Dexia Sabadell, Dexia Crédit Local's Spanish subsidiary, also has a branch in Portugal. Some of these entities hold local banking licences.

The governance of Dexia S. A. and Dexia Crédit Local has been streamlined and standardised, with the members of Dexia S. A.'s Management Board and Board of Directors also being members of Dexia Crédit Local's Management Board and Board of Directors.

After completing the sale of all of the commercial franchises required under the Group's orderly resolution plan at the beginning of 2014, Dexia is now solely focused on managing its legacy assets while protecting the interests of the Group's government shareholders and guarantors. To meet this objective, the Group has established three main goals, which form the core of its 'Company Project':

› Maintain the ability to fund its balance sheet throughout the orderly resolution of its assets;
› Preserve its capital base in order to comply with regulatory requirements; and
› Ensure operational continuity by retaining the necessary expertise and resources, and developing appropriate information systems.

Profile of Dexia Kommunalbank Deutschland

Dexia Kommunalbank Deutschland is a wholly-owned subsidiary of Dexia Crédit Local, the main company of the Dexia Group. It thus belongs to a banking group in which the Belgian and French governments hold a 94.4 % stake. With its balance sheet total of EUR 30.9 billion as of June 30, 2016, the Bank is the largest subsidiary of Dexia Crédit Local.

Dexia Kommunalbank Deutschland benefits from:

- The letter of support provided by Dexia Crédit Local in which this company undertakes to ensure that the Bank is able at all times to comply with its obligations and to fulfil the requirements of the German banking supervisory system,
- A revolving liquidity facility provided by Dexia Crédit Local with a volume of EUR 1 billion, which the Bank has not drawn upon, and
- Other technical and organisational support from the Dexia Group.

In accordance with the plan approved by the European Commission in late December 2012 for the restructuring of the Dexia Group, an orderly resolution of the assets of Dexia Kommunalbank Deutschland is envisaged, without any new lending business. In view of the not insignificant share of non-current assets in the Bank's overall loan book, it is clear that this process will take some time. An accelerated, actively pursued resolution by means of the premature sale of assets is not planned, except where market opportunities are exploited to a limited extent.

Over the next ten years, the assets of Dexia Kommunalbank Deutschland will continuously decrease on account of natural maturities. As of December 31, 2021, the balance sheet total is expected to have declined to EUR 21.4 billion, and its cover pool for Public Pfandbriefe (covered bonds) to EUR 13.3 billion. As of December 31, 2026, these figures will amount to EUR 14.2 billion and EUR 8.6 billion respectively. Since the low interest-rate level on the capital markets is expected to remain intact for the next few years, these projections assume that the creditors' termination rights, which are embedded in these receivables, will not be exercised.

In view of the change in the nature of the commercial focus of the Dexia Group, the business activities of Dexia Kommunalbank Deutschland concentrate on the administration, management, and funding of its extensive portfolio of securities and loans, with the following core areas of focus:

- Preserving operational stability and avoiding operational risks in an increasingly stringent regulatory environment;
- Optimising the funding mix in order to secure advantageous funding costs and to widen the funding base; and
- Maintaining cost discipline, for personnel expenses and also other administrative expenses.

ECONOMIC REPORT

OVERALL ECONOMIC AND INDUSTRY ENVIRONMENT

On June 23, 2016, a majority of 51.9 % of British voters voted in a referendum that had been called for by Prime Minister David Cameron that the United Kingdom should leave the European Union. Most of the political observers and capital market participants had not expected this outcome, and the shock results in significant uncertainties not just for the United Kingdom, but Europe as well:

- For the first time in the history of the European Union, a country had chosen to leave the union, which had been formed in 1992 through the Maastricht Treaty. There is neither a prescribed schedule nor a template that could be used to navigate the exit process. It seems clear, however, that the United Kingdom will not file its application to withdraw pursuant to Article 50 of the EU treaty until next year.
- The reaction of the financial markets was intense but controlled. The financial crisis that some had feared did not happen. Many initially significantly affected sectors, such as the stock markets, soon recovered from the initial shock.
- The mid-term risk that remains is a potential political destabilisation of the European Union. Brexit could provide anti-European forces, especially those in Italy, the Netherlands, and France, with additional fuel and put pressure on pro-European governments.

It is also difficult to predict how Brexit will impact European economic growth. ECB President Mario Draghi announced on June 28, 2016, during the EU summit of the heads of state or government in Brussels, that the growth of the eurozone could be 0.3 to 0.5 percentage points lower within the next three years than previously expected. The International Monetary Fund (IMF) lowered its euro area growth projections for 2017 from 1.7 % to 1.4 % (to 1.6 % for 2016), assuming, which is quite optimistic, that United Kingdom will continue to have unlimited access to the EU internal market.

The first quarter 2016 had started quite well with growth in the aggregate real gross domestic product (GDP) in the eurozone countries of 0.6 % compared to the previous quarter. Spain took first place among the four large eurozone countries with a growth rate of 0.8 %, followed by Germany (0.7 %), France (0.6 %), and Italy (0.3 %). The final growth figures for quarter two 2016 are not available yet, but, according to initial Eurostat estimates, eurozone growth was around 0.3 %.

Only four days after the Brexit decision, Standard & Poor's and Fitch lowered the United Kingdom's rating from AAA and AA+ respectively to AA, referencing the expected lower growth rates and less stable political conditions. The rating agency Moody's, which had already downgraded the country in 2013 from Aaa to Aa1, only changed the outlook from 'stable' to 'negative'. The European club of the 'pure' AAA countries, whose bonds were rated highest by all three major rating agencies, currently consists of seven members (Denmark, Germany, the Netherlands, Luxembourg, Norway, Sweden, and Switzerland).

Another important change in the ratings during the first half of the year included three downgrades – Finland to Aa1/AA+ (Moody's and Fitch), Austria to Aa1 (Moody's), and Poland to BBB+ (Standard & Poor's), as well as two upgrades – Ireland to A3/A (Moody's and Fitch) and Hungary to BBB– (Fitch). › 4

On July 7, 2016, the European Commission announced in a press release that the two Iberian countries of Spain and Portugal are not expected to 'correct their excessive deficits by the recommended deadline'. Spain had reduced its budget deficit from 11.0 % of GDP (2009) to only 5.1 % (2015), and had therefore clearly missed the EU target of 4.2 %. It seems unrealistic that Spain will reach the 2016 target of less than 3 %. Portugal was able to reduce the deficit from 11.2 % (2010) to 4.4 % (2015), but failed to reach the agreed EU target of 2.5 % as well.

In its press release, the European Commission also pointed out that the state of public finances across the euro area has improved dramatically in recent years. The general government deficit in the euro area as a whole decreased from 6.3 % of GDP in 2009 to 2.1 % of GDP in 2015 to a forecast 1.9 % in 2016 and 1.6 % in 2017. According to the projections, the debt-to-GDP ratio of the euro area is supposed to decrease from 94.4 % of GDP in 2014 to 91.1 % in 2017. Currently, only six member states of the European Union are still subject to the corrective component of the stability and growth package, down from 24 member states in 2011.

A look at the development of inflation during the first half of 2016 makes clear that, more than one and a half years after the issuance of the Asset Purchase Programme (APP) at the end of 2014, the European Central Bank (ECB) has not succeeded in even coming close to its target mark of 2 % for the annual inflation rate on the basis of the Harmonised Index of Consumer Prices (HICP). In fact, the HICP fell from 0.2 % (December 2015) to – 0.2 % (February 2016) and concluded the first half of 2016 at 0.1 %. At the same time, the preferred '5Y plus 5Y Forward Inflation Swap Rate', which the ECB is using to measure mid-term inflation outlook, dropped to a historic low of 1.25 % (July 11, 2016). A noticeable increase in inflation and inflation outlook is generally not expected for the coming months.

4 Ratings of selected countries

	Standard & Poor's		Moody's		Fitch	
	04.08.2016	15.01.2016	04.08.2016	15.01.2016	04.08.2016	15.01.2016
Eurozone countries						
Belgium	AA	AA	Aa3	Aa3	AA	AA
Germany	AAA	AAA	Aaa	Aaa	AAA	AAA
France	AA	AA	Aa2	Aa2	AA	AA
Italy	BBB–	BBB–	Baa2	Baa2	BBB+	BBB+
Luxembourg	AAA	AAA	Aaa	Aaa	AAA	AAA
Netherlands	AAA	AAA	Aaa	Aaa	AAA	AAA
Austria	AA+	AA+	Aa1	Aaa	AA+	AA+
Poland	BBB+	BBB+	A2	A2	A–	A–
Portugal	BB+	BB+	Ba1	Ba1	BB+	BB+
Spain	BBB+	BBB+	Baa2	Baa2	BBB+	BBB+
Hungary	BB+	BB+	Ba1	Ba1	BBB–	BB+
Other countries						
Japan	A+	A+	A1	A1	A	A
UK	AA	AAA	Aa1	Aa1	AA	AA+
USA	AA+	AA+	Aaa	Aaa	AAA	AAA

Source: Bloomberg

In order to fight deflation, the Governing Council of the ECB ratified another package to decrease the key interest rate and to expand quantitative easing during its meeting on March 10, 2016. It included the following measures:

- The interest rate for main funding operations was decreased to 0.00 % (previously 0.05 %), the interest rate for top funding facilities to 0.25 % (previously 0.30 %), and the deposit facilities rate to – 0.40 % (previously – 0.30 %).
- The monthly volume of securities purchasing activities within the APP was expanded from EUR 60 billion to EUR 80 billion.
- Investment grade euro-denominated bonds issued by companies (excluding banks) in the euro area were included in the set of eligible securities under the APP.
- A new series of four, targeted longer-term refinancing operations (TLTRO II) with a period to maturity of four years each was issued. The minimum interest rate for the funding of these transactions is the deposit facilities rate.

As of June 30, 2016, the securities portfolios purchased by the ECB under the APP amounted to EUR 1,084.6 billion, which comprises the following four sub-programmes:

- Public Sector Purchase Programme (PSPP): EUR 875.2 billion
- Third Covered Bond Purchase Programme (CBPP3): EUR 183.4 billion
- Asset-Backed Securities Purchase Programme (ABSPP): EUR 19.6 billion
- Corporate Sector Purchase Programme (CSPP): EUR 6.4 billion

In spite of massive ECB purchases, the government bonds of peripheral eurozone countries did not succeed in reaching new all-time low yields. In fact, they ranged from around 1.2 % to 1.7 % (Italy), 1.2 % to 1.8 % (Spain), and 2.5 % to 4.1 % (Portugal) during the period under review. Italian and Spanish securities in particular benefited from the Brexit-induced escape into government bonds and reached mid-year yields of 1.3 % (Italy) and 1.2 % (Spain), while Portuguese government bonds ended the first half of the year at 3.0 %.

One main reason for the relatively poor performance of Portuguese government bonds is that the socialist minority government, which came to power in October 2015, has turned away from the reform path initiated by the former Prime Minister, Pedro Passos Coelho. Several measures initiated by the previous government have been reversed and the previously stricter fiscal policy has been relaxed.

In contrast to that, the market for Spanish government bonds remained relatively unimpressed by the still unclear governmental situation in Spain. The parliamentary election in Spain of June 26, 2016, which followed the election of December 20, 2015, once again did not lead to a clear majority. The conservative Partido Popular led by Prime Minister Mariano Rajoy remained the strongest party, with a slightly increased share of the votes of 33.0 %. The talks on forming a government led by Rajoy in July 2016 have not yet brought a result.

In contrast to the peripheral eurozone, the lowering on yields on the underlying bonds from the core eurozone countries continued, led by Bund bonds. On July 8, 2016, yields on ten-year Bund bonds reached an all-time low of – 0.19 %, while two-year Bund bonds yielded around – 0.69 %.

This development caused the 'Public Sector Purchasing Programme' (PSPP) of the ECB to basically lose the large German government bonds market as the target of the securities portfolio purchase programme. According to its own regulations, the central banks in the euro area may only purchase securities with a minimum yield in the amount of the deposit facility rate (currently – 0.40 %). Therefore, in the middle of July 2016, all Bund bonds with a period to maturity of up to seven years could not be taken into consideration for the PSPP. The market value of all of these Bund bonds traded at that time amounted to almost EUR 1,100 billion. Deducting the Bund bonds that did not meet the minimum yield and period to maturity requirements, the remaining volume available for purchase amounted only to EUR 300 billion.

