S1 2017

SEMI ANNUAL REPORT

DEXIA
KOMMUNALBANK
DEUTSCHLAND
DKD

SEMI ANNUAL REPORT 2017

OVERVIEW OF DEXIA KOMMUNALBANK DEUTSCHLAND

1 Key balance sheet positions

in EUR million	30.06.2017	31.12.2016
Assets		
Loans to public sector entities	13,992.8	14,510.9
Other loans and advances to banks and non-bank customers	5,325.3	6,004.3
Securities	6,574.5	7,750.2
Equity and liabilities		
Pfandbriefe	16,320.1	17,965.3
Other liabilities to banks and non-bank customers	8,811.9	9,613.1
Equity	662.8	663.0
Balance sheet total	**26,257.3**	**28,809.8**

2 Key profit and loss account positions

in EUR million	30.06.2017	30.06.2016
Net interest and commission income	30.6	16.8
Administrative expenses (incl. depreciation)	–16.7	–16.9
Risk provisioning incl. result of financial investments	–14.1	–3.4
Profit/loss for the year	**–0.1**	**–3.4**

3 Other disclosures

	30.06.2017	30.06.2016
Employees (average number)	78	80
Cost-income ratio as %	54.6	100.7

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CONTENTS

EXECUTIVE BODIES OF THE BANK 7

INTERIM MANAGEMENT REPORT 9

Basic information 9

Economic report 10

Overall economic and industry environment 10

Business performance 13

Position 13

Summary of business performance 18

Forecast report 19

Report on risks and opportunities 20

Risk management system 20

Risks 23

Summary of risk situation 30

Internal control system and risk management system 30

INTERIM FINANCIAL STATEMENTS AS OF JUNE 30, 2017 33

Condensed balance sheet as of June 30, 2017 34

Condensed profit and loss account for the period from January 1 to June 30, 2017 36

Condensed notes 38

RESPONSIBILITY STATEMENT 39

EXECUTIVE BODIES OF THE BANK

SUPERVISORY BOARD

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
Executive Vice President of Dexia Crédit Local S. A.

Chairman

Prakash Advani
Head of Group Strategy & Structuring Dexia S. A.

Deputy Chairman
(since March 31, 2017)

Eric Bouthors
Bank employee of Dexia Kommunalbank Deutschland AG

Isabelle Bouvet
Group Head of Market Risk of Dexia S. A. and
Dexia Crédit Local S. A.

Stefanie Gregorius
Bank employee of Dexia Kommunalbank Deutschland AG

Jürgen Jung
Consultant

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.

Deputy Chairman
(to March 30, 2017)

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

Victor von Bothmer
Lawyer

Josef Baiz
Independent financial and economics adviser

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 restructuring plan, which was approved by the European Commission in December 2012, aims to avoid the Group's bankruptcy and liquidation.

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.

As of June 30, 2017, the Dexia Group had 1,082 employees (December 31, 2016: EUR 1,134 employees). Dexia Crédit Local S. A. 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 restructuring plan. Dexia Crédit Local S. A. is domiciled in France, where it holds a banking licence, with branches in Ireland, the USA, Spain and Portugal and subsidiaries in Germany, Italy and Israel. Some of these entities hold local banking licences.

The Dexia Group has discontinued all of its commercial activities and is now solely focused on managing its legacy assets – mainly loans to public sector entities – while protecting the interests of its government owners and guarantors. To meet this objective, the Group has established three main goals:

- 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;
- Ensure operational continuity by retaining the necessary expertise and resources and developing appropriate information systems.

As of June 30, 2017, the Dexia Group's CET1 ratio had increased to 17.0% (December 31, 2016: 16.2%) while its total capital ratio increased to 18.0% (December 31, 2016: 16.8%).

Profile of Dexia Kommunalbank Deutschland

Dexia Kommunalbank Deutschland is a wholly-owned subsidiary of Dexia Crédit Local S. A., 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 26.3 billion as of June 30, 2017, the Bank is the largest subsidiary of Dexia Crédit Local S. A.

Dexia Kommunalbank Deutschland benefits from

- the letter of support provided by Dexia Crédit Local S. A., 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 S. A. with a volume of EUR 500 million, which the Bank has not yet called 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 held in the Bank's overall loan book, this process will take some time.

Over the next ten years, the assets of Dexia Kommunalbank Deutschland will continuously decrease on account of natural maturities. As of December 31, 2022, its balance sheet total is expected to have declined to EUR 18.6 billion, and its cover pool for Public Pfandbriefe (covered bonds) to EUR 12.1 billion. As of December 31, 2027 these figures will amount to EUR 9.8 billion and EUR 7.1 billion respectively. Since the rate of interest on the capital markets is expected to remain low for the next few years, these projections assume that the creditors' termination rights which are embedded in these receivables will not be exercised.

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,
- maintaining cost discipline, for personnel expenses as well as other administrative expenses.

ECONOMIC REPORT

OVERALL ECONOMIC AND INDUSTRY ENVIRONMENT

Looking back at events in Europe in the first six months of 2017, the key political event was Emmanuel Macron's election as France's president. Having entered the race as a political outsider who some months previously had been expected to achieve a respectable showing at best, this candidate surprised observers with a triumphant success in the second ballot held on May 7, 2017: He defeated his competitor, Marine Le Pen, with 66.1% of the votes. Moreover, six weeks later in the French parliamentary elections the party La République en Marche which Macron had only created in April 2016 gained an absolute majority of 308 seats (53.0%), while Len Pen's Front National won just 8 seats (1.4%).

The financial markets reacted with relief to these elections through which the French people had provided Macron with an unexpectedly clear mandate for his announced "fundamental renewal" of France. At the top of the new president's agenda are measures to resolve the country's most urgent economic problems – weak economic growth, a lack of international competitiveness, high unemployment and a high level of sovereign debt – as well as the modernisation and flexibilisation of its political system. In terms of foreign policy Macron, an avowed European, intends to strengthen and develop the EU in close cooperation with Berlin. In mid-July 2017, at a joint press conference Germany's chancellor, Angela Merkel, and Macron announced their determination to lend new momentum to the Franco-German relationship. The two countries intend to develop a road map for the European Union by the end of the year. Merkel left unresolved the extent to which this would include pet projects of Macron such as establishing a joint budget for the Eurozone, the appointment of a European finance minister and developing the euro bailout mechanism, the ESM, into a European monetary fund.

Another key vote, the elections to the lower house of the British parliament, took place on June 8, 2017 in the United Kingdom, which remains a member of the EU for the time being. Buoyed by her Conservative Party's opinion-poll high, in April 2017 – around three years ahead of the regular end of the legislative term – the prime minister Theresa May had called early elections for which she received parliamentary consent. However, her plan to significantly boost the Conservatives' tight voting majority in view of the impending Brexit negotiations backfired dramatically. Her party actually lost its absolute majority and was only able to remain in power through an agreement with Northern Ireland's Democratic Unionist Party. May's position as prime minister is now seen as severely weakened, and there has even been press speculation over her resignation.

Following 44 years of EU membership, on March 29, 2017 the United Kingdom officially initiated its withdrawal from this federation of European states. This date marked the start of the maximum period of two years which Article 50 of the Lisbon Treaty envisages for the conclusion of a withdrawal agreement. The first round of Brexit negotiations began on June 19, 2017, led by the EU's chief negotiator Michel Barnier and the British secretary of state David Davis. It was soon clear that the negotiating partners are still far apart in terms of their positions on key issues such as the size of the exit bill for London, the legal status of the roughly three million EU citizens living in the UK and the future relationship between Ireland and Northern Ireland. According to the ambitious Brexit timetable, negotiation of the withdrawal agreement must have been completed by October 2018 and it will be ratified by the European Parliament in the first quarter of 2019.

Political events aside, the European economy – and the Eurozone's economy in particular – registered a strong performance. In the first quarter of 2017, at 0.6% the aggregate real gross domestic product (GDP) of the Eurozone countries was once again slightly stronger than in the previous quarter (0.5%). Of the key Eurozone economies, Spain came out on top with growth of 0.8%, ahead of Germany (0.6%) as well as France and Italy (both 0.4%). The development of the Economic Sentiment Indicator Euro Area which the European Commission monitors every month suggests that the growth trend is set to continue over the next few months. In July 2017, at 111.2 points (December 31, 2016: 107.8 points) this leading indicator reached its highest level since August 2007 (111.8 points). The leading German economic indicator, the ifo business climate index, climbed to 116 points (July 2017), its highest level since reunification (December 2016: 111.0 points).

On the other hand, the Eurostat figures for the Eurozone's public finances pointed to a mixed picture in the first quarter of 2017. While the aggregate budget deficit fell to 0.9% of the Eurozone's GDP (fourth quarter of 2016: 1.1%), aggregate gross debt increased from 89.2% to 89.5% of GDP. In its monthly report (July 2017) Deutsche Bundesbank presented a calculation showing that, since the start of the financial crisis in 2008, the Eurozone countries have saved almost EUR 1 trillion in interest expenditure thanks to the historically low interest-rate level. Of this amount, EUR 240 billion is attributable to Germany alone. The Bundesbank characterised the state of German public finances as "relatively favourable". Indeed, in the first quarter of 2017 the Federal Republic of Germany achieved a budget surplus of 1.5% of GDP, with a gross debt volume of 66.9%.

