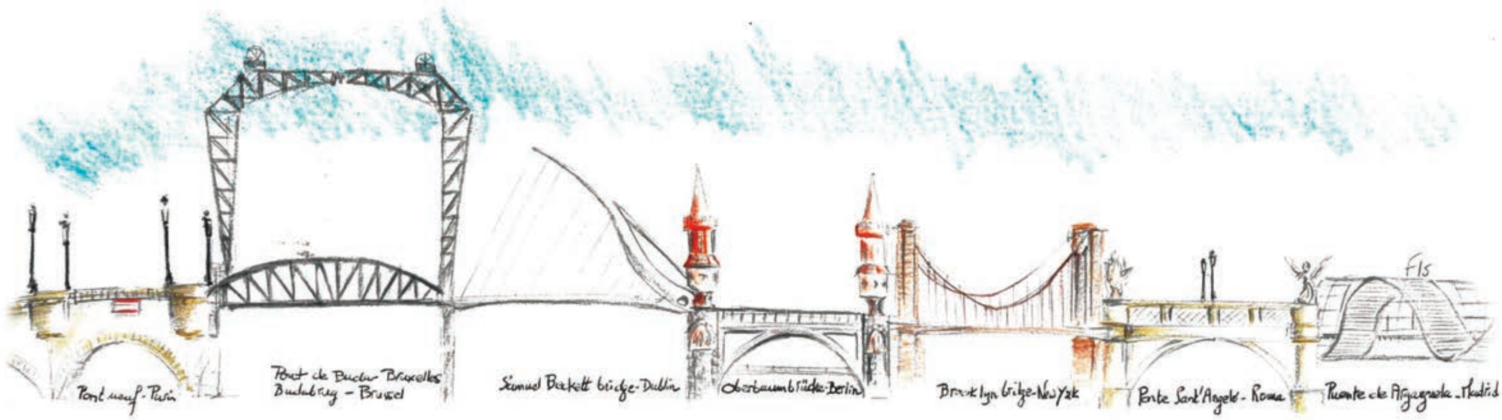

S1 2018

SEMI-ANNUAL REPORT

DEXIA KOMMUNALBANK DEUTSCHLAND
DKD

SEMI-ANNUAL REPORT 2018

OVERVIEW OF

DEXIA KOMMUNALBANK DEUTSCHLAND

1 Key balance sheet positions

in EUR million	30.06.2018	31.12.2017
Assets		
Loans to public sector entities	12,540.9	13,250.0
Other loans and advances to banks and non-bank customers	3,373.2	4,895.2
Securities	2,518.8	6,176.2
Equity and liabilities		
Pfandbriefe	14,182.2	15,728.2
Other liabilities to banks and non-bank customers	3,790.2	7,880.6
Equity	628.2	665.0
Balance sheet total	**18,871.9**	**24,625.0**

2 Key profit and loss account positions

in EUR million	30.06.2018	30.06.2017
Net interest and commission income	37.4	30.6
Administrative expenses (incl. depreciation)	– 14.0	– 16.7
Risk provisioning incl. result of financial investments	36.2	– 14.1
Profit/loss	**63.3**	**– 0.1**

3 Other disclosures

	30.06.2018	30.06.2017
Employees (average number)	75	78
Cost-income ratio as %	37.4	54.6

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Commercial Register No. HRB 194542 B, Berlin-Charlottenburg

CONTENTS

EXECUTIVE BODIES OF THE BANK

SUPERVISORY BOARD

Laurent Bouscharain
Managing Director Dexia Crédit Local S. A., Dublin Branch
Global Head of Financial Market Assets Dexia S. A.
Deputy Head of Assets Dexia S. A.
Chairman

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

Eric Bouthors
Bank employee of
Dexia Kommunalbank Deutschland GmbH

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

Stefanie Gregorius
Bank employee of
Dexia Kommunalbank Deutschland GmbH

Jürgen Jung
Consultant

MANAGEMENT BOARD

Friedrich Munsberg
Managing Director Market
Spokesman

Laurent Fritsch
Managing Director Back Office

TRUSTEE

Victor von Bothmer
Lawyer

Wolfgang Rips
Expert, consultant and auditor

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 States own 99.6% of the Group.

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 which, given the Group's residual size, might destabilise the entire European banking sector.

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

As of June 30, 2018, the Dexia Group had 808 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 enable 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 and Spain and subsidiaries in Germany and Italy which 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.

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, through its Dublin Branch. It thus belongs to a banking group in which the Belgian and French States hold a 99.6% stake. With its balance sheet total of EUR 18.9 billion as of June 30, 2018, 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,
- 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.

The business activities of Dexia Kommunalbank Deutschland continue to 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.

Sale of a securities portfolio

In coordination with the competent committees of the Dexia Group and the Bank's Supervisory Board, in the 1st quarter of 2018 Dexia Kommunalbank Deutschland sold a portfolio comprising

- 108 securities with a nominal value of EUR 3.6 billion and
- 104 related hedges (swaps)

to Dexia Crédit Local S. A., Dublin Branch.
This portfolio consists of bonds from Italy (75.5%) as well as bonds from Portugal (15.0%), Japan (6.0%) and the USA (3.5%).

Country	Nominal value in EUR million	as %	Number of securities
Italy	2,691.9	75.5	95
Portugal	536.1	15.0	4
Japan	213.1	6.0	6
USA	125.0	3.5	3
Total	**3,566.1**	**100.0**	**108**

The portfolio sale is consistent with Dexia Group's wind-down strategy wherein Dexia Crédit Local S.A., Dublin Branch, is acting as primary competence centre in Europe for bonds owned by the Group. Given its proven expertise, Dexia Crédit Local S.A., Dublin Branch, plays a key role to support the Group's asset management.

The purpose of the sale of this portfolio is a long-term improvement in the financial and economic situation of Dexia Kommunalbank Deutschland, in particular a reduction of concentration risks in its lending business and an improvement in its capital structure and risk-bearing capacity.

The sale of this portfolio was completed in March 2018.

Measures for optimisation of the allocation of capital within the Dexia Group

Transformation into a limited-liability company

At an extraordinary Shareholders' Meeting which was held on March 15, 2018, as the sole shareholder Dexia Crédit Local S. A. resolved the Bank's transformation from a stock corporation (Aktiengesellschaft) to a limited-liability company (Gesellschaft mit beschränkter Haftung).

Despite the continuity of the legal entity, this transformation of the Bank entailing a change of legal form gave rise to discontinuity in terms of its executive bodies. The appointment of the managing directors of Dexia Kommunalbank Deutschland GmbH and its Supervisory Board was necessary for this reason.

The members of the old Management Board, Friedrich Munsberg and Laurent Fritsch, were appointed as the Bank's managing directors.

The members of the old Supervisory Board were appointed as the members of the new Supervisory Board: Laurent Bouscharain (Chairman), Prakash Advani (Deputy Chairman), Eric Bouthors, Benoît Debroise, Stefanie Gregorius and Jürgen Jung.

Following its entry in the commercial register held by Charlottenburg Local Court (Amtsgericht Charlottenburg), No. HRB 194542 B, on March 16, 2018, the Bank's transformation into a limited-liability company came into effect.

Distribution of an interim dividend of EUR 100 million

At a further extraordinary Shareholders' Meeting which was held on March 29, 2018, Dexia Crédit Local S. A. resolved the distribution of an interim dividend of EUR 100 million to Dexia Crédit Local S. A.

Once this had been authorised by the Governing Council of the European Central Bank, the interim dividend was transferred to Dexia Crédit Local S. A. in May 2018.

The distribution of the interim dividend in conjunction with the Bank's transformation into a limited liability company serves the goal of optimising the allocation of capital within the Dexia Group.