Decreased yields for the euro area were less pronounced than for the Bund bonds, but very steady. The three-month Euribor yield dropped, not least driven by the ECB key interest rate decrease in March 2016, from – 0.13 % at the beginning of the year to – 0.29 % as of June 30, 2016.

The United Kingdom's decision to leave the European Union resulted in a steep drop in the British pound from USD 1.49 to less than USD 1.30, from which it only slightly recovered in the days that followed. The euro, however, only lost 2 to 3 cents against the USD after the Brexit vote, and was then able to maintain a level of USD 1.10 (June 30, 2016: USD 1.11).

While the Euro Stoxx 50 index and the German DAX index had almost recovered their Brexit losses on the stock markets of up to 11.2 % and 9.6 % respectively just a few days later, the bank share losses were more significant and the recovery weaker. The Stoxx Europe 600 banking index lost a significant 22.1 % at the peak, and the discounts for some of the affected Italian bank shares were even temporarily significantly higher.

Italy's banks have been suffering from non-performing loans for quite some time now. The Italian Central Bank has quantified the total volume to EUR 333 billion (March 31, 2016), which corresponds to around 16.4 % of all Italian bank loans. The Italian government estimated that the capital requirement for an adequate securitisation of these portfolios is around EUR 40 billion.

In April 2016, at the initiative of the Italian government, the 'Atlante' bank resolution fund had been set up to support banks that had gotten into difficulties. The resolution of regional banks had, however, soon eaten up the majority of the EUR 4.25 billion fund volume. Prime Minister Matteo Renzi therefore suggested that billions from the Italian budget could be used to restructure the banks – also in order to avoid the wrath of depositors, who would suffer losses in the event of further restructuring of banks. Italy is supposed to hold a referendum on the Senate reform by the end of October 2016. Renzi is expected to step down if this referendum is rejected. Since the beginning of 2015, however, the restructuring of banks in the European Union has been subject to the strict regulations of the Bank Recovery and Resolution Directive (BRRD), which permits the use of government funds to resolve banks only in very few exceptional cases. In July 2016, attempts to find a compromise for the stabilisation of the Italian banking sector had not yet been concluded.

Brexit and the Italian banking crisis have left their mark on the risk premiums on bank funding. After the Brexit decision, the average premium on five-year credit default swaps on primary senior liabilities calculated by the iTraxx Senior Financials Europe Index for 25 European banks reached a high of 135.5 bp in June 2016, but later fell below the 100 bp mark again.

At EUR 91 billion, the covered bond new issue volume placed in the reporting period with a euro benchmark format (issue volume of EUR 500 million or more, including increases) was clearly higher than value for the same period of the previous year. In the country rankings, France was leading with an issue share of 18.4 %, followed by Germany (18.1 %), and Spain (10.2 %).

Despite the ECB's significant level of demand within the scope of its CBPP3 programme, the spread slightly increased on German Public Pfandbriefe over the swap curve. According to the iBoxx Public Pfandbriefe index, in mid-2016, the average asset swap spread was pricing at – 2.9 bp (December 31, 2015: – 7.3 bp).

As of May 31, 2016, gross sales of Public Pfandbriefe decreased significantly by 24.6 % to EUR 5.3 billion (more current figures are not available at the reporting date) against the same period of the previous year, while the volume outstanding decreased from EUR 180.5 billion (December 31, 2015) to EUR 172.4 billion (– 4.5 %).

BUSINESS PERFORMANCE

In accordance with the plan approved by the European Commission in late December 2012 for the orderly resolution of the Dexia Group, Dexia Kommunalbank Deutschland did not persue any new lending business during the first half of 2016 either. Only in a few cases where the Bank was contractually obliged to submit an extension offer were existing loans extended with a total volume of EUR 3.2 million. All of these loans are guaranteed by German regional or local authorities and are therefore eligible as cover for Public Pfandbriefe.

As of June 30, 2016, the Bank held certificates of deposit of Dexia Crédit Local in the amount of EUR 300 million. The securities are guaranteed by the governments of Belgium (51.4 %), France (45.6 %), and Luxemburg (3.0 %).

In the period under review, the Bank disposed of Japanese government bonds with a nominal value of JPY 58.1 billion (EUR 428.2 million).

To fund its lending operations, issues with a total volume of EUR 1,288.8 million (same period of the previous year: EUR 1,193.1 million) were launched within the framework of new issue business. Of this figure:

- EUR 500.0 million related to Public Pfandbriefe, and
- EUR 788.8 million related to loans taken out.

A Pfandbrief issue with a volume of EUR 500 million and a period to maturity of 5.25 years was launched on June 1, 2016 as the largest individual transaction in these issuing operations. This clearly oversubscribed bond was priced at a re-offer spread of +6 bp over the swap curve. 87 % of the investors were from Germany, and the remainder were from Scandinavia (7 %), the United Kingdom (3 %), and other countries (3 %).

The Bank did not issue any unsecured bearer notes in the period under review.

The Bank uses derivative transactions to hedge interest-rate risks and currency risks. In the period under review, new derivative transactions were entered into with a nominal volume of EUR 1,125.0 billion.

Table › 5 shows the volume of interest-rate and cross-currency interest-rate swaps and options as of June 30, 2016.

5 Derivative transactions

Nominal value in EUR million	30.06.2016	31.12.2015
Interest-rate swaps and cross-currency interest-rate swaps	53,847.1	56,291.1
Options	0.0	30.0
Total	**53,847.1**	**56,321.1**

The ratio of the volume of derivatives to the balance sheet total was 174.3 % (December 31, 2015: 179.4 %).

As of the balance sheet date, the credit equivalent amounts of the interest-rate and cross-currency interest-rate swaps determined according to the mark-to-market method pursuant to Section 13 KWG amounted to EUR 1,761.5 million (December 31, 2015: EUR 1,532.9 million). On balance, collateral for derivatives exposures totalled EUR 4.6 billion (December 31, 2015: EUR 3.6 billion).

Claims against Heta Asset Resolution AG

The portfolio of Dexia Kommunalbank Deutschland includes claims with a volume of EUR 395 million against Austria's Heta Asset Resolution AG (Heta), the successor company of Hypo Alpe Adria Bank International AG (HAA). These claims are secured by a deficiency guarantee issued by the Austrian federal state of Carinthia and Kärntner Landesholding. They are not used as cover for the Bank's outstanding Public Pfandbriefe.

On March 1, 2015, the Austrian Financial Market Authority (Finanzmarktaufsicht, FMA) issued a notice initiating Heta's resolution under the Austrian Federal Act on the Resolution and Recovery of Banks (Bundesgesetz zur Abwicklung und Sanierung von Banken, BaSAG), by imposing a temporary debt moratorium until May 31, 2016, which the Bank's claims against Heta were subject to as well.

On July 15, 2015, as a member of the 'par investors pool', a group of 13 Heta creditors, Dexia Kommunalbank Deutschland brought an action before Frankfurt am Main Regional Court in requesting the immediate repayment of all of the Heta claims held by the pool members participating in this action.

The creditors organised in this pool (banks, in particular Pfandbrief banks, insurance companies, asset managers, and public entities) hold bonds and promissory-note loans with a total volume in excess of EUR 1.4 billion, which Heta or its legal predecessor issued in the period from 2002 to 2007. Dexia Kommunalbank Deutschland is the pool's spokesperson.

On January 21, 2016, the Kärntner Ausgleichszahlungs-Fonds (KAF) published a tender offer with a volume of EUR 7.8 billion pursuant to Section 2a of the Austrian Financial Market Stabilisation Act (Finanzmarktstabilisierungsgesetz, FinStaG) to creditors of Heta claims which are secured through the statutory liability of the Austrian federal state of Carinthia.

For the senior creditors of Heta, which are secured through the statutory liability of the Austrian federal state of Carinthia, this would mean the purchase of 75 % of the nominal value of their claims plus interest accruing in the period up to March 1, 2015.

The tender was extended in March 2016 to Heta creditors intending to accept the tender offer that was to expire on March 11, 2016. They were offered the subscription of a zero-coupon bearer bond from the Republic of Austria in the amount of the nominal value of their claims (including interest until March 1, 2015) with a period to maturity of 18 years in return for payment of their 75 % proceed. In a joint press release, a large group of Heta creditors (including the par investors pool of which Dexia Kommunalbank Deutschland is a member) stated that it did not intend to accept the tender offer, which was deemed inadequate.

On March 14, 2016, the KAF announced that it had been unable to reach the quorum of at least two thirds of the consenting creditors required for acceptance, and that therefore the tender offer had failed.

On April 10, 2016, the FMA announced by notice:

1. A haircut by 53.98 % to 46.02 % for all senior claims against Heta eligible for consideration, which also includes the claims of Dexia Kommunalbank Deutschland,
2. A haircut in the amount of 100 % for all junior claims against Heta,
3. The cancellation of interest payments as of March 1, 2015 on, as well as
4. A standardisation of the periods of maturities of all claims eligible for consideration to December 31, 2023.

On July 11, 2016, Dexia Kommunalbank Deutschland AG, together with the other members of the pool, filed the objection proceedings ('Vorstellung') against the FMA's notice as of April 10, 2016.

On May 18, 2016, the Republic of Austria and 72 Heta creditors (including Dexia Kommunalbank Deutschland), holding Heta debt securities (guaranteed by state) in the amount of approximately EUR 4.9 billion, signed a memorandum of understanding on the settlement of the Heta dispute.

The subject of this memorandum of understanding is a renewed submission of a public tender offer by KAF, which, just as the one from January 2016, is to be based on Section 2a of the Austrian FinStaG. In return, senior Heta creditors are to be offered a cash payment of 75 %. Alternatively, KAF is offering senior Heta creditors a zero-coupon bearer bond in the amount of the nominal value of their claim (including interest until March 1, 2015) with a period to maturity of approximately 13.5 years, which is guaranteed by the Republic of Austria.

Among other things, the implementation of the tender offer is subject to:

- A sufficient number of binding acceptance statements from the Heta creditors,
- A state aid investigation by the European Commission, and
- The ratification of the necessary legal foundations.

The tender is scheduled to be published at the beginning of September 2016, and the zero-coupon bearer bond is intended to be issued in October 2016.

As of December 31, 2015, Dexia Kommunalbank Deutschland had established risk provisioning in the value of EUR 174.8 million. This corresponds to a valuation allowance ratio of 44.2 % on the nominal amount of EUR 395 million. Upon having performed another review of the recoverability of its Heta claims, the Bank decided to maintain this conservative valuation as of June 30, 2016 as well. This valuation is only based on the expected proceeds from the resolution and liquidation of Heta assets. In the first KAF tender offer dated January 21, 2016 the prorated amount was set at EUR 6.0 billion with the assistance of an expert. This corresponds to a ratio of 59.9 % for senior creditors with guaranteed Heta claims. The Bank's valuation of the Heta claims therefore does not take into account any future payments from the Austrian federal state of Carinthia and Kärntner Landesholding on the basis of the issued guarantees.

In its ad-hoc publication on May 18, 2016, Dexia Kommunalbank Deutschland pointed out that the realisation of the conversion of Heta claims into zero-coupon bearer bonds to be issued by the Kärntner Ausgleichszahlungs-Fonds and guaranteed by the Republic of Austria, as set out in the memorandum of understanding, would initially result in an (extraordinary) income for the Bank in the range of EUR 130 million to EUR 140 million (see section Forecast Report for the profit forecast for the financial year 2016).

POSITION

RESULTS OF OPERATIONS

Net interest income and net commission income

Net interest income at the end of the first half of 2016 amounted to EUR 18.0 million and was thus EUR 10.1 million lower than the figure for the same period of the previous year of EUR 28.1 million. The interest income was negatively impacted by the decrease of the Bank's asset portfolio.

Unlike to the first half of 2015, the net interest income of the period under review does not include any one-time income from the early termination of derivative transactions (same period of the previous year: EUR 0.5 million).

