ANNUAL REPORT
2011

L-BANK
Staatsbank für Baden-Württemberg

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GREETINGS FROM THE CHAIRMAN OF THE BOARD

Dear Business Associates,

Fiscal year 2011 went well for L-Bank: we did not fall victim to the financial and sovereign-debt crisis. The fact that our business activities are focused on Baden-Württemberg is one reason for this. The cyclical upswing in the federal state, combined with generally positive economic conditions, have helped the Bank to thrive.

As nuclear power is phased out, the changeover to alternative energies is finally becoming a fact – and an important task for the State of Baden-Württemberg. We will be helping the state government to assert and assure Baden-Württemberg's preeminence in the conservation of resources and efficient use of energy. For L-Bank, the challenge is a familiar one. In the past, we were heavily involved in financing energy efficiency projects and renewable energy generation. Back in the late 90s, for example, L-Bank was already issuing low-interest loans for solar power installations; the Bank also pioneered finance for wind farms.

The state has set itself an admirable target: to turn Baden-Württemberg into a model region for environmentally sensitive business activity. As the State Bank we can and will help the federal state to achieve this goal and continue to provide support. With this in mind, L-Bank is focusing on two key objectives: first, to promote alternative power generation, and second, to promote energy-efficiency initiatives. For the transition to renewable energy – also known as green energy – the Bank is already using low-interest loans to enable SMEs to invest in the relevant technologies. The Bank is providing support for e.g. biogas installations, biomass power stations, biogenic fuel production, investments in photovoltaics, and wind energy and hydroelectric power plants. Such support is especially significant for rural districts. But the changeover to alternative energy is not just about expanding Baden-Württemberg's energy generation capacity: it is also about making major improvements in the efficient use of energy by consumers, businesses and the public sector.

In this respect, the Bank's housing development programmes are rapidly gaining in significance. If we bear in mind that residential buildings account for some 40% of German energy consumption and around one-third of carbon-dioxide emissions, it becomes clear that this sector harbours enormous potential for energy savings. Improving the energy efficiency of existing housing is another major priority. With this in mind, we have further improved our existing offerings. Most of the older buildings in Baden-Württemberg date from before 1979, so were built before stringent energy efficiency regulations came into force. This offers us huge opportunities to save energy and cut CO_2 emissions. To make the most of them, since April 2012 L-Bank has added development programmes for improving the energy performance of buildings to the federal state's existing energy efficiency programme.

Furthermore, our "Energieeffizienzprogramm – Mittelstand" (Energy Efficiency Programme for SMEs) is helping small and medium-sized businesses to implement energy-saving measures when investing in new or upgraded buildings and machinery.

L-Bank also acts as a strong financial partner for Baden-Württemberg's local authorities, for example providing funding for refurbishing schools and administrative buildings, for energy-saving and climate protection schemes, and for environmental engineering.

In the current year we are expecting to provide in excess of EUR 1 billion in finance for energy-efficiency measures across all the business segments most concerned with these priorities, including housing development, business development, agricultural development and municipal infrastructure development.

What other challenges can banks expect to face in 2012? The most immediate challenge for L-Bank – as for many other German banks – is the implementation of Basle III. Under Basle III, banks will need greater liquidity and more equity capital. While liquidity is not an issue for L-Bank, raising the Bank's equity will demand special measures – even from L-Bank. Here we benefit from the fact that L-Bank is able to boost its equity capital by its own efforts. Thanks to the positive result achieved in 2011, combined with the reversal of provisions, we were able to transfer EUR 641 million to the Bank's revenue reserves. This represented a major step towards meeting our capital adequacy obligations and a solid foundation for further successful work by Baden-Württemberg's development bank.

With commitment and sound judgement, L-Bank is helping to transform our society. Our goals are long-term – as State Bank of Baden-Württemberg, we will finance the future of our federal state and the generations to come.

Christian Brand
Chairman of the Board of Management

MANAGEMENT REPORT – REPORT OF THE BOARD OF MANAGEMENT OF L-BANK FOR FISCAL YEAR 2011

L-Bank is the State Bank of Baden-Württemberg. The Bank helps the federal state government to fulfil its economic, structural and social policies by making a broad range of financial instruments available. As a public-law institution, L-Bank is subject to the supervision of the federal state government. The Bank's head office is in Karlsruhe, with a branch office in Stuttgart.

MACROECONOMIC ENVIRONMENT

Fiscal year 2011 was shaped by Europe's sovereign-debt crisis, a general loss of confidence in the single currency, and associated bailouts and rescue packages. Despite this, the German economy as a whole experienced significant growth. Federal Statistical Office figures show that Germany's real gross domestic product (GDP) grew by 3.0% (2010: 3.7%). As expected, strong domestic demand contributed to this positive trend. Overall, price-adjusted consumer spending rose by 1.5% (2010: 0.6%). At 1.0% of nominal GDP (as at 24 February 2012), government borrowing complied with the European Union's Maastricht criterion – which provides for a maximum budget deficit of 3.0% of GDP – for the first time since 2008.

Baden-Württemberg in particular benefited from Germany's economic dynamism. The federal state's GDP showed a 4.4% growth rate (as at 24 February 2012). Once again, the figures for total foreign trade made a substantial contribution, with a 12.9% increase in volume over the previous year. This period of strong economic growth was accompanied by a significant rise in employment, reflected in labour market figures that have been steadily improving since 2005. At 3.7% (2010: 4.3%), the level of unemployment in Baden-Württemberg in December 2011 was significantly below the national unemployment figure of 6.6% (2010: 7.1%).

KEY DEVELOPMENTS AT L-BANK

During the year under review, L-Bank's development activity focused once again on promotion of business, infrastructural projects and housing. Compared to the preceding year, the overall volume of new business declined during the year under review by 47.0% to EUR 8,686.5 million*, down to about the same level as in 2009. The decline in new business is primarily due to the one-off impact of funding a major infrastructural project in 2010.

BUSINESS DEVELOPMENT

In partnership with commercial banks, L-Bank offers a range of business development schemes to business start-ups, small and medium-sized enterprises and agricultural businesses, thereby contributing to sustainable economic growth while also creating and protecting jobs in Baden-Württemberg. In the year under review, the total funding issued by L-Bank for business development pur-

* Figures and information relating to new business trends (incl. comparative figures for the preceding year) were compiled using a new system introduced this year, hence are not always directly comparable to those in our Management Report for 2010.

poses amounted to EUR 2,405.3 million (2010: EUR 2,237.6 million).

A number of significant changes were made to the content and presentation of the development programmes offered by L-Bank in partnership with KfW (Kreditanstalt für Wiederaufbau); these came into effect from 1 April 2011. As part of this initiative, L-Bank's own business development programmes were also renamed.

In 2011, the Bank issued loans totalling EUR 407.6 million to business start-ups and fledgling companies (2010: EUR 445.0 million). The volume of funding approved under the Bank's "Startfinanzierung 80" business start-up programme, which replaced the existing "Starthilfe Baden-Württemberg" programme in Q2 2011, came to a total of EUR 45.9 million in the year under review. Once again, this exceeded the already high level of funding provided in the preceding year (EUR 41.2 million). As part of the extensive series of changes that came into effect on 1 April 2011, financial support for business start-ups and consolidation projects was restricted to a standardised three-year period from the date of business creation. Over 2011 as a whole, this caused the volume of new business in the "start-up finance" segment to decline by 10.4% to EUR 361.7 million: previously business consolidation projects in this programme were entitled to financial support for up to eight years after the business was founded.

During 2011, L-Bank also supported established companies in Baden-Württemberg's SME sector through a wide variety of programmes with a total funding volume of EUR 2,092.8 million. This represents a 22.8% increase in approved funding compared to the same period in 2010. In particular, it is worth noting the significant expansion of two of the programmes in this segment: "Investment Finance" and "Growth Finance". Over the fiscal year, total commitments under these programmes rose by 19.9% to EUR 765.8 million and by 47.9% to EUR 286.6 million respectively. "Investment Finance" benefited primarily from the fact that companies were generally more willing to invest in 2011, whereas "Growth Finance" also benefited from a partial transfer of investments that, prior to 31 March 2011, were funded through our "Start-up Finance" activities.

In 2010 we extended our guarantee programme, under the terms of a time-limited agreement with the State of Baden-Württemberg. The temporary increase in the level of risk assumed by L-Bank (up to a ceiling of EUR 10.0 million per financing transaction) expired on 1 October 2011. This means that L-Bank's level of risk assumption is once again limited to EUR 5.0 million.

In the year under review, development promotion for agricultural businesses set a new record, reaching a total volume of EUR 147.9 million (2010: EUR 144.0 million). Funding issued under our "Energie vom Land" (Energy from the Countryside) programme alone amounted to EUR 93.9 million (2010: EUR 82.5 million). The programme helps to fund energy generation from renewable energy sources. The sharp increase in the volume of approved funding was largely driven by the anticipated reduction of regulated feed-in tariffs on 1 January 2012.

HOUSING DEVELOPMENT

L-Bank issues low-interest loans and grants to finance the construction and acquisition of residential property for owner occupation or rental. By funding modernisation and renovation projects, the Bank also helps to upgrade the energy efficiency of existing properties. Contrary to expectations, the volume of new housing development business fell comparatively steeply during the year under review to EUR 1,065.8 million (2010: EUR 1,406.7 million). The decline in demand for development funding over the year is due, among other things, to changes in the eligibility criteria and conditions of the state housing assistance programme compared to the previous year. Furthermore, with regard to rental accommodation, housing companies are increasingly reluctant to enter into binding commitments in return for financial support. The lower level of approvals in federal state programmes had a direct impact on the uptake of accompanying products such as KfW loans and convertible loans.

To assist with finance for owner-occupied housing, L-Bank issued loans and grants totalling EUR 817.3 million in 2011 (2010: EUR 1,040.0 million). Of this, EUR 332.9 million (2010: EUR 424.0 million) was allocated to the "Living with Children" programme, open to all private individuals in all income brackets who have at least one child. As part of the state housing assistance programme, a total of EUR 222.1 million (2010: EUR 279.3 million) was approved for owner-occupied housing in the year under review.

In addition, L-Bank provided housing development support totalling EUR 239.6 million (2010: EUR 357.2 million) for the construction and modernisation of rental accommodation in 2011. Uptake of funding for rental accommodation provided under the state housing assistance programme was also slow in 2011. With total commitments of just EUR 15.9 million (2010: EUR 56.4 million), the Bank did not issue the full volume of lending projected for this part of the programme.

REFINANCING AND BANK MANAGEMENT

As the State Bank of Baden-Württemberg, L-Bank is able to call on the federal state's maintenance and public (statutory) guarantee obligation, as well as an explicit state guarantee. The latter means that as a creditor, the Bank ranks *pari passu* with the federal state of Baden-Württemberg. Credit rating agencies Moody's Investors Service and Standard & Poor's gave L-Bank Aaa and AA+ ratings, respectively.

By taking a selective approach to utilising refinancing alternatives on offer, the Bank was able to attain its objectives in terms of funding volume, maturity profile and structure. In strategic terms, both medium and long-term refinancing focused on maturities ranging from two to five years. The central instrument here is the Bank's Debt Issuance Programme with a funding limit of EUR 30.0 billion, of which EUR 19,012.8 million (2010: EUR 14,805.5 million) was utilised as at 31 December 2011. Three benchmark bonds were issued in the year under review: one five-year EUR 1.5 billion bond and two USD-denominated bonds for a total of USD 2.75 billion, with maturity periods of three and five years respectively. In addition, the Bank issued private placements in various currencies. In 2011 the total volume of medium and long-term refinancing through borrowings on the capital market came to EUR 9,997.0 million. As at year end, utilisation of the Commercial Paper Programme, which has an upper limit of EUR 10.0 billion and is used for short-term refinancing, amounted to EUR 9,372.0 million (2010: EUR 7,420.1 million).

In terms of liquidity management, L-Bank continued to pursue a conservative investment strategy focusing on good to very good credit ratings. The bulk of the securities held by L-Bank consist of securities with AAA and AA ratings. Over the past fiscal year, the Bank did not do any new securitisation business.

OTHER DEVELOPMENTS

To assist Baden-Württemberg's ongoing development as a major European region, L-Bank provides support for infrastructural projects by issuing loans and other forms of finance. In fiscal year 2001, L-Bank distributed funds amounting to EUR 1,799.4 million (2010: EUR 6,736.4 million), of which EUR 810.8 million alone was earmarked for major investment projects by local authorities. The proportion of infrastructural financing projects in the form of public-private partnerships, licensing and hire purchase agreements rose to EUR 135.9 million (2010: EUR 65.0 million). The decline in new infrastructure development business was primarily the result of a single large-volume transaction in 2010.

As a state-owned service provider, L-Bank is responsible for supervising and processing a large number of financial aid programmes. In addition to distributing funds provided by the state, Baden-Württemberg Stiftung gGmbH and MFG Medien- und Filmgesellschaft Baden-Württemberg mbH, the Bank also distributes subsidies provided by the federal government and European Union. In 2011, the Financial Aid department processed approved funding totalling EUR 930.9 million (2010: EUR 842.2 million), equivalent to 10.7% of L-Bank's total volume of new business. The largest items related to finance for hospitals (EUR 436.9 million), various projects involving water, sewage, flood protection and contaminated sites (EUR 117.1 million) and investment in school construction projects (EUR 89.0 million). Over the past fiscal year, the Bank initiated discussions with the relevant bodies in the new state government on the content of development programmes relating to climate change and pre-school education.

In view of the foreseeable consequences of demographic change, special priority is given to financial support for families with children in Baden-Württemberg. L-Bank provides support to families on behalf of the German federal and state governments by distributing federal family allowances and state educational allowances. In the case of family allowances, the level of applications and approvals remained much the same as in the previous fiscal year: 111,945 applications representing a total of EUR 676.0 million (2010: EUR 662.0 million) were approved. The number of approved applications for state educational allowances fell slightly to a total of EUR 36.9 million (2010: EUR 39.3 million).

As at the balance-sheet date, L-Bank's shareholdings in companies had a total book value of EUR 509.6 million (2010: EUR 498.6 million). The portfolio includes strategic and credit-equivalent interests in companies based in Baden-Württemberg, as well as shares in subsidiaries involved in Baden-Württemberg's regional development.

As at year-end 2011, the book value of the strategic investments held by L-Bank on behalf of the federal state amounted to EUR 443.2 million (2010: EUR 436.8 million). The change compared to the previous year was due to a write-up at a single company. The fair-value guarantee for the Bank's shareholding in Landesbank Baden-Württemberg, which represents a significant proportion of the total portfolio, is underwritten by the federal state of Baden-Württemberg.

Through L-EA Mittelstandsfonds, which has aggregate capital commitments of EUR 500.0 million, L-Bank either takes an interest – generally speaking as a co-investor – in well-established SMEs based in Baden-Württemberg, or supports them with tailor-made mezzanine financing instruments. The strong demand for L-EA Mittelstandsfonds products continues unabated. During 2011, the Bank entered into four new commitments and continued to fund three existing investments. The volume of investment in 2011 came to a total of EUR 12.7 million. As at the balance-sheet date, the portfolio comprised a total of 20 commitments (investments in three funds, 10 individual holdings and seven subordinated loans), currently representing a total investment volume of EUR 119.6 million.

To ensure that Baden-Württemberg remains commercially competitive at both national and international levels, L-Bank operates technology and business parks in Karlsruhe, Reutlingen, Stuttgart and Tübingen through management subsidiaries. To date, some 320 companies with a total of 8,480 employees have established themselves in the parks. Of the total original investment of EUR 466.4 million, EUR 158.2 million was still invested as at the balance-sheet date.

BALANCE SHEET TOTAL AND OPERATING RESULT

During the year under review, L-Bank's balance-sheet total rose by 11.5% to EUR 67,991.9 million. The increase is primarily due to loans for financing a large-scale infrastructural project that were pledged, but not disbursed, in December 2010. In the balance sheet as at 31 December 2011, these are included in the securities portfolio under assets in the amount of EUR 4,717.6 million. On the liabilities side, the rise in the balance-sheet total resulted primarily from increased uptake of the Debt Issuance Programme and the Commercial Paper Programme.

The volume of business, including guarantee undertakings and irrevocable lending commitments, rose by EUR 1,482.4 million to EUR 78,161.7 million as at the balance-sheet date.

Ordinary income – comprising net interest income, net commission income and other operating income – was almost unchanged from 2010 at EUR 477.0 million (2010: EUR 476.6 million). Net interest income, which continues to represent the major portion of the Bank's income, was successfully maintained at the previous year's level, thanks to the favourable refinancing terms available to L-Bank, at a total of EUR 420.8 million (2010: EUR 422.1 million). Since 1 January 2010 interest subsidies have been valued as interest expenses and deducted from net interest income accordingly, as required under commercial law. Thus, they are no longer shown separately in the statement of income. On the other hand, both items are still shown separately in the Management Report, as they were in the previous year. L-Bank regards the funding of interest subsidies as a service to the State of Baden-Württemberg – in accounting terms – as an appropriation of profits. Expenses for interest subsidies are included in the item "Expenses for interest subsidies and other subsidies".

Administrative expenses, which include personnel expenses, general expenses, and also depreciation on tangible fixed assets, rose by 10.5% over the previous year to EUR 136.4 million. This was primarily due to a EUR 9.3 million rise in personnel expenses following a pay-rate increase that came into effect on 1 January 2011, cessation of the effects of the Accounting Law Modernisation Act (BilMoG) on pension provisions, and the first-time formation of provisions for variable remuneration components. Furthermore, general expenses relating to our banking business rose to EUR 37.2 million (2010: EUR 34.1 million).

The operating result before valuation adjustments was 3.6% down on the preceding year due to the increase in administrative expenditure. As at the balance-sheet date, it amounted to EUR 335.0 million (2010: EUR 347.5 million). The positive development of the economy resulted in a significant easing of the Bank's risk position. This meant that income from asset revaluation improved to EUR 411.7 million (2010: EUR –85.5 million). The main reason for this increase – in addition to income from write-offs and write-ups on shareholdings – was the reversal of contingency reserves totalling EUR 352.7 million in response to the more stringent capital adequacy requirements imposed on banks by Basle III. Taking these valuation adjustments into account, the Bank's distributable income rose to EUR 750.7 million (2010: EUR 265.7 million).