ECONOMIC REPORT

OVERALL ECONOMIC AND INDUSTRY ENVIRONMENT

When US president Donald Trump announced the introduction of special tariffs on imports of steel and aluminium products to the USA at a White House press conference on March 1, 2018, this marked the start of a spiral of protectionist measures and countermeasures which had already developed into a global trade dispute halfway through the year. The first country to be affected was China. In early April 2018, the USA imposed a special tariff of 25% on Chinese steel imports and 10% on Chinese aluminium imports. In early June, these measures were expanded to include the EU countries as well as Canada and Mexico. All of the affected countries and also the EU reacted immediately by imposing their own protective tariffs, which in turn led to the Trump administration threatening more extensive measures such as a special 20% levy on car imports. This trade dispute reached its worst point to date on July 6, 2018 with the USA's introduction of further protective tariffs on Chinese products, with an annual import volume of USD 34 billion. If this remains limited to the measures which had entered into force as of this date, the effects on the Eurozone's economy would be relatively minor. However, in view of Trump's threats the risk of a further escalation of the trade dispute cannot be completely dismissed.

The risk of a long-term loss of growth due to rising protectionist barriers has resulted in a significant decline in prices on the particularly sensitive stock markets. In Europe, as of June 30, 2018 the Eurostoxx 50 and Germany's DAX index fell by 7.5% and 9.2% from their respective peaks in the first six months of the year and reached 3,395 and 12,306 points. The comparable markdowns on the Dow Jones index (– 8.8%) and the S&P 500 (– 5.4%) were not significantly lower.

At the same time, key European leading indicators which at the start of the year had signalled a continuation of the strong 2017 growth figures have weakened. The European

Commission's Economic Sentiment Indicator (Eurozone) fell from 114.7 to 112.3 points in the reporting period. The purchasing manager index "IHS Markit Composite (Eurozone)" which is likewise highly respected as an economic indicator suffered a stronger decline, from 58.8 to 54.9 points. Finally, in Germany the leading ifo business climate index fell from 105.0 to 101.8 points and also pointed to declining economic strength.

At a hearing before the European Parliament's Committee on Economic and Monetary Affairs on July 9, 2018, the ECB's President Mario Draghi warned of the negative consequences for the economy of increasing global isolationist tendencies and emphasised that the risks for the Eurozone's economic outlook were mainly associated with the danger of growing protectionism. At the press conference held on June 14, 2018 following the meeting of the ECB's Governing Council in Riga, Draghi had already presented the ECB's growth forecast for the Eurozone's real gross domestic product (GDP) in 2018 – which had been cut to 2.1% (March 2018: 2.4%) – while characterising the risks to the economy as largely balanced.

The ECB mainly reduced its forecast due to the Eurozone's disappointing GDP growth of just 0.4% in the 1st quarter of 2018 (4th quarter of 2017: 0.7%). While at the level of individual countries Spain reported a surprising growth level of 0.7%, the other three major Eurozone countries Germany, France and Italy each registered below-average growth of 0.3%.

In Italy, the government which was formed following the parliamentary elections of March 4, 2018 forced the financial markets to reassess the country's economic prospects. "Movimento 5 Stelle" (+ 7.1% to 32.7%) and "Lega" (+ 13.3% to 17.3%) emerged as the surprise victors of the election, two radical parties which represent the left and right fringes of the political spectrum while advocating a populist and euro-sceptic line. After a little to and fro, in early June 2018 the party leaders Luigi Di Maio (5 Stelle) and Matteo Salvini (Lega) agreed on a government coalition led by the previously entirely unknown law professor Giuseppe Conte as prime minister, who is not a member of any political party. The new government's programme includes costly plans such as significant tax cuts, a far-reaching reversal of the most recent pension reform and a basic income for the unemployed whose realisation would breach the deficit limits agreed with the EU and would significantly increase Italy's already high level of sovereign debt, 133.4% of GDP (March 31, 2018).

The events in Rome triggered strong reactions on the capital markets. A key yardstick of Italy's creditworthiness, the premium for credit default swaps (CDS) to hedge five-year Italian government bonds, reached as high as 287 bp, having priced at around 100 bp prior to the parliamentary elections. On May 29, 2018, the yield on two-year government securities even reached a peak level of 2.77% (– 0.18% prior to the election). These rates subsequently stabilised, helped by the fact that Conte expressed his commitment to the euro after taking office and declared that "there was never any question of leaving the euro". In late June 2018, the above-mentioned CDS premium was pricing at 219 bp and the yield on two-year government securities at 0.69%.

June 23, 2018 marked the second anniversary of the British electorate's Brexit decision in its referendum on the UK's withdrawal from the EU. While no clear concept for this withdrawal was discernible for a long time and the risk of a disorderly "hard Brexit" grew, on March 19, 2018 the EU's chief negotiator Michel Barnier and the British Brexit minister David Davis announced that they had agreed on a 21-month transition phase following the official Brexit date at the end of March 2019. More time elapsed without the government's Brexit plan acquiring any clearer outlines, until on July 12, 2018 the prime minister Theresa May made a surprising move and presented her white paper entitled "The future relationship between the United Kingdom and the European Union". This document of some 100 pages sets out a novel plan whereby the United Kingdom would formally leave the EU's customs union and the EU single market but at the same time remain affiliated with the EU through a form of free-trade zone for goods and merchandise and only obtain free access to the internal market for this purpose. The UK would thus levy duties on the movement of goods according to the EU's rules and transfer these to Brussels, which would resolve the key problem in existing plans: the possible loss of the current customs regime at the border between the Republic of Ireland and Northern Ireland. Services would not be covered by the open trade regime, so that British banks would lose their simplified access to the EU. The plan also maintains the objectives of the United Kingdom regaining sovereign control over immigration as well as the freedom to sign its own trade agreements and no longer being subject to the jurisdiction of the European Court of Justice. The prime minister's new line met with furious protests from exponents of purist Brexit thinking and resulted in the spontaneous resignations of the foreign minister, Boris Johnson, and the Brexit minister, David Davis. It remains to be seen whether May's plan will secure a majority in the British parliament and will also be accepted by the EU.

Another key issue at the European level was the discussion over the path for deepening integration within the European Union. The president of the European Commission, Jean-Claude Juncker, had already presented his thoughts on this matter in September 2017. Shortly thereafter, France's president Emmanuel Macron put forward his vision of a "refounding of the EU" in a celebrated speech at Paris' Sorbonne University. This includes an entire catalogue of initiatives such as the creation of a combined defence budget and the establishment of a comprehensive tax-financed budget for the 19 Eurozone countries, to enable joint investments and to guarantee stability in crisis scenarios.

Two days prior to this Sorbonne speech, on September 24, 2017, in the elections to the German Bundestag the previously comfortable majority of the governing CDU/CSU and SPD coalition declined from 67.2% to just 53.4%. Following the SPD's initial refusal to remain in coalition with the CDU/CSU and the failure of the discussions exploring the formation of a "Jamaica coalition" consisting of the CDU/CSU, FDP and the Greens, at the urging of Germany's president, Frank-Walter Steinmeier, the CDU/CSU and the SPD initiated exploratory discussions in early January 2018, before entering into coalition negotiations which culminated in the presentation of a coalition agreement on February 7, 2018. The SPD requested that this agreement be put to a vote of the SPD's members for approval on March 4, 2018, which was ultimately forthcoming with a majority of 66.0%. The next day, the country's president nominated Angela Merkel for reelection as Germany's chancellor. On March 14, 2018, 171 days after the election, the longest process of forming a government in the history of the Federal Republic of Germany had been completed through Merkel's election as chancellor and the swearing-in of her cabinet.

On June 3, 2018, Merkel provided more concrete details on Germany's reform plans for Europe for the first time. On June 19, 2018, at the Franco-German summit at Schloss Meseberg, she reached agreement on a joint road map for increased European integration, including:

› the launch of an investment campaign in Europe from 2021 within the scope of existing budgetary structures (no separate euro budget),
› the transformation of the existing euro rescue package, the ESM, into a European monetary fund, to ensure that the euro is better protected against new financial crises, and
› the creation of more stringent risk mitigation rules in the banking system (for non-performing loans, insolvency rules, the fight against money laundering etc.). In future, the ESM will serve as the final safety net in case of bank insolvencies.

In late June 2018, the competent European Council initially postponed any concrete resolutions for the implementation of these plans until December 2018.