The credit ratings of European countries did not change much in the period under review. Only one rating change occurred, through Fitch Ratings' downgrading of Italy's rating from BBB+ to BBB (April 21, 2017). Moody's and Standard & Poor's had already downgraded this country to Baa2 and BBB– some time ago. The European club of "pure" AAA countries – whose bonds have been awarded top ratings from all three of these major rating agencies – continues to consist of the following seven members: Denmark, Germany, the Netherlands, Luxembourg, Norway, Sweden and Switzerland. › 4

Moreover, Fitch Ratings and Standard & Poor's upgraded the outlook for their Portugal (BB+) and Spain (BBB+) ratings from stable to positive. Outside Europe, Japan likewise benefited from a stable improvement in the outlook for its single A rating (Fitch Ratings).

At the start of the period under review, the rise in the Eurozone's inflation rate which had begun two months previously gathered steam. The Eurozone's Harmonised Index of Consumer Prices (HICP) climbed to 2% in February 2017 (December 2016: 1.1%) and thus actually slightly exceeded the European Central Bank's (ECB) target level of "below, but close to, 2.0%". However, this momentum was mainly driven by base effects on account of the huge rise in energy prices year-on-year. In a press conference held on January 19, 2017, the ECB's president, Mario Draghi, clarified that he did not yet see the higher level of inflation as sustained and that pressure on the core inflation rate adjusted for energy and food price effects remained "subdued". In fact, in the period up to June 2017 the HICP slipped back to 1.3%. The ECB's preferred indicator measuring the medium-term inflation outlook, the 5Y plus 5Y Forward Inflation Swap Rate (five-year inflation-indexed forward swap rate in five years' time), which had climbed to 1.80% in late January 2017, had also slipped, to 1.58%, halfway through the year 2017.

July 26, 2017 marked the fifth anniversary of Draghi's famous London "Whatever it takes" speech which turned the tide and calmed the blazing Eurozone crisis. Four months previously, Greece had completed an unprecedented debt relief package, Ireland and Portugal had called upon huge EU assistance programmes, while Spain required considerable resources in order to stabilise its banking sector. In some cases, yields on ten-year Spanish and Italian government bonds significantly exceeded 6.0%.

Draghi's remark, which would later be praised as a "stroke of monetary genius", abruptly ended speculation over a collapse of the Eurozone and brought lasting calm to the nervous financial markets, without costing a single euro. The ECB subsequently gradually cut its key interest rate to the rate of 0.0% which still remains in place today, in order to stimulate the stagnating Eurozone economy and tackle nascent deflation. In January 2015 it finally launched a substantial bond purchasing project, with its expanded Asset Purchase Programme (APP).

4 Ratings of selected countries

	Standard & Poor's		Moody's		Fitch	
	30.06.2017	15.01.2017	30.06.2017	15.01.2017	30.06.2017	15.01.2017
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	Aa1	AA+	AA+
Poland	BBB+	BBB+	A2	A2	A–	A–
Portugal	BB+	BB+	Ba1	Ba1	BB+	BB+
Spain	BBB+	BBB+	Baa2	Baa2	BBB+	BBB+
Hungary	BBB–	BBB–	Baa3	Baa3	BBB–	BBB–
Other countries						
UK	AA	AA	Aa1	Aa1	AA	AA
USA	AA+	AA+	Aaa	Aaa	AAA	AAA
Japan	A+	A+	A1	A1	A	A

Source: Bloomberg

Halfway through 2017, the ECB could look back on a series of successes which would not have resulted without its intervention, or at least not to the same extent:

- Following years of stagnation, overall the Eurozone is now on a highly robust growth trajectory, despite variations between individual member states which still remain pronounced. In late July 2017, the International Monetary Fund raised its GDP growth forecast for the current year from 1.7% to 1.9%.
- While the Eurozone's inflation figures had not yet reached the ECB's target range on a long-term basis, the fear of deflation which had long predominated had faded into the background.
- In May 2017, at 9.3% the Eurozone recorded its lowest unemployment rate since March 2009. At its peak level (2013), unemployment had exceeded 12%.
- Yields on government bonds in the Eurozone's peripheral countries were trading at significantly reduced levels by comparison with their peak levels in previous years. Halfway through the year, ten-year securities were delivering yields of 2.16% (Italy), 1.54% (Spain) and 3.03% (Portugal).

The securities portfolios acquired by the ECB as part of its APP increased by almost 27% in the first six months of 2017, to EUR 1,953 billion (December 31, 2016: EUR 1,532 billion). They were divided up between four sub-programmes as follows:

- PSPP: EUR 1,609 billion,
- CBPP3: EUR 223 billion,
- CSPP: EUR 97 billion,
- ABSPP: EUR 24 billion.

At the annual ECB Forum which took place on June 27, 2017 in the Portuguese town of Sintra, Draghi was unexpectedly optimistic in relation to the current situation. He referred to the need for prudence in revising monetary parameters in line with the improving economic conditions and emphasised that deflationary risks had passed and that reflationary forces were now at play. The financial markets interpreted this speech as a signal that the ECB would soon announce its first few steps in order to withdraw from its APP (tapering). However, at his press conference following the meeting of the ECB's Governing Council on July 20, 2017, Draghi backpedalled and did not provide any indication of impending tapering, announcing that a decision on this would be made in the autumn at the earliest.

In response to Draghi's Sintra speech the Bund Future fell a full 500 ticks to 160.3 points, but subsequently stabilised above the 161 points level. Ten-year Bund bonds, the benchmark for European government bonds, were providing a yield of 0.47% on June 30, 2017, while two-year German government securities ended the period under review with a yield of – 0.57%.

In view of the ECB's steady money market policy, interest rates on the euro money market remained virtually unchanged. By comparison with the start of the year, as of June 30, 2017 the 3-month Euribor had only fallen by one basis point to – 0.33%.

On the other hand, having begun the year at a price of USD 1.04 the euro benefited from the Eurozone's robust economic performance and had climbed fairly smoothly to USD 1.14 halfway through the year. Subsequently it even went later beyond the USD 1.18 mark.

Germany's particularly strong economic momentum helped the German stock index (DAX) index to reach a new all-time high of 12,889 points on June 19, 2017. It subsequently fell slightly, to a level of 12,325 points (June 30, 2017), which still represented a strong half-year performance of 7.4%. With a rise of 4.6% to 3,442 points, the performance of the Euro Stoxx 50 index in the same period was somewhat more restrained.

Following their weak performance in the previous year, equities in the banking sector were able to make up ground. The banking crisis in Italy intermittently had a negative impact and repeatedly generated headlines. In mid-July 2017, the Italian finance minister Pier Carlo Padoan summed things up in claiming that "the worst is now over" – following the partial nationalisation of Banca Monte dei Paschi di Siena, the country's third-largest credit institution, and Banca Intesa Sanpaolo's takeover of the two bankrupt cooperative banks Veneto Banca and Banca Popolare di Vicenca – and that the reforms initiated would soon reverse the trend for the sector. The Stoxx Europe 600 banking index closed at 182 points (+ 7.1%) on June 30, 2017. At the same time, risk premiums for bank refinancing declined significantly. The average premium on five-year credit default swaps calculated by the iTraxx Senior Financials Europe Index for 25 European financial institutions on senior unsecured liabilities fell from 94 bp to 53 bp (– 43.6%) over the past six months.

At EUR 78.0 billion (same period in previous year: EUR 92.1 billion), the covered bond new issue volume placed in the period under review with a euro benchmark format (issue volume of EUR 500 million or more, including increases) was 15.3% lower than the previous year's level. In the country ranking, France led the way with a 23.3% share of issues, ahead of Germany (14.8%) and the Netherlands (8.0%).

As of May 31, 2017, sales of Public Pfandbriefe had increased by 1.6% year-on-year to EUR 5.4 billion, while the volume outstanding fell from EUR 155.6 billion (December 31, 2016) to EUR 152.9 billion (– 1.5%).

BUSINESS PERFORMANCE

In accordance with the plan approved by the European Commission in December 2012 for the orderly restructuring of the Dexia Group, Dexia Kommunalbank Deutschland did not pursue any new lending business in the first six months of 2017. 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 4.1 million. All of these loans are guaranteed by German regional or local authorities and are therefore eligible as cover for Public Pfandbriefe.

The Bank also disposed of securities with a nominal value of EUR 658.1 million in the reporting period.

To fund its lending operations, issues with a total volume of EUR 34.5 million (same period in previous year: EUR 1,288.8 million) were launched within the framework of new issue business. This exclusively comprises loans taken out. The Bank did not issue any Pfandbriefe or unsecured bearer notes in the first six months of 2017.

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 30.0 million (same period in previous year: EUR 1,125.0 million).