APPROPRIATION OF PROFITS

Out of the Bank's profit for the year, the State of Baden-Württemberg received a total of EUR 109.7 million (2010: EUR 246.9 million). Of this, EUR 94.4 million (2010: EUR 101.6 million) was spent on interest subsidies and grants. The contribution to Baden-Württemberg's road construction programme remained unchanged at EUR 15.3 million. Net income totalling EUR 641.0 million was transferred to other revenue reserves in order to increase the Bank's Tier I (core) capital ratio.

SUMMARY OF INCOME FROM AN OPERATIONAL PERSPECTIVE in EUR million

	01.01.2011 to 31.12.2011	01.01.2010 to 31.12.2010	Change	Change in %
Net interest income	420.8	422.1	–1.3	–0.3
Net commission income	42.2	40.5	1.7	4.2
Other earnings/expenses	8.4	8.3	0.1	1.2
./. Administrative expenses	136.4	123.4	13.0	10.5
Operating result before risk provisions/ valuations	335.0	347.5	–12.5	–3.6
Risk provisions/valuations	411.7	–85.5	497.2	>100.0
Operating income after risk provisions/ valuations	746.7	262.0	484.7	>100.0
Extraordinary operating result	4.9	4.5	0.4	8.9
Net income before taxes	751.6	266.5	485.1	>100.0
./. Taxes on income	0.9	0.8	0.1	12.5
Distributable income	750.7	265.7	485.0	>100.0
./. Expenses for interest subsidies and other subsidies	94.4	101.6	–7.2	–7.1
./. Contribution to road construction programme	15.3	15.3	0.0	0.0
Net income	641.0	148.8	492.2	>100.0
./. Special distribution	0.0	130.0	–130.0	–100.0

RISK REPORT

To manage risks associated with L-Bank's banking business, a risk management system has been installed with the aim of enabling the Bank to:
- Assess overall risk exposure at any time
- Immediately identify and communicate individual risks
- Identify possible courses of action

The Bank's risk management concept is based on the premise that in the event of unexpected major losses, the Bank's survival should be assured even without the support of the State of Baden-Württemberg (going-concern approach). Thus the Bank's risk management approach is based primarily on the:
- Application of a coherent business strategy and resulting risk strategy
- Constant monitoring of the Bank's risk-bearing capacity
- Risk management and risk control processes
- Full documentation in writing of the Bank's procedures

HOW RISK MANAGEMENT IS ORGANISED

The Bank's risk management approach is largely determined by its statutory development mandate. By setting up development programmes, the State of Baden-Württemberg – represented by the state government – effectively specifies the target customers, intended purpose and regional focus of the Bank's business activities. In return, the State of Baden-Württemberg assumes a public (statutory) guarantee and maintenance obligation and explicitly guarantees L-Bank's liabilities.

On the basis of the Bank's public development mandate, the Board of Management formulates the key principles underpinning the risk policies in the Bank's business strategy, and these are then set down in detail in the Bank's risk strategy and supplementary policies governing procedures and workflows. Each department is then responsible for implementing the Bank's business and risk strategies. The Treasury department is responsible for implementing the interest-rate and currency risk profiles defined by the Board of Management, and for managing liquidity risk. Each department is responsible for managing the counterparty default risk on lending transactions initiated by that department. Operational risks are managed by "risk managers". The latter are divided into central risk managers, who manage operational risks affecting the entire Bank, and decentralised risk managers, who manage the risks associated with specific working procedures. Whereas central risk managers are appointed by senior management, the role of decentralised risk manager is generally fulfilled by the heads of the individual departments, who may also delegate specific tasks to departmental staff as part of their organisational remit.

The Controlling department, working together with the risk managers, is responsible for the quantitative and qualitative assessment and communication of risks. Together with the Payment Transactions department, the Controlling department is also responsible for monitoring compliance with all risk management policies, and for reporting on the risk situation to the Board of Management. The Credit Analysis department assesses the credit standing of individual borrowers and proposes appropriate individual lending limits to the Board of Management, as well as ceilings for the total lending exposure in a given country. The Credit Analysis department also casts the back-office vote on business decisions involving risk. In order to assess risk exposure in qualitative terms, the stress committee carries out regular stress analyses. Risk concentrations are a particular focus of concern. Taking a risk-driven, process-independent approach, the Audit department reviews and assesses the effectiveness and adequacy of the Bank's risk management system, as well as the orderly conduct of all L-Bank's key activities and processes, on behalf of the Board of Management. This department is directly accountable, and reports, to the Board of Management as a whole. The Audit department carries out its duties independently and impartially, and is not required to accept instructions regarding the evaluation or reporting of audit results.

BUSINESS STRATEGY AND RISK STRATEGY

In the business strategy, the Board of Management sets targets for Tier I capital and cost-income ratios, and decides which products should be used to meet the Bank's public-service mandate through development programmes and other development business. The Board of Management uses the development business matrix to allocate selected products to the Bank's respective business activities. The Bank's statutory public-service mandate results in concentrations of default risk (cluster risks) in particular industries, types of collateral, and regions. In order to achieve a balanced aggregate risk profile, the Board of Management sets down in the Bank's business strategy quality requirements for the portfolio structure as a whole. These include, for example, policies that define the credit rating criteria (risk categories) for new business that must be satisfied by borrowers who are not involved in the Bank's development programmes.

The Bank's risk strategy is derived from the business strategy. In the risk strategy, the Board of Management specifies the procedures that should be used to audit the Bank's risk-bearing capacity, lays down policies for new products and markets, and defines the strategies for dealing with counterparty default risk, market price risk, liquidity risk and operational risk.

As part of a quantitative assessment of the Bank's risk-bearing capacity, the Board of Management uses the risk strategy to define risk tolerance limits by specifying the scope of risk coverage capital that should be set aside as cover for losses. More specifically, the Board's risk strategy identifies counterparty default risk, market price risk, liquidity risk, operational risk and general business risk as types of material risk. The quantitative assessment of the Bank's risk-bearing capacity is supplemented by stress analyses, with a particular emphasis on risk tolerances.

With respect to managing counterparty default risk, the risk strategy prepared by the Board of Management includes policies that specify borrowers' minimum credit ratings and credit risk margins, and also obliges business units to take on recoverable collateral. In addition, the Board of Management budgets ceilings for aggregate lending by each business unit over the next three years. Budgets for development programmes are based on the amount of subsidy funding that has been made available in each case. Budgets for other development business carried out in collaboration with commercial banks is primarily based on the levels of demand from the commercial banks. Lending business associated with liquidity management is primarily determined by the refinancing options available. Any investments made for this purpose must meet very high standards of creditworthiness. Taking risk-bearing capacity into account, the risk strategy shows the projected scope of future lending risks and, in particular, of risk concentrations.

With respect to market price risk, L-Bank follows a strategy of following its view of interest rate developments to earn income with acceptable levels of risk. The projected interest rate is determined by capital-market parameters. The latter are subject to constant change, so the Board meets to discuss implementation of the market price risk strategy on a weekly basis.

Because L-Bank's obligations are guaranteed by the federal state, refinancing conditions largely depend on the State of Baden-Württemberg's credit standing on the capital markets. Liquidity risks due solely to a possible downgrade of the federal state's credit rating are classified as negligible. To ensure that funding can be obtained at favourable interest rates, L-Bank maintains intensive investor relations work with buyers of L-Bank debt instruments and manages its profile on the national and international capital markets to the same effect.

L-Bank's strategy is to avoid operational risks that could threaten the Bank's existence. Where operational risks do not pose a threat to the Bank's existence, L-Bank adheres to the principle of profitability. This means that if – taking the probability of occurrence into account – the process of avoiding a loss brought about by the actualisation of operational risks is costlier than the potential loss incurred, the Bank takes no or only mitigating avoidance measures (subject, of course, to statutory regulations).

RISK-BEARING CAPACITY

Monitoring risk coverage capability via dual control mechanisms

The aim of monitoring the Bank's risk-bearing capacity is to safeguard the Bank's continuing existence without relying on external support by the guarantor (going-concern approach).

In the year under review, L-Bank further expanded its risk management system by introducing two control mechanisms for monitoring the Bank's risk-bearing capacity.

Compliance with regulatory requirements and adherence to economic requirements are both equally valid objectives. For this reason, under control mechanism 1 the Bank's regulatory risk-bearing capacity is coupled with its economic risk-bearing capacity. This meant standardising the Bank's regulatory and economic risk coverage capability. The Bank's regulatory risk coverage capability is governed by the requirements of the German Solvency Regulation (SolvV). In line with the going-concern approach, L-Bank calculates the amount of (free) Tier I capital that is not required to meet capital adequacy stipulations pursuant to the Solvency Regulation. To calculate the amount of capital required for regulatory compliance, L-Bank applies an overall ratio of 8.4% (for reasons of prudence). Any Tier I capital exceeding this amount is allocated to the Bank's economic risk coverage capability. This is supplemented by risks reserves that in terms of their loss-compensation function are comparable in quality to the available equity capital: when calculating the Bank's risk exposure as defined by regulatory requirements, these reserves were not considered as risk-reducing factors. In addition, the economic risk coverage capability includes "write-up reserves" stemming from the fall in value of low-interest loans: these were set up before BilMoG came into force.

This combination of regulatory and economic risk coverage capability should be sufficient to cover claims by creditors even in unfavourable scenarios. The economic risk capital is supposed to compensate for unanticipated losses. L-Bank measures unanticipated losses using value-at-risk procedures with a confidence level of 99.0%. Value-at-risk limits are specified for the various types of risk. The sum total of all value-at-risk limits represents the aggregate loss ceiling. Taking into account the primary objective – L-Bank's continued existence – the aggregate loss ceiling should not exceed 80.0% of the economic risk coverage capability. Because first, adherence to value-at-risk limits is regularly monitored; second, the sum total of all value-at-risk limits is not greater than the aggregate loss ceiling, and third, the aggregate loss ceiling is not greater than the risk coverage capability, the monitoring of value-at-risk limits effectively constitutes regular review of the Bank's risk-bearing capacity.

The following tables illustrate the development of the risk coverage capabilities in control mechanism 1 as well as the specific risks to which they pertain.

REGULATORY RISK-BEARING CAPACITY IN CONTROL MECHANISM 1

	31.03.2011	30.06.2011	30.09.2011	31.12.2011
Risk exposure* in EUR millions	22,248.8	22,050.4	21,866.6	19,975.1
Tier I capital in EUR millions	1,932.9	1,950.6	1,949.0	1,939.8
Regulatory risk coverage capital (liable equity) in EUR millions	3,150.8	3,198.9	3,185.2	3,155.0
Tier I capital ratio in %	8.7	8.9	8.9	9.7
Total capital ratio in %	14.2	14.5	14.6	15.8

* Risk exposure includes the capital charges for counterparty risks and the sum of capital charges for market price risks and operational risks (both multiplied by a factor of 12.5). L-Bank calculates credit risk using the standardised approach to credit risk, market price risks using the standard method, and operational risks using the basic indicator approach.

ECONOMIC RISK-BEARING CAPACITY IN CONTROL MECHANISM 1 in EUR millions

	Free Tier I capital as per SolvV	Reserves	Profit		Total RCC	ALC	Share of ALC in RCC in %
			From 2010	From 2011			
31.01.2011	792.0	281.0	91.0	18.4	1,182.4	867.0	73.3
28.02.2011	848.0	281.0	91.0	29.6	1,249.6	867.0	69.4
31.03.2011	819.0	281.0	91.0	48.0	1,239.0	867.0	70.0
30.04.2011	848.0	281.0	91.0	65.4	1,285.4	867.0	67.4
31.05.2011	862.0	352.5	0.0	87.2	1,301.7	867.0	66.6
30.06.2011	863.0	352.5	0.0	103.4	1,318.9	867.0	65.7
31.07.2011	862.0	352.5	0.0	117.4	1,331.9	867.0	65.1
31.08.2011	789.0	352.5	0.0	137.3	1,278.8	867.0	67.8
30.09.2011	862.0	352.5	0.0	140.0	1,354.5	932.0	68.8
31.10.2011	861.0	352.5	0.0	153.5	1,367.0	932.0	68.2
30.11.2011	960.0	352.5	0.0	175.1	1,487.6	932.0	62.7
31.12.2011	1,034.0	352.5	0.0	284.2	1,670.7	932.0	55.8

RCC = Risk Coverage Capability
ALC = Aggregate Loss Ceiling (sum of all value-at-risk limits)
Reserves = Reserves within the meaning of Art. 340f HGB and Art. 26a KWG et seq.

Because the effects of diversification cannot be validated, and in order to comply with the third draft amendment of the Minimum Requirements for Risk Management (MaRisk), the aggregate loss ceiling was raised by EUR 65.0 million on 30 September 2011 in order to cover potential modelling risks associated with these effects. When calculating capital requirements pursuant to the Solvency Regulation, L-Bank did not take account of the risk-mitigating effects of cash contributions from collateral agreements received prior to 31 August 2011. The rise in the USD exchange rate on 31 August 2011 caused a decline in disposable Tier I capital as required under the Solvency Regulation because the exchange rate-related increase in the market value of currency derivatives for hedging currency risks on USD-denominated refinancing required higher capital commitment. As from 1 September 2011, the risk-mitigating effect of cash contributions received from collateral agreements was taken into account again. In the year under review, the aggregate loss ceiling accounted for 55.8% to 73.3% of the Bank's total risk coverage capability.

In control mechanism 2, the value of L-Bank as a whole is used as economic risk coverage capability. This risk coverage capability is counterbalanced first, by the aggregate loss ceiling, and second, by hidden liabilities in fixed assets (where the Bank has avoided writing down securities to the lower of cost or market, or valuing credit default swaps (CDS) at negative market rates). Together, the aggregate loss ceiling and hidden liabilities should not exceed an 80.0% proportion of the Bank's economic risk coverage capability (calculated by value). To assess changes in hidden liabilities, L-Bank subjects them to a robust programme of stress tests. In line with the Bank's business strategy, according to which L-Bank endeavours to hold securities and credit default swaps through to final maturity (intention to "buy and hold"), limits are set on selling due to deteriorating credit ratings. Where a permanent loss of value is likely, the values of the securities and credit default swaps are adjusted.

The increase in the portfolio's net present value, as well as personnel, administrative and risk provisioning expenses, is due to the fall in interest rates. The decline in risk provisioning expenditure as at 30 June 2011 and 31 December 2011 is the result of a more accurate assessment of risk provisioning expenditure for housing development in Saxony. Previously, this risk provisioning expenditure was calculated by applying a standard premium to the risk parameters in respect of housing development in Baden-Württemberg. Now, after a suitable number

ECONOMIC RISK-BEARING CAPACITY IN CONTROL MECHANISM 2 in EUR millions

	Net present value of portfolio	Personnel and general expenses	Risk provisioning expenditure	Total RCC	ALC	Hidden liabilities	Share of ALC and hidden liabilities in RCC in %
31.03.2011	4,052.4	353.2	825.6	2,873.6	867.0	422.5	44.9
30.06.2011	4,292.0	362.6	740.4	3,189.0	867.0	316.5	37.1
30.09.2011	4,352.3	388.0	788.1	3,176.3	932.0	488.0	44.7
31.12.2011	4,847.0	389.8	599.4	3,857.8	932.0	453.9	35.9

RCC = Risk Coverage Capability
ALC = Aggregate Loss Ceiling (sum of all value-at-risk limits)
Hidden liabilities = savings on lower of cost or market write-downs on securities, negative market prices of credit default swaps

of incidents and appropriate period of observation, sufficient data is available for the Bank to calibrate risk parameters on the basis of actual historical trends in housing development in Saxony. Fluctuations in hidden liabilities are due to credit spread shifts. In the year under review, the aggregate loss ceiling plus hidden liabilities accounted for a proportion of fixed assets ranging from 35.9% to 44.9%.

As soon as 80% of the relevant economic risk coverage capability has been taken up, the Board of Management has to inform the supervisory authority. In addition, L-Bank must examine various possible risk response measures.

In such an event there are strict limits imposed on the Bank's various options for reducing risk exposure. L-Bank is committed to certain development loans on the guarantor's behalf. Selling these credit receivables for purposes of risk management would conflict with the Bank's public-service mandate. As part of L-Bank's separate bank management activities, income is generated by investing low-cost refinancing funds in low-risk or risk-free securities. Generally, because of the low associated risks, these securities are not taken into account when calculating the amount of Tier I capital required to comply with Solvency Regulation requirements (zero weighting). As a rule, selling these securities would only make a minimal contribution to reducing the Bank's credit risk exposure. With respect to reducing exposure to market price risks, the Bank is in the process of analysing the negative effects from net interest income that offset the positive risk exposure caused by exchanging the investment of equity capital in ten-year securities for an investment in the overnight money market. Over the coming months L-Bank will be reviewing – independently of the 80% take-up – the extent to which implementing the IRB approach (Internal Ratings-Based approach) would result in reduced exposure to credit risks. For market price risks, changing over from the standard procedure to an internal model would not produce any significant reduction in the Bank's risk exposure, first of all because L-Bank has no trading book, and second because the foreign currency risks in the non-trading portfolio are negligible.

Due to the budgetary situation of the State of Baden-Württemberg, strict limits are imposed on any increase in Tier I capital through capital contributions. Consequently, one of L-Bank's important objectives is to increase Tier I capital through its own efforts, by reinvesting net income and thereby enhancing its risk-bearing capacity.

On condition that the Bank's risk coverage capability provides appropriate cover, and after taking the Bank's business and risk strategies into consideration, the Board of Management has resolved to set an aggregate loss ceiling of EUR 995.0 million for 2012. The aggregate loss ceiling is reconciled with the Bank's risk coverage capability on a monthly basis. The aggregate loss ceiling includes a limit of EUR 7.0 million for minor (immaterial) business transactions within a risk type that has been defined as material.