Political events aside, the trend of stability for the ratings of the Eurozone countries which had been apparent in the previous year remained intact in the period under review. It should be emphasised that all three of the major rating agencies have rewarded Spain's economic development by upgrading their ratings: Standard & Poor's and Fitch from BBB+ to A– and Moody's from Baa2 to Baa1. In May 2018, Moody's confirmed France's Aa2 rating but improved its outlook from "stable" to "positive". By way of justification, Moody's cited the ambitious and far-reaching reform programmes executed by the French government to improve the country's competitiveness and growth prospects as well as its commitment to budget consolidation, with the goal of a gradual reduction in its sovereign debt. Conversely, in the same month Moody's cut the outlook for its Italy rating from "negative" to "on review for possible downgrade". In terms of the main reasons for this decision, the agency cited the risk of weakening Italian budget discipline in view of the new government's plans and the risk of a delay or even a reversal of structural reforms. 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, Luxembourg, the Netherlands, Norway, Sweden and Switzerland. › 4

In July 2018, the EU statistics authority, Eurostat, published the Eurozone's debt data as of March 31, 2018, according to which aggregate gross debt has increased slightly to 86.8% of GDP (December 31, 2017: 86.7%). Greece (180.4%), Italy (133.4%) and Portugal (126.4%) remain the countries with the highest levels of gross debt. Both Italy and Portugal registered an increase in their level of debt by comparison with the previous quarter, by 1.6 and 0.7 percentage points respectively. In its stability programme which it resolved in April 2018, the German government confirmed that it remained committed to a budget without any new debt. In the 2019 budget year at the latest, Germany's debt ratio is to fall from 62.9% (1st quarter of 2018) back below the maximum level of 60% of GDP prescribed by the Maastricht Treaty.

At 2.0% in June 2018, the Eurozone's Harmonised Index of Consumer Prices (HICP) also published by Eurostat reached the ECB's target range (December 2017: 1.4%). This increase was mainly due to energy prices and to a lesser extent prices for food and services. The ECB characterised this price trend as "muted overall", but noted growing pressure due to increasing capacity utilisation and rising wages. For the year 2018 as a whole, the ECB expects an HICP value of 1.7%. Halfway through the year, at 1.73% 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) was at exactly this level (December 31, 2017: 1.72%).

At the above-mentioned meeting of the ECB's Governing Council in Riga on June 14, 2018, as expected the ECB left

4 Ratings of selected countries

	Standard & Poor's		Moody's		Fitch	
	30.06.2018	31.01.2018	30.06.2018	31.01.2018	30.06.2018	31.01.2018
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+
Portugal	BBB–	BBB–	Ba1	Ba1	BBB	BBB
Spain	A–	BBB+	Baa1	Baa2	A–	A–
Other countries						
UK	AA	AA	Aa2	Aa2	AA	AA
USA	AA+	AA+	Aaa	Aaa	AAA	AAA
Japan	A+	A+	A1	A1	A	A

Source: Bloomberg

its key interest rate at the level of zero per cent which has been unchanged since March 2016. It also announced the end of its bond purchases within the framework of its expanded Asset Purchase Programme (APP). In the period up to late September 2018, it will continue to spend EUR 30 billion each month for additional bond purchases. Its net purchases will then decline to EUR 15 billion per month and they will cease completely from the end of 2018. Despite this, the ECB intends to reinvest upcoming maturities from its APP holdings "for as long as necessary".

The securities portfolios acquired overall by the ECB as part of its APP increased by 7.4% in the reporting period to EUR 2,455 billion (December 31, 2017: EUR 2,286 billion). They were divided up between four sub-programmes as follows:

- PSPP: EUR 2,012 billion,
- CBPP3: EUR 254 billion,
- CSPP: EUR 162 billion,
- ABSPP: EUR 27 billion.

The fact that the ECB intends to wait a while for its next key interest rate increase despite its planned withdrawal from the APP is illustrated by its choice of words in its forward guidance regarding its future interest-rate policy. It expects "interest rates to remain at their present levels at least through the summer of 2019 and in any case for as long as necessary to ensure that the evolution of inflation remains aligned with the current expectations of a sustained adjustment path".

The expected cooling of the Eurozone economy and the two key interest-rate hikes implemented by the US central bank, the Fed, in the first six months of 2018 put some pressure on the euro's exchange rate. Having started off in 2018 at a level of USD 1.20, in early February 2018 it reached a peak of USD 1.25 and ended the reporting period at a level of USD 1.17.

In view of the ECB's steady interest rate policy, interest rates on the euro money market remained virtually unchanged. By comparison with the start of the year, as of June 30, 2018 the 3-month Euribor had only increased by one basis point to –0.32%.

Ten-year Bund bonds, the benchmark for European government bonds, were providing a yield of 0.32% halfway through 2018 (December 31, 2017: 0.43%), while two-year German government securities ended the period under review with a yield of –0.67% (–0.63%).

Following their strong decline in the previous year, the banks' terms for unsecured borrowings picked up again. This was demonstrated by the iTraxx Senior Financials Europe Index for 30 European financial institutions (average premium for five-year credit default swaps on senior unsecured liabilities), which increased from 43 bp to 89 bp in the first six months of 2018.

At EUR 87.5 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 12% higher than the previous year's level. In the country ranking, France and Germany lead the way, each with a 19% share of issues, ahead of the Scandinavian countries (17%) and the Netherlands (10%).

According to the figures provided in the Deutsche Bundesbank's statistics, as of May 30, 2018 (more recent figures are unavailable) sales of Public Pfandbriefe (covered bonds) had decreased by 30.6% year-on-year to EUR 3.6 billion, while the volume outstanding fell from EUR 152.9 billion (December 31, 2017) to EUR 142.9 billion (–6.6%).

BUSINESS PERFORMANCE

In accordance with the plan approved by the European Commission in late December 2012 for the orderly resolution of the Dexia Group, Dexia Kommunalbank Deutschland did not pursue any new lending business in the first six months of 2018.

The Bank did not enter into any new business in the form of extensions of existing loans in the first six months of 2018.

As its most significant business transaction, in March 2018 the Bank disposed of a securities portfolio with a nominal value of around EUR 3.6 billion (see "Sale of a securities portfolio").

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 95.0 million (same period in previous year: EUR 30.0 million).

Table › 5 shows the volume of interest-rate and cross-currency interest-rate swaps as of June 30, 2018.

5 Derivative transactions

Nominal value in EUR million	30.06.2018	31.12.2017
Interest-rate swaps and cross-currency interest-rate swaps	31,229.3	44,227.4

The ratio of the volume of derivatives to the balance sheet total amounted to 165.5% (December 31, 2017: 179.6%).

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 increased to EUR 1,617.5 million (December 31, 2017: EUR 1,240.7 million). On balance, collateral for derivatives exposures totalled EUR 1.5 billion (December 31, 2017: EUR 3.2 billion).

POSITION

RESULTS OF OPERATIONS

Net interest income and net commission income

Net interest income in the first six months of 2018 amounted to EUR 38.3 million (same period in previous year: EUR 31.5 million) and was thus EUR 6.8 million higher than the previous year's figure.

This improvement was mainly attributable to the earnings contribution in the amount of EUR 16.3 million (same period in previous year: EUR 7.6 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 received a significant volume of low-cost deposits from its parent company Dexia Crédit Local S. A. (see "Financial and liquidity position").

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

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

Overall, net interest and commission income totalled EUR 37.4 million (same period in previous year: EUR 30.6 million). › 6

Administrative expenses

The number of employees declined from 77 (December 31, 2017) to 75, while personnel expenses decreased slightly by 1.2%.

On the other hand, non-compensation expenses fell significantly year-on-year, by 20.7% to EUR 10.2 million. This decrease is mainly attributable to reduced deposit protection contributions as well as lower legal and project costs.

A further reason is the decline in the contribution made to the restructuring fund (bank levy) of the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin) to EUR 14.6 million, compared to EUR 15.2 million in the previous year. The Bank once again made use of the opportunity to cover 15% (EUR 2.2 million) of the payment amount by submitting an irrevocable payment commitment to the Single Resolution Board and to capitalise this as an other asset. Of the remaining EUR 12.4 million, as of June 30, 2018 a pro rata amount of EUR 6.2 million was registered as non-compensation expenses.