Table › 5 shows the volume of interest-rate and cross-currency interest-rate swaps and options as of June 30, 2017.

5 Derivative transactions

Nominal value in EUR million	30.06.2017	31.12.2016
Interest-rate swaps and cross-currency interest-rate swaps	45,757.3	51,348.4
Options	0.0	0.0
Total	**45,757.3**	**51,348.4**

The ratio of the volume of derivatives to the balance sheet total amounted to 174.3% (December 31, 2016: 178.2%).

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 Article 274 of the Capital Requirements Regulation (CRR) had decreased to EUR 1,357.0 million (December 31, 2016: EUR 1,547.0 million). On balance, collateral for derivatives exposures totalled EUR 3.4 billion (December 31, 2016: EUR 3.8 billion).

POSITION

RESULTS OF OPERATIONS

Net interest income and net commission income

Net interest income in the first six months of 2017 improved to EUR 31.5 million (same period in previous year: EUR 18.0 million) and was thus EUR 13.5 million higher than the previous year's figure.

This improvement was mainly attributable to the earnings contribution in the amount of EUR 7.6 million (same period in previous year: EUR 0.0 million) which resulted from the early termination of derivative transactions and was included in net interest income. A further positive factor was the fact that, in the period under review, the Bank replaced a significant volume of non-banks' demand and fixed-term deposits with lower-cost deposits of its parent company Dexia Crédit Local S. A. (see Financial and liquidity position section).

As in the previous year, no trading-book business was entered into in the period under review.

The Bank continues to assume a negative profit for the year in its earnings forecast for the financial year 2017. In this case, in line with its terms of issue the profit participation rights capital would not be serviced for the financial year 2017. Accordingly, as in the same period in the previous year net interest income for the reporting period does not include pro rata expenses for servicing of the Bank's profit participation rights capital.

Net commission income in the amount of EUR – 0.9 million (same period in previous year: EUR – 1.2 million) mainly comprises expenses for pro rata management fees for guaranteed loans, custody charges paid and commission for brokerage of customer deposits.

Overall, net interest and commission income totalled EUR 30.6 million (same period in previous year: EUR 16.8 million) › 6.

Administrative expenses

The number of employees declined from 81 as of December 31, 2016 to 78, while personnel expenses increased by 4.1% to EUR 3.6 million by comparison with the same period in the previous year. In particular, this reflected increased expenses for the company pension scheme.

On the other hand, non-compensation expenses with a volume of EUR 12.8 million (same period in previous year: EUR 13.2 million) decreased by 2.8%.

The decline is due to the reduced contribution made to the restructuring fund (bank levy) of the German Financial Market Stabilisation Agency (Bundesanstalt für Finanzmarkt-

6 Development of key profit and loss account positions

	30.06.2017 in EUR million	30.06.2016 in EUR million	Change as %
Interest income	1,110.6	1,053.3	5.4
Interest expense	–1,079.1	–1,035.3	4.2
Net interest income	31.5	18.0	75.2
Net commission income	–0.9	–1.2	–22.7
Net interest and commission income	**30.6**	**16.8**	**82.1**
Personnel expenses	–3.6	–3.5	4.1
Other administrative expenses (non-compensation expenses)	–12.8	–13.2	–2.8
Depreciation, amortisation and valuation adjustments on intangible assets and property, plant and equipment	–0.2	–0.2	5.1
Administrative expenses	–16.7	–16.9	–1.2
Partial operating result	**13.9**	**–0.1**	**> 100.0**
Other operating income and expenses	0.1	0.1	–31.1
Risk provisioning	–14.3	–3.4	> –100.0
Result of financial investments	0.2	0.1	> 100.0
Operating result	**–0.1**	**–3.4**	**–96.3**
Tax expense	0.0	0.0	0.0
Profit/loss for the year	**–0.1**	**–3.4**	**–96.3**

stabilisierung, FMSA). This decreased to EUR 15.2 million (same period in previous year: EUR 16.4 million). The Bank once again made use of the opportunity to cover 15% (EUR 2.3 million) of the payment amount by submitting an irrevocable payment commitment to the FMSA and to capitalise this as an other asset. Of the remaining EUR 12.9 million, a pro rata amount of EUR 6.5 million was registered as non-compensation expenses.

Allowing for the impairment of fixed assets (depreciation) in the amount of EUR 0.2 million (same period in previous year: EUR 0.2 million), overall administrative expenses decreased to EUR 16.7 million (same period in previous year: EUR 16.9 million).

The ratio of administrative expenses to net interest and commission income (cost-income ratio) amounted to 54.6% (same period in previous year: 100.7%).

Risk provisioning

Net risk provisioning amounted to EUR –14.3 million in the first six months of 2017 (same period in previous year: EUR –3.4 million).

No excess liability resulted from the loss-free valuation of the banking book.

Result of financial investments

The result of financial investments in the amount of EUR 0.2 million (same period in previous year: EUR 0.1 million) includes the net redemption volume for maturities of investment securities. This does not include depreciation on fixed assets items due to permanent impairment, since this was not necessary.

Operating result before tax

The operating result before tax amounted to EUR –0.1 million (same period in previous year: EUR –3.4 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 time of settlement of these differences with a sufficient degree of probability.

FINANCIAL AND LIQUIDITY POSITION

In the period under review, the registered Public Pfandbriefe item decreased by EUR 0.7 billion to EUR 12.8 billion (December 31, 2016: EUR 13.5 billion). This decline reflected scheduled maturities and debtors' exercise of termination rights.

The bearer Pfandbriefe item decreased by EUR 1.0 billion to EUR 3.5 billion (December 31, 2016: EUR 4.5 billion).

The overall Pfandbriefe item thus reached EUR 16.3 billion (December 31, 2016: EUR 18.0 billion), which represented 62.2% (December 31, 2016: 62.4%) of the balance sheet total.

Other liabilities to banks increased to EUR 5.4 billion (December 31, 2016: EUR 4.3 billion). › 7

Securities repurchase agreements increased to EUR 2.1 billion (December 31, 2016: EUR 0.9 billion), of which EUR 0.6 billion related to business with Dexia Crédit Local S. A.

The Bank's use of open-market loans provided by Deutsche Bundesbank remained marginal in the first six months of 2017. As of June 30, 2017, the Bank had taken out open-market loans with a volume of just EUR 90.0 million (December 31, 2016: EUR 130.0 million).

On this balance sheet date, Dexia Kommunalbank Deutschland's available credit line with Deutsche Bundesbank on the basis of pledged securities amounted to EUR 935.7 million. The Bank also held further unencumbered securities eligible for central bank borrowings with a loan value of EUR 397.0 billion.

On July 21, 2017, the ECB announced that with effect as of December 31, 2021 it would no longer permit wind-down entities to participate in refinancing transactions within the Eurosystem. This measure affects all of the wind-down entities participating in the Eurosystem, including the Dexia Group's Dexia Crédit Local S. A. together with its subsidiaries Dexia Kommunalbank Deutschland and Dexia Crediop. Until this decision of the ECB comes into effect, the volume of the Dexia Group's refinancing transactions within the Eurosystem is limited to a maximum amount of EUR 5.2 billion.

In its press release of July 21, 2017, the Dexia Group pointed out that it had currently only made very slight use of refinancing transactions within the Eurosystem and likewise only intended to make marginal use of them in future. In case of significant disturbances on the financial markets, the Group reserves the right to request liquidity assistance from national central banks in the form of emergency liquidity assistance (ELA).

As of the end of the reporting period, the Bank's portfolio of secured refinancing funds in the form of Public Pfandbriefe and other secured borrowings totalled EUR 18.2 billion, which amounted to 69.5% (December 31, 2016: 64.7%) of the balance sheet total.

Other liabilities to non-bank customers decreased to EUR 3.4 billion (December 31, 2016: EUR 5.3 billion). This mainly comprised non-banks' demand and fixed-term deposits.

At the start of the current year, the Bank adjusted its business policy for deposit business in line with the revised market conditions. Together with Dexia Crédit Local S. A., it was resolved that a portion of the volume of non-banks' demand and fixed-term deposits would be replaced with lower-cost deposits of the parent company. Halfway through the year, non-banks' demand and fixed-term deposits had declined from EUR 4.9 billion as of December 31, 2016 to EUR 3.1 billion. At the same time, the volume of deposits held by Dexia Crédit Local S. A. had increased to EUR 1.8 billion.