The Bank continued to cover its unsecured funding requirement entirely by means of deposit-taking and by taking out promissory-note loans.

The Bank benefited from continuing, cost-effective funding of securities holding through securities repurchase agreements on the interbank market and via the Eurex Repo trading platform. Funding of securities was thus possible on significantly more favourable terms than via open-market operations with the Deutsche Bundesbank.

Due to the market, however, funding costs for deposits increased slightly.

As in the same period of the previous year, no trading-book businesses were entered into in the period under review.

The Bank's profit continues to predict a negative profit for the financial year 2016 in its forecast. In this case, in line with its terms of issue, servicing the profit participation rights capital would not be possible for the financial year 2016. As in the same period of the previous year, pro rata expenses for servicing the Bank's profit participation rights capital therefore does not include net interest income for the period under review.

Net commission income in the amount of EUR –1.2 million mainly comprises expenses for pro rata management fees for guaranteed loans and custody charges paid and commission for brokerage of customer deposits.

Overall, net interest and commission income totalled EUR 16.8 million (same period of the previous year: EUR 26.6 million). › 6

Administrative expenses

Compared to December 31, 2015, the Bank increased its level of employment by four employees to 82. Consequently, personnel expenses increased by 3.8 % to EUR 3.5 million.

The labour agreement that had been concluded in 2014 expired on April 30, 2016. Afterwards, the parties to the labour agreement for the private and public banking sector had agreed to a new labour agreement with a term of 33 months (expiring at the end of January 2019). It provides a 3.7 % increase in wages for the affected employees in three steps from October 2016 and therefore will only affect the second half of 2016.

6 Development of key profit and loss account positions

	30.06.2016 in EUR million	30.06.2015 in EUR million	Change as %
Interest income	1,053.3	1,183.2	−11.0
Interest expense	−1,035.3	−1,155.1	−10.4
Net interest income	18.0	28.1	−36.0
Net commission income	−1.2	−1.5	−22.2
Net interest and commission income	**16.8**	**26.6**	**−36.8**
Personnel expenses	−3.5	−3.4	3.8
Other administrative expenses (non-compensation expenses)	−13.2	−8.7	52.2
Depreciation, amortisation and valuation adjustments on intangible assets and property, plant and equipment	−0.2	−0.2	−0.2
Administrative expenses	−16.9	−12.3	38.0
Partial operating result	**−0.1**	**14.3**	**−100.8**
Other operating income and expenses	0.1	0.0	0.0
Risk provisioning	−3.4	−64.6	−94.7
Result of financial investments	0.1	−91.6	−100.1
Operating result	**−3.4**	**−141.9**	**−97.6**
Tax expense	0.0	0.0	−0.1
Profit/loss	**−3.4**	**−141.9**	**−97.6**

The significant increase in non-compensation expenses by 52.2 % to EUR 13.2 million is attributable exclusively to the contribution (bank levy) to the restructuring fund of the German Federal Agency for Financial Market Stabilisation (Bundesanstalt für Finanzmarktstabilisierung (FMSA)) which, for the entire year 2016, amounts to EUR 16.4 million (previous year: EUR 15.8 million) and which is not recognised as a tax-deductible business expense.

The Bank made use of the option to cover 15 % (EUR 2.5 million) of the payable amount through the issuance of an irrevocable payment obligation to FMSA and to capitalise it under other assets. Of the remaining EUR 13.9 million (85 %), the pro rata share, attributable to the period under review in the amount of EUR 7.0 million, was recognised as non-compensation expenses. In the absence of the FMSA notice for the 2015 annual contribution, the bank levy had only been accounted for with a pro rata estimate of EUR 2.4 million in the same period of the previous year. As in the previous year, the Bank has filed an appeal against notice on the bank levy of the FMSA.

Adjusted for this bank levy effect, non-compensation expenses remained almost unchanged at EUR 6.2 million (same period of the previous year: EUR 6.3 million).

Allowing for the impairment in the value of fixed assets (depreciation) of EUR 0.2 million, overall administrative expenses increased to EUR 16.9 million (same period of the previous year: EUR 12.3 million).

The ratio of administrative expenses to net interest and commission income (cost-income ratio) amounted to 100.7 % (same period of the previous year: 46.1 %).

Risk provisioning

The net risk provisions of the first half of 2016 amounted to EUR −3.4 million (same period of the previous year: EUR −64.6 million).

The one-time profit from the collection of a depreciated repayment claim of EUR 9.4 million from the profit participation certificate of a German bank that the Bank had purchased in 2002 had a positive impact.

Results of financial investments

Due to redemption gains from the securities of fixed assets, the cumulative results of financial investments in the first half of 2016 amounted to EUR 0.1 million (same period of the previous year: EUR −91.6 million).

Operating result before tax

The operating result before tax amounted to EUR −3.4 million (same period of the previous year: EUR −141.9 million).

Taxes

Deferred tax assets resulting from temporary differences between the commercial and tax balance sheets were not recognised, since it is not possible to predict the settlement of these differences with a sufficient degree of probability.

FINANCIAL AND LIQUIDITY POSITION

In the period under review, the registered Public Pfandbriefe decreased by EUR 0.8 billion to EUR 14.0 billion, and the bearer Pfandbriefe by EUR 0.2 billion to EUR 4.6 billion. The reasons for the decrease were scheduled maturities.

The overall Pfandbriefe item thus reached EUR 18.6 billion (including pro rata interest) (December 31, 2015: EUR 19.7 billion), which represented 60.2 % (December 31, 2015: 62.7 %) of the balance sheet total.

Other liabilities to banks decreased by EUR 0.4 billion to EUR 3.9 billion. › 7

Securities repurchase agreements increased to EUR 1.5 billion (December 31, 2015: EUR 1.2 billion), of which EUR 0.4 billion related to business with Dexia Crédit Local and its branch in Dublin (December 31, 2015: EUR 0.4 billion).

The Bank's use of open-market loans provided by the Deutsche Bundesbank remained relatively marginal during the first half of 2016. As of June 30, 2016, the Bank had taken out open-market loans with a volume of EUR 0.8 billion (December 31, 2015: EUR 1.6 billion). As of this date, Dexia Kommunalbank Deutschland's available credit line with the Deutsche Bundesbank based on pledged securities amounted to EUR 1.0 billion. The Bank also held further unencumbered securities eligible for central bank borrowings with a nominal volume of EUR 604.9 million.

As of the end of the period under review, the Bank's portfolio of secured refinancing funds in the form of Public Pfandbriefe and other secured borrowings totalled EUR 20.5 billion, which amounted to 66.5 % of the balance sheet total.

Other liabilities to non-bank customers increased by EUR 0.9 billion to EUR 7.0 billion. This mainly comprised non-banks' demand and fixed-term deposits, which have risen to EUR 6.6 billion (December 31, 2015: EUR 5.7 billion). Customers have a broad range of deposit products in line with market conditions in this business segment.

Overall, the liquidity situation of Dexia Kommunalbank Deutschland remained adequate due to its high volume of claims, which have solid credit ratings and are eligible for cover and central bank borrowings, together with its extensive deposit business.

The Bank remains integrated within the Dexia Group's central liquidity management system. The EUR 1.0 billion revolving liquidity facility granted by Dexia Crédit Local was extended for another year in October 2015. As in previous years, the Bank did not draw upon this facility in the period under review.

7 Development of key balance sheet equity and liabilities

	30.06.2016 in EUR million	31.12.2015 in EUR million	Change as %
Registered Pfandbriefe	393.6	526.7	–25.3
Other liabilities	3,948.9	4,329.0	–8.8
Liabilities to banks	4,342.5	4,855.7	–10.6
Registered Pfandbriefe	13,642.7	14,354.7	–5.0
Other liabilities	6,982.5	6,104.0	14.4
Liabilities to non-bank customers	20,625.2	20,458.7	0.8
Public Pfandbriefe	4,562.7	4,797.1	–4.9
Other debt securities	30.0	30.5	–1.4
Securitised liabilities	4,592.8	4,827.6	–4.9
Subordinated liabilities	60.0	60.0	0.0
Profit participation rights capital	49.3	49.3	0.0
Subscribed capital	432.5	432.5	0.0
Reserves	399.4	399.4	0.0
Accumulated losses	–177.5	–174.1	1.9
Equity	654.4	657.7	–0.5
Other liabilities	576.5	486.2	18.6
Balance sheet total	**30,900.7**	**31,395.4**	**–1.6**

Moreover, in this respect, it should be noted that the letter of support issued by Dexia Crédit Local on February 28, 2011, includes a legally binding commitment to make up any liquidity shortfalls of Dexia Kommunalbank Deutschland.

The Bank's liquidity ratio under regulatory requirements is determined in accordance with the German Liquidity Regulation (Liquiditätsverordnung, LiqV). The ratio of the funds available in the first time bucket (due daily or within a period of up to one month) and the payment commitments which may fall due within this period may not fall below 1.

In the reporting period, the liquidity ratio according to Section 2 LiqV fluctuated between 1.11 (minimum) and 1.46 (maximum), and averaged 1.30. › 8

8 Liquidity position

	Minimum	Maximum	Average
Liquidity ratio	1.11	1.46	1.30

Volume of outstanding Pfandbriefe and Pfandbriefe cover

The total volume of Public Pfandbriefe outstanding had decreased to EUR 18.3 billion as of June 30, 2016 (December 31, 2015: EUR 19.3 billion). At the same time, the volume of cover pool assets used for cover declined to EUR 19.9 billion (December 31, 2015: EUR 21.0 billion).

Dexia Kommunalbank Deutschland has long maintained a nominal overcollateralisation ratio (ratio of the cover pool's nominal value to the nominal value of the outstanding Pfandbriefe) of at least 8.15 %, without being statutorily or contractually obliged to do so. As of June 30, 2016, the nominal overcollateralisation ratio amounted to 9.0 % (December 31, 2015: 8.6 %), and its present-value overcollateralisation ratio (ratio of the cover pool's present value to the present value of the volume of outstanding Pfandbriefe) was 18.6 % (December 31, 2015: 16.5 %).

Dexia Kommunalbank Deutschland complies with the recommendation of the Association of German Pfandbrief Banks (Verband deutscher Pfandbriefbanken, vdp) to apply the rules prescribed by the vdp credit differentiation model. With the vdp credit differentiation model, the vdp has developed a method which limits the inclusion of non-investment grade government debt in the cover calculation by means of rating-dependent markdowns. Allowing for these markdowns, as of June 30, 2016, the nominal overcollateralisation ratio decreased slightly to 8.7 % and the present-value overcollateralisation ratio to 18.3 %.

The structure of the cover pool thus changed only slightly. The proportion of exposures to central governments decreased to 10.5 % (December 31, 2015: 13.1 %), while the proportion of exposures to regional authorities rose to 59.6 % (December 31, 2015: 57.1 %). Exposures to local authorities and other debtors accounted for 26.4 % (December 31, 2015: 26.4 %) and 3.6 % (December 31, 2015: 3.4 %) respectively of the cover pool. Cover claims from Germany amounted to 67.0 % (December 31, 2015: 65.0 %) of the cover pool and were thus slightly higher than on December 31, 2015. Claims from Italy (10.4 % of the cover pool), Belgium (6.1 %), and Austria (5.4 %) followed.

Standard & Poor's rating of the Public Pfandbriefe issued by Dexia Kommunalbank Deutschland AG remained unchanged at A (outlook stable).

In the first half of 2016, Dexia Kommunalbank Deutschland commissioned Scope Ratings rating agency with the very first rating of the Public Pfandbriefe. On May 4, 2016, the rating agency announced the rating of the Public Pfandbriefe issued by Dexia Kommunalbank Deutschland at AA– (outlook stable). According to Scope, the main bases of this valuation are the solid credit quality of the cover assets, which is expressed in the low default rates as well as the available nominal overcollateralisation.

NET ASSETS POSITION

Compared to the end of the previous year, the balance sheet total of Dexia Kommunalbank Deutschland decreased by EUR 0.5 billion, or 1.6 %, to EUR 30.9 billion.