6 Development of key profit and loss account positions

	30.06.2018 in EUR million	30.06.2017 in EUR million	Change as %
Interest income	1,479.3	1,110.6	33.2
Interest expense	–1,440.9	–1,079.1	33.5
Net interest income	38.3	31.5	21.5
Net commission income	–0.9	–0.9	–3.5
Net interest and commission income	**37.4**	**30.6**	**22.3**
Personnel expenses	–3.6	–3.6	–1.2
Other administrative expenses (non-compensation expenses)	–10.2	–12.8	–20.7
Depreciation, amortisation and valuation adjustments on intangible assets and property, plant and equipment	–0.2	–0.2	–3.9
Administrative expenses	–14.0	–16.7	–16.2
Partial operating result	**23.4**	**13.9**	**68.6**
Other operating income and expenses	3.7	0.1	> 100.0
Risk provisioning	36.0	–14.3	> 100.0
Result of financial investments	0.1	0.2	–40.7
Operating result	**63.3**	**–0.1**	**> 100.0**
Tax expense	0.0	0.0	0.0
Profit/loss	**63.3**	**–0.1**	**> 100.0**

Allowing for the impairment in value 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 by 16.2% to EUR 14.0 million (same period in previous year: EUR 16.7 million).

The ratio of administrative expenses to net interest and commission income (cost-income ratio) improved to 37.4% (same period in previous year: 54.6%).

Other operating income and expenses
In the period under review, an unscheduled write-down recognised in the past on the Bank's Charlottenstrasse 82 property was cancelled. The write-up amount is EUR 3.6 million and has been reported under other operating income.

Risk provisioning
Net risk provisioning amounted to EUR 36.0 million in the first six months of 2018 (same period in previous year: EUR –14.3 million). This mainly consists of the full release of the reserves according to Section 340f of the German Commercial Code (Handelsgesetzbuch, HGB) (EUR 34.4 million) as well as profits from the premature repayment of Public Pfandbriefe (EUR 5.7 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 0.1 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 63.3 million (same period in previous year: EUR –0.1 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 0.4 billion to EUR 11.9 billion (December 31, 2017: EUR 12.3 billion). This decline reflected scheduled maturities and debtors' exercise of termination rights. Moreover, as part of its market management activities the Bank repurchased its own outstanding Public Pfandbriefe with a volume of EUR 0.2 billion.

The bearer Pfandbriefe item decreased by EUR 1.2 billion to EUR 2.3 billion (December 31, 2017: EUR 3.5 billion).

The overall Pfandbriefe item thus reached EUR 14.2 billion (December 31, 2017: EUR 15.7 billion), which represented 75.1% (December 31, 2017: 63.9%) of the balance sheet total.

Other liabilities to banks decreased to EUR 2.4 billion (December 31, 2017: EUR 6.7 billion). › 7

7 Development of key balance sheet equity and liabilities

	30.06.2018 in EUR million	31.12.2017 in EUR million	Change as %
Registered Pfandbriefe	277.3	291.2	–4.8
Other liabilities	2,393.4	6,660.2	–64.1
Liabilities to banks	**2,670.8**	**6,951.4**	**–61.6**
Registered Pfandbriefe	11,587.7	11,965.1	–3.2
Other liabilities	1,396.7	1,220.4	14.5
Liabilities to non-bank customers	**12,984.4**	**13,185.5**	**–1.5**
Public Pfandbriefe	2,317.2	3,471.9	–33.3
Other debt securities	10.0	10.2	–1.7
Securitised liabilities	**2,327.2**	**3,482.0**	**–33.2**
Subordinated liabilities	**10.0**	**20.0**	**–50.0**
Profit participation rights capital	**0.0**	**14.3**	**–100.0**
Subscribed capital	432.5	432.5	0.0
Reserves	132.5	399.4	–66.8
Accumulated profits/losses	63.3	–166.9	–137.9
Equity	**628.2**	**665.0**	**–5.5**
Other liabilities	**251.3**	**294.6**	**–14.7**
Balance sheet total	**18,871.9**	**24,625.0**	**–23.4**

Securities repurchase agreements decreased considerably to EUR 104.7 million (December 31, 2017: EUR 2.2 billion). The Bank exclusively entered into these agreements with Dexia Crédit Local S. A.

As of June 30, 2018, the Bank had still not taken out any open-market loans provided by Deutsche Bundesbank (December 31, 2017: EUR 0.0 million).

On June 30, 2018, Dexia Kommunalbank Deutschland's available credit line with Deutsche Bundesbank on the basis of pledged securities amounted to EUR 514.9 million. The Bank also held further unencumbered securities eligible for central bank borrowings with a loan value of EUR 317.1 billion.

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 14.0 billion, which amounted to 74.3% (December 31, 2017: 71.4%) of the balance sheet total.

Other liabilities to non-bank customers increased to EUR 1.4 billion (December 31, 2017: EUR 1.2 billion).

Halfway through the year, non-banks' demand and fixed-term deposits and promissory note loans amounted to EUR 1.1 billion (December 31, 2017: EUR 0.9 billion). At the same time, the volume of deposits held by Dexia Crédit Local S. A. amounted to EUR 0.8 billion (December 31, 2017: EUR 3.3 billion). This decline is mainly attributable to the reduced liquidity requirements due to the sale of a securities portfolio with a volume of around EUR 3.6 billion (see "Sale of a securities portfolio").

Please refer to Table › 8 for details of the development of the Bank's overall funding structure (excluding cash collateral).

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

The Bank remains integrated within the Dexia Group's central liquidity management system.

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 short-falls of Dexia Kommunalbank Deutschland.

The liquidity coverage ratio (LCR) is calculated pursuant to the 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

8 Development of funding structure (excluding cash collateral)

	30.06.2018		31.12.2017	
	in EUR million	as %	in EUR million	as %
Public Pfandbriefe	13,919.5	83.6	15,422.9	67.5
Funding transactions with Deutsche Bundesbank	0.0	0.0	0.0	0.0
Securities repurchase agreements with banks	104.7	0.6	1,941.1	8.5
of which to Dexia Group	104.7	0.6	1,450.1	6.3
Securities repurchase agreements (Eurex Repo)	0.0	0.0	212.5	0.9
Liabilities to banks	879.9	5.3	3,346.6	14.7
of which to Dexia Group	785.0	4.7	3,250.0	14.2
Liabilities to non-bank customers	1,101.1	6.6	908.1	4.0
Other (including own funds)	648.2	3.9	709.3	4.4
Total	**16,653.5**	**100.0**	**22,540.6**	**100.0**

according to prescribed rules in the one-month period following the reporting date. The minimum ratio in the half-year under review was increased from 0.8 to 1.0 as of January 1, 2018; the liquidity coverage ratio of Dexia Kommunalbank Deutschland fluctuated between 1.14 and 2.57.

In addition, the Bank calculates the non-risk-dependent leverage ratio (LR) pursuant to the 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, 2018, it amounted to 3.43%.

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 (possible only from 2021) at the earliest.

The regulation for determining the liquidity ratio under German regulatory requirements in accordance with the German Liquidity Regulation (Liquiditätsverordnung, LiqV) is no longer applicable for credit institutions that meet the requirements for LCR according to CRR.

Volume of Pfandbriefe outstanding and Pfandbriefe cover

The total volume of Public Pfandbriefe outstanding had decreased to EUR 13.9 billion as of June 30, 2018 (December 31, 2017: EUR 15.4 billion). At the same time, the volume of cover pool assets used for cover declined to EUR 14.5 billion (December 31, 2017: EUR 16.7 billion).

As of June 30, 2018, the nominal overcollateralisation ratio amounted to 4.34% (December 31, 2017: 8.31%) and the present-value overcollateralisation ratio (ratio of the cover pool's present value to the present value of the volume of Pfandbriefe outstanding) was 12.42% (December 31, 2017: 17.10%). The reason for the reduction of the overcollateralisation ratio was the improved quality of the cover pool due to the sale of a securities portfolio with a nominal value of around EUR 3.6 billion in the 1st quarter of 2018.

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. As of June 30, 2018, there were no deductions according to the rules of the vdp's credit differentiation model.