7 Development of key balance sheet equity and liabilities

	30.06.2017 in EUR million	31.12.2016 in EUR million	Change as %
Registered Pfandbriefe	366.2	381.8	–4.1
Other liabilities	5,362.7	4,301.9	24.7
Liabilities to banks	**5,729.0**	**4,683.7**	**22.3**
Registered Pfandbriefe	12,413.2	13,085.1	–5.1
Other liabilities	3,449.1	5,311.2	–35.1
Liabilities to non-bank customers	**15,862.4**	**18,396.3**	**–13.8**
Public Pfandbriefe	3,540.6	4,498.4	–21.3
Other debt securities	10.0	30.5	–67.2
Securitised liabilities	**3,550.6**	**4,528.9**	**–21.6**
Subordinated liabilities	**20.0**	**20.0**	**0.0**
Profit participation rights capital	**24.3**	**43.9**	**–44.7**
Subscribed capital	432.5	432.5	0.0
Reserves	399.4	399.4	0.0
Accumulated losses	–169.1	–168.9	0.1
Equity	**662.8**	**663.0**	**0.0**
Other liabilities	**408.2**	**474.1**	**–13.9**
Balance sheet total	**26,257.3**	**28,809.8**	**–8.9**

8 Development of funding structure

	30.06.2017		31.12.2016	
	in EUR million	as %	in EUR million	as %
Public Pfandbriefe	16,031.9	66.1	17,596.3	64.1
Funding transactions with Deutsche Bundesbank	90.0	0.4	130.0	0.5
Securities repurchase agreements with banks	1,602.9	6.6	493.2	1.8
of which to Dexia Group	620.7	2.6	455.2	1.7
Securities repurchase agreements (Eurex Repo)	523.5	2.2	425.0	1.5
Liabilities to banks	1,833.0	7.6	2,741.4	10.0
of which to Dexia Group	1,800.0	7.4	1,700.0	6.2
Liabilities to non-bank customers	3,107.6	12.8	4,938.4	18.0
Other (including own funds)	1,050.3	4.3	1,115.9	4.1
Total	**24,239.2**	**100.0**	**27,440.2**	**100.0**

Please refer to Table › 8 for details of the development of the Bank's overall funding structure.

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 for central bank borrowings, together with its active deposit business.

The Bank remains integrated within the Dexia Group's central liquidity management system. The revolving liquidity facility granted by Dexia Crédit Local S. A. was extended for a further year in October 2016, with its volume reduced from EUR 1 billion to EUR 500 million. As in previous years, the Bank did not draw upon this facility in the period under review.

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

The liquidity coverage ratio (LCR) is calculated pursuant to CRR in conjunction with the Delegated Regulation on the LCR. This indicator represents the ratio of available qualifying liquid assets to the net liquidity outflows determined according to prescribed rules in the one-month period following the reporting date. The minimum ratio in the period under review was 0.8; the liquidity coverage ratio of Dexia Kommunalbank Deutschland fluctuated between 1.08 and 1.49.

The Bank's liquidity ratio under German regulatory requirements continues to be determined in accordance with the German Liquidity Regulation (Liquiditätsverordnung, LiqV). The ratio of the funds available in the first maturity band (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 a figure of 1.

In the reporting period, the liquidity ratio according to Section 2 LiqV fluctuated between 1.07 (minimum) and 1.30 (maximum) and averaged 1.20. › 9

9 Liquidity position

	Minimum	Maximum	Average
Liquidity ratio	1.07	1.30	1.20

In addition, the Bank calculates the non-risk-dependent leverage ratio (LR) pursuant to CRR in conjunction with the Delegated Regulation on the LR. In simple terms, this indicator represents the ratio of an institution's regulatory capital to its volume of business. As of June 30, 2017, it amounted to 2.98%.

No binding minimum limit is currently applicable for the leverage ratio. As things currently stand, a minimum limit of 3% will come into effect from 2019 at the earliest. The Bank expects to comply with this minimum limit at the time of its introduction.

Volume of Pfandbriefe outstanding and Pfandbriefe cover

The total volume of Public Pfandbriefe outstanding had decreased to EUR 16.1 billion as of June 30, 2017 (December 31, 2016: EUR 17.6 billion). At the same time, the volume of cover pool assets used for cover declined to EUR 17.4 billion (December 31, 2016: EUR 19.1 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 Pfandbriefe outstanding) of at least 8.15%, without being statutorily or contractually obliged to do so. As of June 30, 2017, its nominal overcollateralisation ratio amounted to 8.44% (December 31, 2016: 8.40%) and its present value overcollateralisation ratio (ratio of the cover pool's present value to the present value of the volume of Pfandbriefe outstanding) was 15.54% (December 31, 2016: 17.30%).

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, 2017 the nominal overcollateralisation ratio decreased slightly to 8.19% (December 31, 2016: 8.14%) and the present value overcollateralisation ratio to 15.30% (December 31, 2016: 17.03%).

The structure of the cover pool thus changed only slightly. The proportion of exposures to central governments decreased to 9.1% (December 31, 2016: 12.1%), while the proportion of exposures to regional authorities rose to 60.2% (December 31, 2016: 58.8%) and the proportion of exposures to local authorities increased to 27.3% (December 31, 2016: 26.0%). Exposures to other debtors accounted for 3.4% (December 31, 2016: 3.1%) of the cover pool. Cover claims from Germany increased to 70.1% (December 31, 2016: 67.9%) of the total cover pool. Claims from Italy (10.5%), Belgium (6.7%) and Austria (5.8%) followed.

The rating agency Standard & Poor’s continues to assign the Public Pfandbriefe issued by Dexia Kommunalbank Deutschland AG an A rating (outlook stable).

The rating agency Scope Ratings continues to allocate the Public Pfandbriefe an AA– (outlook stable) rating.

In determining the makeup of its cover pool for Public Pfandbriefe, Dexia Kommunalbank Deutschland traditionally maintains a steady-handed approach emphasising continuity. For many years now, its nominal overcollateralisation ratio has exceeded the target figure of 8.15% of its Pfandbriefe outstanding, with only slight changes in its debtor structure.

NET ASSETS POSITION

The balance sheet total of Dexia Kommunalbank Deutschland decreased by EUR 2.5 billion (or –8.9%) by comparison with the end of the previous year to EUR 26.3 billion (December 31, 2016: EUR 28.8 billion).

In the loans and advances to banks item, loans to public sector entities fell slightly, on account of maturities, to EUR 0.3 billion. Other loans and advances to banks declined to EUR 5.2 billion, mainly due to the decrease in cash collateral to secure derivative exposures and securities repurchase agreements. › 10

Loans and advances to non-bank customers declined by EUR 0.5 billion to EUR 13.9 billion (December 31, 2016: EUR 14.4 billion). This was mainly due to scheduled maturities.

For the same reason and due to sales, the Bank’s portfolio of bonds and debt securities declined by EUR 1.2 billion to EUR 6.6 billion (December 31, 2016: EUR 7.8 billion).

10 Development of key balance sheet assets

	30.06.2017 in EUR million	31.12.2016 in EUR million	Change as %
Loans to public sector entities	325.0	352.0	–7.7
Other loans and advances	5,169.6	5,824.4	–11.2
Loans and advances to banks	**5,494.6**	**6,176.4**	**–11.0**
Mortgage loans	35.9	37.5	–4.3
Loans to public sector entities	13,667.8	14,159.0	–3.5
Other loans and advances	155.7	187.7	–17.1
Loans and advances to non-bank customers	**13,859.4**	**14,384.2**	**–3.6**
From public sector issuers	5,261.2	5,942.7	–11.5
From other issuers	1,307.9	1,802.0	–27.4
Own debt securities	5.4	5.5	–0.4
Bonds and debt securities	**6,574.5**	**7,750.2**	**–15.2**
Other assets	**328.8**	**499.1**	**–34.1**
Balance sheet total	**26,257.3**	**28,809.8**	**–8.9**

Bonds and debt securities amounted to 25.0% (December 31, 2016: 26.9%) of the balance sheet total, while loans represented 54.0% (December 31, 2016: 51.1%).

Total domestic and foreign exposures to public-sector debtors (public sector lending) decreased by EUR 1.2 billion to EUR 19.3 billion (December 31, 2016: EUR 20.5 billion). This corresponded to a 73.3% (December 31, 2016: 71.0%) share of the balance sheet total.

Own funds

Within the Common Equity Tier 1 (CET1) capital, the subscribed capital and the reserves remained unchanged.

The net loss reported for the financial year 2016 amounted to EUR – 0.2 million. Within the scope of offsetting of losses, the profit participation rights capital was called upon with a volume of EUR 5.4 million in accordance with the applicable contractual terms. The accumulated losses for 2016 thus decreased to EUR – 168.9 million. This figure was approved on March 30, 2017 and carried forward to new account.

In accordance with the provisions of the CRR, an intra-year loss must be included in the calculation of regulatory own funds. This amounted to EUR – 0.1 million as of June 30, 2017.

The deduction of the intangible assets on the Common Equity Tier 1 capital required according to the CRR amounted to EUR – 0.4 million as of June 30, 2017.

Overall, as of June 30, 2017 the Common Equity Tier 1 capital thus reached a volume of EUR 662.4 million (December 31, 2016, following the approval of the annual financial statements: EUR 662.7 million)

The Bank does not have any Additional Tier 1 capital.

Tier 2 capital had decreased to EUR 23.3 million as of June 30, 2017 (December 31, 2016, following the approval of the annual financial statements: EUR 27.4 million).