AGGREGATE LOSS CEILING AND INDIVIDUAL LOSS CEILINGS FOR 2012 in EUR millions

	Limit
Aggregate loss ceiling	995.0
Counterparty default risks	650.0
Market price risks	105.0
Liquidity risks	65.0
Operational risks	20.0
Real property risks	20.0
Modelling risk	65.0
Immaterial business transactions	7.0
Margin of error	63.0

New regulations mean that the need for regulatory Tier I capital will increase in 2013 and 2014. In order to investigate whether the Bank's risk coverage capability will continue to be sufficient in coming years, L-Bank drew up appropriate budgetary accounts as part of its risk strategy (e.g. balance sheet, statement of income, Tier I capital requirement in compliance with the Solvency Regulation, requirements for value-at-risk limits). These budgetary accounts are based on the following material assumptions:

- → The current regulatory framework laying down future Tier I capital requirements (Basle III) was taken into account (e.g. successive increases in minimum Tier I capital ratio, enhanced capital requirements for financial investments)
- → No additional need for Tier I capital due to credit rating downgrades
- → No increase in hidden liabilities due to credit rating downgrades
- → Over the next few years, L-Bank may use net income to enhance its capital adequacy

L-Bank's preliminary calculations indicate that – based on the assumptions listed above – the Bank's risk-bearing capacity in both control mechanism 1 and control mechanism 2 will be sustainable in the light of projected growth forecasts.

Performing stress analyses

Value-at-risk models are used to carry out quantitative risk measurement. The actuarial models used for risk measurement assume a degree of stability in financial market conditions that, in view of the current ongoing financial crisis, only has limited validity. Consequently the calculated results may differ substantially from the results achieved in reality. To minimise this risk, the Bank supplements its quantitative risk assessment with a risk assessment based on stress scenario analyses. By carrying out such analyses, L-Bank identifies patterns of risk factors that may have a major impact on the Bank's activities. In these stress scenario analyses, the Bank starts by developing and analysing scenarios that, in terms of their effects, have an isolated impact on a single type of risk (e.g. counterparty default risk, market price risk, liquidity risk, operational risk). In a second stage, the key risk factors for each individual risk type are defined as actual risk carriers (e.g. unemployment as a factor in counterparty default risk), and the Bank then investigates how they interact with risk factors affecting other types of risk. At this stage of the process, the analysis is based on a combination of in-house expertise with a scoring method. By identifying the interactions between risk factors, the Bank gains an insight into risk concentrations both within individual risk types and across all risk types. This enables the Bank to formulate stress scenarios that match the interactions between risk factors. The system described above does not preclude the existence of unidentified scenarios that could threaten the Bank's existence, so the Bank also makes certain assumptions concerning losses for the individual risk types and examines the conditions in which such losses might arise (by means of inverse stress tests).

Currently, identifying the quantitative impact of the formulated scenarios is dependent on quantitative data from expert estimates. These estimates – hence also the quantitative implications – are characterised by a high degree of uncertainty. For this reason the Bank is currently developing a multidimensional scoring system that will mean that quantitative, one-dimensional expert estimate can be substituted by a scoring system that, while qualitative in nature, is nevertheless multidimensional. This qualitative estimate is combined with time-series analyses of observable risk factors. L-Bank takes the view that this approach will allow the Bank's expert knowledge to be used more comprehensively for quantitative analysis compared to the quantitative expert estimates currently in use.

For default risks, the applied scenarios result in increasing credit risks and consequently to a greater need for regulatory and economic capital. With an eye to Baden-Württemberg's economic structure, one of the scenarios is predicated on a severe cyclical downturn in the automotive industry. With respect to market price risk, various extraordinary changes in yield curves are modelled on the basis of interest rate curves over the past 20 years. These include exceptionally large interest-rate rises and falls, as well as changes in the shape of the yield curve. In the case of currency risk, criteria include a 20.0% upward or downward variance in the valuation of foreign currencies against the EUR. In stress analyses of liquidity risk, underlying criteria for market-wide effects include a change in the Central Bank's refinancing policy and capital market-driven changes in refinancing conditions. With respect to the Bank itself, the scenarios explore the impact of a downwards Bank credit rating change, as well as changes in client and investor behaviour. Operational risks are also identified and assessed by means of scenario building. For the purposes of stress scenarios, it is assumed that both the probability of occurrence and quantitative impact of these loss scenarios are heightened.

RISK MANAGEMENT AND RISK CONTROLLING

L-Bank's risk management and risk controlling processes include the identification, assessment, management, monitoring and communication of material risks.

COUNTERPARTY DEFAULT RISK

Counterparty default risk refers to a possible loss from a lending transaction within the meaning of the German Banking Act (Art. 19 KWG) in the event that the counterparty does not meet its contractual obligations. The reason for non-fulfilment of a contract may be specific, or related to the borrower's credit standing, or political in nature – for example because the government directly opposes performance of the contract. L-Bank further differentiates counterparty default risk according to the moment in the process at which it arises. Subsets include performance risk, settlement risk and credit risk (counterparty and issuer risk).

Quantitative assessment based on value at risk

Risks on unanticipated losses are restricted inter alia by applying value-at-risk (VaR) limits. The Board of Management sets these limits for each business unit based on the unit's individual risk-bearing capacity, business strategy and risk strategy. Due to the specific characteristics of the Bank's housing development activities (associated with its public-service mandate), it makes little sense to apply a "market model". For this reason, unanticipated losses in the Bank's housing development business are calculated using a proprietary statistical risk-assessment method. This assumes a 12-month holding period and a confidence level of 99.0%. When calculating the value at risk, proceeds from the realisation of any collateral provided are taken into account: L-Bank adjusts the recovery ratios to match current realisation values in each case. In view of the fact that the Bank's housing development business is characterised by a large number of homogeneous borrowers, correlations between individual borrowers are not taken into consideration. The probability that a borrower will default is assessed by reference to weighted average annual defaults in the target market segment over the past 25 years.

In other lending, unanticipated losses are estimated using the Monte Carlo simulation method based on internal and external ratings as well as rating-dependent probabilities of default provided by rating agencies (confidence level: 99.0%). These

VALUE AT RISK FOR COUNTERPARTY DEFAULT RISK IN 2011 in EUR millions

	01.01.2011		31.03.2011		30.06.2011		30.09.2011		31.12.2011	
	Limit	Used	Limit	Used	Limit	Used	Limit	Used	Limit	Used
Aggregate loss ceiling	867.0	576.3	867.0	661.9	867.0	665.5	932.0	598.1	932.0	595.5
Share of counterparty default risk in %	72.1	82.0	75.0	82.4	75.0	83.5	69.7	76.9	69.7	77.0
Counterparty default risk	625.0	472.3	650.0	545.1	650.0	555.5	650.0	459.7	650.0	458.4
Private clients	15.0	7.2	15.0	8.2	15.0	8.0	15.0	5.2	15.0	5.0
Companies in the financial sector	250.0	161.8	250.0	225.5	250.0	240.6	250.0	237.2	250.0	230.0
Other companies	350.0	294.0	350.0	281.2	350.0	275.2	350.0	183.7	350.0	190.0
Public sector	10.0	9.3	35.0	30.2	35.0	31.7	35.0	33.5	35.0	33.4

estimates take into consideration correlations with the borrowers' respective home countries. In the case of the Bank's "Companies in the financial sector" and "Public sector" business lines, a standardised 30.0% recovery rate is applied. With respect to business development, the risk-mitigating effects of taking further collateral in addition to reassignment of claims on end-clients have been taken into consideration since 30 June 2011. Otherwise value-at-risk calculations do not take account of potential realisation proceeds from any collateral provided. Currently the Bank is expanding the models used for value-at-risk calculations to include migration risk and spread risk. Almost the entire portfolio is invested in Europe, so risks associated with currency transactions are only of secondary importance. The risk that L-Bank might incur losses as a result of restrictions on payment transactions due to legal constraints in the various countries concerned is consequently regarded as very minor.

The largest proportion of the aggregate loss ceiling is represented by the value-at-risk limit for counterparty default risk. In the first quarter of 2011, due to the downgrading of Portugal's credit rating and the general increase in default probabilities, especially in the better categories of risk, the value-at-risk limit for default risks was raised – without increasing the aggregate loss ceiling – by EUR 25.0 million to EUR 650.0 million. L-Bank holds corresponding securities in investment assets and assumes that the securities would be repaid in full once they fall due.

In the case of "Corporate clients", c. EUR 36.0 million relates to housing development (finance for housing companies). A significant proportion of the remaining value at risk arises from credit-equivalent shareholdings (L-EA Mittelstandsfonds, L-EA Garantiefonds, L-EA Venture Fonds) and finance for projects in the infrastructural sector where L-Bank is underwriting the risk for other banks. At c. EUR 115.0 million, the value at risk for "Companies in the financial sector" relates to the "borrower's bank" principle underpinning our business development activities. Of the value at risk in our "Public sector" business, EUR 20.0 million relates to the PIIGS nations (Portugal, Italy, Ireland, Greece and Spain).

The Controlling department monitors compliance with VaR limits on a quarterly basis and initiates risk response measures when these are exceeded.

Timely and adequate risk provisions

L-Bank allows for risks that have become acute by setting aside provisions. L-Bank has issued appropriate guidelines for setting up valuation allowances (value adjustments). The following table shows the changing value adjustments for each business unit, as well as their associated risks, in EUR millions. It includes valuation allowances that are deducted from net present values when calculating the capital required to determine net holdings pursuant to the Solvency Regulation. Any valuation allowances that are not deducted from book values when calculating the capital required under the Solvency Regulation remain available to L-Bank as risk coverage capital in control mechanism 1 (e.g. reserves pursuant to Art. 340f HGB and Art. 26a KWG et seq.). The corresponding risk portfolios are comprised of the gross book values of loans, the net present values of securities and investments, as well as surety balances and credit-equivalent levels of interest-rate derivatives calculated in compliance with the Solvency Regulation, and taking netting and collateral agreements into account. The valuation allowances reported include portfolio value adjustments on securities/CDS worth EUR 30.0 million that were not deducted directly from the book values of the securities/CDS due to the lack of specific assignment.

VALUE ADJUSTMENT RATIOS AS AT 31.12.2011 in EUR millions

	Private clients		Companies in the financial sector		Other companies		Public sector		Total		Ratio in %
	Adjustm.	Portfolio	Adjustm.	Portfolio	Adjustm.	Portfolio	Adjustm.	Portfolio	Adjustm.	Portfolio	
31.12.2009	91.4	8,195.8	31.6	35,584.0	788.0	14,408.5	0.0	8,907.2	910.9	67,095.6	1.4
31.12.2010	87.9	7,749.9	31.6	34,156.0	674.2	11,887.1	0.0	14,273.0	793.7	68,066.0	1.2
31.03.2011	88.4	7,611.2	31.6	32,638.5	654.5	11,810.9	0.0	18,673.3	774.5	70,733.9	1.1
30.06.2011	87.7	7,485.9	31.6	32,379.6	652.4	11,765.2	0.0	18,931.7	771.7	70,562.4	1.1
30.09.2011	88.2	7,368.8	31.6	32,285.9	599.3	11,817.3	0.0	18,866.3	719.1	70,338.2	1.0
31.12.2011	100.4	7,251.9	31.6	33,710.5	567.1	11,659.9	0.0	20,177.2	699.1	72,799.5	1.0

Qualitative assessment based on classification of credit ratings and collateral

For the qualitative assessment of default risks, each borrower is assigned a credit rating expressed as a class of risk (i.e. risk category 1). In assigning individual ratings, L-Bank takes account of the peculiarities of the relevant client's structure. For borrowers involved in development finance forowner-occupied housing, the homogeneity of the customer group means that they are assigned a default rating based on the average probability of default. A flat rating is also used for commitments under the various L-EA funds (L-EA Mittelstandsfonds, L-EA Garantiefonds, L-EA Venture Fonds). These clients are always provided with intensive support and subjected to continuous monitoring. The following table shows the default probabilities of the individual risk categories and shows internal risk categories against the corresponding external risk categories.

Organisation units responsible for issuing loans are always obliged to ensure that lending decisions are backed by sufficient collateral, in order to reduce both the unsecured portion and loss exposure. The value of the collateral should not depend on the borrower's credit rating. L-Bank has specified acceptable types of collateral, and also specified the maximum value that should be assigned to each type when determining the unsecured portion. Collateral that should be assigned a value of "0" must nevertheless be accepted if this is in line with industry standards and if, in the event of realisation, the Bank can expect to realise recovery proceeds.

To indicate the loss exposure, the risk-mitigating effects of certain types of collateral are also taken into account. Payables from regional banks that are guaranteed by "grandfathering" and are underwritten by public guarantee and maintenance obligations are assigned to risk category 1. Similarly, loans that are guaranteed by local authorities and real-estate loans secured on residential properties in Baden-Württemberg are also allocated to risk category 1. Where collateral is provided in the form of property charges on residential property in Baden-Württemberg – independent of the real-estate loan, but within the relevant lending ratio – it is assigned to risk category 4. In the case of *Pfandbriefe* and similar bond issues (e.g. Covered Bonds), priority is given to the external rating of the issue.

RISK CATEGORIES AND CORRESPONDING DEFAULT PROBABILITIES

Risk category	1	2	3	4	5	6	7	8	9	10	11	12	13	14
Mean probability of default in %	0.01	0.03	0.06	0.13	0.27	0.56	1.15	2.35	4.75	9.37	17.63	30.72	100	100
Range of default probability in %	0.01	0.02	0.04	0.09	0.19	0.39	0.80	1.65	3.35	6.70	12.95	23.55		
	0.02	0.04	0.09	0.19	0.39	0.80	1.65	3.35	6.70	12.95	23.55	100	100	100
External		AA+		A		BBB			BB–	B	CCC+	CC	Bailout/ Restructuring	Liquidation
	AAA	AA	A+	A–	BBB+	BBB–	BB+	BB	B+	B–	CCC	C		
		AA–									CCC–			
	Investment grade						Non-investment grade							

The following table shows the risk portfolios for each of the Bank's business units. They comprise the gross book values of loans, the net present values of securities and investments, as well as surety balances and credit-equivalent levels of interest-rate derivatives, calculated in compliance with the Solvency Regulation and taking netting and collateral agreements into account.

RISK STRUCTURE OF THE BANK'S LOAN PORTFOLIO AS AT 31.12.2011 in EUR millions

	Private clients	Companies in the financial sector	Other companies and self-employed persons	Public sector	L-Bank total	Percentage
Risk category 1	3,113.6	13,037.5	5,357.6	17,288.0	38,796.7	53.3
Risk category 2	19.2	3,518.6	421.1	2,149.7	6,108.6	8.4
Risk category 3	3,393.6	4,599.7	1,067.6	625.7	9,686.6	13.3
Risk category 4	82.6	10,513.5	1,518.4	0.0	12,114.5	16.6
Risk category 5	0.0	1,109.8	759.2	0.0	1,869.0	2.6
Risk category 6	534.7	266.3	592.0	113.9	1,506.8	2.1
Risk category 7	0.1	210.5	634.5	0.0	845.0	1.2
Risk category 8	0.0	428.3	230.1	0.0	658.4	0.9
Risk category 9	0.0	4.0	353.4	0.0	357.4	0.5
Risk category 10	0.0	20.3	236.5	0.0	256.8	0.4
Risk category 11	0.0	0.0	34.9	0.0	34.9	0.0
Risk category 12	73.1	0.2	160.2	0.0	233.4	0.3
Risk category 13	0.0	0.0	142.8	0.0	142.8	0.2
Risk category 14	35.0	1.9	146.5	0.0	183.5	0.3
Other	0.0	0.0	5.2	0.0	5.2	0.0
Total	7,251.9	33,710.5	11,659.9	20,177.2	72,799.5	100.0

The total exposure amounting to EUR 72,799.5 million includes securities totalling EUR 20,764.7 million. L-Bank aims to hold securities and CDS to final maturity (no trading book) and consequently treats them as loans. The Bank applies a moderated form of the lower of cost or market principle. Due to anticipated permanent impairments, L-Bank has written down securities totalling EUR 10.0 million and reduced the book value accordingly. A further risk provision of EUR 30.0 million was set up for the securitisation portfolio as a whole. Due to a lack of specific assignment, this amount was not deducted from the gross investment portfolio. The credit quality of the securities and CDS is shown below. Any savings on the lower of cost or market value of securities or negative market values of CDS are included in hidden liabilities.

RISK STRUCTURE OF THE SECURITIES/CDS PORTFOLIO AS AT 31.12.2011 in EUR millions

Risk category	Portfolio	Hidden liabilities
1	18,064.9	169.0
2	4,651.0	29.7
3	1,711.5	73.1
4	921.7	93.7
5	30.0	35.7
6	152.8	32.1
7	121.1	3.1
8	74.4	17.5
9	4.0	0.0
10	5.3	0.0
Total	25,736.6	453.9

The portfolio total of EUR 25,736.6 million shown in the table breaks down into net holdings of securities totalling EUR 20,764.7 million and nominal values of CDS totalling EUR 4,971.9 million.

The securities/CDS portfolio shown in the table also includes securitised assets (ABS, CLN) totalling c. EUR 1,303.5 million. The ratings of the securitised assets changed in fiscal year 2011 as a result of changes and adjustments in the valuation models used by the rating agencies, as well as deterioration in the underlying portfolios. A one-off value adjustment made in the previous year was successfully written back to earnings in the year under review due to the redemption of the relevant security in the amount of EUR 30.3 million. This is offset by new valuation allowances totalling EUR 8.3 million.

All liquidity management transactions are recorded in the Bank's own books. Where securitisation tranches were acquired with a rating below AA at the time of purchase, the interest and principal repayments were, without exception, covered by a government or supranational agency with a rating of at least AA. The following table provides an overview of L-Bank's portfolio of asset-backed securities and credit-linked notes and the associated risk profile.

PORTFOLIO OF ASSET-BACKED SECURITIES AND CREDIT-LINKED NOTES AS AT 31.12.2011

	Nominal value in EUR millions	AAA	AA range	A range	BBB range	BB range	B range	CCC range
Asset-backed securities	425.6	48.1%	24.3%	24.7%	0.0%	0.0%	2.9%	0.0%
Credit-linked notes	877.9	26.1%	57.0%	0.0%	4.8%	12.1%	0.0%	0.0%

The classification is based on the lowest external rating of the transaction in each case unless a guarantor has a better credit rating. In that case, the guarantor's lowest external rating takes precedence.