Cover claims from Germany increased to 75.4% (December 31, 2017: 68.0%) of the total cover pool. In the further ranking claims from Belgium followed with 7.1% (6.3%), Austria with 6.8% (6.0%) and Italy with 4.4% (13.5%). The proportion of exposures to central governments decreased to 5.5% (December 31, 2017: 12.4%) and the proportion of exposures to local authorities to 23.9% (26.3%), while the proportion of exposures to regional authorities rose to 66.9% (58.1%). Exposures to other debtors accounted for 3.7% (3.2%) of the cover pool.

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

The rating agency Scope Ratings lowered the rating for the Public Pfandbriefe issued by the Bank due to the reduced overcollateralisation by one notch from AA– to A+ with stable outlook.

NET ASSETS POSITION

The balance sheet total of Dexia Kommunalbank Deutschland decreased by EUR 5.8 billion (or – 23.4%) by comparison with the end of the previous year to EUR 18.9 billion (December 31, 2017: EUR 24.6 billion).

In the loans and advances to banks item, loans to public sector entities fell, on account of maturities, to EUR 0.2 billion. Other loans and advances to banks declined to EUR 3.2 billion, mainly due to the decrease in cash collateral to secure derivative exposures and securities repurchase agreements. › 9

Loans and advances to non-bank customers declined by EUR 0.6 billion to EUR 12.6 billion (December 31, 2017: EUR 13.2 billion). This was mainly due to scheduled maturities.

Mainly on account of the sale of a securities portfolio with a volume of around EUR 3.6 billion (see "Sale of a securities portfolio"), the Bank's portfolio of bonds and debt securities declined by EUR 3.7 billion to EUR 2.5 billion (December 31, 2017: EUR 6.2 billion).

Bonds and debt securities thus declined considerably to 13.3% (December 31, 2017: 25.1%) of the balance sheet total, while loans increased to 67.7% (December 31, 2017: 54.6%).

Total domestic and foreign exposures to public sector debtors (public sector lending) decreased by EUR 3.8 billion to EUR 14.4 billion (December 31, 2017: EUR 18.2 billion). This corresponded to a 76.1% (December 31, 2017: 74.1%) share of the balance sheet total.

Own funds

In accordance with the regulations of the Capital Requirements Regulation (CRR) only a loss incurred during the year for the calculation of the regulatory own funds must be considered. As of June 30, 2018 this loss incurred during the year amounted to EUR 0.0. The Tier 1 capital decreased to EUR 556.9 million as of June 30, 2018 (after adoption of the annual financial statements as of 31 December 2017: EUR 664.6 million).

The subscribed capital within the Common Equity Tier 1 (CET1) remained unchanged; the reserves were offset with the balance sheet loss carried forward in the course of the transformation of the Bank from a stock corporation (Aktiengesellschaft) to a limited-liability company (Gesellschaft mit beschränkter Haftung).

The net loss reported for the financial year 2017 amounts to EUR – 0.1 million. Within the scope of offsetting of losses the profit participation rights capital was called upon with a volume of EUR 2.1 million in accordance with the applicable contractual provisions. Thus the accumulated losses 2017 decreased to EUR – 166.9 million. This was determined on March 30, 2018 and forwarded to new account or rather now offset with the reserves.

Deductions to the Common Equity Tier 1 to be formed according to the CRR amounted to EUR 8.1 million as of June 30, 2018.

Overall the Common Equity Tier 1 reached a volume of EUR 556.9 million as of June 30, 2018.

9 Development of key balance sheet assets

	30.06.2018 in EUR million	31.12.2017 in EUR million	Change as %
Loans to public sector entities	211.5	303.1	– 30.2
Other loans and advances	3,177.6	4,722.1	– 32.7
Loans and advances to banks	**3,389.1**	**5,025.2**	**– 32.6**
Mortgage loans	32.6	34.4	– 5.0
Loans to public sector entities	12,329.4	12,946.9	– 4.8
Other loans and advances	195.6	173.1	13.0
Loans and advances to non-bank customers	**12,557.6**	**13,154.4**	**– 4.5**
From public sector issuers	1,818.5	4,988.0	– 63.5
From other issuers	695.6	1,182.7	– 41.2
Own debt securities	4.7	5.5	– 15.0
Bonds and debt securities	**2,518.8**	**6,176.2**	**– 59.2**
Other assets	**406.4**	**269.2**	**51.0**
Balance sheet total	**18,871.9**	**24,625.0**	**– 23.4**

10 Development of own funds

in EUR million	30.06.2018	31.12.2017
Subscribed capital	432.5	432.5
Reserves	132.5	399.4
Accumulated balance sheet loss	0.0	–168.9
Intra-year loss	0.0	–0.1
Intangible Assets	–0.3	–0.4
Expected loss amounts from IRB portfolios	–0.8	0.0
Other deductions from Tier 1 capital (IPC)	–6.9	0.0
Tier 1 capital	**556.9**	**662.4**
Profit participation rights capital	0.0	0.0
Subordinated liabilities	0.3	2.0
Regulatory acknowledged general credit risk adjustments in accordance with Section 340f HGB	0.0	6.8
IRB excess of provisions over expected losses	0.0	10.3
Tier 2 capital	**0.3**	**19.1**
Total	**557.2**	**681.5**
CET1 ratio	44,4	25,9
Total capital ratio	44,5	26,7

The Bank does not have any Additional Tier 1 capital.

Tier 2 capital decreased to EUR 0.3 million as of June 30, 2018 (after adoption of the annual financial statements as of December 31, 2017: EUR 19.1 million). Within the Tier 2 capital subordinated loans amounting to EUR 0.3 million have been considered. › 10

The Bank's CET1 ratio calculated according to the CRR reached 44.4% as of June 30, 2018 (after adoption of the annual financial statements as of December 31, 2017: 25.9%) while its total capital ratio arrived at 44.5% (December 31, 2017: 26.7%).

Both of these capital ratios continue to significantly exceed the statutory 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 2018:

- Mainly due to the sale of a securities portfolio with a volume of around EUR 3.6 billion, the balance sheet total decreased by 23.4% to EUR 18.9 billion (December 31, 2017: EUR 24.6 billion).
- The Bank did not enter into any new lending business in the form of loan extensions in the reporting period.
- The profit and loss account ended the period with a net income of EUR 63.3 million (June 30, 2017: EUR –0.1 million).
- Tier 1 capital amounted to EUR 556.9 million. The Tier 1 capital ratio amounted to 44.4% (December 31, 2017: 25.9%).
- Dexia Kommunalbank Deutschland maintained an adequate liquidity position.
- As of June 30, 2018, the Bank's number of employees had decreased to 75 (December 31, 2017: 77).

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

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, 2018, Dexia Kommunalbank Deutschland had 75 employees (incl. its managing directors), including one trainee (December 31, 2017: 77 employees). In the period under review, three employees left the Bank while one new employee was hired.

EVENTS AFTER THE BALANCE SHEET DATE

At an extraordinary shareholders' meeting held on July 13, 2018, the distribution of a further interim dividend for the current business year of EUR 25 million was resolved. The interim dividend has already been transferred to Dexia Crédit Local S.A. in July 2018. The shareholder stated that, according to the level of knowledge available as per this day, this amount will be covered by the company's expected annual profit as of December 31, 2018.

FORECAST REPORT

The Bank envisages the following developments for the financial year 2018:

- The balance sheet total will decrease to approximately EUR 18.0 billion as of December 31, 2018.
- As of December 31, 2018, the Bank's Tier 1 capital is expected to reach a level which will roughly match its volume as of June 30, 2018.
- The Bank's Tier 1 capital ratio will likely amount to approximately 50% at the end of 2018 and will thus continue to significantly exceed the statutory requirements.
- The Bank expects to report a net income for the year which will amount to a higher two-digit million amount.
- Dexia Kommunalbank Deutschland's liquidity position will remain adequate.

In summary, for Dexia Kommunalbank Deutschland's financial year 2018 we thus expect that the Bank's net assets and financial position will remain stable in overall terms and envisage significantly improved results of operations.

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 non-quantifiable risks associated with the Bank's business are identified and subsequently assessed in terms of their potential impact on the Bank's net assets, financial position and results of operations. Possible effects on Pfandbrief business are also analysed. All of the Bank's relevant organisational units are included in this regular process, 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 and funding risk as well as
- operational risk (including IT and 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 managing director 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 (MaRisk), the portfolio present value and the portfolio market value indicators are key elements of the Bank's overall risk management system. Additional procedures have been introduced for the management and monitoring of liquidity and funding risks.