Under the loans and advances to banks items, other loans and advances increased to EUR 6.6 billion (December 31, 2015: EUR 5.7 billion) mainly due to a rise in cash collateral to secure negative derivative exposures and securities repurchase agreements in the amount of EUR 1.0 billion. › 9

Scheduled maturities resulted in a EUR 0.5 billion decline in loans and advances to non-bank customers to EUR 15.0 billion.

Compared to the end of the previous year, the Bank's portfolio of bonds and debt securities declined by 9.1 % (EUR 0.9 billion) to EUR 8.5 billion. Bonds and debt securities decreased to 27.5 % of the balance sheet total (December 31, 2015: 29.8 %), while loans decreased to 49.9 % of the balance sheet total (December 31, 2015: 51.0 %).

9 Development of key balance sheet assets

	30.06.2016 in EUR million	31.12.2015 in EUR million	Change as %
Loans to public sector entities	464.5	533.1	−12.9
Other loans and advances	6,649.5	5,694.5	16.8
Loans and advances to banks	7,114.0	6,227.6	14.2
Mortgage loans	39.1	40.6	−3.6
Loans to public sector entities	14,691.6	15,197.1	−3.3
Other loans and advances	228.5	232.1	−1.5
Loans and advances to non-bank customers	14,959.2	15,469.7	−3.3
From public sector issuers	6,185.9	7,000.8	−11.6
From other issuers	2,303.3	2,340.7	−1.6
Own debt securities	11.9	11.6	3.1
Bonds and debt securities	8,501.1	9,353.0	−9.1
Other assets	326.4	345.0	−5.4
Balance sheet total	**30,900.7**	**31,395.4**	**−1.6**

Total domestic and foreign exposures to public sector debtors (public sector lending) decreased by EUR 1.4 billion to EUR 21.3 billion. This corresponded to a 69.1 % share of the balance sheet total (December 31, 2015: 72.4 %).

The United Kingdom's exit from the European Union due to the referendum on June 23, 2016, will not have no direct effects on Dexia Kommunalbank Deutschland. As of June 30, 2016, the credit exposure to British banks, all of which have at least an investment grade rating, was at EUR 137.6 million, of which EUR 75.3 million were secured. Furthermore, the Bank is holding government bonds denominated in British pounds amounting to GBP 80.0 million, which are fully secured through foreign-currency swaps.

Own funds

According to the Capital Requirements Regulation (CRR), the calculation of regulatory own funds has to be determined on the basis of an intra-year loss, which amounts to EUR −3.4 million as of June 30, 2016. The Common Equity Tier 1 capital (CET1 capital) therefore decreased to EUR 654.1 million as of June 30, 2016 (December 31, 2015 after the approval of the annual financial statements: EUR 657.5 million).

Under the CET1 capital item, the subscribed capital and the reserves remained unchanged.

The overall net loss reported for the financial year 2015 amounted to EUR −99.5 million. Within the scope of offsetting losses in the profit participation rights capital, capital was drawn upon with a volume of EUR 9.5 million, in accordance with the applicable contractual provisions. Accumulated net losses for 2015 were thus decreased to EUR −174.1 million. This loss was approved on March 24, 2016 and carried forward to a new account.

The items to be deducted from CET1 capital in accordance with the CRR amounted to EUR −0.3 million as of June 30, 2016.

In total, CET1 capital therefore reached an amount of EUR 654.1 million as of June 30, 2016.

The Bank does not have any Additional Tier 1 capital (AT1 capital).

Tier 2 capital (T2 capital) decreased to EUR 35.2 million as of June 30, 2016 (December 31, 2015 after the approval of the annual financial statements: EUR 46.3 million). The T2 capital includes profit participation rights capital and subordinate loans amounting to EUR 18.2 million. Regulatory acknowledged general credit risk adjustments in accordance with Section 340f of the German Commercial Code (Handelsgesetzbuch, HGB) and an excess over expected losses based on internal ratings are further elements of the T2 capital and jointly amount to EUR 17.0 million. › 10

The Common Equity Tier 1 capital ratio (CET1 ratio) calculated according to the CRR amounted to 19.6 % as of June 30, 2016 (December 31, 2015: 19.3 %). The total capital ratio according to the CRR reached 20.7 % as of June 30, 2016 (December 31, 2015: 20.6 %).

Both of these capital ratios continued to significantly exceed the regulatory requirements.

10 Development of own funds (figures after to the approval of the annual financial statements)

in EUR million	30.06.2016	31.12.2015
Subscribed capital	432.5	432.5
Reserves	399.4	399.4
Accumulated balance sheet loss	–174.1	–174.1
Intra-year loss	–3.4	0.0
Intangible assets	–0.3	–0.2
Tier 1 capital	**654.1**	**657.5**
Profit participation rights capital	9.5	15.3
Subordinated liabilities	8.7	14.7
Regulatory acknowledged general credit risk adjustments acc. Section 340f HGB	6.3	6.1
IRB excess of provisions over expected losses	10.7	10.3
Tier 2 capital	**35.2**	**46.3**
Total	**689.3**	**703.8**

SUMMARY OF BUSINESS PERFORMANCE

In summary, the following comments are, in order, regarding the net assets, financial position, and results of operations of Dexia Kommunalbank Deutschland:

- As planned, the balance sheet total decreased by 1.6 % to EUR 30.9 billion.
- New lending business was only performed in the context of cover pool and liquidity management, with the exception of a low volume of loan prolongations.
- The profit and loss account ended the period under review with a net loss of EUR –3.4 million (June 30, 2015: EUR –141.9 million).
- Tier 1 capital shown in the balance sheet slightly decreased to EUR 654.1 million. The Tier 1 capital ratio amounted to 19.6 % (December 31, 2015: 19.3 %).
- Dexia Kommunalbank Deutschland maintained an adequate liquidity position, with deposit business.
- As of June 30, 2016, the Bank's number of employees amounted to 82.

In summary, the Bank's net assets and financial situation were stable, while the results of operations barely balanced and had suffered due to its high Heta risk provisioning in the same period of the previous year.

The Management Board would like to express its thanks and appreciation to all of the Bank's employees for their considerable dedication. We would also like to thank the works council and the representative body for senior executives for our constructive working relationships.

EMPLOYEES

On June 30, 2016, Dexia Kommunalbank Deutschland had 82 employees (December 31, 2015: 78 employees). Overall, three employees left the company during the period under review. The personnel requirements were satisfied by recruiting seven new employees.

FORECAST REPORT

The Bank envisages the following trends for the financial year 2016:

- The balance sheet total will decrease to approximately EUR 29 billion, as of December 31, 2016.
- As of December 31, 2016, the Bank's Tier 1 capital is expected to reach a level of approximately EUR 644.5 million.
- Its Tier 1 capital ratio will likely amount to approximately 19.6 % at the end of 2016 and will thus continue to significantly exceed the statutory requirements.
- The Bank upholds its forecast published in the Annual Report 2015, which states that it will report a net loss for the year. It envisages that this will fall in the range of EUR –15 million to EUR –25 million.
- Dexia Kommunalbank Deutschland will maintain an adequate liquidity position, and its deposit business is expected to remain stable.

In its ad-hoc publication on May 18, 2016, Dexia Kommunalbank Deutschland pointed out that the realisation of the conversion of Heta claims, as described in the memorandum of understanding, would initially result in an (extraordinary) income for the Bank in the range of EUR 130 million to EUR 140 million. At the same time, the Bank has confirmed its forecast published in the Annual Report 2015, which states that it will report a net loss for 2016 in the range of EUR –15 million to EUR –25 million (see section Business Performance – Claims against Heta Asset Resolution AG).

If the Heta conversion transaction during the financial year 2016 should be possible to conclude with the expected result, the Bank intends to close pending transactions and, if applicable, other measures that, taken together, will lead to the reported profit/loss for the year in the range stated.

The Management Board feels obligated to do so in order to strengthen the Bank's present-value capital base in the interest of continued compliance with regulatory requirements as well as accounting standards.

In summary for Dexia Kommunalbank Deutschland's financial year 2016, we thus expect a stable development of net assets and the financial situation. With regard to the results of operations, suffered in the in the previous year by the high Heta risk provisioning, we expect a net loss for the year in the range indicated above.

In a press release dated August 10, 2016, the Dexia Group announced that its condensed consolidated financial statements as of June 30, 2016 had been prepared in accordance with the accounting rules based on a going-concern assumption. The 2015 annual financial statements of the Dexia Group are thus based upon a series of assumptions which form the basis for the business plan for the Dexia Group's resolution, and are outlined below.

- The business plan was constructed from market data observable at the end of September 2012; the underlying macroeconomic assumptions are reviewed as part of the semi-annual reviews of the entire plan.
  In particular, the updates made on the basis of data available as at December 31, 2015 and validated by the Management Board of the Dexia Group on June 14, 2016 take into account an updated funding plan based on the most recent market conditions. They also incorporate regulatory developments to date, such as the final version of the CRD IV Directive and the implementation of the IFRS 9 accounting standard from 2018, based on assumptions known to date.
  The revised business led to adjustments being made in relation to the original plan, but they do not raise any issues regarding the trajectory of the Group's resolution over the long term.
- The business plan assumes maintenance of the banking licences of various entities as well as the rating of Dexia Crédit Local S. A.
- It relies on a robust funding capacity, which is dependent on investor appetite for the debt guaranteed by Belgium, France and Luxembourg, and the Dexia Group's ability to raise secured funding.
- In this respect, since the approval of the Orderly Resolution Plan in December 2012, the Group's funding structure has benefited from an increase in market, secured or guaranteed funding, at a lower cost than anticipated in the business plan, for larger volumes and longer maturities. This enabled the Group to reduce its recourse to central bank funding and to exit the exceptional funding mechanisms put in place in 2012. By way of prudent liquidity management, the Group also established liquidity reserves with the aim in particular to deal with an increase in the amount of cash collateral posted to its derivatives counterparties. Furthermore, the Group also armed itself against part of the potential effects of the result of the referendum on the United Kingdom remaining in the European Union, by covering its pound sterling requirements over several months.

However, over the duration of the Group's resolution, uncertainties remain regarding the implementation of the business plan:

- It is especially exposed to the evolution of accounting and prudential rules.
- The financial characteristics of the Dexia Group since its entry into resolution do not allow it to ensure compliance with certain regulatory ratios over the whole resolution period, given the evolution of the regulatory framework and of the macroeconomic environment since 2012.
  The business plan is indeed also sensitive to the evolution of the macroeconomic environment. In this regard, the uncertainty generated by the result of the referendum on the United Kingdom remaining in the European Union has resulted in extremely severe volatility of market parameters, including exchange rates, interest rates and credit spreads, to which the Group is particularly sensitive. As at June 30, 2016, the extent of the movements observed remains within the proportions already seen in the past. An unfavourable evolution of these parameters over time could, however, weigh on the Group's liquidity and its solvency through an increase in the amount of cash collateral posted by the Group to its derivatives counterparties (as the sensitivity of the liquidity requirement to this parameter is in the order of EUR 1.2 billion for a 10 basis point variation of long-term rates) or an impact on the valuation of assets, financial liabilities and OTC derivatives, the variations of which are booked to the income statement, or are liable to result in a variation of the AFS reserve and the level of the Group's regulatory capital.
- Finally, if market demand for government-guaranteed debt were to decline, Dexia Group would need to turn to more costly funding sources, which would directly impact the profitability assumed in the original business plan.

The latest update to the business plan shows a surplus liquidity position over the entire projection horizon. The determination of this surplus liquidity relies on a projection of the amount of cash collateral and it is therefore sensitive to variations in the latter. In 2016, sustained activity in long-term guaranteed issues and secured funding, under volatile market conditions, enabled the Group's liquidity reserves to be kept at a level of EUR 14 billion as at June 30, 2016, despite an increase in the net cash collateral posted of EUR 5 billion since December 31, 2015, to EUR 37 billion.

Due to the Bank's membership of the Dexia Group, these comments on the Dexia Group are also indirectly applicable to Dexia Kommunalbank Deutschland.

REPORT ON RISKS AND OPPORTUNITIES

RISK MANAGEMENT SYSTEM

Dexia Kommunalbank Deutschland maintains a risk management and risk controlling system for identification, assessment, management, monitoring and notification of key risks and associated risk concentrations. This system is continuously refined.