Profit participation rights capital and subordinated loans were included in the Tier 2 capital in an amount of EUR 4.7 million. Regulatory acknowledged general credit risk adjustments in accordance with Section 340f of the German Commercial Code (Handelsgesetzbuch, HGB) and an internal rating based excess over expected losses were further elements of the Tier 2 capital and jointly amounted to EUR 18.6 million. › 11

The Tier 1 capital ratio (CET1 ratio) calculated according to the CRR amounted to 24.4% as of June 30, 2017 (December 31, 2016, following the approval of the annual financial statements: 22.5%). As of June 30, 2017, the total capital ratio according to the CRR reached 25.2% (December 31, 2016, following the approval of the annual financial statements: 23.5%).

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

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 in the first six months of 2017:

- As planned, the balance sheet total decreased by 8.9% to EUR 26.3 billion (December 31, 2016: EUR 28.8 billion).
- New lending business was only entered into in the form of a marginal volume of loan extensions (EUR 4.1 million).
- The profit and loss account ended the period with a net loss for the year of EUR – 0.1 million (June 30, 2016: EUR – 3.4 million).

11 Development of own funds

in EUR million	30.06.2017	31.12.2016
Subscribed capital	432.5	432.5
Reserves	399.4	399.4
Accumulated balance sheet loss	– 168.9	– 168.9
Intra-year loss	– 0.1	0.0
Intangible assets	– 0.4	– 0.3
Tier 1 capital	**662.4**	**662.7**
Profit participation rights capital	0.7	4.9
Subordinated liabilities	4.0	6.0
Regulatory acknowledged general credit risk adjustments acc. Section 340f HGB	7.8	5.0
IRB excess of provisions over expected losses	10.8	11.5
Tier 2 capital	**23.3**	**27.4**
Total	**685.7**	**690.1**

- Tier 1 capital amounted to EUR 662.4 million. The Tier 1 capital ratio amounted to 24.4% (December 31, 2016, following the approval of the annual financial statements: 22.5%).
- Dexia Kommunalbank Deutschland maintained an adequate liquidity position.
- As of June 30, 2017, the Bank's number of employees had decreased to 78 (December 31, 2016: 81).

In summary, in the period under review the Bank's net assets and financial position were stable while its results of operations were balanced.

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, 2017, Dexia Kommunalbank Deutschland had 78 employees (December 31, 2016: 81 employees). Overall, in the period under review six employees left the Bank while three new employees were hired.

FORECAST REPORT

The Bank envisages the following trends for the financial year 2017:

- The balance sheet total will decrease to approximately EUR 23.9 billion as of December 31, 2017.
- As of December 31, 2017, the Bank's Tier 1 capital is expected to reach a level of around EUR 664.6 million.
- The Bank's Tier 1 capital ratio will likely amount to approximately 24.1% at the end of 2017 and will thus continue to significantly exceed the statutory requirements.
- The Bank stands by the outlook presented in its Annual Report 2016 and thus expects to report at most a seven-digit figure as its net loss for the year.
- Dexia Kommunalbank Deutschland's liquidity position will remain adequate.

In summary, for Dexia Kommunalbank Deutschland's financial year 2017 we thus expect that the Bank's net assets, financial position and results of operations will remain stable in overall terms.

In its press release of September 1, 2017 the Dexia Group announced that its condensed consolidated semi annual financial statements as of June 30, 2017 had been prepared in accordance with the accounting rules based on the going concern principle. This requires a series of assumptions which form the basis for the business plan for the Dexia Group's restructuring and are outlined below.

- The business plan is based upon market data as of late September 2012. The underlying macroeconomic assumptions are revised every six months, within the scope of a review of the overall plan.
- In particular, the updates implemented on the basis of the data as of December 31, 2016 which the Board of Directors of the Dexia Group resolved on August 30, 2017 reflect a refinancing plan which is in line with current market conditions. They also cover the effects of regulatory changes, such as those resulting from the final wording of the Capital Requirements Directive IV (CRD IV), and implementation of the International Financial Reporting Standard 9 (IFRS 9) which is valid from 2018.
- The revised business plan accordingly includes changes to the original business plan – particularly in terms of profitability, solvency and the financing structure – which will result in significant adjustments by comparison with the originally assumed process for the resolution of assets, without currently calling into question its basis.
- The business plan assumes that the various units will maintain their banking licences and that Dexia Crédit Local S. A. will maintain its rating.
- The plan moreover relies on a stable funding programme which is dependent on the level of investor demand for debt securities guaranteed by the Belgian, French and Luxembourg governments and on the capacity of the Dexia Group to raise secured funds.

Following the approval of the restructuring plan in December 2012 the Dexia Group's funding structure benefited from an increased secured and guaranteed funding volume, with considerably lower costs and longer maturities than those stipulated in the business plan. This enabled the Dexia Group firstly to eliminate entirely the extraordinary refinancing mechanisms introduced in 2012 and secondly to significantly reduce its refinancing via central banks to EUR 90 million as of June 30, 2017.

On July 21, 2017, the ECB announced that with effect from December 31, 2021 winding-up companies would no longer have access to the Eurosystem. Due to the significant decrease in the Dexia Group's funding volume since late 2012 and the diversification of its sources of financing, this decision is only likely to have a limited impact. Moreover, through its prudent liquidity management as of June 30, 2017 the Dexia Group had developed liquidity reserves with a volume of EUR 21.2 billion.

However, uncertainties will continue to apply in terms of the implementation of this business plan, for the duration of the orderly resolution of its assets:

- In particular, its implementation is subject to uncertainties associated with developments in the fields of accounting and regulation.
- Due to the financing structure of the Dexia Group which has been in place since it embarked upon the orderly resolution of its assets, it may not be possible to comply with certain regulatory indicators during the orderly rundown.
- Moreover, the Group remains sensitive to the development of the macroeconomic environment and in relation to market parameters, including exchange rates, interest rates and credit spreads whose fluctuations may influence the business plan. An adverse trend for these parameters might, over the course of time, adversely affect the liquidity position of the Group and its solvency, in particular:
  - due to rising cash collateral requirements to secure derivative exposures (a 10 bp decline in long-term interest rates will result in an increase of approximately EUR 1 billion in cash collateral requirements) or
  - due to effects on valuations of assets, liabilities and OTC derivatives whose fluctuations in value are recognised in the profit and loss account and may result in changes in the AFS reserve as well as the Group's regulatory capital.
- If the level of demand for government-guaranteed bonds were to decline, the Dexia Group might ultimately be forced to use more expensive funding sources, which would directly influence the level of profitability assumed in its original business plan.

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

Within the scope of its annual risk inventory process, all quantifiable and nonquantifiable 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, which is implemented once a year. The following risk types have been classified as significant:

- credit risk (including country risk),
- market risk (including interest rate risk and spread risk),
- liquidity risk and funding risk as well as
- operational risk (including legal risk).

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 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.

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

The Risk Controlling department provides the relevant decision-makers with the necessary information for management of these risks. It implements the risk strategy prescribed by the Management Board and monitors, in particular, general credit risk, market risk (including the interest rate risk for the banking book), liquidity risk and operational risk. 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), the capital planning process (four-year horizon) in accordance with the Minimum Requirements for Risk Management (Mindestanforderungen an das Risikomanagement, MaRisk) issued by the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin), the portfolio present value and the portfolio market value 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 standalone basis, according to the going-concern approach and also the liquidation approach. Existing support measures – such as Dexia Crédit Local S. A.'s letter of support and revolving liquidity facility – are not included in this calculation.

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 the reference timeframe. Risk-reducing diversification effects between the individual risk types are only taken into consideration for the market risk risk type. The going-concern approach provides the primary perspective from the point of view of internal risk management. The liquidation approach serves as an additional perspective.

The risk-covering potential within the scope of the going-concern approach is determined on the basis of regulatory capital and the planned outcome for the defined assessment period. The portion of regulatory capital which is necessary for fulfilment of the minimum capital requirements under regulatory requirements is deducted from the risk-covering potential.

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 may be meaningfully assigned risk-covering potential. If a new, quantifiable material risk is identified in the risk inventory, this will be considered within the scope of the determination of the Bank's risk-bearing capacity. In principle, there is no obligation for non-material risks to be included in the risk-bearing capacity calculation, but they are included in individual cases. Risk amounts are currently determined for credit risk (general credit risk and CVA), market 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 potential to the above-mentioned risk types. › 12

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

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

Within the scope of the ongoing methodological development of the Bank's risk-bearing capacity system, no significant changes to the risk-bearing capacity concept were implemented in the first six months of 2017.

On the basis of the going-concern approach, the Bank's risk-bearing capacity is given as of June 30, 2017. › 13

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 to these risk drivers over time. They thus provide important information for internal risk management purposes, both at the level of the overall Bank and at the level of individual risks.

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

12 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 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 estimate of the accumulated liquidity gap for the one-year horizon and closure subject to increased refinancing premiums.
Operational risk		Statistical approach on the basis of a historical simulation of all loss events since recording of losses began.