Monitoring of problem loans

L-Bank defines problem loans as loans where there are strong indications that in order to avert or minimise losses, actions may be necessary that go beyond the normal scope of loan administration and intensified contact with the client, and may extend to the requirement for the provision of additional collateral as part of collaboration with the client in an intensive support process. In addition to payment defaults or interruptions, such indications include low credit ratings (risk category 9 or worse). L-Bank distinguishes between problem loans that are being restructured and problem loans at the workout stage.

As at 31 December 2011, the Bank's portfolio of problem loans amounted to EUR 1,444.9 million. This was distributed between the Bank's business units as shown below:

PROBLEM LOAN PORTFOLIO AS AT 31.12.2011 in EUR millions

	Total risk portfolio	Problem loan portfolio		Workout		Restructuring	Value adjustments
		Total	%	Total	%		
Private clients	7,251.9	296.2	4.1	67.9	0.9	228.3	100.4
Companies in the financial sector	33,710.5	11.3	0.0	1.9	0.0	9.4	31.6
Other companies and self-employed persons	11,659.9	1,137.4	9.8	133.6	1.2	1,003.8	567.1
Public sector	20,177.2	0.0	0.0	0.0	0.0	0.0	0.0
Total	72,799.5	1,444.9	2.0	203.4	0.3	1,241.5	699.1

Value adjustments shown for "Companies in the financial sector" are mainly (EUR 30.0 million) due to portfolio value adjustments for securitised assets. The latter consist of securities where L-Bank has no relationship with the debtors of the securitised receivables and consequently monitors the securitised assets as a whole more closely, although the portfolio has not been released to problem loan processing.

Assessing risk concentrations

Due to our public-service mandate, L-Bank is exposed to certain risk concentrations.

In housing development, for example, there is a concentration risk associated with the collateral provided. The value of residential property is determined according to the provisions of the Lending Value Ordinance, whereby L-Bank claims the privileges associated with small loans and generally omits on-site inspections. Due to the conditions in the housing development market, a proportion of c. 44.4% is not secured by real-estate loans. Instead, collateral takes the form of land charges covered by contract.

Because housing development funding is restricted to the jurisdiction in which the guarantor is located, the Bank's housing development activities are associated with a concentration risk linked to residential property in Baden-Württemberg. In the event of a severe economic downturn, first, the default rate would rise, and second, earnings from the realisation of collateral would fall. In order to assess this risk, L-Bank analysed the cyclical sensitivity of the various regions in Baden-Württemberg. To do this, the Bank investigated regional risks threatening the solvency of borrowers in the individual regions in the event of a severe economic downturn. The risk that a borrower in a given region becomes insolvent increases in line with the regional economy's dependency on exports, as well as the level of unemployment in the region. The risk of insolvency decreases if price levels for residential property in the region are low and the region has a well-integrated infrastructure. The risk of insolvency is expressed as the variance between the level of borrowers' risk in the region and the risk confronting an average borrower in Baden-Württemberg. The Bank used a scoring system to determine the relative exposure in each case. The table below shows a comparative ranking of the regions and the Bank's housing finance portfolio in each region. The highest rank indicates the highest level of relative risk. 47.9% of the Bank's housing development finance is committed in regions with above-average sensitivity to economic growth (ranked 1 to 4 inclusive). Thus, measured in terms of the federal state's economic sensitivity, the economic sensitivity of the loan portfolio rates as average.

FINANCE FOR RESIDENTIAL PROPERTY IN BADEN-WÜRTTEMBERG AS AT 31.12.2011

Rank	Portfolio in EUR millions	Percentage of total portfolio in %
1	545.1	4.9
2	3,007.8	27.2
3	1,082.0	9.8
4	658.9	6.0
5	2,566.6	23.2
6	1,039.6	9.4
7	874.9	7.9
8	1,266.0	11.5
Total	11,040.9	100.0

Guarantees are subject to another collateral-related concentration risk. Of the guarantees received (without public guarantee or maintenance obligation) worth c. EUR 11,838.0 million, the State of Baden-Württemberg accounts for some EUR 7,119.3 million. Due to the credit standing of the State of Baden-Württemberg, L-Bank regards this risk as negligible. Another EUR 2,724.6 million is associated with sureties/guarantees provided by other local authorities in Germany. A total of EUR 1,864.1 million is based on sureties/guarantees provided by private individuals, companies, banks, public-sector bodies in Germany that are not local authorities, and central and regional governments abroad.

Due to L-Bank's business model, there is a concentration risk associated with receivables from banks (EUR 31,287.7 million). The Bank's obligation to issue development loans through borrowers' banks (excepting loans awarded through the various housing development schemes and programmes) means that L-Bank's exposure to banks amounted to EUR 10,097.8 million as at 31 December 2011. These lendings to banks are secured by reassignment of claims on end-clients. Another EUR 4,135.7 million are attributable to the fact that L-Bank has underwritten the commercial banks' exposure to end-client risk. This means that c. 45.5% of the Bank's total lending commitment relates to business development. Another EUR 17,054.2 million relate to transactions carried out by L-Bank in addition to development business, where L-Bank invests low-cost refinancing funds in low-risk or risk-free issuers. Of the EUR 17,054.2 million just mentioned, EUR 10,378.1 million is secured by public guarantee/maintenance obligation, and EUR 1,610.6 million against *Pfandbriefe*. Of the remaining EUR 5,065.5 million, roughly 80.7% is assigned to risk categories 1 to 4. Approximately 19.3% is allocated to risk categories 5 to 8. Just 0.02% is allocated to risk category 10, with a mean default probability of 9.37%.

In regional terms, the Bank's public-service mandate means that it is exposed to a concentration risk for the region "Germany". 83.1% of the risk portfolio is assignable to Germany. In turn, 63.0% of this is associated with the federal state of Baden-Württemberg and the Free State of Saxony.

The table also includes securitised assets. These are allocated to specific countries on the basis of the home country of the issuing special-purpose entity.

REGIONAL STRUCTURE OF LOAN PORTFOLIO AS AT 31.12.2011 in EUR millions

	Private clients	Companies in the financial sector	Other companies and self-employed persons	Public sector	L-Bank total	Percentage
Germany total	7,250.4	25,764.8	11,270.9	16,203.1	60,489.3	83.1
Belgium	0.0	20.0	0.0	207.3	227.3	0.3
Finland	0.0	1.3	0.0	323.2	324.5	0.4
France	0.1	832.4	38.4	560.4	1,431.2	2.0
Greece	0.0	0.0	0.0	0.0	0.0	0.0
Ireland	0.0	679.9	5.0	0.0	684.9	0.9
Italy	0.0	338.7	0.0	452.8	791.5	1.1
Luxembourg	0.0	176.0	2.9	0.0	178.9	0.2
Netherlands	0.2	1,183.0	49.6	480.5	1,713.3	2.4
Austria	0.2	902.5	44.9	782.5	1,730.2	2.4
Portugal	0.0	0.0	30.8	113.9	144.6	0.2
Spain	0.0	739.7	1.0	158.7	899.5	1.2
Denmark	0.0	173.7	0.0	263.2	437.0	0.6
Great Britain*	0.0	1,224.9	0.8	177.3	1,403.1	1.9
Switzerland	0.9	358.3	180.8	41.1	581.2	0.8
Rest of Europe	0.0	13.2	0.0	413.2	426.5	0.6
Europe total	1.4	6,643.8	354.3	3,974.1	10,973.6	15.1
USA	0.0	462.3	10.0	0.0	472.3	0.6
Other countries	0.0	839.7	24.7	0.0	864.4	1.2
Overseas total	1.4	7,945.8	388.9	3,974.1	12,310.3	16.9
Total	7,251.9	33,710.5	11,659.9	20,177.2	72,799.5	100.0

* Including Crown colonies (Jersey and the Cayman Islands)

The Bank's risk exposure in the PIIGS nations stood at c. EUR 2,520.5 million as at 31 December 2011. Of this, some EUR 861.0 million (34.2%) is secured against EU *Pfandbriefe*, *Pfandbriefe* or Covered Bonds. Roughly EUR 722.2 million (28.7%) is payable by national or regional governments. Around 25.0% or EUR 629.3 million is associated with uncollateralised securitised loans. Unsecured claims against banks amount to a total of c. EUR 195.0 million (7.7%).

Policies for managing counterparty default risk

Counterparty default risk is managed by setting individual limits for issuers, counterparties and borrowers. The Bank aims to limit cluster risk by establishing portfolio limits for risk categories, industries and regions. In this respect, L-Bank's public-service mandate imposes tight constraints. Consequently, the representation of cluster risks is useful above all as a means of raising awareness of the concentration risks associated with the Bank's public-service mandate. The maximum loan amount that L-Bank can issue to a single borrower incurring a commercial risk outside the Federal Republic of Germany is restricted by appropriate limits set at national level (country limits).

The Board of Management has resolved that in the case of transactions where a binding margin is not specified in advance, a risk-based margin should be applied.

The Bank's duty to make first-time, ongoing and incident-related evaluations of credit standing and collateral means that appropriate risk response measures can be taken in good time, thereby minimising loss exposure.

A tightly controlled system of reminders helps to facilitate the early collection of outstanding debts.

As part of the Bank's risk strategy, the Board of Management specifies the credit quality requirements that development business not associated with specific programmes must satisfy, since such business is primarily conducted as part of the bank management strategy and L-Bank wishes to generate income from refinancing, not by assuming risks.

Monitoring and communication

Default risks are monitored primarily by monitoring adherence to the limits provided, and also through an early warning system for risks.

The issuer, counterparty and borrower limits are set by the Board of Management, based on an internal analysis of credit quality and monitored on a daily basis by the Controlling department. When any of these limits are exceeded, appropriate risk response measures are initiated on the same day.

Country limits are also determined by the Board of Management on the basis of an analysis of the risk situation of each country, and the Controlling department monitors compliance with these limits. Again, if the limits are exceeded, risk response measures are initiated on the same day.

Cluster risks in the Bank's lending business are managed by applying portfolio limits to industries and regions. These limits are set by the Board of Management as part of the business and risk strategy. The Controlling department monitors compliance with the portfolio limits on a quarterly basis. If these limits are exceeded, the Board of Management is notified and possible risk response measures are proposed.

In support of the risk early warning system, the Bank carries out analyses of deteriorating credit ratings at client level, of loans at the intensive processing or problem loan stage, of levels of compliance with Art. 18 KWG, and of changes in earnings ratios for defaulted loans in the housing development sector.

MARKET PRICE RISK

Market price risk refers to potential losses caused by unfavourable price movements on the money and capital markets. L-Bank has no trading book. Thus market price risks only arise in the non-trading portfolio (bank book). When analysing market price risks, L-Bank distinguishes between:

- Interest rate risks
- Currency risks
- Risks on stocks and shares and other equity positions (= shareholdings)
- Option risks

Market price risk is managed primarily by means of interest-rate swaps and cross-currency interest-rate swaps. As at 31 December 2011, the portfolio of interest-rate swaps (incl. swaptions) had a nominal value of EUR 78,235.0 million. Cross-currency interest-rate swaps had a nominal value of EUR 11,446.3 million.

In addition other market price risks are present in the form of real-estate risks. These reflect the risks posed by negative trends in real-estate prices and rents.

Quantitative assessment based on value at risk

Risks from unanticipated losses are estimated using the value-at-risk (VaR) method. When assessing such risks on the money and capital markets, L-Bank uses the historical simulation method with a confidence level of 99.0%: this involves evaluating relative changes in market data over ten working days in the last 250 working days. For a more accurate estimation of market price risk in the EUR non-trading portfolio, L-Bank has resolved to supplement the existing VaR model with additional VaR models, always applying the worst VaR value in each case. Consequently L-Bank has already implemented models in the year under review based on absolute as well as weighted changes in market data (with a decay factor of 0.993). In the current fiscal year, the Bank is implementing a model that mirrors market data.

In 2011, a value-at-risk limit of EUR 20.0 million was set for unanticipated losses on real-estate risks. As at year-end 2011, the actual VaR amounted to EUR 14.5 million.

VALUE AT RISK FOR MARKET PRICE EXPOSURE IN 2011 in EUR millions

	01.01.2011		31.03.2011		30.06.2011		30.09.2011		31.12.2011	
	Limit	Used	Limit	Used	Limit	Used	Limit	Used	Limit	Used
Aggregate loss ceiling	867.0	576.3	867.0	661.9	867.0	665.5	932.0	598.1	932.0	595.5
Percentage of market price risk	10.4	11.8	12.1	12.2	12.1	11.1	11.3	9.0	11.3	8.9
Market price risk	90.0	68.1	105.0	80.5	105.0	73.8	105.0	53.6	105.0	53.0

Qualitative assessment based on stress scenarios

VaR values allow potential unanticipated losses under normal market conditions to be quantified. The Bank also simulates stress, extreme and worst-case scenarios with the aim of estimating potential losses in the event of extreme market changes.

L-Bank also uses the stress tests to examine the impact of a parallel shift in the yield curve by 200 basis points upwards or downwards. The tests are used to calculate the proportion of liable equity capital that would be lost in such a scenario, pursuant to Art. 10 KWG (German Banking Act).

The following table shows the loss in market value when projecting a parallel shift of the yield curve by +/–200 basis points.

Managing market price risks

To manage any market price risks incurred, the Board of Management specifies value-at-risk (VaR) limits. The Controlling department is responsible for calculating the value at risk for interest-rate and currency risks, using the historical simulation method.

To further limit interest-rate risk in the non-trading portfolio, the Board of Management regularly defines a maturity-based target risk structure. This sets out the target interest-rate risk profile. The permissible variance of actual from target risk structure is restricted by setting a limit for each maturity band.

To quantify real-estate risk, L-Bank uses worst-case assumptions to calculate the potential reduced yield on invested capital if the property were sold. The estimate is based on historical and projected trends in real-estate pricing.

The Controlling department is responsible for monitoring interest-rate risk and currency risk. The value-at-risk figures calculated each day are compared with the specified limits. The Controlling department also monitors compliance with the target risk structure and permissible variance. A daily risk report is submitted to the individual Board members responsible for risk controlling and the trading departments.

LIQUIDITY RISK

Liquidity risk includes, first, the risk that payment obligations cannot be met when they fall due (liquidity risk in the narrow sense). Also, it includes the risk that transactions either cannot be concluded at all, or cannot be concluded at the expected price (market liquidity risk). Furthermore, it includes the risk that sufficient liquidity cannot be obtained on the expected terms when required (liquidity funding risk).

NEGATIVE CHANGES IN NET PRESENT VALUE DUE TO INTEREST-RATE RISKS

	Year-end 31.12.2011	Maximum 27.01.2011	Minimum 13.07.2011	Average
Net present value loss in EUR millions	398.4	416.8	326.0	368.0
Percentage of liable equity capital as per Art. 10 KWG	12.6	13.2	10.2	11.6

In the year under review, L-Bank's excellent position on the capital markets – supported by the State of Baden-Württemberg's guarantee – meant that refinancing could be obtained on terms favourable to both the Bank and its investors. Borrowings on the capital markets continued to focus on maturities ranging from two to five years. The broad diversity of the Bank's investor base was reflected in the placement of three benchmark bonds (of EUR 1.5 billion, USD 1.5 billion and USD 1.25 billion respectively), as well as a series of private placements denominated in euros and foreign currencies. The Bank's "Commercial Paper Programme" with a funding limit of EUR 10.0 billion once again attracted considerable interest from investors.

Despite generally difficult conditions on the capital markets during 2011, the Bank was able to execute its refinancing plans without restrictions. The Bank also purchased a modest level (EUR 185.9 million) of options to increase senior unsecured issues placed in the year under review. These options were hedged using derivative instruments. The Bank holds a portfolio of securities eligible for refinancing transactions with the European Central Bank (ECB), with a nominal value of EUR 17.5 billion. The Bank did not take advantage of the option to include promissory note loans in the investment portfolio eligible for ECB refinancing.

Quantitative assessment using value at risk

Value at risk for liquidity risk (liquidity funding risk) is calculated on the basis of historical trends in L-Bank's refinancing terms. The underlying assumption is that the Bank is only able to refinance net disbursements on less advantageous terms. The net present value of the resulting expenses represents the value at risk.

The value at risk for market liquidity risk describes the potential loss incurred if the Bank is unable respectively to buy or to sell certain positions within 24 hours, but instead only within 10 days, due to little or no demand on the capital markets.

Liquidity funding risk equates to the risk of a potential deterioration in the refinancing options available to the Bank. To avoid dual calculations, only the liquidity funding risk is taken into account when calculating the VaR for liquidity risk.

VALUE AT RISK FOR LIQUIDITY RISK IN 2011 in EUR millions

	01.01.2011		31.03.2011		30.06.2011		30.09.2011		31.12.2011	
	Limit	Used	Limit	Used	Limit	Used	Limit	Used	Limit	Used
Aggregate loss ceiling	867.0	576.3	867.0	661.9	867.0	665.5	932.0	598.1	932.0	595.5
Percentage of liquidity risk	7.5	2.3	7.5	2.4	7.5	2.4	7.0	3.1	7.0	2.9
Liquidity risk	65.0	13.0	65.0	15.7	65.0	16.0	65.0	18.3	65.0	17.3

Quantitative assessment using regulatory ratios

Liquidity risk in the narrow sense is monitored by the Controlling department using the ratios specified in the German Liquidity Regulation. As required by the regulation, the liquidity ratio is calculated and reported on a monthly basis. The calculation compares anticipated payments over the next 30 days with anticipated disbursements over the same period. In the period under review, incoming payments should exceed outgoing disbursements. As at year-end, the liquidity ratio was 1.8. The mean liquidity ratio over the year was 2.2.