As part of the Dexia Group, where appropriate and expedient, Dexia Kommunalbank Deutschland applies the Dexia Group's standard risk measurement definitions, guidelines and methods. This enables the Bank's consistent inclusion in the Dexia Group's risk management framework.

Risk policy guidelines and structures are laid down in the organisational manual, to which all of the Bank's employees have access via its intranet. This serves as the basis for a uniform handling and internal notification system for all significant types of risk, and supports Dexia Kommunalbank Deutschland's targeted risk management procedures.

Within the scope of its annual risk inventory process, all quantifiable and non-quantifiable risks associated with the Bank's business are identified and subsequently assessed in terms of their potential impact on the Bank's net assets, financial position and results of operations. Possible effects on Pfandbrief business are also analysed. All of the Bank's relevant organisational units are included in this regular process. The risk types which have been classified as significant are:

- Credit risks (including country risks),
- Market price risks (including interest-rate risks, spread risks),
- Liquidity risks and funding risks, as well as
- Operational risks.

On the basis of the Bank's business strategy and the results of its risk inventory, the Management Board has defined a risk strategy which is consistent with its business strategy, both for the Bank as a whole and also for its Pfandbrief business. This risk strategy specifies its risk policy guidelines (risk culture, risk appetite and risk propensity) and defines risk management goals and the relevant risk limitation measures.

The Risk Controlling department provides the relevant decision-makers with the necessary information for managing these risks. It implements the risk strategy prescribed by the Management Board and monitors, in particular, general credit risks, market price risks, liquidity risks and operational risks. Risk Controlling is also responsible for the ongoing development of the Bank's risk measurement and valuation methods. In line with the Bank's schedule of responsibilities, the Risk Controlling department reports to the member of the Management Board with responsibility for back-office functions.

Internal Audit reviews the appropriateness of the Bank's risk control and risk management system on an ad hoc basis and within the scope of the annual audit plan.

The risk-bearing capacity concept (one-year horizon) and the capital planning process (four-year horizon) in accordance with MaRisk and the portfolio present value (PPV) and the portfolio market value (PMV) indicators are core elements of the Bank's overall risk management system.

In addition, material individual risks are separately registered, analysed, valued and limited.

Risk-bearing capacity concept

Risk-bearing capacity is determined on a stand-alone basis, according to the going-concern approach and also the liquidation approach. Existing support measures – such as Dexia Crédit Local's letter of support and revolving liquidity facility – are not included.

The Bank uses different levels of confidence for each approach – it applies a confidence level of 95.0 % for the going-concern approach and a level of 99.9 % for the liquidation approach. As a rule, a (rolling) assessment period of twelve months is used. Risk-reducing diversification effects are only considered for the 'market price risks' risk category. The going-concern approach provides the primary perspective from the point of view of internal risk management. The liquidity view serves as a supplementary perspective.

Risk-covering resources are determined on the basis of regulatory own funds and the planned outcome for the defined assessment period. The portion of regulatory own funds, which is necessary for fulfilment of the banking supervisory minimum capital requirements, is deducted from the risk-covering resources.

The calculation of the assignable risk amounts includes in the risk-bearing capacity calculation any risks which have been characterised as material in the risk inventory and which may be meaningfully assigned risk-covering resources. If a new, quantifiable material risk is identified in the risk inventory, this will be considered within the scope of the Bank's risk-bearing capacity determination. Non-material risks are not assigned risk-covering resources. Risk amounts are currently determined for credit risk (general credit risk and credit value adjustment (CVA)), market price risk (interest-rate risk, basis risk and spread risk), funding risk and operational risk. For all of these risk types, a Value at Risk method is applied in order to determine the risk amount, on the basis of various assumptions. Model risks are also considered.

Further latent risks are considered by assigning only part of the overall risk-covering resources to the above-mentioned risk types. › 11

Even though they have been identified as material risks in the risk inventory, the Bank's risk-bearing capacity concept does not include liquidity risks in the narrowly defined sense, since this risk cannot be meaningfully assigned own funds. Dexia Kommunalbank Deutschland has separate procedures for the management of liquidity risk.

Since operational risks cannot be operationally managed by means of short-term measures, no separate limit is assigned for them. The limit thus matches the risk contribution and is deducted from the available risk-covering resources.

Within the scope of the methodological development of the risk-bearing capacity system, in the first half of 2016, the following significant changes to the risk-bearing capacity concept were implemented:

- Development of the integrated market price risk measuring tool;
- Limitation of the securitisation of the market price risk to these items subject to a market price risk deemed relevant by commercial law;
- Adjustments due to validation results (e.g. adjustments of the model risk premium); and
- Limit reallocation (increase of credit risks, reduction of market price risk and funding risk).

In relation to the going-concern approach, risk-bearing capacity was given as of June 30, 2016. › 12 The utilisations changed during the first half of 2016 due to the methodological changes outlined above and, in particular, due to the changed allocation of the provided risk-covering resources.

In addition, the Bank uses risk management instruments in the form of individual reports on all relevant risk types, which provide detailed information on the key risk drivers and changes over time. They thus provide important information for internal risk management purposes, both at the level of the overall Bank and also at the level of individual risks.

In addition, the Bank regularly conducts stress tests for all risk types – including all relevant positions – within the scope of its risk-bearing capacity calculation.

Portfolio present value and portfolio market value

Another key control parameter is the portfolio present value (PPV), which is calculated every day and reported to the Bank's decision-makers. For this purpose, the present values of all interest-bearing balance-sheet and off-balance sheet positions are pooled and supplemented with other assets as well as associated balance-sheet positions. The PPV provides an indication of the development of the portfolio value, subject to a going-concern assumption. The Management Board and the Supervisory Board are notified immediately if the ratio of Tier 1 capital and PPV falls below a defined limit. On June 30, 2016, the ratio amounted to 1.43, which is slightly below that on December 31, 2015 to 1.45. The PPV is supplemented by the portfolio market value (PMV) – which also considers the credit spreads of asset and liability positions and thus reflects a liquidation scenario – and by the scenario PPV, which also includes the assumption of increased costs, in order to close funding gaps.

Stress tests

Stress scenarios are an important and permanent component of the Bank's risk management process in order to identify risk concentrations and possible equity shortfalls. They provide transparency regarding the effects of extraordinary but plausible events.

For the market risk and liquidity risk types, in the period under review the Bank calculated the stress tests required by MaRisk on a daily basis.

11 Assumptions for the calculation of risk-bearing capacity

Risk type		Comments on the risk measurement methods
General credit risk	Non-specific general credit risk	Calculation of a Value at Risk using the Gordy model with a granularity adjustment (Hirschman-Herfindahl index).
	CVA charge	Calculation in accordance with the standardised method in compliance with regulatory requirements (Article 384 of the CRR).
Market price risk		Comprises interest-rate risk, basis risk and spread risk. Value at Risk on the basis of a historical simulation for all current assets positions and subject to trustee dual control.
Funding risk		Conservative estimation of the accumulated liquidity gap within the one-year horizon and closure with increased funding spreads.
Operational risk		Value at Risk on the basis of a historical simulation of all loss events since recording of losses began.

12 Risk-bearing capacity according to a going-concern perspective in the normal scenario

Risk-covering resources	Available risk-covering resources		Provided risk-covering resources	
in EUR million	30.06.2016	31.12.2015	30.06.2016	31.12.2015
Own funds	689.3	637.0	90 % of the available risk-covering resources	
Capital requirements	−287.4	−277.5		
Free own funds	**401.9**	**359.5**		
Horizon Δ own funds	−40.0	29.1		
Horizon Δ capital requirements	−20.8	−21.7		
Further components	17.6	30.4		
Total	**358.7**	**397.3**	**322.8**	**357.5**

Risk potential	Limit on provided risk-covering resources in EUR million		Utilisation as %	
	30.06.2016	31.12.2015	30.06.2016	31.12.2015
General credit risk & CVA-Charge	121.1	83.9	63.5	102.5
Market price risk	75.7	117.4	71.8	79.1
Funding risk	105.9	134.2	93.5	71.0
Operational risk	20.1	22.1		
Total	**322.8**	**357.6**	**77.6**	**82.8**

In addition, quarterly historical stress tests are implemented for all individual risk types (general credit risk, market price risk, funding risk and operational risk). Another core area of focus is the hypothetical overall bank stress test, which is based upon a 'sovereign debt crisis' scenario and also a 'serious economic downturn' scenario, covering multiple types of risk.

The results of these stress tests are considered in the overall assessment of risk-bearing capacity, and they may thus serve as a basis for implementation of enhanced risk monitoring measures.

Risk management for Pfandbrief business

As a Pfandbrief bank, Dexia Kommunalbank Deutschland falls under the scope of the German Pfandbrief Act (Pfandbriefgesetz, PfandBG). This requires a suitable risk management system (Section 27 PfandBG) for monitoring of all risks associated with Pfandbrief business.

As well as safeguarding compliance with the statutory requirements for overcollateralisation for Pfandbriefe, in line with the dynamic approach pursuant to Section 5 (1) and Section 6 (2) of the German Pfandbrief Present Value Regulation (Pfandbrief-Barwertverordnung), the Bank calculates stress scenarios for interest-rate and currency risks. For some time now, the Bank has maintained a nominal overcollateralisation ratio (ratio of the nominal value of the cover pool to the nominal value of the outstanding Pfandbriefe) of at least 8.15 %, without being statutorily or contractually obliged to do so.

Credit risk for the cover pool is restricted by means of a limit system. The cover portfolio focuses on high-quality assets with ratings within the rating interval of AAA to A+. In addition, the proportion of cover assets with a non-investment grade rating is limited.

While at the overall bank level foreign-currency risk is hedged by means of derivative transactions, as a rule, the derivatives incorporated in the foreign-currency positions are not included in the cover pool. Open foreign-currency positions thus exist at the level of the cover pool, but are restricted by means of limits. In addition, various cash flow analyses are implemented for monitoring of liquidity risk, and risk concentration is monitored at the borrower level.

RISKS

MARKET PRICE RISKS

Market risk comprises the following key sub-categories:

- Interest-rate risks (including basis risks);
- Credit spread risks; and
- Foreign-currency risks.

Interest-rate risk refers to the loss potential on interest-related positions which result from a change in the interest-rate level or the interest-rate structure for the Bank's portfolio value.

As a rule, interest-rate risks are hedged by entering into interest-rate swaps. Limits restrict the residual interest-rate risk. Interest-rate risk is managed and monitored at the portfolio level and at the overall bank level.

The management has at its disposal two risk-related indicators which are calculated on the basis of the fair-value method as key management parameters for interest-rate risks: the Basis Point Value (BPV or PV01) and Value at Risk (VaR). The BPV describes the potential present-value change in the overall portfolio in case of a parallel shift in the interest rates for the full range of maturities by 100 bp, while PV01 describes this in case of a 1 bp increase per defined time bucket.

The Value at Risk (VaR) calculates the maximum expected loss within a defined holding period, with a sufficient degree of probability. The Bank calculates the VaR every day on the basis of a confidence level of 99.0 % and a holding period of ten days. The Bank has created various sub-portfolios: the long-term sub-portfolio Local Balance Sheet Management (Local BSM) and the short-term sub-portfolio Cash & Liquidity Management (CLM).

The short-term interest-rate risks are limited to EUR 15.0 million (+/–100 BPV) and to EUR 1.5 million in terms of the VaR, while the long-term interest-rate risks are limited to EUR 5.0 million. In addition, the interest-rate risk (PV01) maturity ranges specified for Local BSM are limited. The interest sensitivity of the credit spreads is measured daily. No separate limit is imposed.