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

Risk-covering potential	**Available Risk-covering potential**		**Provided risk-covering potential**	
in EUR million	**30.06.2017**	**31.12.2016**	**30.06.2017**	**31.12.2016**
Eligible capital	685.7	680.9		
Own funds requirements	−268.6	−253.7		
Free eligible capital	**417.2**	**427.2**	90% of the available risk-covering potential	
Horizon Δ eligible capital	−2.4	4.2		
Horizon Δ own funds requirements	−20.8	−36.8		
Further elements of risk-covering potential	−22.6	−25.0		
Total	**371.4**	**369.6**	**334.3**	**332.6**

Risk potential	**Limit on provided risk-covering potential**		**Utilisation**	
	in EUR million		as %	
	30.06.2017	**31.12.2016**	**30.06.2017**	**31.12.2016**
General credit risk & CVA charge	126.1	125.5	70.5	70.3
Market risk	78.8	78.4	35.6	38.5
Funding risk	110.4	109.8	92.3	91.6
Operational risk	18.9	18.9		
Total	**334.3**	**332.6**	**71.1**	**71.5**

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. As of June 30, 2017, the PPV to Tier 1 capital ratio amounted to 1.49. 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 component of the Bank's risk management process, in order to identify risk concentrations and possible equity capital shortfalls. They provide transparency regarding the effects of extraordinary but plausible events.

For the market risk and liquidity risk types, the Bank calculates the stress tests required by MaRisk on a daily basis.

In addition, quarterly historical stress tests are implemented for all individual risk types (general credit risk, market risk, funding risk and operational risk). Moreover, a core area of focus is the hypothetical overall bank stress tests, which are based up-on the "sovereign debt crisis" scenario and also the "serious economic downturn" scenario.

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 en-hanced 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 in regard to overcollateralisation for Pfandbriefe, the Bank calculates stress scenarios for interest-rate and currency risks in line with the dynamic approach pursuant to Section 5 (1) and Section 6 (2) of the German Pfandbrief Present Value Regulation (Pfandbrief-Barwertverordnung, PfandBarwertV). In case of an impending fall below a present value overcollateralisation level of 2%, measures must be implemented immediately to ensure compliance with the statutory requirements. 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 Pfandbriefe outstanding) 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

CREDIT RISK

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 risk, 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.

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.

Market-independent credit analysis and loan processing is ensured through an appropriate operational structure for management of credit risk.

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

- requirements for derivatives and money market business (including credit support annexes)
- credit line monitoring,
- monitoring of credit default risk,
- early risk-detection methods,
- reporting on external and internal rating changes and
- portfolio management and monitoring on the basis of the general credit risk report and the results of the risk-bearing capacity calculation, including stress scenarios.

Derivative transactions may only be entered into subject to the legally binding conclusion of a German Framework Agreement or an ISDA Framework 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, 2017, the Bank had a net contributor position of EUR 3.4 billion (December 31, 2016: EUR 3.8 billion).

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 18 overruns occurred for individual derivatives counterparties. These overruns were immediately eliminated. Moreover, on 12 days money market limits were briefly exceeded due to strong market movements for securities collateral.

Overall, German debtors account for 61.0% (December 31, 2016: 61.3%) of the Bank's credit exposures, followed by debtors from Italy (16.2%) and Belgium (6.9%).

Moreover, 92.5% of the Bank's assets are eligible for cover and some of them are also eligible for central bank borrowings and for Eurex Repo transactions. As of June 30, 2017, 96.4% 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 volume of assets (including credit risk mitigation techniques) is shown for each specific asset class in Tables › 14 and › 15, with a breakdown of external and internal ratings on the basis of the CoRep reporting as of June 30, 2017.

14 Total exposure by external rating

Asset class	External rating	Risk position 30.06.2017 in EUR million	Risk position 31.12.2016 in EUR million	Average risk weight as %
Central governments or central banks	AAA to AA–	13,353.0	14,331.4	0.0
	A+ to A–	236.3	245.2	20.0
	BBB+ to BBB–	–	–	–
	BB+ to BB–	333.1	326.9	0.0
	B+ to B–	–	–	–
	No rating	–	–	–
Regional or local authorities	AAA to AA–	–	–	–
	A+ to A–	–	–	–
	BBB+ to BBB–	57.4	61.8	20.0
	BB+ to BB–	–	–	–
	B+ to B–	–	–	–
	No rating	–	–	–
Public sector entities	AAA to AA–	325.5	343.5	20.0
	A+ to A–	–	–	–
	BBB+ to BBB–	–	–	–
	BB+ to BB–	–	–	–
	B+ to B–	–	–	–
	No rating	104.1	108.5	100.0
Multilateral development banks	AAA to AA–	270.8	267.0	0.0
	A+ to A–	–	–	–
	BBB+ to BBB–	–	–	–
	BB+ to BB–	–	–	–
	B+ to B–	–	–	–
	No rating	–	–	–
Institutions	AAA to AA–	25.1	24.5	0.3
	A+ to A–	71.8	40.4	47.2
	BBB+ to BBB–	–	–	–
	BB+ to BB–	–	–	–
	B+ to B–	–	–	–
	No rating	134.2	119.9	2.0
Corporates	AAA to AA–	4.6	14.1	20.0
	A+ to A–	–	–	–
	BBB+ to BBB–	–	–	–
	BB+ to BB–	–	–	–
	B+ to B–	–	–	–
	No rating	146.4	157.1	100.0
Defaulted positions	CCC+ or lower	0.0	–	–
Others	AAA to AA–	86.9	85.4	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	212.3	219.8	100.0
Total		**15,480.7**	**16,463.2**	

15 Total exposure by internal rating

Asset class	Internal rating	Risk position		Average default probability	Average loss given default	Average risk weight	Average expected loss
		30.06.2017	31.12.2016				
		in EUR million	in EUR million	as %	as %	as %	as %
Central governments and central banks	AAA to AA–	1,279.3	1,487.5	–	5.4	–	–
	A+ to A–	–	109.8	–	–	–	–
	BBB+ to BBB–	3,460.6	3,505.1	0.2	26.6	41.9	0.1
	BB+ to BB–	–	–	–	–	–	–
	B+ to B–	–	–	–	–	–	–
Institutions	AAA to AA–	214.3	231.3	0.0	3.0	1.8	0.0
	A+ to A–	587.3	626.6	0.1	18.6	13.4	0.0
	BBB+ to BBB–	535.8	807.1	0.3	21.4	37.4	0.1
	BB+ to BB–	187.6	238.1	1.4	6.6	22.4	0.1
	B+ to B–	–	25.9	–	–	–	–
Corporates	AAA to AA–	–	–	–	–	–	–
	A+ to A–	–	–	–	–	–	–
	BBB+ to BBB–	27.4	36.7	0.5	26.0	51.1	0.1
	BB+ to BB–	–	–	–	–	–	–
	B+ to B–	–	–	–	–	–	–
Other non credit-obligation assets	AAA to AA–	4.7	2.5	–	5.0	–	–
	A+ to A–	48.8	50.3	0.1	30.3	20.1	–
	BBB+ to BBB–	3.7	4.1	0.2	33.2	27.9	–
	BB+ to BB–	–	–	–	–	–	–
	B+ to B–	–	–	–	–	–	–
Total		**6,349.4**	**7,125.1**				

As well as the Internal Rating Based Approach (IRB Approach) pursuant to Articles 142ff of the CRR, the Bank also uses the Credit Risk Standard Approach pursuant to Articles 111ff of the CRR for determination of the total capital charge for credit risk. 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 semi-public enterprises. German federal states and their municipalities are permanently excluded from 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 employed. 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.

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

Credit risk continues to be quantified within the scope of the risk-bearing capacity calculation by means of a credit default model (CVaR, Gordy model). These results undergo a detailed plausibility and development analysis.

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

Credit exposure to public-sector entities and financial institutions

Table › 16 shows Dexia Kommunalbank Deutschland's nominal credit exposure and credit risk equivalence amounts in relation to borrowers, with a breakdown by country.

Credit exposure decreased from EUR 23.4 billion to EUR 22.2 billion (–6.0%). Especially claims against Spanish borrowers declined by EUR 420.0 million to just EUR 29.5 million. It remains the case that the Bank is not subject to any significant risks in connection with the United Kingdom's decision to leave the EU (Brexit).

16 Credit exposure to public-sector entities and financial institutions as of June 30, 2017*

Country	Sovereign	Sub-sovereign entities	Others	Total	as part of cover pool for Public Pfandbriefe (nominal)	loans	securities	average weighted residual maturity
	in EUR million	in EUR million	in EUR million	in EUR million	in EUR million	in EUR million	in EUR million	in EUR million
Belgium	–	1,276.6	233.3	**1,510.0**	1,171.4	1,400.8	45.0	8.4
Germany	131.3	12,439.3	844.7	**13,415.4**	12,207.2	11,779.0	1,329.2	11.1
France	–	14.6	337.2	**351.8**	12.0	–	49.2	2.3
United Kingdom	–	–	158.6	**158.6**	–	–	83.2	2.5
Italy	3,157.9	287.6	122.2	**3,567.6**	1,827.0	–	3,499.8	11.8
Japan	–	236.4	–	**236.4**	224.4	–	236.4	19.8
Austria	67.5	976.7	–	**1,044.2**	1,008.9	1,017.7	26.5	6.0
Portugal	461.9	50.0	315.3	**827.2**	445.0	225.3	602.0	8.9
Spain	19.4	–	10.1	**29.5**	78.8	–	29.3	8.9
USA	–	346.3	66.7	**413.0**	148.6	–	346.3	10.7
Supranational	–	–	271.4	**271.4**	191.2	–	271.4	7.1
Others	26.1	99.9	26.5	**152.5**	100.4	99.9	50.9	1.8
Total	**3,864.1**	**15,727.4**	**2,386.0**	**21,977.5**	**17,414.9**	**14,522.7**	**6,569.1**	**10.6**

* Repo and derivatives transactions have been recognised at their credit equivalent amount; loans and securities at their carrying amount; not including cover pool assets.