LIQUIDITY RATIO IN 2011
PURSUANT TO THE LIQUIDITY REGULATION

Month	Liquidity ratio
January	1.7
February	2.2
March	2.5
April	1.9
May	1.6
June	2.2
July	2.2
August	2.5
September	2.9
October	2.3
November	2.7
December	1.8
Average ratio	2.2

Quantitative assessment based on stress scenarios

L-Bank holds liquidity reserves in order to cover short-term refinancing needs. To calculate these liquidity reserves, the securities portfolio is broken down into highly liquid (7-day liquidity buffer), liquid (30-day liquidity buffer) and other securities. It is important to ensure that the Bank's liquidity requirements for time frames of one week or one month are covered by appropriate liquidity buffers. L-Bank also ensures that it has liquidity reserves capable of bridging any additional funding needs that may arise from stress scenarios over time frames of at least one month. For this purpose the Bank analyses stress scenarios based on in-house, market-driven or combined causes. Liquidity buffers are reviewed on a monthly basis. By limiting and monitoring – on a daily basis – the maximum liquidity requirements for one month, the Bank ensures that the liquidity buffer is not just sufficient to cover the funding needs on the reporting date, but over the whole of the following month. For the liquidity forecast, when reviewing the liquidity buffer that equates to the liquidity required over days 8 to 30, the Bank assumes – for reasons of prudence – that the maximum permissible monthly liquidity threshold of EUR 10.5 billion (less the liquidity requirement for days 1 to 7) will be required, even if the liquidity forecast indicates that the actual liquidity requirement will be lower. In the stress scenarios, when reviewing the liquidity buffer that equates to the liquidity required over days 8 to 30, the Bank assumes that the maximum amount of the maximum monthly permissible liquidity threshold (less the liquidity requirement for days 1 to 7), plus the liquidity requirement calculated on the basis of the relevant stress scenario, will be required.

LIQUIDITY BUFFER SUBJECTED TO STRESS SCENARIOS AS AT 31.12.2011 in EUR millions				
		Stress scenario		
	Liquidity forecast	In-house causes	Market causes	In-house and market causes combined
Day 1 to day 7				
Liquidity buffer	10,831.2	10,831.2	10,335.4	10,335.4
Liquidity requirements	845.0	850.9	883.2	889.1
Disposable liquidity buffer	9,986.2	9,980.3	9,452.2	9,446.3
Day 8 to day 30				
Liquidity buffer	15,028.8	15,022.8	13,994.3	13,988.4
Liquidity requirements	9,655.0	9,649.1	9,616.8	9,610.9
Disposable liquidity buffer	5,373.8	5,373.8	4,377.5	4,377.5

The minimal variance between the liquidity forecast and the stress scenarios is due on the one hand to the fact that the liquidity forecast is drawn up in line with the principle of prudence, so for example the Bank does not assume that the maturities of due time deposits will be extended. In addition, thanks to L-Bank's business model, in terms of refinancing it only has a very negligible amount of indeterminate cash flows that could, in stress situations, create an unexpected need for liquidity.

Management policies

Liquidity management comes under the remit of the Treasury department. The system is based on a computer-assisted liquidity forecast that depicts all anticipated cash flows over the next ten years. The system produces a daily analysis for the current month and the two months following. A monthly analysis is produced for any months remaining in the fiscal year, and for the following fiscal year. An annual analysis is produced for years three to ten. When producing this liquidity forecast, L-Bank assumes that contractual maturities shall apply. For future interest rate adjustments relating to housing development, the Bank extrapolates the current nominal interest rate. No assumptions are made regarding the prolongation of time deposits. These are updated on a daily basis as part of liquidity management. Budgeted figures for anticipated disbursements are updated monthly, based on new business forecasts.

L-Bank has formulated a number of policies for managing liquidity risk. Limits have been placed on participation in individual securities issues and on liquidity requirements for a single month. Holdings of ECB-eligible securities and securities that can be converted on demand may not fall below a minimum threshold.

The Controlling department is responsible for assessing, monitoring and reporting liquidity risk.

OPERATIONAL RISK

Operational risk represents the risk of losses due to the inadequacy or failure of internal processes, individuals or systems, or as a result of external events. This definition includes legal risks.

Assessment procedures and management

For operational risks, VaR is estimated using a model similar to that used in the insurance industry to determine the risk of major disasters. The assumed confidence level is 99.0%. The model is based on expert estimates of the probability of occurrence of, and extent of damage resulting from, disruptions in any risk-bearing process at L-Bank. The estimates, which are audited, are aggregated to arrive at an overall VaR for the Bank as a whole. The Bank is obliged to resort to estimates simply because to date, the Bank has only experienced a limited number of loss events associated with operational risks, and the consequential damages have been negligible. Hence it is not possible to calculate the VaR on the basis of historical data.

The Controlling department is responsible for identifying and assessing the size and scope of operational risks across all departments, with the aid of structured interviews. The identified risks are assigned to five categories. These are defined in terms of both the impact on L-Bank's financial status of a potential risk were it to materialise, and also the anticipated frequency of such an occurrence. In 2011, a value-at-risk limit of EUR 20.0 million was specified for operational risks. As at year-end, operational risk cover amounted to EUR 6.5 million.

The Bank has taken out insurance in order to reduce the business impact of certain loss events should operational risks actually materialise. To further reduce operational risks, a range of specific policies have been developed (e.g. two-person verification, random spot checks, a new product process governing new types of transactions or processes, explicit authorisation of payments exceeding EUR 1.0 million, IT permissions management system that excludes conflicts of interest between incompatible activities).

BUSINESS RISK

Business risk is defined as the risk that development programme uptake declines, earnings are reduced, and the Bank is unable to cut costs to the same extent. L-Bank can only generate income through transactions that comply with the Bank's public-service mandate. In this sense, a business risk is a risk that L-Bank cannot avoid.

Assessment procedures and management

Personnel expenses and staffing levels are managed – inasmuch as is reasonably possible – by means of productivity analyses. The main aim of productivity analysis is to determine optimum staffing levels required for the performance of assigned duties based on target task times. This means that it is easy to identify spare capacity if the volume of business changes: this in turn means that costs can be reduced.

Taking the "liquidation approach", business risk would be factored into the Bank's risk coverage capability based on net present value; fixed personnel and general costs, to which L-Bank is exposed by declining development programmes, would also be taken into account. The level of these personnel and general expenses is determined through appraisal by qualified experts.

DOCUMENTATION OF PROCEDURES

L-Bank has adopted a modular approach to the rules governing corporate structure and workflow organisation.

With respect to workflow organisation, the Bank differentiates between operational directives – which represent binding prescriptions for action – and operational manuals. Operational directives always apply, regardless of the underlying workflow or IT systems used. Operational manuals, on the other hand, are either IT user manuals, or describe specific processes. L-Bank has broken down the entire loan administration process into multiple stages: granting of loans, further processing of loans, processing of problem loans, loan restructuring and loan workout (settlement). Criteria have been established for each stage in the process and must be complied with when a loan is being processed. These processing criteria represent the master lending process. A master process has also been established for trading transactions. This sets down the processing criteria for reviewing opportunities for trades; for agreeing, recording, forwarding and changing closing dates; for updating the trading portfolio; for the legal form of contracts; for closing trades outside the Bank's own trading rooms and normal working hours (late trades); for recording and monitoring telephone calls, and for ongoing settlement and supervisory activities.

The rules governing corporate structure describe where particular business activities are carried out (organisation chart and schedule of responsibilities).

The rules governing "management and representation" describe who may carry out specific business activities.

Statutory requirements pertaining to employment law and industrial relations are managed by service agreements and employment policies.

The respective current version of the Bank's written documentation is always available for employees to consult on the L-Bank intranet.

KEY FEATURES OF THE INTERNAL CONTROL AND RISK MANAGEMENT SYSTEM IN TERMS OF THE ACCOUNTING PROCESS

With respect to the accounting process, L-Bank has an internal control and risk management system that includes specific rules relating to corporate structure and workflow management. These rules are supposed to ensure compliance with existing accounting standards and regulations, as well as the orderly conduct and reliability of the Bank's accounting functions. The accounting process itself covers everything from the booking and processing of a transaction through to the preparation of the annual financial statements. L-Bank's Board of Management is responsible for defining the Bank's internal control and risk management system as it relates to the accounting function. System implementation is the responsibility of the Accounting department, in collaboration with the Controlling and Payment Transactions departments. The Audit department carries out regular, process-independent checks in order to monitor the reliability of the internal control and risk management system as it affects accounting.

L-Bank prepares its financial statements in accordance with the provisions of the German Commercial Code (HGB) and German Bank Accounting Directive (RechKredV), with due regard for generally accepted accounting principles. The practical interpretation of these regulations is set out in internal manuals and directives governing the various workflows within L-Bank. The Accounting department is responsible for monitoring internal documents on a regular basis, and for adapting them in line with any legal or regulatory changes. By involving the Accounting department in the standardised process for launching new products, the Bank is also ensuring that new products are correctly set up from an accounting perspective.

Documentation of the accounting process is carefully organised so that it is easy for competent third parties to understand. All relevant documents are stored in compliance with statutory time frames.

The two departments most heavily involved in the accounting process (Accounting and Payment Transactions) have clearly separated functions: the Payment Transactions department manages subledgers for loans, securities and debt and equity accounting. The data is automatically transferred by an interface to the general ledger. The Accounting department is responsible for managing the general ledger, laying down rules for assigning items to accounts, operating the bookkeeping and ledger management system and administrating the financial accounting system.

For financial accounting purposes, L-Bank uses standard software which supports the following functions:

- Prevention of unauthorised access by a system of permissions based on authorisation levels
- Prevention of errors by means of plausibility checks
- Detection of errors by means of two-person verification, standardised reconciliation routines and comparisons of budgeted with actual figures

These measures also serve to ensure that assets and liabilities are correctly assigned and reported and also plausibly valued.

Up-to-date, reliable and relevant reports on the risk management system as it relates to accounting are regularly submitted to the Board of Management and heads of department. The Board of Management provides the Supervisory Board and its committees with regular updates on the progress of the Bank's business activities, and also provides up-to-date reports on exceptional events.

COMPLIANCE, MONEY LAUNDERING AND FRAUD PREVENTION, DATA PROTECTION

Adherence to existing statutory regulations governing compliance, prevention of money laundering and data protection is assured by appropriate organisational measures and ongoing monitoring of relevant business transactions. Activities associated with compliance and data protection on the one hand, and with money laundering and fraud prevention on the other, are kept functionally separate. In the year under review, the Bank's hazard analysis system for the prevention of money laundering and other criminal acts was adjusted in line with the respective enhanced legal provisions. As part of the Bank's preventive measures, a binding Code of Ethics and Code of Conduct were drawn up for all L-Bank employees. No extraordinary events were recorded in the year under review.

PERSONNEL REPORT

The number of L-Bank employees remains, almost unchanged from the preceding year, at 1,218 as at 31 December 2011. A total of 53 employees left the Bank during the year under review, primarily due to retirement. 49 new appointments were made, both in the lending and corporate support departments and in the back-office departments. In the latter departments in particular, the aim was to meet increased regulatory requirements.

The proportion of female employees in the workforce as a whole remained at a high level, at 56.6% over the year as a whole. The ratio of female managers rose to 33.0% (2010: 30.4%). Among other things, the average length of service of Bank employees indicates that L-Bank is a preferred employer: at 16.8 years, the average length of service has once again increased over the previous year. The number of employees who resign remains very low, at 1.1%.

During the year under review, the Personnel department focused in particular on new ways of improving our employees' work-family balance. Since 2011 our Karlsruhe and Stuttgart offices have offered day-care facilities to L-Bank employees. The centres are equipped to look after children aged from one year upwards for the entire working day. The Bank also set up a parent-and-child office that is intended to cover situations where a family's regular childcare is not available for short periods.

According to the Compensation Directive pertaining to public-sector institutions in Germany, the Bank must review the adequacy of its remuneration systems at least annually. The 2011 review was based on the updated business and risk strategy: no changes were required.

SUPPLEMENTARY REPORT

No other incidents or events of particular significance occurred after the fiscal year ending 31 December 2011.

OUTLOOK

Following a temporary economic slowdown in early 2012, experts are expecting economic activity to pick up again over the remainder of the year. Thus, for 2012, the federal government is expecting Germany's real gross domestic product (GDP) to show an average growth of 0.7% over the year as a whole. As in the preceding fiscal year, economic growth in 2012 and 2013 is increasingly driven by domestic demand. The conditions for consumer spending and business investment are still positive. On the other hand, in view of the distinct slowdown in economic momentum both internationally and in Europe in particular, export levels will only increase slightly, thereby losing some of their influence on GDP growth in relative terms. Over the next few years, a timely solution to the sovereign debt crisis and restoration of confidence in the common currency are the two key conditions for positive development of both German and European economies.

Further developments in Baden-Württemberg will also be affected by the political and economic conditions mentioned above. The IFO Institute's early indicator is predicting that the federal state's real gross domestic product will grow by 1.5% in 2012. Based on the increase in purchasing power over the past year, combined – as predicted – with ongoing favourable conditions for finance, Baden-Württemberg's businesses remain confident that they will be able to sell their products. Consequently, it is likely that growth in employment will continue, albeit at a much slower pace.

In light of the above-mentioned macroeconomic conditions, L-Bank forecasts a slight decline in the operating result before risk provisions/valuations over the next two fiscal years. Rising costs will be the main reason for the change in 2012. The operating result after valuation adjustments achieved in 2011 was due primarily to the one-off effect of reversing contingency reserves: the Bank will not achieve the same result in 2012. The balance sheet total for 2012 and 2013 will also show a slight decline.

Over the next few years, the Bank's business activities will not undergo any significant structural changes. Only slight adjustments in the organisation of individual development programmes and processes are anticipated.

In terms of economic development activity, the Bank's business development unit will be focusing on the broad-based programmes for promoting energy efficiency and energy savings projects that are due to be launched on 1 April 2012. With respect to finance for SMEs, fiscal years 2012 and 2013 are generally expected to bring a further increase in demand for both growth and investment finance. In addition to traditional debt-capital products, L-Bank will continue to offer companies and banks in Baden-Württemberg an extensive range of guarantees and sureties, equity-related financing solutions and syndicated loans. After the very satisfactory results achieved in the year under review, L-Bank expects to see a consistently high volume of new enquiries relating to business development products over the next few years.

L-Bank will also continue to support housing development through 2012 and 2013 by offering various programmes for the acquisition and modernisation of residential property. The Bank is expecting the overall volume of new business over the forecast period to remain constant. As a consequence of the change of government in Baden-Württemberg, the structure of the federal state's housing assistance programme will focus increasingly on eco-environmental aspects in the future. Furthermore, the programme's existing focus on finance for owner-occupied housing is shifting over to rental housing assistance. Of ongoing significance for the future development of the Bank's housing development activities is the question of whether, and to what extent, the federal government will continue to support subsidised finance for housing from 2014 onwards.

With respect to financial aid, a number of short-term adjustments in support for pre-school language learning are imminent. These will result in further expansion of this development programme: in terms of case numbers, it is already the Bank's largest financial aid programme. The current funding approach in this area will probably only continue until the summer of 2012. In other development work, funding available under the "Climate Change Plus" programme will be increased and L-Bank will assume greater responsibility for the development funding process. In view of the budgetary consolidation planned by the state government, however, it is likely that the total volume of new approvals for financial aid will decline slightly over 2012 and 2013. In the case of family allowances, the Bank is expecting applications and approvals to remain at comparably high levels over the next couple of years. As from 1 October 2012, the state educational allowance is expected to undergo a realignment that will result in a higher volume of commitments during the transition phase from the old to the new programme. With the abolition of tuition fees in Baden-Württemberg as from summer semester 2012, there will be no further new business under the student loan programme, which has been in place since 2007. The Bank will continue to support existing commitments for some considerable time to come, however.

Over 2012 and 2013, the level of refinancing sought by the Bank will remain more or less unchanged from the year under view. Thanks to the Bank's excellent position in the money and capital markets, raising funds should not become any more difficult, and the Bank is not expecting refinancing costs to increase.

In view of the package of reforms imposed by Basle III and the stress tests imposed by the European Banking Authority, capital adequacy requirements for banks will gradually become more stringent over the next few years. For L-Bank, this will present some major challenges. The Bank will have to reinvest a large proportion of any surplus net income made over the next few years so that it is not obliged to scale down the volume of its business activity.

REPORT OF THE SUPERVISORY BOARD

The Board of Management kept the Supervisory Board and its committees informed of the Bank's development as well as major business transactions throughout the year under review. Their regular reports included in particular reports on business strategy, risk strategy and business development, as well as quarterly reports on the Bank's risk exposure, a report summarising the results of internal audits, and a report on the structure of L-Bank's remuneration systems.

Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft, Stuttgart, carried out the statutory annual audit for fiscal year 2011. They issued an unqualified auditor's opinion. The auditor took part in discussions of the 2011 annual financial statements by the Supervisory Board, Audit Committee and Credit Committee. In these discussions, the auditors reported on the main findings of their audit activities, answered questions and provided additional information. The Supervisory Board discussed the auditor's report and did not raise any objections to the final outcome of the audit.

In a meeting on 4 May 2012, the Supervisory Board examined and approved the Bank's annual financial statements for fiscal year 2011 and took note of the Management Report.

The Supervisory Board approved the Board of Management's proposal to transfer EUR 641,000,000.00 of the net profit for fiscal year 2011 (totalling EUR 641,940,728.95) to other revenue reserves and carry forward the remaining amount of EUR 940,728.95.