Moreover, the total portfolio consisting of CLM and Local BSM is restricted to a VaR limit of EUR 2.5 million. › 13

13 Overall limits for management of interest-rate risks

in EUR million	Value at Risk (99 %, 10 days)	+/–100 bp
Cash & liquidity management	1.5	15.0
Local balance sheet management	–	5.0
Total	**2.5**	**–**

The following values resulted on the basis of these assumptions: › 14 and 15

14 Limit utilisation for cash & liquidity management

in EUR million	Value at Risk (99 %, 10 days)	+100 bp	–100 bp
Average	0.5	6.8	–6.8
Minimum	0.1	–1.0	–12.7
Maximum	1.1	12.7	1.0
Last trading day	0.2	1.9	–1.9

15 Limit utilisation for local balance sheet management

in EUR million	Value at Risk (99 %, 10 days)	+100 bp	–100 bp
Average	0.4	–2.7	2.8
Minimum	0.1	–4.3	0.8
Maximum	1.0	–0.7	4.4
Last trading day	0.2	–0.7	0.8

The Treasury department, which is responsible for the management of interest-rate risks, is notified by means of a daily risk report of the development of interest-rate risk and the levels of limit utilisation. The Bank's Asset Liability Management Committee – which meets on a monthly basis – is responsible for strategic interest-rate risk management.

Credit spreads reflect the yield markup on bonds subject to a risk of default. The Bank regularly measures the valuation effects of changes in credit spreads. Credit spread risk is restricted within the scope of the risk-bearing capacity system.

The Bank holds a large volume of European government bonds, some of which were subject to heightened spread risks over the past few years. During the first half of 2016, risk premiums for claims against government entities of the peripheral eurozone countries of Italy, Portugal and Spain increased. Further increases of the risk premiums for these bonds would have a negative tending effect on the Bank's risk-bearing capacity and the Bank's portfolio market value.

Foreign-currency risk results from negative changes in value due to exchange-rate fluctuations of foreign currencies. As a rule, the Bank hedges foreign-currency risks by means of cross-currency swaps. As of June 30, 2016, it did not have any significant non-hedged foreign-currency positions. Applicable basis risks ('currency basis spread risks') are regularly monitored, but are not limited.

CREDIT RISKS

Credit risk is the risk of a borrower or a contracting party being unable to meet its obligations to Dexia Kommunalbank Deutschland, either in whole or in part.

To limit credit risks, subject to consultation with the Dexia Group, the Management Board specifies credit lines and lending-authority rules for all contracting parties. The same applies for clearing houses and central counterparties.

Derivative transactions may only be entered into subject to the legally binding conclusion of a German Framework Agreement or an ISDA agreement with the contracting party. A further precondition is the legally binding conclusion of a credit support annex (CSA) in accordance with the Bank's standards. The value of the collateral exchanged is monitored on a daily basis. Detailed information regarding the value and structure of the collateral granted is provided every week at the Management Board's meeting. As of June 30, 2016, the Bank had a net contributor position of EUR 4.6 billion (December 31, 2015: EUR 3.6 billion).

Dexia Kommunalbank Deutschland has frozen all credit lines (except for money-market and derivative limits) for new risk exposures. Moreover, all contracting parties entered on the Bank's monitoring list due to defined criteria (including a downgrade of four notches/a rating which reaches the non-investment grade segment) are separately monitored.

The Risk Controlling department provides and monitors the calculation for levels of credit-line utilisation on a daily basis. The Management Board is immediately notified of any overruns of credit lines and is obliged to decide on appropriate measures. In the period under review, due to fair-value fluctuations, 27 overruns occurred for individual borrowers in the derivatives portfolio. These overruns were immediately eliminated.

An appropriate operational structure for management of credit risks is qualitatively and quantitatively safeguarded, in terms of credit analysis and also loan processing, in line with the internal requirements.

Borrowers in Germany account for approximately 59.4 % of the Bank's portfolio, followed by claims against borrowers from Italy (14.4 %) and Belgium (7.0 %).

Moreover, around 89.6 % of the Bank's assets are eligible for cover and much of them are also eligible for central bank borrowings and for repo transactions. As of June 30, 2016, 94.7 % of all assets have an internal rating of BBB– (investment grade) or higher. Adequate risk classification systems (ratings) are in place for all of the Bank's customer groups. Due to the structure of existing business, portfolio management focuses on regionally diversifying and credit rating class-related management. Foreign claims resulting from loans and securities especially undergo a regular review covering existing risks and opportunities and the resulting strategic options.

The Bank's total exposure (including credit-risk-mitigation techniques) is shown for each specific asset class in Tables › 16 and › 17 , with a breakdown of external and internal ratings on the basis of the CoRep reporting as of June 30, 2016.

The following measures are implemented in order to limit credit risk and the related concentrations of risk:

- Credit-line monitoring;
- Monitoring of credit default risk;
- Early risk-detection methods;
- Reporting on external and internal rating changes; and
- Portfolio management on the basis of the general credit risk report and the results of the risk-bearing capacity calculation, including stress scenarios.

The Management Board and the Supervisory Board are regularly notified of the credit risk and the measures implemented to limit this risk.

As well as the Internal Rating Based Approach (IRB Approach) pursuant to Articles 142 et seq. of the CRR, the Bank also uses the Credit Risk Standard Approach pursuant to Articles 111 et seq. of the CRR for determination of the total capital charge for credit risks. Exposure values under the IRB Approach are determined for loans to central governments and central banks, institutions and undertakings. If the Bank has not implemented any independent rating systems for borrowers for which the usage requirements for the IRB Approach are fulfilled, the Credit Risk Standard Approach is applied for these credit risk positions in accordance with the CRR. In particular, this comprises loans to German and foreign municipal and semipublic enterprises. German federal states and their municipalities are permanently excluded from the application of the IRB Approach under Article 150 of the CRR.

As a company belonging to the Dexia Group, the Bank applies the standard rating methods of the Dexia Group. This includes regular validation of the methods and models used. Please refer to the annual risk report of the Dexia Group for further information regarding the rating models used, the model assumptions, and the premises for the methods applied.

16 **Total exposure by external rating**

Asset class	External rating	Exposure at default		Average risk weight
		30.06.2016	31.12.2015	
		in EUR million	in EUR million	as %
Central governments or central banks	AAA to AA–	14,724.4	15,528.4	0.0
	A+ to A–	264.9	232.1	20.0
	BBB+ to BBB–	–	–	–
	BB+ to BB–	–	–	–
	B+ to B–	–	–	–
	No rating	–	–	–
Regional or local authorities	AAA to AA–	–	–	–
	A+ to A–	–	–	–
	BBB+ to BBB–	62.4	64.9	20.0
	BB+ to BB–	–	–	–
	B+ to B–	–	–	–
	No rating	–	–	–
Public sector entities	AAA to AA–	384.8	448.5	20.0
	A+ to A–	–	–	–
	BBB+ to BBB–	–	–	–
	BB+ to BB–	–	–	–
	B+ to B–	–	–	–
	No rating	112.6	117.8	100.0
Multilateral development banks	AAA to AA–	268.9	265.2	0.0
	A+ to A–	–	–	–
	BBB+ to BBB–	–	–	–
	BB+ to BB–	–	–	–
	B+ to B–	–	–	–
	No rating	–	–	–
Institutions	AAA to AA–	–	–	–
	A+ to A–	49.7	17.1	50.0
	BBB+ to BBB–	–	–	–
	BB+ to BB–	–	–	–
	B+ to B–	–	–	–
	No rating	284.9	96.2	2.0
Corporates	AAA to AA–	13.9	3.5	20.0
	A+ to A–	–	–	–
	BBB+ to BBB–	–	–	–
	BB+ to BB–	–	–	–
	B+ to B–	–	–	–
	No rating	172.4	182.8	100.0
Defaulted positions	CCC+ or lower	220.2	220.2	100.0
Others	AAA to AA–	87.8	90.1	0.0
	A+ to A–	93.4	92.8	0.0
	BBB+ to BBB–	–	–	–
	BB+ to BB–	25.8	25.1	0.0
	B+ to B–	–	–	–
	No rating	580.3	578.8	42.6
Total		**17,346.4**	**17,963.4**	

The ratings determined on the basis of the internal risk classification methods and the associated probabilities of default (PDs) and loss given defaults (LGDs) are an integral part of the Bank's approval, monitoring and control processes.

17 **Total exposure by internal rating**

Asset class	Internal rating	Exposure at default 30.06.2016 in EUR million	Exposure at default 31.12.2015 in EUR million	Average default probability as %	Average loss given default as %	Average risk weight as %	Average expected loss as %
Central governments and central banks	AAA to AA –	1,609.1	1,652.5	0.0	5.4	0.0	0.0
	A+ to A–	158.3	638.7	0.1	20.0	19.6	0.0
	BBB+ to BBB–	3,586.6	3,168.9	0.2	26.9	42.3	0.1
	BB+ to BB–	–	421.4	–	–	–	–
	B+ to B–	–	–	–	–	–	–
Institutions	AAA to AA–	220.4	377.3	0.0	3.0	1.8	0.0
	A+ to A–	927.7	773.5	0.1	18.1	19.3	0.0
	BBB+ to BBB–	602.3	683.6	0.3	12.6	26.2	0.0
	BB+ to BB–	354.4	413.7	1.4	8.0	23.1	0.1
	B+ to B–	65.7	67.0	5.2	0.9	3.6	0.1
Corporates	AAA to AA–	–	–	–	–	–	–
	A+ to A–	7.5	7.5	0.1	34.9	11.9	0.0
	BBB+ to BBB–	31.1	32.9	0.5	26.2	51.2	0.1
	BB+ to BB–	–	–	–	–	–	–
	B+ to B–	–	–	–	–	–	–
Other non credit-obligation assets	AAA to AA–	2.5	0.1	0.0	5.0	0.0	0.0
	A+ to A–	52.0	57.5	0.1	30.3	20.1	0.0
	BBB+ to BBB–	4.2	0.3	0.2	33.3	27.6	0.0
	BB+ to BB–	–	–	–	–	–	–
	B+ to B–	–	–	–	–	–	–
Total		**7,621.7**	**8,295.0**				

Within the scope of the risk-bearing capacity calculation, credit risks are quantified by means of a credit default model (Credit Value at Risk (CvaR), Gordy model). These results undergo a detailed plausibility and development analysis.

Credit exposure in selected European countries

Table › **18** shows the entire credit exposure to borrowers in selected countries.

Risk provisioning

The fair value of existing repayment and interest claims held within the loan book is reviewed within the scope of regular (at least quarterly) and ad hoc loan monitoring. An ad hoc review is implemented in case of negative information (early warning indicators) regarding the borrower, which may result in this borrower's inclusion on the Bank's monitoring list, for instance. Credit-related default or default on interest or redemption payments of more than 90 days are objective indications that may also necessitate a valuation adjustment.

18 **Credit exposure to public-sector entities and financial institutions in selected countries as of June 30, 2016***

Country	Sovereign in EUR million	Sub-sovereign entities in EUR million	Others in EUR million	Total in EUR million	as part of cover pool for Public Pfandbriefe (nominal) in EUR million	loans in EUR million	securities in EUR million	average weighted residual maturity in years
Italy	3,167.9	306.0	128.4	**3,602.3**	2,081.2	–	3,528.0	12.5
Poland	158.3	–	–	**158.3**	157.0	–	158.3	4.2
Portugal	461.9	49.9	316.7	**828.6**	465.0	225.2	603.4	9.9
Spain	19.4	100.2	441.6	**561.2**	578.8	100.2	455.9	5.8
Hungary	142.0	–	–	**142.0**	132.5	–	142.0	1.4
Total	**3,949.5**	**456.2**	**886.7**	**5,292.4**	**3,414.5**	**325.4**	**4,887.6**	**4.2**

* Repo and derivatives transactions have been recognised at their credit equivalent amount; loans and securities at their carrying amount.

As of June 30, 2016, Dexia Kommunalbank Deutschland had only established risk provisioning in the form of specific valuation allowances or depreciations for its claims against Heta Asset Resolution AG.

LIQUIDITY RISKS

Liquidity risks consist of the following sub-categories:
- Liquidity risk (more narrowly defined);
- Funding risk; and
- Market liquidity risk.

Liquidity risk refers to the risk of the Bank being unable to fulfil its present and future payment commitments in a timely manner or being unable to fulfil them in full.