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 – 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 risks 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.

11 Assumptions for the calculation of risk-bearing capacity

	Risk type	Comments on the risk measurement methods
General credit risk	Non-specific general credit risk	Calculation of a Value at Risk using the Gordy model with a granularity adjustment (Hirschmann-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.

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 according to 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 deemed 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. › 11

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

Since there is no substantial risk appetite for operational risk and short-term measures are less appropriate for its management, no separate limit is assigned for this. 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, the following significant change to the risk-bearing capacity concept was implemented in the first six months of 2018:

› Revision of the risk model to determine the funding risk.

On the basis of the going-concern approach, the Bank's risk-bearing capacity has improved significantly as of June 30, 2018. › 12 This is mainly due to the risk-mitigating effects arising from the sale of a securities portfolio with a nominal value of around EUR 3.6 billion in March 2018 (see "Sale of a securities portfolio").

It can be observed that a slight increase in the available risk-covering potential leads partially to a significant decrease of the risk amounts (especially credit risk and funding risk). As a result, the utilisation of the internal capital model is declining to the same extent.

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 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	30.06.2018	31.12.2017	30.06.2018	31.12.2017
Eligible capital	557.2	681.5	90% of the available risk-covering potential	
Own funds requirements	–152.0	–253.4		
Free eligible capital	**405.2**	**428.1**		
Horizon Δ eligible capital	6.3	–6.4		
Horizon Δ own funds requirements	–7.8	–62.4		
Further elements of risk-covering potential	–8.1	–18.3		
Total	**395.6**	**341.0**	**356.1**	**306.9**

Risk potential	Limit on provided risk-covering potential (in EUR million)		Utilisation (as %)	
	30.06.2018	31.12.2017	30.06.2018	31.12.2017
General credit risk & CVA charge	135.2	115.6	21.5	75.0
Market risk	67.6	57.8	24.8	51.8
Funding risk	135.2	115.6	19.8	92.2
Operational risk	18.0	18.0		
Total	**356.1**	**306.9**	**25.4**	**78.6**

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, 2018, the PPV to Tier 1 capital ratio amounted to 1.43. 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 upon 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 enhanced risk monitoring measures.

Risk management for Pfandbrief business

As a Pfandbrief bank, Dexia Kommunalbank Deutschland falls under the scope of the German Pfandbrief Act (Pfandbriefgesetz, PfandBG). This requires a suitable risk management system under 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.

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. Internal reporting is provided at least quarterly.

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 risks, subject to consultation of the Dexia Group the management 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. Counterparties registered on the basis of defined criteria (early warning indicators for risks) are separately monitored in the monitoring list.

Market-independent credit analysis and loan processing ensure an appropriate segregation of duties and an appropriate process structure.

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, 2018, the Bank had a net contributor position of EUR 1.5 billion (December 31, 2017: EUR 3.2 billion). This decline is attributable to the disposal of the hedged derivatives in connection with the sale of a securities portfolio with a volume of around EUR 3.6 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 the disposal of derivatives 11 overruns occurred for individual derivatives counterparties. These overruns were immediately eliminated. No money market limits were exceeded in the period under review.

Overall, German debtors account for 75.0% (December 31, 2017: 61.7%) of the Bank's credit exposures, followed by debtors from Belgium (8.0%) and Austria (6.4%).

Moreover, 94.1% of the Bank's assets are eligible for cover pool and some of them are also eligible for central bank borrowings and for repo transactions. As of June 30, 2018, 98.6% of all assets have an internal rating of BBB– (investment grade) or higher (December 31, 2017: 96.8%). 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 › 13 and › 14, with a breakdown of external and internal ratings on the basis of the CoRep reporting as of June 30, 2018.

13 Total exposure by external rating

Asset class	External rating	Risk position 30.06.2018 in EUR million	Risk position 31.12.2017 in EUR million	Average risk weight as %
Central governments or central banks	AAA to AA–	11,899.2	12,587.7	0.0
	A+ to A–	–	224.0	–
	BBB+ to BBB–	–	200.6	–
	BB+ to BB–	–	126.2	–
	B+ to B–	–	–	–
	No Rating	–	–	–
Regional or local authorities	AAA to AA–	–	–	–
	A+ to A–	–	–	–
	BBB+ to BBB–	0.2	56.9	20.0
	BB+ to BB–	–	–	–
	B+ to B–	–	–	–
	No Rating	–	–	–
Public sector entities	AAA to AA–	262.6	279.7	20.0
	A+ to A–	–	–	–
	BBB+ to BBB–	–	–	–
	BB+ to BB–	–	–	–
	B+ to B–	–	–	–
	No Rating	87.5	102.2	100.0
Multilateral development banks	AAA to AA–	273.1	267.7	0.0
	A+ to A–	–	–	–
	BBB+ to BBB–	–	–	–
	BB+ to BB–	–	–	–
	B+ to B–	–	–	–
	No Rating	–	–	–
Institutions	AAA to AA–	17.1	13.7	0.6
	A+ to A–	24.2	54.1	50.0
	BBB+ to BBB–	–	–	–
	BB+ to BB–	–	–	–
	B+ to B–	–	–	–
	No Rating	–	75.8	–
Corporates	AAA to AA–	10.7	10.2	20.0
	A+ to A–	–	–	–
	BBB+ to BBB–	–	–	–
	BB+ to BB–	–	–	–
	B+ to B–	–	–	–
	No Rating	101.7	113.6	100.0
Defaulted positions	CCC+ or lower	–	–	–
Others	AAA to AA–	87.5	59.5	0.0
	A+ to A–	103.6	131.0	0.0
	BBB+ to BBB–	–	–	–
	BB+ to BB–	–	–	–
	B+ to B–	–	–	–
	No Rating	187.5	190.9	100.0
Total		**13,055.0**	**14,493.8**	

14 Total exposure by internal rating

Asset class	Internal rating	Risk position		Average default probability	Average loss given default	Average risk weight	Average expected loss
		30.06.2018	31.12.2017				
		in EUR million	in EUR million	as %	as %	as %	as %
Central governments and central banks	AAA to AA–	1,289.9	1,187.9	0.0	5.1	0.0	0.0
	A+ to A–	–	–	–	–	–	–
	BBB+ to BBB–	779.5	3,406.6	0.2	26.4	39.8	0.1
	BB+ to BB–	–	–	–	–	–	–
	B+ to B–	–	–	–	–	–	–
Institutions	AAA to AA–	122.1	127.2	0.0	3.0	1.8	0.0
	A+ to A–	200.3	374.9	0.1	26.8	26.3	0.0
	BBB+ to BBB–	268.3	532.3	0.3	30.1	51.8	0.1
	BB+ to BB–	–	186.6	–	–	–	–
	B+ to B–	175.1	–	3.4	3.0	9.0	0.1
Corporates	AAA to AA–	–	–	–	–	–	–
	A+ to A–	–	–	–	–	–	–
	BBB+ to BBB–	14.8	25.6	0.7	20.0	50.0	0.1
	BB+ to BB–	–	–	–	–	–	–
	B+ to B–	–	–	–	–	–	–
Other assets excluding loan commitments	AAA to AA–	6.9	4.7	0.0	5.0	0.0	0.0
	A+ to A–	49.4	47.3	0.1	26.4	14.1	0.0
	BBB+ to BBB–	–	3.6	–	–	–	–
	BB+ to BB–	–	–	–	–	–	–
	B+ to B–	–	–	–	–	–	–
Total		**2,906.3**	**5,896.7**				

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 risks. Exposure values under the IRB Approach are determined for loans to central governments and central banks, institutions and undertakings. If the Bank has not implemented any independent rating systems for borrowers for which the usage requirements for the IRB Approach are fulfilled, the Credit Risk Standard Approach is applied for these credit risk positions in accordance with the CRR. In particular, this comprises loans to German and foreign municipal and 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 (PDs) and loss given defaults (LGDs) are an integral part of the Bank's approval, monitoring and control processes.

Credit risks continue 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 › 15 shows Dexia Kommunalbank Deutschland's nominal credit exposure and credit risk equivalence amounts in relation to borrowers, with a breakdown by country.