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 also 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.

MARKET RISK

Market risk comprises the following key sub-categories:
- interest rate risk (including basis risk),
- credit spread risk and
- foreign currency risk.

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 risk is 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 risk: 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 change in the interest rates for the full range of maturities by 100 basis points, while PV01 describes this in case of a one basis point increase per defined maturity band.

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 Balance Sheet Management (BSM) and the short-term sub-portfolio Cash & Liquidity Management (CLM).

For the short-term and long-term interest rate risk, various +/– 100 BPV and VaR limits apply. In addition, the interest rate risk (PV01) maturity ranges specified for BSM are limited. The interest sensitivity of the credit spreads is measured daily. No separate limit is imposed.

As of June 30, 2017, these limits are as follows: › 17

17 Limits for management of interest rate risk

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

The following figures resulted on the basis of these assumptions: › 18 and › 19

18 Limit utilisation for cash & liquidity management

in EUR million	Value at Risk (99%, 10 days)	+100 bp	−100 bp
Average	0.1	4.2	−4.2
Minimum	0.1	−2.0	−10.0
Maximum	0.3	10.0	2.0
Last trading day	0.3	−1.2	1.2

19 Limit utilisation for balance sheet management

in EUR million	Value at Risk (99%, 10 days)	+100 bp	−100 bp
Average	0.2	−2.1	2.2
Minimum	0.1	−3.5	0.6
Maximum	0.4	−0.5	3.8
Last trading day	0.1	−1.4	1.7

The Treasury & Assets department which is responsible for the management of interest rate risk is notified daily of the development of interest rate risk and the level 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 not limited at the portfolio level. 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 risk over the past few years. In the first six months of 2017, risk premiums for claims against government entities of the peripheral Eurozone countries Portugal and (to a lesser extent) Italy and Spain in particular declined. A widening of the risk premiums for these claims would generally have a negative impact on the Bank's risk situation.

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 risk by means of cross-currency swaps. As of June 30, 2017, it did not have any non-hedged foreign currency positions. Applicable basis risk (currency basis risk) is regularly monitored, but not limited.

LIQUIDITY RISK

Liquidity risk consists 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 of 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 risk 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 following periods: "spot-next" (for the next-but-one working day), one week and one month.

As well as the absolute liquidity position, Table › 20 shows 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) as well as Pfandbrief overcollateralisation assumptions.

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

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

20 Liquidity scenarios according to MaRisk, section BTR 3.2, as of June 30, 2017

	Horizon	Date	Reserve	Liquidity gap	Liquidity position	Reserve / liquidity gap
			in EUR million	in EUR million	in EUR million	as %
Normal scenario	Spot/next	04.07.17	1,785.4	−466.8	1,318.6	382
	1 week	07.07.17	1,963.6	−756.3	1,207.4	260
	1 month	31.07.17	2,214.5	−1,505.1	709.3	147
Institution-specific stress scenario	Spot/next	04.07.17	2,590.4	−1,074.7	1,515.7	241
	1 week	07.07.17	2,768.4	−1,305.2	1,463.2	212
	1 month	31.07.17	2,951.7	−2,117.4	834.3	139
Market-wide stress scenario	Spot/next	04.07.17	2,108.3	−556.6	1,551.7	379
	1 week	07.07.17	2,275.1	−974.6	1,300.5	233
	1 month	31.07.17	2,450.3	−1,971.5	478.8	124
Combined stress scenario	Spot/next	04.07.17	2,830.1	−1,164.4	1,665.7	243
	1 week	07.07.17	2,962.6	−1,523.5	1,439.1	194
	1 month	31.07.17	3,163.4	−2,583.7	579.7	122

Moreover, the Bank has implemented scenarios for medium-term forecast periods (greater than one month and up to twelve months), which are based on the scenarios used for short-term liquidity measurement (up to one month).

The long-term liquidity risk is measured on a monthly basis by comparing the liquidity requirements and the liquidity surplus (gap) with the liquidity reserves for the various maturity bands within a period of five working days following the last day of the month, for a period of up to 50 years.

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

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 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 the level of the overall portfolio. The Bank's Asset Liability Management Committee measures maturity mismatches and analyses any necessary measures on a monthly basis.

Funding risk is also restricted by means of a limit in the risk-bearing capacity concept. On the development of the Bank's funding structure, please also refer to the financial and liquidity position section.

The Bank's liquidity situation was adequate and it maintained a high volume of claims which have solid credit ratings and are eligible for cover and for central bank borrowings. At the start of the current year, the Bank adjusted its business policy for deposit business in line with the revised market conditions. Together with Dexia Crédit Local S. A., it was resolved that a portion of the volume of non-banks' demand and fixed-term deposits would be replaced with lower-cost deposits of the parent company. The more advantageous refinancing terms are thus being exploited in order to improve the results of operations.

Market liquidity risk refers to the risk of being unable to unwind transactions due to insufficient market depth or in case of market disruptions or of 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 risk will thus not be relevant for valuation purposes. All of the Bank's securities have therefore been entered on its banking book. It does not have any positions in its trading book.

Dexia Kommunalbank Deutschland considers market liquidity risk to be non-material. However, the realisability and refinancing capacity of its assets (in particular, of the securities held) are monitored daily within the scope of its liquidity risk management and are assessed in appropriate stress scenarios.

OPERATIONAL RISK

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 risk, personnel risk, IT-related systemic risk and also reputational risk and risk associated with outsourcing and projects.

The ultimate goal for management of operational risk is to minimise losses which may result from operational loss events, to avoid risks jeopardising the Bank's existence and to identify and monitor material operational risks within the scope of the Risk Control and Self Assessment (RCSA) which must be performed at least annually. This also includes the continuous improvement of existing procedures and the review of possible measures to reduce the level of complexity and for automation of existing processes and controls.

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.

The Bank uses a Group-wide IT application for registration, valuation, monitoring and historicisation of operational risk. 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 future. Through an escalation process, the overall Management Board and Internal Audit are immediately notified of any loss events.

The Operational Risk & Information Security Committee, which meets on a quarterly basis, discusses losses and risks with the Management Board, representatives of the IT department, the IT and information security officer, the compliance officer and the Bank's Internal Audit department. The Operational Risk Management system (Risk Controlling) registers notified losses. Two cases were reported in the first six months of 2017.

The annual RCSA identifies and analyses the operational risk 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 Management system. 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 costs 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 risk.

The Bank has also established processes through which it manages and monitors outsourcing activities pursuant to Section 25b KWG as well as changes relating to new processes or new products or markets. In case of significant changes to the Bank's systems or operational structure, the effects on existing control processes including the risk controlling, compliance and audit functions must be examined in advance. No material risks have been identified.

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. The combined approach adopted for IT risk management – which comprises basic protection as well as object-specific detailed risk analysis – is based on the procedural model published by the German Federal Office for Information Security (Bundesamt für Sicherheit in der Informationstechnik, BSI).

In regard to the Bank's currently applicable legal risk, it should be pointed out that legal proceedings are pending in four cases. These relate to variable-rate 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. This entails a loan volume with an outstanding principal balance of EUR 9.2 million as of June 30, 2017. 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, the court of first instance found entirely in favour of Dexia Kommunalbank Deutschland, while in the fourth case its ruling was only partially in favour of the Bank. Two of these four legal disputes are currently subject to appeal proceedings. In the other two cases, the appeal proceedings have already been completed; the court of appeal has ruled in the Bank's favour in one case and against it in another. Appeal proceedings on points of law have been initiated against both of these appeal decisions. In two further cases, complaints of participation certificate creditors are pending versus Dexia Kommunalbank Deutschland whose amounts in dispute represent a low seven-digit figure overall. The two plaintiffs are an equity investment company and its managing partner. In relation to the complaint involving the far larger amount in dispute, in March 2017 a first partial ruling (which is not yet non-appealable) was issued in favour of Dexia Kommunalbank Deutschland for almost all of the matter in controversy. Only in relation to a low-value partial claim was the case not yet ready for a decision. This decision will be made at a later date. The plaintiff has now lodged an appeal against the partial ruling. In view of the court rulings already issued in similar cases, the Bank is confident that the complaints will be dismissed outright and with final effect.

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 Bank's risk situation was stable in the first six months of 2017.