Stuttgart, 4 May 2012

Chairman of the Supervisory Board
Dr Nils Schmid MdL
Minister of Economic Affairs for the State of Baden-Württemberg

LANDESKREDITBANK BADEN-WÜRTTEMBERG – FÖRDERBANK
BALANCE SHEET AS AT 31.12.2011

ASSETS	31.12.2011 EUR	31.12.2011 EUR	31.12.2011 EUR	31.12.2010 EUR
1. CASH RESERVE				
a) cash in hand		36,164.05		43,351.28
b) current balances with central banks		528,187,892.17		350,856,998.95
thereof: with Deutsche Bundesbank EUR 528,187,892.17 (EUR 350,856,998.95)				
c) current balances with postal giro offices		–.–		–.–
			528,224,056.22	**350,900,350.23**
2. RECEIVABLES FROM BANKS				
a) due on demand		10,328,652.70		106,699,818.69
b) other claims		21,100,095,993.16		19,078,132,411.97
			21,110,424,645.86	**19,184,832,230.66**
3. RECEIVABLES FROM CUSTOMERS			**22,786,390,528.59**	**21,709,361,396.75**
thereof: secured through real-estate liens EUR 7,762,618,484.40 (EUR 8,446,176,775.96) Municipal loans EUR 7,704,722,287.17 (EUR 6,414,301,965.81)				
4. DEBENTURES AND OTHER FIXED-INTEREST SECURITIES				
a) money market securities				
aa) from public issuers	–.–			150,369,535.64
thereof: eligible as collateral with Deutsche Bundesbank EUR –.– (EUR 150,369,535.64)				
ab) from other issuers	–.–			–.–
thereof: eligible as collateral with Deutsche Bundesbank EUR –.– (–.–)				
		–.–		150,369,535.64
b) bonds and debentures				
ba) from public issuers	3,871,655,966.14			3,502,602,575.74
thereof: eligible as collateral with Deutsche Bundesbank EUR 3,654,466,617.60 (EUR 3,483,179,669.51)				
bb) from other issuers	17,263,178,835.29			14,244,300,978.79
thereof: eligible as collateral with Deutsche Bundesbank EUR 14,639,072,823.76 (EUR 11,903,157,915.43)				
		21,134,834,801.43		17,746,903,554.53
c) own notes		215,789,154.24		200,956,776.44
Nominal value: EUR 212,319,000.00 (EUR 198,044,000.00)				
			21,350,623,955.67	**18,098,229,866.61**
Carried forward:			**65,775,663,186.34**	**59,343,323,844.25**

ASSETS	31.12.2011 EUR	31.12.2010 EUR
Carried over:	65,775,663,186.34	59,343,323,844.25
5. SHARES AND OTHER NON-FIXED-INTEREST SECURITIES	–.–	–.–
6. SHAREHOLDINGS thereof: in financial institutions EUR 301,986,360.47 (EUR 301,986,360.47) in financial services institutions EUR –.– (–.–)	484,771,272.79	475,561,835.28
7. HOLDINGS IN AFFILIATED COMPANIES thereof: in financial institutions EUR -.- (-.-) in financial services institutions EUR -.- (-.-)	24,809,201.51	23,009,202.02
8. FIDUCIARY ASSETS thereof: fiduciary loans EUR 95,090,222.57 (EUR 107,506,707.29)	95,910,018.69	108,352,384.92
9. INTANGIBLE ASSETS		
a) Purchased licences, industrial property rights and similar rights and assets as well as licences to such rights and assets	9,972,163.71	8,061,142.11
10. TANGIBLE FIXED ASSETS	126,794,277.80	136,253,181.59
11. OTHER ASSETS	1,106,543,224.40	696,139,109.55
12. ACCRUED ITEMS	367,474,101.73	210,634,617.75
TOTAL ASSETS	67,991,937,446.97	61,001,335,317.47

LANDESKREDITBANK BADEN-WÜRTTEMBERG – FÖRDERBANK
BALANCE SHEET AS AT 31.12.2011

LIABILITIES	31.12.2011 EUR	31.12.2011 EUR	31.12.2011 EUR	31.12.2010 EUR
1. LIABILITIES TO FINANCIAL BANKS				
a) due on demand		80,726,007.33		120,830,299.74
b) with agreed term or notice period		17,717,181,640.37		18,408,352,701.18
			17,797,907,647.70	**18,529,183,000.92**
2. LIABILITIES TO CUSTOMERS				
a) savings deposits				
aa) with agreed notice period of three months	–.–			–.–
ab) with agreed notice period of more than three months	–.–			–.–
b) Other liabilities				
ba) due on demand	84,857,521.07			92,501,764.08
bb) with agreed term or notice period	8,278,553,009.22			7,592,808,938.45
		8,363,410,530.29	**8,363,410,530.29**	**7,685,310,702.53**
3. SECURITISED LIABILITIES				
a) notes issued		36,755,194,091.32		30,322,437,170.53
b) other securitised liabilities		–.–		–.–
thereof: money market securities EUR –.– (–.–)				
own acceptances and promissory notes in circulation EUR –.– (–.–)				
			36,755,194,091.32	**30,322,437,170.53**
4. FIDUCIARY LIABILITIES			**95,910,018.69**	**108,352,384.92**
thereof: fiduciary loans EUR 95,090,222.57 (EUR 107,506,707.29)				
5. OTHER LIABILITIES			**148,794,300.08**	**131,275,118.18**
6. DEFERRED ITEMS			**497,702,135.89**	**413,448,460.84**
7. PROVISIONS				
a) provisions for pensions and similar obligations		154,641,099.00		146,773,090.82
b) tax provisions		–.–		–.–
c) other provisions		194,993,485.32		210,124,658.18
			349,634,584.32	**356,897,749.00**
8. SUBORDINATED LIABILITIES			**770,666,820.04**	**752,671,937.65**
Carried forward			**64,779,220,128.33**	**58,299,576,524.57**

LIABILITIES	31.12.2011 EUR	31.12.2011 EUR	31.12.2010 EUR
Carried over:		64,779,220,128.33	58,299,576,524.57
9. PROFIT-SHARING RIGHTS OUTSTANDING		539,925,800.00	539,925,800.00
thereof: due within 2 years EUR –.– (–.–)			
10. FUND FOR GENERAL BANKING RISKS		304,000,000.00	304,000,000.00
11. EQUITY			
a) subscribed capital	250,000,000.00		250,000,000.00
b) capital reserve	950,850,789.69		950,850,789.69
c) revenue reserves			
ca) legal reserve	–.–		–.–
cb) Reserve for shares in a company with a controlling or majority interest	–.–		–.–
cc) statutory reserves	–.–		–.–
cd) other revenue reserves	526,000,000.00		507,000,000.00
d) unappropriated retained earnings	641,940,728.95		149,982,203.21
		2,368,791,518.64	1,857,832,992.90
TOTAL LIABILITIES		67,991,937,446.97	61,001,335,317.47

1. CONTINGENT LIABILITIES			
a) contingent liabilities from settled bills of exchange passed on	–.–		–.–
b) liabilities from sureties and guarantee contracts	8,124,300,021.20		7,846,931,334.83
c) liability from the provision of collateral for external debts	–.–		–.–
		8,124,300,021.20	7,846,931,334.83
2. OTHER COMMITMENTS			
a) repurchase commitments from reverse repurchase transactions	–.–		–.–
b) placement and underwriting commitments	–.–		–.–
c) irrevocable lending commitments	2,045,511,798.48		7,830,995,935.27
		2,045,511,798.48	7,830,995,935.27

LANDESKREDITBANK BADEN-WÜRTTEMBERG – FÖRDERBANK
STATEMENT OF INCOME FOR THE FISCAL YEAR 1 JANUARY TO 31 DECEMBER 2011

	2011 EUR	2011 EUR	2011 EUR	2010 EUR
1. INTEREST EARNINGS FROM				
a) lending and money market transactions	1,589,394,628.89			1,623,665,078.05
b) fixed-interest and book-entry securities	633,381,682.69			542,703,103.98
		2,222,776,311.58		**2,166,368,182.03**
2. INTEREST EXPENSES thereof: from interest subsidies on loans EUR 90,613,387.00 (EUR 97,791,936.00)		1,898,379,048.36		1,847,606,841.05
			324,397,263.22	**318,761,340.98**
3. CURRENT INCOME FROM				
a) shares and other non-fixed-interest securities		–.–		–.–
b) shareholdings		5,749,195.03		5,500,972.15
c) holdings in affiliated companies		–.–		–.–
			5,749,195.03	**5,500,972.15**
4. COMMISSION EARNINGS			**47,043,983.51**	**45,539,703.84**
5. COMMISSION EXPENSES			**4,818,069.74**	**5,012,993.70**
6. OTHER OPERATING INCOME			**19,803,373.86**	**18,950,632.70**
7. GENERAL ADMINISTRATIVE EXPENSES				
a) personnel expenses				
aa) wages and salaries	71,678,263.20			66,179,407.57
ab) social security contributions and expenses for pensions and other benefits thereof: for pension provision EUR 5,576,071.18 (EUR 2,197,167.91)	16,350,190.04			12,488,802.97
		88,028,453.24		78,668,210.54
b) other administrative expenses		37,218,833.12		34,080,676.41
			125,247,286.36	**112,748,886.95**
8. WRITE-DOWNS AND VALUE ADJUSTMENTS ON INTANGIBLE AND TANGIBLE ASSETS			**11,156,712.85**	**10,643,255.16**
9. OTHER OPERATING EXPENSES			**25,487,169.90**	**24,990,851.84**
Carried forward			**230,284,576.77**	**235,356,662.02**

	2011 EUR	2010 EUR
Carried over	230,284,576.77	235,356,662.02
10. WRITE-DOWNS AND VALUE ADJUSTMENTS ON RECEIVABLES AND CERTAIN SECURITIES AS WELL AS ADDITIONS TO PROVISIONS FOR LOAN LOSSES	–.–	41,462,378.36
11. INCOME FROM REVALUATION OF RECEIVABLES AND CERTAIN SECURITIES AS WELL AS THE REVERSAL OF PROVISIONS FOR LOAN LOSSES	390,068,283.20	–.–
12. WRITE-DOWNS AND VALUE ADJUSTMENTS ON SHAREHOLDINGS, SHARES IN AFFILIATED COMPANIES AND SECURITIES TREATED AS FIXED ASSETS	–.–	44,064,008.47
13. INCOME FROM REVALUATION OF SHAREHOLDINGS, SHARES IN AFFILIATED COMPANIES AND SECURITIES TREATED AS FIXED ASSETS	21,642,157.02	–.–
14. INCOME FROM NORMAL BUSINESS ACTIVITIES	641,995,016.99	149,830,275.19
15. TAXES ON INCOME AND EARNINGS	852,260.53	821,470.61
16. OTHER TAXES NOT STATED UNDER LINE ITEM 9	184,230.72	185,208.65
17. NET INCOME	640,958,525.74	148,823,595.93
18. PROFIT CARRIED FORWARD FROM PREVIOUS YEAR	982,203.21	1,158,607.28
	641,940,728.95	149,982,203.21
19. TRANSFERS TO REVENUE RESERVES a) to other revenue reserves	–.–	19,000,000.00
20. RETAINED PROFIT	641,940,728.95	130,982,203.21

L-BANK CASH FLOW STATEMENT AS AT 31.12.2011

	01.01.–31.12.2011 EURk	01.01.–31.12.2010 EURk
Net profit/loss for the period	**640,959**	**148,824**
NON-CASH ITEMS INCLUDED UNDER NET PROFIT/LOSS FOR THE PERIOD AND RECONCILIATION WITH CASH FLOW FROM OPERATING ACTIVITIES		
1. Depreciation, value adjustments and write-ups on receivables including contingent liabilities and securities	–378,872	61,301
2. Depreciation, value adjustments and write-ups on fixed assets	11,157	10,643
3. Depreciation, value adjustments and write-ups on financial assets	4,212	12,557
4. Changes in provisions (excluding loan loss provisions)	–20,801	6,991
5. Other non-cash expenses/income	0	0
6. Profit/loss on the sale of tangible fixed assets	–1,210	–52
7. Profit/loss on the sale of financial assets	–2,853	47
8. Other adjustments (net)	–190,026	–451,436
Subtotal	**62,566**	**–211,125**
CHANGES TO ASSETS AND LIABILITIES FROM OPERATING ACTIVITIES		
9. Receivables from banks	–1,919,797	313,277
10. Receivables from customers	–697,179	–136,426
11. Securities	–3,261,377	–1,153,775
12. Other assets	–552,801	–550,157
13. Liabilities to banks	–731,275	–644,702
14. Liabilities to customers	678,100	815,015
15. Securitised liabilities	6,432,757	1,848,304
16. Other liabilities	123,073	–843,602
17. Interest and dividends received	1,900,110	2,333,292
18. Interest paid	–1,709,233	–1,881,035
19. Extraordinary income/expenditure	0	0
20. Income tax payments	–852	–821
Cash flow from operating activities	**324,092**	**–111,755**
21. Proceeds from sales of financial assets	5,378	5,090
22. Proceeds from sales of fixed assets	5,102	53
23. Disbursements for investments in financial assets	–19,747	–19,031
24. Disbursements for investments in fixed assets	–7,501	–13,337
25. Cash flows from other investment activities (net)	0	0
Cash flow from investment activities	**–16,768**	**–27,225**
26. Proceeds from equity contributions	0	0
27. Disbursements to company owners and minority shareholders	–130,000	–50,000
28. Cash flows from other capital (net)	0	0
Cash flow from financing activities	**–130,000**	**–50,000**
Net change in cash and cash equivalents	**177,324**	**–188,980**
Effects of exchange rate movements and valuation changes on cash and cash equivalents	0	0
Cash and cash equivalents at the start of the period	350,900	539,880
Cash and cash equivalents at the end of the period	528,224	350,900
	177,324	**–188,980**

STATEMENT OF CHANGES IN EQUITY AS AT 31.12.2011

			Statement of changes in equity		
	Subscribed capital EURk	Capital reserve EURk	Retained income EURk	Retained profit EURk	Equity EURk
Status as at 31.12.2009	**250,000**	**950,851**	**507,000**	**51,158**	**1,759,009**
Dividend payout				–50,000	–50,000
Capital increase					0
Capital reserve increase					0
Withdrawal from the capital reserve					0
Capital reserve increase					0
Withdrawal from the retained income					0
2010 net income for the year				148,824	148,824
Balance as at 31.12.2010	**250,000**	**950,851**	**507,000**	**149,982**	**1,857,833**
Dividend payout				–130,000	–130,000
Capital increase					0
Capital reserve increase					0
Withdrawal from the capital reserve					0
Capital reserve increase			19,000	–19,000	0
Withdrawal from the retained income					0
2011 net income for the year				640,959	640,959
Balance as at 31.12.2011	**250,000**	**950,851**	**526,000**	**641,941**	**2,368,792**

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR L-BANK AS AT 31.12.2011

GENERAL PRINCIPLES

L-Bank (Landeskreditbank Baden-Württemberg – Förderbank) was established by a law passed on 11 November 1998, effective as from 1 December 1998. Article 2, para. 1, clause 1 of the above-mentioned law established the share capital of L-Bank at EUR 250 million.

The balance sheet of L-Bank was prepared in accordance with the provisions of the German Commercial Code (HGB) and the applicable accounting directive for banks and financial services institutions (RechKredV).

The balance sheet and statement of income comply with the standard forms in RechKredV. The "Interest expenses" item has been supplemented to include a "of which" note (Art. 265, para. 5, HGB).

When taken together the majority shareholdings reported are of secondary importance. Preparation of a consolidated financial statement was thus waived (Art. 296, para. 2, HGB).

PRINCIPLES OF CURRENCY CONVERSION

Currency conversion has been carried out according to the provisions in Art. 256a in conjunction with Art. 340h HGB and in IDW RS BFA Opinion 4. Assets and liabilities denominated in foreign currencies, as well as all pending foreign currency cash transactions, are converted at the mean spot rate on 30 December 2011. In the case of forward currency contracts, the forward rate is divided into cash and interest portions.

For currency conversion purposes the Bank calculates currency exposure by offsetting the claims and obligations from on-balance-sheet and off-balance-sheet transactions in the respective currency against each other. These transactions are classified and valued as separately hedged in each currency. Accordingly, all expenses and income from currency conversion within the meaning of Art. 340h HGB are included in the statement of income.

ACCOUNTING AND VALUATION METHODS

Assets, liabilities and pending transactions are valued according to the general provisions of Art. 252 et seq. HGB, taking into account the specific provisions applying to financial institutions (Art. 340e et seq. HGB).

FINANCIAL ASSETS AND LIABILITIES

Receivables from financial institutions and customers are always stated at their nominal value, whereas liabilities are stated at repayment value. Differences (premiums and discounts) with respect to claims and liabilities are stated under accrued or deferred items and written back on a pro rata basis. Administrative charges are collected immediately. Low-interest and zero-interest receivables are discounted. Zero bonds issued and similar liabilities are stated at the offer price plus any prorated interest accrued at the balance-sheet date.

The Bank treats loans linked to development programmes for which it subsidises the interest portion as low-interest lending transactions. Such development programme loans are stated at their net present value. Provisions have been made for interest subsidies on irrevocable lending commitments related to development programmes. Earnings from interest subsidies carried by the Bank are stated under net interest income.

All identifiable individual lending risks as well as country risks have been adequately provided for by making specific loan loss allowances or provisions. General bad-debt provisions have been set up for latent lending risks. Individual and general loan loss allowances are offset against assets or stated under provisions. Where credit derivatives are stated under guarantee obligations, portfolio adjustments have been made.

Securities in the liquidity reserve are stated at either cost of acquisition or the lower of stock exchange or market price at the balance-sheet date, in accordance with the strict “lower of cost or market” principle. Where possible, stock market quotations have been used to determine market values. Where no active markets are available, model values have been used, based in turn on market data (yield curves, spread curves) and other available information (e.g. probabilities of default).

Securities treated as fixed assets are stated at their depreciated historical costs, whereby differences between the book value and the repayment amount are treated as income in proportion to their term. Depreciation on securities in the financial investment portfolio is only applied in the event of permanent loss of value. Provision has been made for general risks by means of portfolio value adjustments.

Holdings and shares in affiliated companies are stated at acquisition cost or, in the event of an enduring loss of value, at the lower fair value as at the balance-sheet date, analogous to the rules governing fixed assets. Where there is no further likelihood of a permanent loss of value, the original value has been reinstated as appropriate.

FIXED AND INTANGIBLE ASSETS

Intangible assets and tangible fixed assets are valued at acquisition or production cost, less scheduled depreciation. Where necessary, i.e. where it is anticipated that a reduction in value may be permanent, extraordinary write-downs are made. Minor-value assets are combined in an annual summary item and depreciated over five years.

PROVISIONS

Provisions for pensions and similar obligations are determined according to actuarial principles using Dr Heubeck's mortality tables (RT 2005 G). As a general rule the Projected Unit Credit (PUC) method is used for valuation purposes. The rate of interest applied is currently 5.13% (2010: 5.16%). Future salary and pension adjustments are included in the calculation, based on a projected average increase of 2% p.a.