15 Credit exposure to public sector entities and financial institutions as of June 30, 2018*

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 years
Germany	301.5	11,122.0	556.5	**11,980.0**	10,830.6	10,505.2	1,157.3	11.3
Belgium	–	1,120.3	159.3	**1,279.5**	1,024.6	1,236.3	25.0	8.5
Austria	67.4	949.3	–	**1,016.7**	981.9	991.3	25.4	5.4
Italy	704.6	0.9	49.9	**755.4**	633.9	–	755.4	5.7
Portugal	55.5	225.0	–	**280.5**	190.0	225.0	55.5	2.2
Supranational	–	–	273.5	**273.5**	191.2	–	273.5	6.1
USA	–	122.1	34.8	**157.0**	72.5	–	122.1	12.4
France	–	13.0	121.0	**134.0**	10.8	–	47.9	1.3
United Kingdom	–	–	27.9	**27.9**	–	–	7.7	0.7
Netherlands	–	–	24.9	**24.9**	–	–	24.9	1.1
Finland	–	20.4	–	**20.4**	21.4	20.4	–	7.0
Others	19.4	14.5	–	**33.9**	414.3	14.5	19.4	5.0
Total	**1,148.4**	**13,587.4**	**1,247.8**	**15,983.7**	**14,371.2**	**12,992.6**	**2,514.1**	**10.1**

* Repo and derivatives transactions have been recognised at their credit equivalent amount; loans and securities at their carrying amount; not including cover pool assets.
Loans and securities column are sub-items of the Total column.
Instruments held in the cover pool may exceed the exposure in the Total column, since borrowed securities from the reverse repo/securities lending are also included.

Credit exposure decreased from EUR 20.5 billion to EUR 16.0 billion (–22.1%). As well as scheduled redemptions and maturities, the sale of a securities portfolio with a volume of around EUR 3.6 billion resulted in a significant reduction in the Bank's holdings of securities from foreign issuers (see "Sale of a securities portfolio").

The average rating, weighted by asset volume, is AA (December 31, 2017: AA–).

It remains the case that the Bank is not subject to any significant risks in connection with the United Kingdom's withdrawal from the EU (Brexit).

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. Risk provisioning was not necessary as of June 30, 2018.

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

The management has at its disposal two risk-related indicators which are calculated on the basis of the fair value method as key management parameters for interest rate 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 1 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 short-term and long-term interest rate risks, various +/−100 BPV and VaR limits apply. In addition, the interest rate risk (PV01) maturity ranges specified for BSM are limited. A VaR limit applies for the aggregate of the BSM and CLM sub-portfolios. The interest sensitivity of the credit spreads is calculated daily. No separate limit is imposed.

As of June 30, 2018, these limits are as follows: › 16

16 Limits for management of interest rate risks

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

The following figures resulted on the basis of these assumptions: › 17 and › 18

17 Limit utilisation for cash & liquidity management

in EUR million	Value at Risk (99%, 10 days)	+100 bp	−100 bp
Average	0.1	−0.2	0.2
Minimum	0.0	−5.2	−3.7
Maximum	0.1	3.7	5.2
Last trading day	0.1	−1.7	1.7

18 Limit utilisation for balance sheet management

in EUR million	Value at Risk (99%, 10 days)	+100 bp	−100 bp
Average	0.2	−1.2	1.4
Minimum	0.0	−3.8	−3.8
Maximum	0.5	3.6	4.3
Last trading day	0.3	1.4	−1.4

The Treasury & Assets department which is responsible for the management of interest rate risks 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 for bonds' default risk (and implicitly also for loans or other long-term assets). The Bank regularly measures the valuation effects of changes in credit spreads. Credit spread risks are not limited at the portfolio level. Credit spread risk is restricted within the scope of the risk-bearing capacity system.

Due to the sale of a securities portfolio with a volume of around EUR 3.6 billion in March 2018, the Bank's holdings of government and other bonds – some of which were subject to heightened spread risks over the past few years – have declined significantly. In the first six months of 2018, inter alia the risk premiums widened for the Bank's claims against Italian debtors, which decreased from EUR 3,448.6 million (December 31, 2017) to EUR 705.0 million. A further widening of the risk premiums for these claims would 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 risks by means of cross-currency swaps. As of the reporting date, it did not have any non-hedged foreign currency positions. The applicable basis risk (currency basis risk) is regularly monitored, but is not limited.

LIQUIDITY RISK

Liquidity risk consists of the following sub-categories:
- liquidity risk (including intraday liquidity risk),
- 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. 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 › 19 shows the ratio of the reserve to the liquidity gap in the various liquidity scenarios.

19 Liquidity scenarios according to MaRisk, section BTR 3, as of June 30, 2018

	Horizon	Date	Reserve	Liquidity gap	Liquidity position	Reserve / liquidity gap
			in EUR million	in EUR million	in EUR million	as %
Normal scenario	spot/next	03.07.18	598.4	–156.3	442.0	382.8
	1 week	07.07.18	598.1	–188.0	410.0	318.1
	1 month	31.07.18	588.2	–297.6	290.7	197.7
Institution-specific stress scenario	spot/next	03.07.18	717.2	–156.3	560.8	458.8
	1 week	07.07.18	716.9	–188.0	528.8	381.3
	1 month	31.07.18	806.9	–299.8	507.0	269.1
Market-wide stress scenario	spot/next	03.07.18	695.2	–202.3	493.0	343.7
	1 week	07.07.18	694.9	–300.3	394.7	231.4
	1 month	31.07.18	746.7	–535.4	211.2	139.5
Combined stress scenario	spot/next	03.07.18	896.6	–202.3	694.3	443.3
	1 week	07.07.18	896.3	–300.3	596.1	298.5
	1 month	31.07.18	952.9	–537.7	415.2	177.2

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 over-collateralisation 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.

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 refer to the section "Financial and liquidity position".

The Bank's liquidity situation remained adequate, with a consistently sufficient volume of liquid funds and claims which have solid credit ratings and are eligible for cover pool and for central bank borrowings. The Bank's refinancing requirements declined significantly following the sale of a securities portfolio with a volume of around EUR 3.6 billion. The Bank pursues active deposit business and receives deposits from Dexia Crédit Local S. A. as part of the Group's cash and liquidity management system.

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 assigned to its banking book. It does not have any positions in its trading book.

Dexia Kommunalbank Deutschland considers the 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 risk and also reputational risk and the 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 relevant 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 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. Overall, 3 cases were reported in the first six months of 2018. In general, these did not have any financial effect.

The annual RCSA identifies and analyses 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.

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 were identified in the first six months of 2018.

The IT infrastructure and the process 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 risks, it should be pointed out that as of June 30, 2018 legal proceedings were pending in one case. These relate to variable-rate loans which Dexia Kommunalbank Deutschland granted, including two loans whose interest rate is tied to the development of the Swiss franc's exchange rate against the euro (outstanding principal balance: EUR 3.1 million). Dexia Kommunalbank Deutschland has rejected the claims brought against it in these proceedings. The court of the first instance has ruled entirely in favour of Dexia Kommunalbank Deutschland in these proceedings.

In two further judicial proceedings, 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. In the second case, the court of the first instance has ruled in favour of Dexia Kommunalbank Deutschland. The plaintiff has now lodged an appeal against both of these rulings. In view of the court rulings already issued in similar cases, the Bank is confident that both complaints will be dismissed outright and with final effect.

SUMMARY OF RISK SITUATION

Through the implementation of the revised orderly resolution plan 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 improved significantly in the first six months of 2018.

Besides natural amortisation of its loan and securities portfolio, the sale of a bond portfolio reduced the volume of risk assets and led to a decline in the Bank's funding needs. The Bank's volume of assets with a non-investment grade rating remains at just 1.4% of its credit portfolio (December 31, 2017: 3.2%) at a low level.

Credit spreads on claims against government entities of the peripheral Eurozone countries Italy, Portugal and Spain increased in the first six months of 2018. The affected receivables from loans and bonds amount to EUR 1,055 million (December 31, 2017: EUR 4,360 million) and could thus be significantly reduced. A widening of the risk premiums for these claims would continue to have a generally negative impact on the Bank's risk situation.