Credit spreads on claims against government entities of the peripheral Eurozone countries Italy, Portugal and Spain narrowed in the first six months of 2017 and contributed to an improved overall risk situation. A widening of the risk premiums for these claims would generally have a negative impact on the Bank's risk situation. In the reporting period, the Bank's total nominal credit exposure to these countries decreased from EUR 4,836.8 million to EUR 4,424.3 million.

Besides natural amortisation of its loan and securities portfolio, the sale of various bank and German federal state bonds reduced the volume of risk assets. Overall, the Bank's volume of assets with a non-investment grade rating remains unchanged at just 3.6% of its credit portfolio (December 31, 2016: 3.6%).

The level of utilisation of risk-bearing capacity, within the scope of the going-concern approach, has decreased slightly to 71.1% (December 31, 2016: 71.5%). The volume of risks changed only slightly in the period under review. The risk-covering potential provided increased slightly, by EUR 1.7 million, since increasing minimum capital requirements and the shrinking Tier 2 capital were overcompensated for through a decline in risk assets.

The Bank's liquidity situation remained adequate.

As of June 30, 2017, the Bank's own funds totalled EUR 685.7 million (December 31, 2016, following the approval of the annual financial statements: EUR 690.1 million) and its Tier 1 capital EUR 662.4 million (December 31, 2016, following the approval of the annual financial statements: EUR 662.7 million). The Bank's CET1 ratio increased to 24.4% (December 31, 2016, following the approval of the annual financial statements: 22.5%), and its total capital ratio to 25.2% (December 31, 2016: 23.5%). Both of these capital ratios significantly exceed the regulatory requirements.

No 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 competent employees 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 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 risk. 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-based controls, the Bank 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 ensures 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, the functions for registration of the transactions of the divisions involved in the accounting process are clearly segregated from one another. 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 inputted data are analysed by means of checks against time-series analyses and target/actual comparisons, their plausibility is reviewed 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 rule-compliant 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 31, 2017

Dexia Kommunalbank Deutschland AG

The Management Board

Munsberg **Fritsch**

INTERIM FINANCIAL STATEMENTS 2017 OF DEXIA KOMMUNALBANK DEUTSCHLAND AG

CONDENSED BALANCE SHEET OF DEXIA KOMMUNALBANK DEUTSCHLAND AG AS OF JUNE 30, 2017

21 Assets

			30.06.2017	31.12.2016
	in EUR	in EUR	in EUR	in EUR thousand
1. Cash reserve assets				
a) Cash on hand		1,887.42		1
b) Balances with central banks		81,533,228.73		246,056
c) Balances with post office giro institutions		0.00	81,535,116.15	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		324,959,161.59		351,955
c) Other loans and advances		5,169,610,512.76	5,494,569,674.35	5,824,463
4. Loans and advances to non-bank customers				
a) Mortgage loans		35,893,082.24		37,521
b) Loans to public sector entities		13,667,846,381.26		14,158,961
c) Other loans and advances		155,655,117.78	13,859,394,581.28	187,692
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	5,261,180,348.62			5,942,750
bb) from other issuers	1,307,867,872.08	6,569,048,220.70		1,802,002
c) Own debt securities		5,430,728.46	6,574,478,949.16	5,451
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		337,210.39		282
c) Goodwill		0.00		0
d) Advance payments to suppliers		0.00	337,210.39	0
12. Property, plant and equipment			4,483,375.49	4,654
13. Capital called in but not yet paid in			0.00	0
14. Other assets			4,952,376.44	2,641
15. Prepayments				
a) From issuing and lending business		164,741,794.26		174,429
b) Other		72,798,878.98	237,540,673.24	70,928
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			**26,257,291,956.50**	**28,809.786**

22 Equity and liabilities

	in EUR	in EUR	30.06.2017 in EUR	31.12.2016 in EUR thousand
1. Liabilities to banks				
a) Registered Mortgage Pfandbriefe issued		0.00		0
b) Registered Public Pfandbriefe issued		366,243,492.26		381,786
c) Other liabilities		5,362,731,950.34	5,728,975,442.60	4,301,907
2. Liabilities to non-bank customers				
a) Registered Mortgage Pfandbriefe issued		0.00		0
b) Registered Public Pfandbriefe issued		12,413,227,902.40		13,085,052
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		3.,449,131,021.68	15,862,358,924.08	5,311,236
3. Securitised liabilities				
a) Debt securities issued				
aa) Mortgage Pfandbriefe	0.00			0
ab) Public Pfandbriefe	3,540,616,336.11			4,498,421
ac) other debt securities	10,001,857.53	3,550,618,193.64		30,466
b) Other securitised liabilities		0.00	3,550,618,193.64	0
3a. Trading portfolio			0.00	0
4. Trust liabilities			0.00	0
5. Other liabilities			219,368,628.94	283,849
6. Deferred income				
a) From issuing and lending business		12,738,551.74		13,648
b) Other		166,082,352.44	178,820,904.18	163,498
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		9,780,818.13	10,057,619.55	12,783
8. Subordinated liabilities			20,000,000.00	20,000
9. Profit participation rights capital			24,259,383.64	43,897
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) Accumulated losses		–169,054,322.18	662,832,859.87	–168,921
Total equity and liabilities			**26,257,291,956.50**	**28,809,786**
1. Contingent liabilities				
a) Contingent liabilities from rediscounted bills		0.00		0
b) Liabilities from guarantees and warranty agreements		40,884,735.91		43,052
c) Liability from the provision of collateral for third-party liabilities		0.00	40.884.735,91	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		–	–	–

CONDENSED PROFIT AND LOSS ACCOUNT OF DEXIA KOMMUNALBANK DEUTSCHLAND AG FOR THE PERIOD FROM JANUARY 1 TO JUNE 30, 2017

23 Expenses

			01.01.–30.06.2017	01.01.–30.06.2016
	in EUR	in EUR	in EUR	in EUR thousand
1. Interest expense			1,079,057,725.44	1,035,266
2. Commission expenses			1,166,848.64	1,442
3. Net expense for trading portfolio			0.00	0
4. General administrative expenses				
a) Personnel expenses				
aa) wages and salaries	3,068,354.21			2,986
ab) social security contributions and expenses for old-age pensions and support	565,036.50	3,633,390.71		504
b) Other administrative expenses		12,845,714.94	16,479,105.65	13,211
5. Depreciation, amortisation and valuation adjustments on intangible assets and property, plant and equipment			233,580.28	222
6. Other operating expenses			3,518.64	1
7. Depreciation, amortisation and valuation adjustments on receivables and specific types of securities and allocations to accruals in lending business			14,320,778.87	3,448
8. Depreciation, amortisation and valuation adjustments on equity investments, shares in affiliated companies and securities treated as fixed assets			0.00	0
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			8,001.86	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			**1,111,269,559.38**	**1,057,088**

24 Income

	in EUR	in EUR	01.01.–30.06.2017 in EUR	01.01.–30.06.2016 in EUR thousand
1. Interest income from				
a) Loan and money market business		977,698,158.71		903,111
b) Fixed income securities and book-entry securities		132,883,030.49	1,110,581,189.20	150,143
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			259,576.29	268
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
7. Income from write-ups of equity investments, shares in affiliated companies and securities treated as fixed assets			236,422.44	109
8. Other operating income			58,672.25	81
9. Extraordinary income			0.00	0
10. Income from assumption of losses			0.00	0
11. Net loss			133,699.20	3,376
Total			**1,111,269,559.38**	**1,057,088**

CONDENSED NOTES

Pursuant to Section 37w of the German Securities Trading Act (Wertpapierhandelsgesetz, WpHG), the semi annual financial statements as of June 30, 2017 have been prepared in accordance with the relevant provisions of the German Commercial Code (Handelsgesetzbuch, HGB), the German Stock Corporation Act (Aktiengesetz, AktG) and PfandBG as well as the German Regulation on the Accounting of Banks and Financial Services Institutions (Verordnung über die Rechnungslegung der Kreditinstitute und Finanzdienstleistungsinstitute, RechKredV). The applicable accounting standards of the Accounting Standards Committee of Germany (Deutsches Rechnungslegungs Standards Committee) are complied with. The accounting and valuation methods applied in the semi annual financial statements as of June 30, 2017 were the same as those applied in the annual financial statements as of December 31, 2016.

The notes on the key changes in the items of the condensed balance sheet and the condensed profit and loss account were provided in the interim management report.

The interim financial statements and the interim management report as of June 30, 2017 have not been audited pursuant to Section 317 HGB, and nor have they been reviewed by an auditor.

RESPONSIBILITY STATEMENT

We hereby provide an assurance that, to the best of our knowledge, the semi annual report 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 so as to provide a true and fair view while describing the key risks and opportunities of the company's likely development in the remainder of the financial year within the meaning of Section 289 (1) Clause 4 HGB.

Berlin, August 31, 2017

Dexia Kommunalbank Deutschland AG

The Management Board

Munsberg **Fritsch**

DEXIA
KOMMUNALBANK
DEUTSCHLAND

DKD