The remaining provisions are stated at the required repayment amount, and take into consideration all identifiable risks from doubtful liabilities and impending losses from pending transactions. Provisions with a remaining term of more than one year are discounted at the average market interest rate over the last seven fiscal years that corresponds to their remaining term.

In 2011, remaining possible write-backs of provisions for pensions totalling EUR 0.7 million and for loan loss provisions totalling EUR 1.7 million made in fiscal year 2010 as a consequence of transitional arrangements for the Accounting Law Modernisation Act (BilMoG) were fully netted against necessary additions.

Expense provisions within the meaning of Art. 249, para. 1, clause 3 HGB (old version) shall be maintained either until they are used for the purpose for which they were set up (i.e. the relevant event occurs) or until they are written back because the original reason for their existence ceases to exist.

Interest accruing on provisions is stated under interest income.

TREATMENT OF HEDGING TRANSACTIONS

The Bank enters into derivative transactions primarily in order to manage the aggregate interest-rate risk exposure; these transactions have no balance-sheet value. Derivative transactions are also undertaken in order to hedge individual transactions (microhedges). Where necessary, the hedged transaction and hedging instrument are combined as a valuation unit (macrohedge) as per Art. 254 HGB. The accounting treatment of macrohedges is based on the so-called "freezing method", in which changes in the compensatory offsetting values (i.e. changes to the attributable fair values of hedged transactions and hedging instruments as a result of the hedged risk) are not taken into account in the financial statements.

With respect to the parameters used for valuation, there is a perfect match between the hedged transactions and hedging instruments grouped together to create macrohedges (perfect hedges). Thus neither the hedged transaction nor the hedging instrument is valued in relation to the hedged risk. The effectiveness of valuation units (macrohedges) was investigated using the critical terms match method. Because the key conditions of the hedged and hedging transactions all match, the offsetting payment flows or value changes balance out – both prospectively and retrospectively – over the term of the hedge. Where applicable, the book values stated in the table below have been converted into EUR at the mean spot rate on 30 December 2011.

HEDGED TRANSACTION IN MACROHEDGE

	Book value (EURk)	thereof interest-rate risk	thereof currency risk	thereof price risk	thereof credit risk
Assets	864,732	46,726	–	502,006	316,000
Debts	935,813	887,909	47,904	–	–
Total	1,800,545	934,635	47,904	502,006	316,000

PRINCIPLES OF THE GERMAN BANKING ACT (KWG)

In fiscal year 2011 the Bank complied at all times with the applicable regulations governing the equity capital and liquidity of financial institutions as set forth in the German Banking Act (KWG).

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR L-BANK AS AT 31.12.2011

BREAKDOWN OF SELECTED ITEMS UNDER ASSETS AND LIABILITIES BY REMAINING TERM OR NOTICE PERIOD

	31.12.2011 EURk	31.12.2010 EURk
RECEIVABLES FROM BANKS		
due on demand	10,329	106,700
up to three months	3,284,496	1,822,147
more than three months to one year	1,827,305	1,558,560
more than one year to five years	9,938,654	9,594,786
more than five years	6,049,641	6,102,639
RECEIVABLES FROM CUSTOMERS		
up to three months	712,413	870,229
more than three months to one year	1,456,572	946,755
more than one year to five years	4,047,645	4,491,266
more than five years	16,569,761	15,401,111
DEBENTURES AND OTHER FIXED-INTEREST SECURITIES		
Bonds and debentures that mature in the following year	1,533,081	1,919,246
LIABILITIES TO BANKS		
due on demand	80,795	120,830
up to three months	2,205,782	2,710,223
more than three months to one year	1,223,827	902,302
more than one year to five years	6,024,300	5,950,866
more than five years	8,263,204	8,844,962
LIABILITIES TO CUSTOMERS		
due on demand	84,858	92,502
up to three months	1,519,884	1,609,920
more than three months to one year	24,251	14,784
more than one year to five years	976,531	715,058
more than five years	5,757,887	5,253,047
SECURITISED LIABILITIES		
up to three months	10,646,256	7,690,832
more than three months to one year	4,816,709	5,008,571
more than one year to five years	19,586,218	14,926,534
more than five years	1,706,011	2,696,500
thereof: maturing in the following year in the subitem "Debentures issued": EUR 15,462,965,000 (2010: EUR 12,699,403,000)		

EXPLANATIONS OF INDIVIDUAL BALANCE-SHEET ITEMS

	31.12.2011 EURk	31.12.2010 EURk
RECEIVABLES FROM BANKS		
This item comprises:		
– receivables from affiliated companies	–	–
– receivables from companies in which an equity interest is held	5,366,979	4,867,572
RECEIVABLES FROM CUSTOMERS		
This item comprises:		
– receivables from affiliated companies	49,706	56,954
– receivables from companies in which an equity interest is held	191,516	226,597
– subordinated claims	58,474	48,581
DEBENTURES AND OTHER FIXED-INTEREST SECURITIES		
This item comprises:		
– receivables from companies in which an equity interest is held	2,083,050	2,114,023

The subitem “Bonds and debentures” does not contain any securitised subordinated claims or claims on affiliated companies or companies in which an equity interest is held.

	31.12.2011 EURk	31.12.2010 EURk
Of the securities in this item that are eligible for listing, the following are:		
– listed	20,766,347	17,512,209
– not listed	604,277	586,021

Securities with a book value (excluding prorated interest accrued) of EUR 20,751,683,000 are assigned to investment assets: of this, EUR 6,415,884,000 are valued as fixed assets. The market value of these securities is EUR 6,175,761,000. The market value reserve is EUR 898,450,000.

	31.12.2011 EURk	31.12.2010 EURk
SHARES AND OTHER NON-FIXED-INTEREST SECURITIES		
Of the securities in this item that are eligible for listing, the following are:		
– listed –	–	
– not listed	–	–

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR L-BANK AS AT 31.12.2011

EXPLANATIONS OF INDIVIDUAL BALANCE-SHEET ITEMS

	31.12.2011 EURk	31.12.2010 EURk
SHAREHOLDINGS		
Of the securities eligible for listing that are included in shareholdings, the following are:		
– listed	68,884	69,330
– eligible for listing, but not listed	–	–
Because of the intention to retain these shareholdings over the long term, short-term fluctuations in value amounting to EUR 3.0 million do not appear in the financial statements.		
HOLDINGS IN AFFILIATED COMPANIES		
This item does not contain any shares that are securitised in the form of securities eligible for listing.		
FIDUCIARY ASSETS		
This item comprises:		
– Receivables from banks	75,561	82,912
– Receivables from customers	20,349	25,440
TANGIBLE FIXED ASSETS		
This item comprises:		
– Plots and buildings used for the Bank’s own activities	111,293	116,258
– Plant and office equipment	6,067	5,495
OTHER ASSETS		
thereof subordinated	7,534	7,530
ACCRUED AND DEFERRED ITEMS		
ASSETS		
– Difference between disbursement amount or acquisition cost and lower nominal value of receivables (claims)	242,492	108,777
– Difference between issue price and higher repayable amount of liabilities	77,315	53,761
LIABILITIES TO BANKS		
This item comprises:		
– Liabilities to affiliated companies	–	–
– Liabilities to companies in which an equity interest is held	304,471	1,232,614
LIABILITIES TO CUSTOMERS		
This item comprises:		
– Liabilities to affiliated companies	–	–
– Liabilities to companies in which an equity interest is held	–	–

EXPLANATIONS OF INDIVIDUAL BALANCE-SHEET ITEMS

	31.12.2011 EURk	31.12.2010 EURk
FIDUCIARY LIABILITIES		
Fiduciary liabilities comprise		
– Liabilities to banks	11,369	15,484
– Liabilities to customers	84,541	92,868
ACCRUED AND DEFERRED ITEMS LIABILITIES		
– Difference between disbursement amount or acquisition cost and greater nominal value of receivables	19,816	26,198
– Difference between issue price and lower repayable amount of liabilities	11,285	8,740
SUBORDINATED LIABILITIES		
This item does not contain any liabilities to affiliated companies or companies in which an equity interest is held.		
Interest expenses incurred for subordinate liabilities amounted to	28,092	31,724

Borrowings that exceed 10% of the total amount of subordinated liabilities break down as follows:

Currency:	JPY
Amount in EUR million:	99.8
Interest rate in %:	2.14
Date of maturity:	24.08.2018

Subordinated liabilities are intended exclusively for use as supplementary capital and comply with the requirements of the German Banking Act (KWG). The important factor here is the subordinated nature of the Bank's liability in relation to all non-subordinated liabilities towards other creditors. In the event of liquidation, the liabilities of all other creditors would be satisfied in full before any payments were made to subordinated creditors.

A retroactive limitation of the subordination, or of the original term (at least five years) or notice period is not possible.

Under State law, L-Bank is not capable of insolvency.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR L-BANK AS AT 31.12.2011

INDIVIDUAL AMOUNTS THAT MAY BE OF IMPORTANCE IN ASSESSING THE ANNUAL FINANCIAL STATEMENTS:

	31.12.2011 EURk	31.12.2010 EURk
OTHER ASSETS		
– Balancing item from currency conversion	897,895	514,763
– Receivables from swaps	172,479	141,577
– Works of art	14,244	14,284
– Participation certificates	7,534	7,530
– Receivables from the sale of developed property	6,622	8,141
– Options	2,580	2,580
OTHER LIABILITIES		
– Balancing item from currency conversion	–	–
– Single (bullet) repayments on swaps	137,431	120,063
– Commitments from short option positions	2,580	2,580
DEFERRED INCOME		
– Single payments received in advance on swaps	466,578	378,433
PROVISIONS		
Among other provisions:		
– Provisions for commitments to interest-subsidised loans	52,870	45,164
CONTINGENT LIABILITIES AND OTHER COMMITMENTS		
Before deduction of risk provisions, liabilities from sureties and guarantee contracts include:		
– Loan guarantees to financial institutions	1,724,031	1,391,069
– Credit default swaps	4,971,943	5,007,887
The overwhelming proportion of contingent liabilities comprise credit risks from borrowers with a first-class credit rating. 97.0% of the total portfolio of contingent liabilities have an Investment Grade rating.		
COMMISSION EARNINGS		
– Income from other services	32,905	30,308
– Income from surety fees	14,139	15,231
COMMISSION EXPENSES		
– Consulting fees paid	2,401	1,978
– Surety fees paid	2,124	2,807
OTHER OPERATING INCOME		
– Rental income	5,488	6,107
– Income from services for third parties	5,012	5,152
– Write-back of provisions	3,686	4,188

INDIVIDUAL AMOUNTS THAT MAY BE OF IMPORTANCE IN ASSESSING THE ANNUAL FINANCIAL STATEMENTS:

	31.12.2011 EURk	31.12.2010 EURk
GENERAL ADMINISTRATIVE EXPENSES		
Other administrative expenses include auditor's fees (2011: excl. sales tax):		
– for auditing services	365	446
– for other certification services	–	90
OTHER OPERATING EXPENSES		
– Expenses for subsidies awarded in the course of processing development programmes for the State of Baden-Württemberg	19,157	19,157
WRITE-DOWNS AND VALUE ADJUSTMENTS ON SHAREHOLDINGS, SHARES IN AFFILIATED COMPANIES AND SECURITIES TREATED AS FIXED ASSETS		
– Unscheduled write-downs	26,061	44,467
thereof: credit-related write-downs on fixed-asset securities	8,271	31,836
TOTAL VALUE OF ASSETS AND LIABILITIES DENOMINATED IN FOREIGN CURRENCIES		
– Assets	1,321,303	1,241,168
– Debts	17,816,181	15,868,661
The exchange rate risk from foreign exchange balance-sheet items is essentially covered by off-balance-sheet hedging transactions. Currency conversion produced miscellaneous operating income in the sum of	183	154

PROVISION OF COLLATERAL

Securities with a total value of EUR 12,778.5 million (2010: EUR 9,116.7 million) were deposited with Deutsche Bundesbank for refinancing liabilities to banks. As at 31/12/2011, no securities had been credited in the course of open-market transactions (2010: EUR –.–). As at 31/12/2011, securities with a value of EUR 346.6 million were subject to repurchase agreements (2010: EUR 231.7 million). As collateral for OTC transactions, the Bank paid out cash sureties totalling EUR 1,547.1 million (2010: EUR 815.2 million), stated under receivables from banks, and accepted cash sureties amounting to EUR 396.2 million (2010: EUR 247.8 million), stated under liabilities to banks.

TRANSACTIONS WITH CLOSELY ASSOCIATED COMPANIES AND PERSONS

As at 31.12.2011, transactions concluded with closely associated companies and persons on conditions that do not conform with market conditions had a stated value of EUR 16.9 million (2010: EUR 16.4 million). These transactions consisted of shareholder loans.

OTHER FINANCIAL COMMITMENTS

With respect to equity investments, there are payment obligations for outstanding contributions to subscribed capital that have not yet been called in amounting to EUR 30.1 million. By acquiring a shareholding in Landesbank Baden-Württemberg (LBBW) with effect from 1 January 2005, L-Bank became a guarantor of LBBW. L-Bank assumed joint and several liability for all LBBW liabilities incurred prior to 18 July 2005, but internally is liable in proportion to its capital share. In the event of claims against L-Bank arising from liabilities incurred prior to 1 January 2005, the Bank is entitled to hold the previous guarantors jointly and severally liable in full. As at the balance-sheet date there are no transactions within the meaning of Art. 285, sections 3 and 3a HGB (new version) that are significant for an assessment of the Bank's financial situation.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR L-BANK AS AT 31.12.2011

DERIVATIVE TRANSACTIONS

As at the balance-sheet date, L-Bank had concluded a number of derivative transactions (forward transactions within the meaning of Art. 36 RechKredV). With the exception of credit derivatives, they are used primarily as hedges against interest-rate and currency risks. A breakdown of the derivatives portfolio appears below. For purposes of reporting derivative transactions, no netting of the positive and negative market values of contracts with the same counterparty was undertaken. As a general rule, insolvency-proof netting agreements are in place. Furthermore L-Bank has entered into collateral agreements with the Bank's main business partners with the aim of reducing any existing mutual risk of default by providing collateral in the form of cash. Fully hedged derivative structures embedded in underlying transactions are not included in the tables. In accordance with Art. 285, section 18 HGB, derivative transactions are valued using the market valuation method as follows:

DERIVATIVE TRANSACTIONS – SUMMARY OF AMOUNTS in million EUR	Nominal values 31.12.2011	Nominal values 31.12.2010	Market values positive 31.12.2011	Market values negative 31.12.2011	Market values positive 31.12.2010	Market values negative 31.12.2010
INTEREST-RATE RISKS						
– Interest-rate swaps	77,570	74,096	2,531	–4,587	2,092	–3,237
– Interest-rate options						
Purchases (long)	60	60	0	–	2	–
Sales (short)	60	60	–	0	–	–2
Interest-rate risks – total	**77,690**	**74,216**	**2,531**	**–4,587**	**2,094**	**–3,239**
CURRENCY RISKS						
– Forward currency contracts/ swaps	7,189	6,709	205	–2	143	–59
– Currency swaps, cross-currency interest-rate swaps	11,446	9,860	924	–306	720	–243
Currency risks – total	**18,635**	**16,569**	**1,129**	**–308**	**863**	**–302**
SHARES AND OTHER PRICE RISKS						
– Equity forward contracts (no nominal value)	–	–	–	–	–	–
Shares and other price risks – total	–	–	–	–	–	–
CREDIT DERIVATIVES (CDS)						
– Protection seller	4,972	5,008	0	–214	1	–154
– Protection buyer	–	–	–	–	–	–
Credit derivatives – total	**4,972**	**5,008**	**0**	**–214**	**1**	**–154**

On balance, no meaningful profit or loss on foreign exchange transactions or interest rate valuations are due from interest-rate/currency swaps and the corresponding hedged items, especially on debentures issued in foreign currencies. Positive market values of interest-rate/currency swaps totalling EUR 898 million are due to changes in spot exchange rates. A balancing item from the currency conversion was set up in this amount on the asset side and stated under "Other assets".

Interest-rate swaps in the non-trading portfolio are used primarily to control total interest-rate exposure, and show a net negative market value of EUR 2,056 million as at year-end 2011. These interest-rate swaps are not valued in the balance sheet. Both assets and liabilities contain interest-induced hidden reserves that are significantly greater than the negative market values of the interest-rate swaps.

Credit default swaps (CDs) for which L-Bank is selling protection are included under contingent liabilities at a nominal amount of EUR 4,972 million.

DERIVATIVE TRANSACTIONS – BY COUNTERPARTY in million EUR	Nominal values 31.12.2011	Nominal values 31.12.2010	Market values positive 31.12.2011	Market values negative 31.12.2011	Market values positive 31.12.2010	Market values negative 31.12.2010
– Banks in the OECD	92,645	85,613	3,364	–4,627	2,607	–3,276
– Public-sector agencies in the OECD	–	–	–	–	–	–
– Other counterparties (including stock exchange transactions)	8,652	10,180	296	–482	351	–419
Total	**101,297**	**95,793**	**3,660**	**–5,109**	**2,958**	**–3,695**

DERIVATIVE TRANSACTIONS – BY TERM Nominal values in million EUR	Interest-rate risks 31.12.2011	Interest-rate risks 31.12.2010	Currency risks 31.12.2011	Currency risks 31.12.2010	Credit derivatives 31.12.2011	Credit derivatives 31.12.2010
Remaining terms						
– up to 3 months	2,260	3,295	8,053	6,092	50	35
– up to 1 year	7,578	6,388	2,058	3,317	416	45
– up to 5 years	38,528	37,009	7,082	5,916	2,656	1,392
– over 5 years	29,324	27,524	1,442	1,244	1,850	3,536
Total	**77,690**	**74,216**	**18,635**	**16,569**	**4,972**	**5,008**

The transactions reported here do not include commercial transactions.

VALUING DERIVATIVE FINANCIAL INSTRUMENTS

The market valuation of derivatives is based on market data as at 30/12/2011 obtained by the Bank from external providers: yield curves; exchange rates; CD spread curves; CFC, swaption and FX volatilities. The parameters required for our interest-rate structure models are, in part, obtained through calibration using historical time series (mean reversion parameters in Hull-White models, as well as correlation parameters).