The level of utilisation of risk-bearing capacity, within the scope of the going-concern approach, has decreased to 25.4% in the period under review (December 31, 2017: 78.6%). The provided risk-covering potential increased by EUR 49.2 million despite of the interim distribution, since the minimum capital requirements have decreased sharply due to a decline in risk-weighted assets. The risk amounts especially for credit and funding risks decreased significantly. The decisive factor was the sale of the bond portfolio mentioned above.

The Bank's liquidity situation remained adequate. Through implemented measures as well as the ongoing positive market environment, the Bank could further reduce its funding needs and therefore optimise its funding costs and liquidity requirements.

The Bank's total own funds amounted to EUR 557.2 million as of June 30, 2018 (December 31, 2017 following the adoption of the annual financial statements: EUR 683.7 million), Tier 1 capital amounted to EUR 556.9 million (December 31, 2017: EUR 664.6 million). The CET1 ratio increased to 44.4% (December 31, 2017: 25.9%), the total capital ratio rose to 44.5% (December 31, 2017: 26.7%). Both of these capital ratios continued to significantly exceed the regulatory requirements.

There have been no developments since the balance sheet date that would give rise to any changes in the presentation 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 risks. This information is followed up on in accordance with the process for the preparation of financial statements. The relevant responsibilities are defined in the organisational manual. Job descriptions have been specified for all of the employees entrusted with the accounting process. They are assigned to the Back Office. The accounting process is documented in a form which expert third parties are able to follow.

The control system of Dexia Kommunalbank Deutschland consists of organisational arrangements and integrated IT-supported controls. As well as these IT-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 Board 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 29, 2018

Dexia Kommunalbank Deutschland GmbH

The Management Board

Munsberg

Munsberg **Fritsch**

INTERIM FINANCIAL STATEMENTS 2018 OF DEXIA KOMMUNALBANK DEUTSCHLAND GMBH

CONDENSED BALANCE SHEET OF DEXIA KOMMUNALBANK DEUTSCHLAND GMBH AS OF JUNE 30, 2018

20 Assets

			30.06.2018	31.12.2017
	in EUR	in EUR	in EUR	in EUR thousand
1. Cash reserve assets				
a) Cash on hand		1,721.18		1
b) Balances with central banks		184,059,167.60		44,469
c) Balances with post office giro institutions		0.00	184,060,888.78	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		211,502,647.29		303,106
c) Other loans and advances		3,177,562,424.51	3,389,065,071.80	4,722,120
4. Loans and advances to non-bank customers				
a) Mortgage loans		32,637,422.31		34,354
b) Loans to public sector entities		12,329,351,271.88		12,946,937
c) Other loans and advances		195,628,648.10	12,557,617,342.29	173,089
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	1,818,481,943.31			4,987,972
bb) from other issuers	695,640,284.52	2,514,122,227.83		1,182,714
c) Own debt securities		4,676,277.56	2,518,798,505.39	5,501
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		285,772.69		336
c) Goodwill		0.00		0
d) Advance payments to suppliers		0.00	285,772.69	0
12. Property, plant and equipment			7,846,792.93	4,375
13. Capital called in but not yet paid in			0.00	0
14. Other assets			7,575,125.02	5,387
15. Prepayments				
a) From issuing and lending business		147,272,393.23		155,435
b) Other		59,392,895.16	206,665,288.39	59,189
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			**18,871,914,787.29**	**24,624,985**

21 Equity and liabilities

	in EUR	in EUR	30.06.2018 in EUR	31.12.2017 in EUR thousand
1. Liabilities to banks				
a) Registered Mortgage Pfandbriefe issued		0.00		0
b) Registered Public Pfandbriefe issued		277,314,539.52		291,160
c) Other liabilities		2,393,440,981.95	2,670,755,521.47	6,660,234
2. Liabilities to non-bank customers				
a) Registered Mortgage Pfandbriefe issued		0.00		0
b) Registered Public Pfandbriefe issued		11,587,675,988.61		11,965,149
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		1,396,736,507.53	12,984,412,496.14	1,220,378
3. Securitised liabilities				
a) Debt securities issued				
aa) Mortgage Pfandbriefe	0.00			0
ab) Public Pfandbriefe	2,317,246,857.75			3,471,864
ac) other debt securities	10,001,857.53	2,327,248,715.28		10,173
b) Other securitised liabilities		0.00	2,327,248,715.28	0
3a. Trading portfolio			0.00	0
4. Trust liabilities			0.00	0
5. Other liabilities			148,878,860.84	138,887
6. Deferred income				
a) From issuing and lending business		11,126,950.35		11,873
b) Other		87,540,010.79	98,666,961.14	150,355
6a. Deferred tax liabilities			0.00	0
7. Accruals				
a) Accruals for pensions and similar obligations		0.00		0
b) Tax accruals		144,025.67		277
c) Other accruals		3,568,696.60	3,712,722.27	5,328
8. Subordinated liabilities			10,000,000.00	20,000
9. Profit participation rights capital			0.00	14,343
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		132,464,604.96		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	0.00	0.00		50,702
d) Accumulated profits/losses		63,274,905.19	628,239,510.15	– 166,923
Total equity and liabilities			**18,871,914,787.29**	**24,624,985**
1. Contingent liabilities				
a) Contingent liabilities from rediscounted bills		0.00		0
b) Liabilities from guarantees and warranty agreements		12,671,030.65		43,052
c) Liability from the provision of collateral for third-party liabilities		0.00	12,671,030.65	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		0.00	0.00	0

CONDENSED PROFIT AND LOSS ACCOUNT OF DEXIA KOMMUNALBANK DEUTSCHLAND GMBH FOR THE PERIOD FROM JANUARY 1 TO JUNE 30, 2018

22 Expenses

			01.01.–30.06.2018	01.01.–30.06.2017
	in EUR	in EUR	in EUR	in EUR thousand
1. Interest expense			1,440,943,548.22	1,079,058
2. Commission expenses			1,060,594.92	1,167
3. Net expense for trading portfolio			0.00	0
4. General administrative expenses				
a) Personnel expenses				
aa) wages and salaries	3,062,451.82			3,068
ab) social security contributions and expenses for old-age pensions and support	526,183.60	3,588,635.42		565
b) Other administrative expenses		10,191,850.05	13,780,485.47	12,846
5. Depreciation, amortisation and valuation adjustments on intangible assets and property, plant and equipment			224,514.66	234
6. Other operating expenses			9,774.34	4
7. Depreciation, amortisation and valuation adjustments on receivables and specific types of securities and allocations to accruals in lending business			0.00	14,321
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			7,883.86	8
13. Profits transferred under a profit pool, a profit transfer agreement or a partial profit transfer agreement			0.00	0
14. Net income			63,274,905.19	0
Total			**1,519,301,706.66**	**1,111,270**

23 Income

	in EUR	01.01.–30.06.2018 in EUR	01.01.–30.06.2017 in EUR thousand
1. Interest income from			
a) Loan and money market business	1,412,920,489.69		977,698
b) Fixed income securities and book-entry securities	66,338,004.11	1,479,258,493.80	132,883
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		185.396.26	260
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		36,020,466.70	0
7. Income from write-ups of equity investments, shares in affiliated companies and securities treated as fixed assets		140,135.96	236
8. Other operating income		3,697,213.94	59
9. Extraordinary income		0.00	0
10. Income from assumption of losses		0.00	0
11. Net loss		0.00	134
Total		**1,519,301,706.66**	**1,111,270**

CONDENSED NOTES

Pursuant to Section 115 of the German Securities Trading Act (Wertpapierhandelsgesetz, WpHG), the semi-annual financial statements as of June 30, 2018 have been prepared in accordance with the relevant provisions of the German Commercial Code (Handelsgesetzbuch, HGB), the German Act on Limited Liability Companies (GmbH-Gesetz, GmbHG) and the German Pfandbrief Act (Pfandbriefgesetz, 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, 2018 were the same as those applied in the annual financial statements as of December 31, 2017.

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, 2018 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 29, 2018

Dexia Kommunalbank Deutschland GmbH

The Management Board

Munsberg **Fritsch**

DEXIA
KOMMUNALBANK
DEUTSCHLAND