As an important liquidity control instrument, a liquidity forecast is produced every day and provides an overview of liquidity movements. Moreover, the Risk Controlling department determines the short-term liquidity risks by comparing the defined liquidity reserve with the accumulated liquidity requirements for the following month (liquidity position). This liquidity position is determined on a daily basis, subject to various stress scenarios (idiosyncratic stress, market-wide stress, combined stress) in accordance with MaRisk section BTR 3.2. These calculations refer to the periods: spot/next (for the next-but-one working day), one week, and one month.

As well as the absolute liquidity position, Table › 19 indicates the ratio of the reserve to the liquidity gap in the various liquidity scenarios.

Securities eligible for Eurex Repo and ECB borrowings which are classified as highly liquid investments and are not used within the first week are recognised as a liquidity reserve. Beyond the scope of this one-week period, free securities eligible for Eurex Repo or ECB borrowings are included in the reserve. In addition, in determining its overall reserve to cover any liquidity gaps arising, the Bank considers various haircuts (ECB and stress haircuts), additional haircuts for market movements and as well as different Pfandbrief overcollateralisation assumptions.

The lowest calculated liquidity position (reserve plus liquidity gap) for the spot/next, one-week and one-month periods is reported daily.

To determine the liquidity gap, different maturity assumptions (extensions) for unsecured deposits of municipal customers and other investors are included in the scenarios. In addition, pro rata drawdowns on the guarantees and liquidity lines provided by Dexia Kommunalbank Deutschland and liquidity outflows from the increased payment of cash collateral are simulated.

The long-term liquidity risk is measured on a monthly basis by comparing the liquidity requirements and the liquidity gap with the liquidity reserves for the various time buckets within a period of five working days following the last day of the month, for a period of up to 50 years. In addition, a short-term (90-day) and a long-term (10-year) liquidity forecast is produced on a monthly basis.

Funding risk refers to the risk of only being able to obtain the necessary liquid funds at an increased cost.

The Bank measures the risk of increased strain on its future results of operations due to structural liquidity mismatches (liquidity gaps) by regularly analysing the maturity mismatches between asset and liability positions at the level of the overall bank and also at the level of the cover pool. The simulations based on these analyses illustrate the likely effects on future results of operations in case of an increase in the funding costs. No limit applies for the maturity mismatch at

19 Liquidity scenarios according to MaRisk, section BTR 3.2, as of June 30, 2016

	Horizon	Date	Reserve	Liquidity gap	Liquidity position	Reserve/ liquidity gap
			in EUR million	in EUR million	in EUR million	as %
Normal scenario	Spot/next	02.07.2016	2,627.6	–523.0	2,104.6	502.4
	1 week	07.07.2016	2,795.5	–1,122.9	1,672.6	249.0
	1 month	31.07.2016	2,988.4	–1,972.3	1,016.2	151.5
Institution-specific stress scenario	Spot/next	02.07.2016	3,177.5	–1,680.8	1,496.7	189.0
	1 week	07.07.2016	3,344.3	–2,144.2	1,200.1	156.0
	1 month	31.07.2016	3,587.2	–2,995.7	591.5	119.7
Market-wide stress scenario	Spot/next	02.07.2016	2,981.0	–600.9	2,380.2	496.1
	1 week	07.07.2016	3,133.8	–1,492.8	1,641.0	209.9
	1 month	31.07.2016	3,350.3	–2,694.7	655.6	124.3
Combined stress scenario	Spot/next	02.07.2016	3,430.1	–1,758.6	1,671.5	195.0
	1 week	07.07.2016	3,583.4	–2,514.1	1,069.3	142.5
	1 month	31.07.2016	3,722.8	–3,718.2	4.6	100.1

the level of the overall portfolio. Maturity mismatches are measured and an analysis is implemented to identify any necessary measures on a quarterly basis.

Funding risk is also restricted by means of a limit in the risk-bearing capacity concept.

Please see Table › 20 for the development of the Bank's funding structure.

The Bank's key instrument for raising long-term liquid funds is the Public Pfandbrief, which is secured by means of cover assets that are registered in the cover pool. Open-market operations with the Deutsche Bundesbank and securities repurchase agreements with other banks and the Eurex Repo trading platform are other instruments which the Bank uses for secured liquidity procurement.

The Bank issues promissory-note loans and accepts deposits from municipal customers and other investors for the purpose of unsecured liquidity-raising. The total volume of these deposits, which account for almost all of the Bank's unsecured funding, increased as of the balance sheet date from EUR 5.7 billion to EUR 6.6 billion.

The letter of support issued by Dexia Crédit Local on February 28, 2011 includes a legally binding commitment to make up any liquidity shortfalls of Dexia Kommunalbank Deutschland. The Bank remains integrated within the Dexia Group's central liquidity management system. As planned, the EUR 1 billion revolving liquidity facility granted by Dexia Crédit Local was extended for another year as planned in October 2015.

The Bank's funding structure changed only slightly in the first half of 2016. As of June 30, 2016, the share of customer deposits had increased compared to the previous year, while the absolute amount and the share of funding transactions with the Deutsche Bundesbank had declined. Using the available funding instruments, raising of funds for the desired maturities was possible at all times.

Market liquidity risks refer to the risk of being unable to unwind transactions due to insufficient market depth, or in case of market disruptions or only being able to do so subject to losses.

The 'going-concern/held-to-maturity' approach of Dexia Kommunalbank Deutschland assumes that positions will be held up to their final maturity – unless permanent impairment is apparent – and that market liquidity risks will thus not be relevant for valuation purposes. All of the Bank's securities have therefore been entered into its banking book. It does not have any positions in its trading book.

Dexia Kommunalbank Deutschland considers market liquidity risks to be non-material and does not maintain any additional monitoring and limit system for this purpose.

OPERATIONAL RISKS

The Bank defines operational risk as the risk of direct or indirect losses which arise due to the inappropriateness or the failure of internal processes and systems or personnel, or due to external events and which have financial or non-financial effects. This definition includes, in particular, legal risks, personnel risks, IT-related systemic risks, and also reputational risks and risks associated with outsourcing and projects, but not strategic risks.

The ultimate goal for management of operational risks is to minimise losses, which may result from operational loss events, to avoid risks jeopardising the Bank's existence, and to identify material operational risks within the scope of the annual Risk Control and Self Assessments (RCSA).

Operational events which have resulted in an unexpected loss or a profit of more than EUR 1,000 are notifiable incidents. Cases with significant non-financial effects are also included and classified by means of a rating scale.

20 Development of funding structure

	30.06.2016		31.12.2015	
	in EUR million	as %	in EUR million	as %
Public Pfandbriefe	18,270.5	61.9	19,270.0	64.4
Funding transactions with Deutsche Bundesbank	800.0	2.7	1,600.0	5.3
Securities repurchase agreements with banks	508.9	1.7	592.3	2.0
Securities repurchase agreements (Eurex Repo)	971.4	3.3	570.0	1.9
Liabilities to banks	1,186.6	4.0	1,012.5	3.4
of which to Dexia Group	378.4	1.3	432.7	1.4
Liabilities to non-bank customers	6,553.2	22.2	5,729.1	19.1
Other (including own funds)	1,202.5	4.1	1,147.9	3.8
Total	**29,493.1**	**100.0**	**29,921.8**	**100.0**

The Bank uses a Group-wide IT application for registration, valuation, monitoring and historicisation of operational risks. In case of losses, the departments involved are required to analyse the relevant business processes, estimate the loss, and produce proposals on how to avoid this in the future. Within the scope of an escalation process, the overall Management Board and Internal Audit are immediately notified of any loss events.

The Operational Risk Committee, which meets on a quarterly basis, discusses losses and risks with the Management Board, Head of Risk Controlling, Internal Audit and the Bank's compliance officer. The Operational Risk Management system registers notified losses. Overall, four cases were reported in the first half of 2016.

The annual RCSA identifies and analyses the operational risks in the various processes by means of risk inventories and reviews the control systems for risk limitation. Possible measures enabling a reduction in the level of risk are discussed and, where expedient, action plans are agreed, whose implementation is monitored by the Operational Risk Manager. Following completion of the RCSA process, the results of the individual RCSAs are presented to the Management Board.

For its implementation of projects, the Bank uses an appropriate project risk management system in order to identify possible events or situations with a negative impact (damage) on the project's outcome as a whole, or on individual planning factors such as its scope, the cost and the volume of time required, and to prevent or at least minimise these events or situations by initiating appropriate measures. The Bank's Project Management Office Committee, which meets on a monthly basis, monitors the overall project risks.

The IT infrastructure and the operational structure include contingency plans and packages of measures for the purposes of risk limitation and risk avoidance. In addition, within the scope of its contingency planning, the Bank maintains an emergency data centre in order to ensure business continuity in case of crisis situations.

In regard to the Bank's currently existing legal risks, it should be pointed out that legal proceedings are pending in four cases that relate to variablerate loans which Dexia Kommunalbank Deutschland granted in 2006 and 2007 and whose interest rate is tied to the development of the Swiss franc's exchange rate against the euro. It entails a loan volume with an outstanding principal balance of EUR 9.6 million as of June 30, 2016. This volume is divided up between a small number of borrowers. Dexia Kommunalbank Deutschland has rejected the claims brought against it in these proceedings. In three of these four cases, first-instance rulings have now been issued in the Bank's favour. In the fourth case, the court only partly gave right to the arguments made by Dexia Kommunalbank Deutschland AG. All four cases are now pending before the court of appeals.

Please see the section Business performance – Claims against Heta Asset Resolution AG for details of the claims against Austria's Heta Asset Resolution AG held in Dexia Kommunalbank Deutschland's portfolio.

SUMMARY OF RISK SITUATION

Through the implementation of the revised plan for the restructuring of the Dexia Group of December 28, 2012, a stable long-term framework was established for the future business activities of the Group and thus also for Dexia Kommunalbank Deutschland.

The now once again increasing of risk premiums for claims against government entities of the peripheral eurozone countries of Italy, Portugal and Spain had a slightly negative impact on the Bank's risk situation in the period under review. In the reporting period, the Bank's total nominal credit exposure to these peripheral eurozone countries decreased by maturity from EUR 5,035.8 million to EUR 4,992.1 million. In addition, the Bank has a small volume of assets with a non-investment grade rating (internal rating) (5.3 % of its portfolio). As of June 30, 2016, the Bank had established adequate risk provisioning in the form of specific valuation allowances.

The level of utilisation of risk-bearing capacity in the going-concern approach has decreased only slightly from 82.8 % to 77.6 %. While the provided risk-covering resources decreased slightly by EUR – 34.6 million, the current market developments and methodological adjustments in the measuring of the market price risk and a slight reduction of credit risk had a positive effect.

The Bank's liquidity situation remained adequate due to its high volume of claims which have solid credit ratings and are eligible for cover and central bank borrowings, together with deposit business.

The Bank's own funds decreased to EUR 689.3 million (after the approval of the annual financial statements December 31, 2015: EUR 703.8 million). The Bank's Common Equity Tier 1 capital ratio (CET1 ratio) increased to 19.6 % (December 31, 2015: 19.3 %), and the total capital ratio to 20.7 % (December 31, 2015: 20.6 %). Both of these capital ratios significantly exceed the regulatory requirements.

On May 18, 2016, the Republic of Austria and 72 Heta creditors (including Dexia Kommunalbank Deutschland), holding Heta debt securities (guaranteed by state) in the amount of approximately EUR 4.9 billion, signed a memorandum of understanding on the settlement of the Heta dispute. If the conversion of Heta claims, as described in the memorandum of understanding, were to take place, it would initially result in an (extraordinary) income for the Bank in the range of EUR 130 million to EUR 140 million (see also sections Business performance – Claims against Heta Asset Resolution AG, and Forecast Report).

No other events occurred after the balance sheet date which would necessitate a different assessment of the risk situation.

INTERNAL CONTROL SYSTEM AND RISK MANAGEMENT SYSTEM

Information management

All risk-related information is centrally registered in the Bank's risk management system, systemically processed within the framework of its reporting, and provided to the Bank's decision-makers every day, or more frequently if necessary. The IT system also provides the employees responsible with access to analysis results. A functional and targeted flow of information, which is tailored to its specific recipients, ensures a high level of risk awareness on the part of the employees of Dexia Kommunalbank Deutschland.