Product group	Main valuation model
Interest-rate and currency derivatives	DCF method
Caps/floors, swaptions	Black 76
Complex interest-rate structures	Interest-rate structure models (BGM model, Hull-White model, modified Hull-White model for multiple currencies)
Credit derivatives	Intensity model

INFORMATION ON TAX LIABILITIES

In accordance with the applicable German tax statutes, (Art. 5, para. 1, section 2, KStG and Art. 3, section 2, GewStG), L-Bank is exempt from corporate income and trade tax.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR L-BANK AS AT 31.12.2011

HOLDINGS IN ACCORDANCE WITH ART. 285, SECTION 11, HGB/ART. 340A (4), SECTION 2 HGB

No. Name, registered office	Direct shareholding in %	Equity * in EURk	Earnings * in EURk
1. Austria Beteiligungsgesellschaft mbH, Stuttgart	33.34	35,317	2,035
2. Baden-Württemberg International – Gesellschaft für internationale wirtschaftliche und wissenschaftliche Zusammenarbeit mbH, Stuttgart	24.00	3,479	–3,766
3. CONTTEK Holding GmbH, Pforzheim	44.75	5,910	1,051
4. DBAG Expansion Fund GmbH & Co. KG, Frankfurt/Main	35.48	****	****
5. Dorner GmbH, Gaildorf	40.00	***	***
6. EB Automotive Group GmbH, Wallerstein	30.97	–21,740	–1,803
7. greenovation Biotech GmbH, Heilbronn	28.74	387	–2,174
8. IntelliShop Holding GmbH, Achern	27.60	287	–166
9. KOKI Technik Holding GmbH, Konstanz	36.55	13,176	7,119
10. Louis Renner GmbH & Co. KG, Gärtringen	37.40	1,796	977
11. MBG Mittelständische Beteiligungsgesellschaft Baden-Württemberg GmbH, Stuttgart	26.80	37,903	2,115
12. Mellifera 3. Beteiligungsgesellschaft mbH, Weinheim	26.00	11,338	891
13. Micropelt GmbH, Freiburg	20.10	–5,611	–2,342
14. Panoratio Holdings Inc., San Francisco, USA	20.51	–171**	–1,043**
15. PT German Centre Indonesia, Bumi Serpong Damai, Indonesia	83.67	–1,797**	–1,617**
16. Renner, Megenhardt & Co. GmbH, Gärtringen	37.35	169	7
17. Schwarzer GmbH, Heilbronn	21.00	2,853	–345
18. SeeTec AG, Philippsburg	47.61	–1,389	–2,561
19. seleon GmbH, Heilbronn	31.70	4,946	308

HOLDINGS IN ACCORDANCE WITH ART. 285, SECTION 11, HGB/ART. 340A (4), SECTION 2 HGB

No. Name, registered office	Direct shareholding in %	Equity * in EURk	Earnings * in EURk
20. StEP Stuttgarter EngineeringPark GmbH, Stuttgart	100.00	6,270	–1,378
21. Stulz H + E GmbH, Grafenhausen	46.06	35,785	–705
22. Symbios AG, Karlsruhe	31.50	354	122
23. SYMPORE GmbH, Tübingen	34.98	***	***
24. Technologiepark Karlsruhe GmbH, Karlsruhe	96.00	10,682	1,078
25. Technologieparks Tübingen-Reutlingen GmbH, Tübingen	100.00	6,368	–252
26. ulrich GmbH & Co. KG, Ulm	21.29	7,111	3,140
27. ulrich Verwaltungs GmbH, Ulm	21.32	55	4
28. Wessel-Werk Beteiligungsverwaltung GmbH, Karlsruhe	35.00	–2,088	–1,527

* As at the last fiscal year available in each case.
** Conversion rate: EUR 1 = IDR 11,873; EUR 1 = USD 1.2939.
*** No annual financial statements were prepared due to insolvency.
**** New business startup: no annual financial statements yet available.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR L-BANK AS AT 31.12.2011

STATEMENT OF CHANGES IN FIXED ASSETS

Fixed assets Balance-sheet items	Acquisition costs 01.01.2011 EURk	Additions EURk	Retirements EURk	Transfers EURk	Write-ups EURk	Total depreciation EURk	Book value 31.12.2011 EURk	Depreciation 2011 EURk
Debentures and other fixed-interest securities	17,410,944						20,751,683	–8,271
Shares and other non-fixed-interest securities	–			Net change pursuant to Art. 34 (3) clause 2 RechKredV: 3,049,084			–	–
Shareholdings	764,329						484,771	–17,789
Holdings in affiliated companies	36,906						24,809	–
Intangible assets	19,877	4,869	–283	–	–	–14,491	9,972	–2,958
Fixed assets	230,437	2,631	–13,905	–	–	–92,369	126,794	–8,198
Other assets	14,307	88	–129	–	–	–22	14,244	–

TOTAL REMUNERATION OF COMMITTEES AND EXECUTIVE BODIES OF L-BANK

Directors' remuneration	Fixed remuneration		Variable remuneration		Other remuneration		Sum total	
in EURk	2011	2010	2011	2010	2011	2010	2011	2010
Christian Brand	439	432	184	226	20	20	643	678
Jürgen Hägele	327	322	147	181	19	18	493	521
Dr Manfred Schmitz-Kaiser	288	284	129	158	25	24	442	466
Dr Karl Epple	272	268	74	90	15	12	361	370
	1,326	1,306	534	655	79	74	1,939	2,035

Provisions totalling EUR 608,000 have been made for variable remuneration due to be paid out in 2012. In 2011 the members of the Board of Management received benefits totalling EUR 56,000 according to their entitlements under civil-service law.
No remuneration is paid for directorships in fully-owned Group companies.
A commitment has been made to the members of the Board of Management undertaking to pay a pension upon termination of their Board of Management contract. The amount of the pension is based on an agreed percentage of their last annual fixed salary.

	31.12.2011 EURk	31.12.2010 EURk
– Supervisory Board	150	155
– Payments to former members of the Board of Management or their surviving dependants	771	844
– Advisory Board remuneration (incl. travel costs)	125	60
– Pension provisions for former members of the Board of Management and their surviving dependants	10,344	10,908

LOANS TO EXECUTIVE BODIES (INCLUDING CONTINGENCIES AND COMMITMENTS)	31.12.2011 TEUR	31.12.2010 TEUR
– Supervisory Board	61	401
– Board of Management	650	694

All loans earn interest at standard market rates.

AVERAGE NUMBER OF EMPLOYEES IN 2011

	Male	Female	Total
Employees*	507	673	1,180
of whom: full-time employees	483	386	869
part-time employees	24	287	311

* Excluding vocational trainees and interns.

DIRECTORSHIPS HELD BY BOARD OF MANAGEMENT MEMBERS AND EMPLOYEES OF L-BANK PURSUANT TO ART. 340A PARA. 4 SECTION 1, HGB

CHRISTIAN BRAND, CHAIRMAN OF THE BOARD OF MANAGEMENT

BWK GmbH Unternehmensbeteiligungsgesellschaft, Stuttgart	Member of the Supervisory Board
Sächsische Aufbaubank – Förderbank, Dresden	Member of the Administrative Board
Schwäbische Hüttenwerke Automotive GmbH, Wasseralfingen	Member of the Supervisory Board
SHW AG, Aalen	Member of the Supervisory Board
Vorarlberger Landes- und Hypothekenbank AG, Bregenz	Member of the Supervisory Board
Wüstenrot & Württembergische AG, Stuttgart	Member of the Supervisory Board
Wüstenrot Holding AG, Ludwigsburg	Vice-Chairman of the Supervisory Board

JÜRGEN HÄGELE, VICE-CHAIRMAN OF THE BOARD OF MANAGEMENT

Business-Park Göppingen GmbH, Göppingen	Member of the Supervisory Board
Sächsische Aufbaubank – Förderbank, Dresden	Deputy Member of the Administrative Board

DR MANFRED SCHMITZ-KAISER, MEMBER OF THE BOARD OF MANAGEMENT

BioPro Baden-Württemberg GmbH, Stuttgart	Member of the Supervisory Board
MBG Mittelständische Beteiligungsgesellschaft Baden-Württemberg GmbH, Stuttgart	Member of the Supervisory Board
Tourismus-Marketing GmbH Baden-Württemberg, Stuttgart	Vice-Chairman of the Supervisory Board

DR KARL EPPLE, MEMBER OF THE BOARD OF MANAGEMENT

Baden-Württembergische Spielbanken Managementgesellschaft mbH, Baden-Baden	Member of the Supervisory Board
Bau- und Wohnungsverein Stuttgart, Stuttgart	Chairman of the Administrative Board

EXECUTIVE BODIES OF L-BANK

BOARD OF MANAGEMENT

Christian Brand
Chairman

Jürgen Hägele
Vice-Chairman

Dr Manfred Schmitz-Kaiser

Dr Karl Epple

SUPERVISORY BOARD MEMBERS 2011

Regular members

Representatives of the state government*

Dr Nils Schmid MdL
Minister of Finance and Economic Affairs
Chairman
since 12.05.2011

Ernst Pfister MdL
Minister of Economic Affairs
Chairman
until 12.05.2011

Willi Stächele MdL
Minister of Finance
Vice-Chairman
until 12.05.2011

Alexander Bonde
Minister for Rural Affairs and Consumer Protection
Vice-Chairman
since 12.05.2011

Rudolf Köberle MdL
Minister for Rural Affairs, Food and Consumer Protection
Vice-Chairman
until 12.05.2011

Reinhold Gall MdL
Minister of the Interior
Vice-Chairman
since 12.05.2011

Heribert Rech MdL
Minister of the Interior
Vice-Chairman
until 12.05.2011

Franz Untersteller MdL
Minister for the Environment, Climate and Energy
since 12.05.2011

Tanja Gönner MdL
Minister for the Environment, Conservation and Transport
until 12.05.2011

Katrin Altpeter MdL
Minister of Labour and Social Affairs, Family, Women and Senior Citizens
since 12.05.2011

Dr Monika Stolz MdL
Minister of Labour and Social Affairs, Families and Senior Citizens
until 12.05.2011

Klaus-Peter Murawski
State Secretary, Ministry of State
since 16.05.2011

Hubert Wicker
State Secretary, Ministry of State
until 16.05.2011

Ingo Rust MdL
Member of the State Parliament of Baden-Württemberg
until 05.07.2011

Claus Schmiedel MdL
Chairman of the SPD parliamentary group
since 05.07.2011

Edith Sitzmann MdL
Chairman of the Greens parliamentary group
since 05.07.2011

Other members**

Martin Lamm
Managing Director
Bauunternehmung Lamm

Wirtsch.-Ing. Bernd Bechtold
President of Karlsruhe CCI

Heinz Kälberer
Former Lord Mayor of Vaihingen
until 23.09.2011

Leni Breymaier
Regional Manager
VER.DI Baden-Württemberg

Dr Jürgen Schütz
Former District Administrator, Heidelberg
until 20.10.2011

Gerhard Burkhardt
Chairman of the Board of Management of Verband baden-württembergischer Wohnungsunternehmen e.V.

Dr Maximilian Dietzsch-Doertenbach
Managing Partner
Doertenbach & Co. GmbH

Consulting members

Clemens Meister
Chairman of the Central Staff Council of L-Bank, Karlsruhe

Reiner Enzmann
Chairman of the Staff Council of L-Bank, Karlsruhe

Thomas Dörflinger
Chairman of the Staff Council of L-Bank, Stuttgart

* Members ex officio.

** Personally appointed.

Alternate members

State government representatives

Ingo Rust MdL
State Secretary, Ministry of Finance and Economic Affairs
since 05.07.2011

Richard Drautz
State Secretary, Ministry of Economic Affairs
until 12.05.2011

Dr Stefan Scheffold MdL
State Secretary, Ministry of Finance
until 12.05.2011

Dr Herbert O. Zinell
Assistant Secretary, Ministry of the Interior
since 13.05.2011

Günther Benz
Assistant Secretary, Ministry of the Interior
until 13.05.2011

Wolfgang Reimer
Assistant Secretary, Ministry for Rural Affairs
since 16.05.2011

Dr Albrecht Rittmann
Assistant Secretary, Ministry for Rural Affairs, Food and Consumer Protection
until 16.05.2011

Helmfried Meinel
Assistant Secretary, Ministry of the Environment, Climate and Energy
since 16.05.2011

Bernhard Bauer
Assistant Secretary, Ministry of the Environment, Conservation and Transport
until 16.05.2011

Jürgen Lämmle
Assistant Secretary, Ministry of Labour and Social Affairs, Family, Women and Senior Citizens
since 13.05.2011

Dieter Hillebrand MdL
State Secretary, Ministry of Labour and Social Affairs, Families and Senior Citizens
until 12.05.2011

Michael Kleiner
Assistant Secretary Head of Dept. I, Ministry of State

Peter Hofelich MdL
since 05.07.2011

Andrea Lindlohr MdL
Vice-Chairman of the Greens parliamentary group
since 21.10.2011

Reinhold Gall MdL
Member of the State Parliament of Baden-Württemberg
until 12.05.2011

Deputies

Joachim Wohlfeil
President of the Karlsruhe Chamber of Trades and Crafts

Dr-Ing. Hansjörg Rieger
Managing Partner of RUD Ketten Rieger & Dietz GmbH & Co. KG

Gerhard Roßwog
President, Baden-Württembergischer Genossenschaftsverband e.V.

Roger Kehle
President, Association of Local Authorities in Baden-Württemberg

Andreas Schmitz
Speaker for the Board of Management, HSBC Trinkaus & Burkhardt AG

Wilhelm Freiherr von Haller
Chairman of the Board of Management, Sal.Oppenheim jr. & Cie.

Other state government deputies

Prof. Dr Willi Weiblen
Assistant Secretary
Head of Business Planning and Administration, Ministry of Economic Affairs
unti 15.08.2011

Walter Leibold
Assistant Secretary
Head of Financial Policy and Investments, Ministry of Finance and Economic Affairs

Joachim Hauck
Assistant Secretary
Head of the Department of Agriculture, Ministry of Rural Affairs and Consumer Protection

Volker Jochimsen
Assistant Secretary
Head of Constitutional, Municipal, Savings Bank and Legal Affairs, Ministry of the Interior

Johann-Christoph Kleinschmidt
Undersecretary
Head of the Central Office, Ministry of Labour and Social Affairs, Family, Women and Senior Citizens
since 15.08.2011

Jutta Lück
Assistant Secretary
Head of Administration, Ministry of the Environment, Climate and Energy

Thomas Halder
Assistant Secretary
Ministry for Labour and Social Affairs, Families and Senior Citizens
until 13.05.2011

Dr Georg Walch
Undersecretary
Head of Budgetary and Tax Policy, Tax Assessment, Real Estate and Investments, Ministry of State

Norbert Schmitt
Chief Undersecretary
Head of State Investments and Banking, Ministry of Finance
until 15.08.2011

PROPOSAL BY THE BOARD OF MANAGEMENT FOR THE DISTRIBUTION OF NET PROFIT

The Board of Management hereby proposes to the Supervisory Board of L-Bank that out of the net profit for fiscal year 2011 totalling EUR 641,940,728.95, an amount of EUR 641.0 million should be transferred to other revenue reserves and the remaining amount of EUR 940,728.95 should be carried forward to the current fiscal year.

Karlsruhe, 28 March 2012

L-Bank

Christian Brand Jürgen Hägele Dr Manfred Schmitz-Kaiser Dr Karl Epple

DECLARATION OF THE BOARD OF MANAGEMENT REGARDING THE FINANCIAL STATEMENTS OF LANDESKREDITBANK BADEN-WÜRTTEMBERG – FÖRDERBANK AS AT 31.12.2011

To the best of our knowledge, and in accordance with the applicable accounting and reporting principles, we confirm that the annual financial statements give a true and fair view of the Bank's assets, liabilities, financial position and profit or loss, and that the Management Report includes a true and fair review of the development and performance of the business and the position of the Bank, together with a description of the principal opportunities and risks associated with the Bank's expected development.

Karlsruhe, 28 March 2012

Christian Brand Jürgen Hägele Dr Manfred Schmitz-Kaiser Dr Karl Epple

AUDITOR'S REPORT

We have certified the financial statements and Management Report as follows:

We have audited the financial statements – comprising the balance sheet, income statement, notes, cash flow statement and statement of changes in equity – as well as the accounting methods and Management Report of Landeskreditbank Baden-Württemberg – Förderbank, Karlsruhe, for the fiscal year from 1 January 2011 to 31 December 2011. The accounting and the preparation of financial statements and Management Report in accordance with German commercial law are the responsibility of the corporation's management. Our responsibility is to express an opinion on the financial statements, including the accounting methods and Management Report, on the basis of our audit.

We conducted our audit of the financial statements in accordance with Art. 317 HGB (German Commercial Code) and German generally accepted standards for the audit of financial statements promulgated by the IDW (Institute of Public Auditors in Germany). Those standards require that we plan and perform the audit such that misstatements, errors and irregularities materially affecting the presentation of the assets, liabilities, financial position and results of operations both in the financial statements, as per generally accepted accounting principles, and in the Management Report, are detected with reasonable assurance.

In determining the audit procedures, knowledge of the business activities and the economic and legal environment of the corporation, as well as expectations relating to possible misstatements, are taken into account. Within the scope of the audit, the effectiveness of the accounting-related internal control systems and the evidence supporting the details in the books of account, financial statements and Management Report are examined predominantly on the basis of sampling. The audit includes an assessment of the accounting principles used and material estimates made by the corporation's management, as well as an appraisal of the overall presentation of the financial statements and the Management Report. We believe that our audit provides a sufficiently reliable basis for our opinion.

Our audit did not give rise to any reservations.

In our opinion, based on the findings of our audit, the financial statements comply with the statutory legal requirements and give a true view of the institution's assets, financial position and results of operations in accordance with the generally accepted accounting principles. The Management Report is consistent with the financial statements and as a whole provides a suitable view of the corporation's position and accurately portrays the opportunities and risks of future development.

Stuttgart, 28 March 2012

Ernst & Young GmbH
Wirtschaftsprüfungsgesellschaft

Prof. Dr Caduff
Auditor

Dr Frey
Auditor

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