Accounting-related internal control and risk management system

The goal of the accounting-related internal control and risk management system is to ensure compliance with accounting standards and regulations, and to ensure the orderliness of the accounting, including correct information in financial statements.

The Accounting department is responsible for the general ledger and for regular monitoring of the accounting and its adjustment in line with statutory and regulatory changes. The Back Office department handles the inventory management of banking business in the subsidiary ledgers and technical implementation. The Risk Controlling department values financial instruments, while the Credit department values general credit risks. This information is followed up on in accordance with the process for the preparation of financial statements. The relevant responsibilities are defined in the organisational manual. Job descriptions have been specified for all of the employees entrusted with the accounting process. They are assigned to the Back Office. The accounting process is documented in a form which expert third parties are able to follow.

The control system of Dexia Kommunalbank Deutschland consists of organisational arrangements and integrated, IT-supported controls. As well as these IT-supported controls, it has also installed further regular and ad hoc control procedures.

Dexia Kommunalbank Deutschland uses the software SAP ERP and SAP-compatible modules as an integrated Bank-wide solution. This safeguards an uninterrupted flow of data and largely avoids transfers to other IT applications or manual interference. A competence-based access and authorisation concept establishes controls so as to prevent unauthorised interference with the accounting process. In addition, transaction registration functions are clearly segregated from one another in terms of the divisions participating in the accounting process. The market departments enter transactions in the subsidiary ledger, while the Back Office subsequently reviews and authorises these transactions in accordance with the dual control principle (deal certainty policy). Further interim and final results following processing of the input data are analysed by means of checks against time-series analyses and target/actual comparisons, their plausibility is checked by means of close consultation between Risk Controlling and Accounting and, where appropriate, these results are assessed on a case-by-case basis.

The Accounting department is integrated in the new products process. This ensures rulecompliant and proper accounting for new, non-routine business transactions.

Internal Audit monitors the functional capacity of the accounting-related internal control and risk management system by means of regular process-independent audits, with changing audit focuses.

The management information system provides the management with timely reporting in the form of monthly financial statements under commercial law. The Management Board provides the Supervisory Board and its committees with regular reports, at least once per quarter, on the Bank's current business development. It also provides prompt information in case of specific events.

Berlin, August 26, 2016

Dexia Kommunalbank Deutschland AG

The Management Board

Munsberg **Fritsch**

INTERIM FINANCIAL STATEMENTS 2016 OF DEXIA KOMMUNALBANK DEUTSCHLAND AG

CONDENSED BALANCE SHEET OF DEXIA KOMMUNALBANK DEUTSCHLAND AG AS OF JUNE 30, 2016

21 Assets

			30.06.2016	31.12.2015
	in EUR	in EUR	in EUR	in KEUR
1. Cash reserve assets				
a) Cash on hand		1,665.21		2
b) Balances with central banks		45,190,191.12		60,466
c) Balances with post office giro institutions		0.00	45,191,856.33	0
2. Debt securities of public sector entities and bills permitted for funding at central banks				
a) Treasury bills and non-interest-bearing Treasury financing papers and similar debt securities issued by public sector entities		0.00		0
b) Bills		0.00	0.00	0
3. Loans and advances to banks				
a) Mortgage loans		0.00		0
b) Loans to public sector entities		464,522,284.50		533,144
c) Other loans and advances		6,649,502,051.28	7,114,024,335.78	5,694,492
4. Loans and advances to non-bank customers				
a) Mortgage loans		39,144,435.25		40,597
b) Loans to public sector entities		14,691,575,318.83		15,197,067
c) Other loans and advances		228,481,255.91	14,959,201,009.99	232,057
5. Debt securities and other fixed income securities				
a) Money market securities				
aa) from public sector issuers	0.00			0
ab) from other issuers	0.00			0
b) Bonds and debt securities				
ba) from public sector issuers	6,185,876,381.14			7,000,752
bb) from other issuers	2,303,254,698.75	8,489,131,079.89		2,340,672
c) Own debt securities		11,930,850.91	8,501,061,930.80	11,574
6. Shares and other non-fixed income securities			0.00	0
6a. Trading portfolio			0.00	0
7. Equity investments			0.00	0
8. Shares in affiliated companies			0.00	0
9. Trust assets			0.00	0
10. Equalisation claims against the public sector, including debt securities resulting from their conversion			0.00	0
11. Intangible assets				
a) Self-generated industrial property rights and similar rights and assets		0.00		0
b) Licences, industrial property rights and similar acquired for consideration Rights and assets and licences to such rights and assets		255,238.94		156
c) Goodwill		0.00		0
d) Advance payments to suppliers		0.00	255,238.94	0
12. Property, plant and equipment			4,806,154.97	4,971
13. Capital called in but not yet paid in			0.00	0
14. Other assets			10,532,167.13	8,401
15. Prepayments				
a) From issuing and lending business		185,253,916.11		194,157
b) Other		80,379,064.33	265,632,980.44	76,852
16. Deferred tax assets			0.00	0
17. Surplus from offsetting			0.00	0
18. Deficit not covered by equity			0.00	0
Total assets			**30,900,705,674.38**	**31,395,360**

22 Equity and liabilities

			30.06.2016	31.12.2015
	in EUR	in EUR	in EUR	in KEUR
1. Liabilities to banks				
a) Registered Mortgage Pfandbriefe issued		0.00		0
b) Registered Public Pfandbriefe issued		393,575,543.19		526,734
c) Other liabilities		3,948,905,155.42	4,342,480,698.61	4,329,013
2. Liabilities to non-bank customers				
a) Registered Mortgage Pfandbriefe issued		0.00		0
b) Registered Public Pfandbriefe issued		13,642,735,382.40		14,354,739
c) Savings deposits				
ca) with an agreed notice period of three months	0.00			0
cb) with an agreed notice period of more than three months	0.00	0.00		0
d) Other liabilities		6,982,499,366.58	20,625,234,748.98	6,104,004
3. Securitised liabilities				
a) Debt securities issued				
aa) Mortgage Pfandbriefe	0.00			0
ab) Public Pfandbriefe	4,562,723,834.80			4,797,143
ac) other debt securities	30,042,953.42	4,592,766,788.22		30,465
b) Other securitised liabilities		0.00	4,592,766,788.22	0
3a. Trading portfolio			0.00	0
4. Trust liabilities			0.00	0
5. Other liabilities			371,841,260.74	276,283
6. Deferred income				
a) From issuing and lending business		14,904,093.17		16,151
b) Other		178,402,549.72	193,306,642.89	187,972
6a. Deferred tax liabilities			0.00	0
7. Accruals				
a) Accruals for pensions and similar obligations		0.00		0
b) Tax accruals		276,801.42		277
c) Other accruals		11,091,543.38	11,368,344.80	5,496
8. Subordinated liabilities			60,000,000.00	60,000
9. Profit participation rights capital			49,338,392.72	49,338
10. Fund for general banking risks			0.00	0
11. Equity				
a) Called-in capital				
Subscribed capital	432,500,000.00			432,500
less outstanding deposits not called in	0.00	432,500,000.00		0
b) Capital reserve		348,684,911.98		348,685
c) Revenue reserves				0
ca) Legal reserve	0.00			0
cb) reserve for shares in a controlling undertaking or an undertaking with a majority interest	0.00			0
cc) statutory reserves	0.00			0
cd) other revenue reserves	50,702,270.07	50,702,270.07		50,702
d) Net profit/accumulated losses		–177,518,384.63	654,368,797.42	–174,142
Total equity and liabilities			**30,900,705,674.38**	**31,395,360**
1. Contingent liabilities				
a) Contingent liabilities from rediscounted bills		0.00		0
b) Liabilities from guarantees and warranty agreements		45,165,917.67		47,333
c) Liability from the provision of collateral for third-party liabilities		0.00	45,165,917.67	0
2. Other obligations				
a) Repurchase obligations resulting from non-genuine repurchase transactions		0.00		0
b) Placement and underwriting commitments		0.00		0
c) Irrevocable lending commitments		8,076,923.08	8,076,923.08	8,077

CONDENSED PROFIT AND LOSS ACCOUNT OF DEXIA KOMMUNALBANK DEUTSCHLAND AG FOR THE PERIOD FROM JANUARY 1 TO JUNE 30, 2016

23 Expenses

			01.01.–30.06.2016	01.01.–30.06.2015
	in EUR	in EUR	in EUR	in KEUR
1. Interest expense			1,035,265,922.90	1,155,091
2. Commission expenses			1,441,951.30	1,629
3. Net expense for trading portfolio			0.00	0
4. General administrative expenses				
a) Personnel expenses				
aa) wages and salaries	2,986,121.67			2,881
ab) social security contributions and expenses for old-age pensions and support	504,277.01	3,490,398.68		483
b) Other administrative expenses		13,210,826.71	16,701,225.39	8,681
5. Depreciation, amortisation and valuation adjustments on intangible assets and property, plant and equipment			222,155.68	223
6. Other operating expenses			1,289.00	21
7. Depreciation, amortisation and valuation adjustments on receivables and specific types of securities and allocations to accruals in lending business			3,447,668.45	64,569
8. Depreciation, amortisation and valuation adjustments on equity investments, shares in affiliated companies and securities treated as fixed assets			0.00	91,635
9. Expenses from assumption of losses			0.00	0
10. Extraordinary expenses			0.00	0
11. Taxes on income and earnings			0.00	0
12. Other taxes not shown under Item 6			7,975.86	8
13. Profits transferred under a profit pool, a profit transfer agreement or a partial profit transfer agreement			0.00	0
14. Net income			0.00	0
Total			**1,057,088,188.58**	**1,325,220**

24 **Income**

	in EUR	in EUR	01.01.–30.06.2016 in EUR	01.01.–30.06.2015 in KEUR
1. Interest income from				
a) Loan and money market business		903,110,764.36		1,014,319
b) Fixed income securities and book-entry securities		150,143,008.93	1,053,253,773.29	168,899
2. Current income from				
a) Shares and other non-fixed income securities		0.00		0
b) Equity investments		0.00		0
c) Shares in affiliated companies		0.00	0.00	0
3. Income from profit pools, profit transfer agreements or partial profit transfer agreements			0.00	0
4. Commission income			267,904.41	119
5. Net income from trading portfolio			0.00	0
6. Income from write-ups of receivables and specific types of securities and from the release of accruals in lending business			0.00	0
7. Income from write-ups of equity investments, shares in affiliated companies and securities treated as fixed assets			108,618.83	0
8. Other operating income			81,309.28	9
9. Extraordinary income			0.00	0
10. Income from assumption of losses			0.00	0
11. Net loss			3,376,582.77	141,875
Total			**1,057,088,188.58**	**1,325,220**

CONDENSED NOTES

The semi-annual financial statements as of June 30, 2016 were prepared pursuant to Section 37w Securities Trading Act, according to the decisive regulations of the German Commercial Code (HGB), the German Companies Act (AktG) and the German Pfandbrief Act, as well as according to the regulations concerning the accounting of credit institutions and financial services institutions. The German accounting standards of the Deutsche Rechnungslegungs Standards Committee, which are to be applied, have been complied with. The same accounting and valuation methods were applied in the semi-annual financial statements as of June 30, 2016, as in the annual financial statements as of December 31, 2015.

The explanations concerning the essential changes to the items in the condensed balance sheet and the condensed profit and loss statement were given in the interim management report.

The interim financial statements and the interim management report as of June 30, 2016 were neither audited in line with Section 317 HGB nor reviewed by an auditor.

RESPONSIBILITY STATEMENT

We hereby provide an assurance that, to the best of our knowledge, the interim financial statement provides a true and fair view of the company's net assets, financial position, and results of operations, while complying with the principles of orderly accounting. We also provide an assurance that, to the best of our knowledge, the company's business performance – including its business results – and its position have been presented in the management report to provide a true and fair view while describing the key risks and opportunities within the meaning of Section 289 (1), Clause 4 HGB.

Berlin, August 26, 2016

Dexia Kommunalbank Deutschland AG

The Management Board

Munsberg

Munsberg **Fritsch**

DEXIA
KOMMUNALBANK
DEUTSCHLAND
DKD