ANNUAL REPORT
2018

L-BANK
Staatsbank für Baden-Württemberg

L-BANK IN FIGURES

OVERVIEW 2014–2018 in EUR millions

	2014	2015	2016	2017	2018
Total assets	70,190.09	73,294.92	75,075.39	70,669.98	69,608.87
Equity	2,714.68	2,765.31	2,814.64	2,865.23	2,963.98
Net interest income[1]	375.54	365.41	368.93	323.41	331.37
Net income	49.19	50.63	49.33	50.59	50.18

	2014	2015	2016	2017	2018
Tier 1 capital ratio	14.17%	16.38%	18.00%	18.67%	18.59%
Tier 1 capital ratio fully phased-in[2]	13.95%	16.38%	18.00%	18.67%	18.59%
Total capital ratio	16.87%	19.00%	20.29%	20.73%	20.59%
Return on equity	11.75%	10.28%	12.19%	5.44%	6.29%
Cost-income ratio	41.97%	42.82%	41.65%	52.39%	44.53%

2018	Moody's	Standard & Poor's
Rating	Aaa	AAA

1 Based on business operations. 2 Basel III CET1 ratio.

CONTENTS

A Letter to our *Business Partners*

Dear Business Partners,

Politically turbulent times give rise to unexpected, unpredictable business risks. Even companies that are well-positioned in their markets, enjoying what appear to be the best market opportunities, suddenly find themselves confronted by threatening changes and formidable challenges. State interventions undermine open markets, restrict trade, or sanction movements of goods that are – at least for those engaged in power politics – no longer desirable. As a result, demand plummets without any advance warning. For small and medium-sized businesses situated further up the supply chain, such shortfalls are very difficult to overcome.

We must never lose sight of the fact that our prosperity is not something to be taken for granted. Only by making sustained efforts and being willing to embrace the new can Baden-Württemberg remain successful. But as a development bank, we are not merely concerned with our federal state's economic prospects. Social cohesion and ecological awareness are key to safeguarding the living conditions and future viability of communities in Baden-Württemberg. Social harmony and societal equilibrium are vital factors in our social market economy. This is why we give such a high priority to housing development, whether for purposes of home ownership or for rental accommodation. New build or conversion, extension or age-appropriate upgrade – quality of life begins at home. The state government has responded to the growing pressure on the housing market by setting up the 'Housing Construction BW 2018/2019' development programme, making state support for housing development even more attractive. The enthusiastic take-up of the state's housing assistance options – for home ownership and rental accommodation alike – shows that things are moving in the right direction.

To achieve the targets set down in the Baden-Württemberg Climate Protection Act, the federal state aims to halve energy consumption and cover 80% of the remaining energy demand from renewable energy sources. We are helping to optimise consumption of energy and resources by offering high-volume, precisely tailored funding programmes supported by carefully targeted grants. We must treat our environment with care – not simply for reasons of ecological responsibility, but because it makes clear, easily verifiable economic sense to do so, especially in view of the many attractive opportunities for entrepreneurs to create new products based on green technologies.

Our business activities continued to preserve a harmonious equilibrium between economy, ecology and social engagement in 2018. Once again, our efforts were very successful: at EUR 4.6 billion, the overall volume of lending approved in 2018 exceeded the already high levels achieved in the previous year. Our enterprise development activities helped to bolster Baden-Württemberg's business competitiveness and innovative strength. Our development finance for fledgling companies and established SMEs saw higher demand than ever; we provided businesses with loans totalling EUR 3.15 billion. Our business zone development efforts made good progress with major projects such as the Mannheim Medical Technology Campus, and a sharp increase in the volume of our financial assistance to a total of EUR 2.72 billion clearly shows that our commitment to providing services on behalf of the state government is as impressive as ever. For this, we give warm thanks to all our employees who, in their various capacities at L-Bank, are responsible for our consistently high performance.

Dr. Axel Nawrath
Chief Executive Officer, L-Bank

Greetings from the *State Premier*

Albert Einstein, who was born in Baden-Württemberg, once said that 'I have no special talents. I am only passionately curious.' Experimenters and inventors such as Carl Benz, Robert Bosch, Gottlieb Daimler, Ferdinand Graf von Zeppelin and Artur Fischer were also curious. They all embody Baden-Württemberg's vision and talent for invention. Experimenting, developing and researching are part of our native tradition.

This is why our state holds so many top rankings – whether in terms of world market leadership, international patents, unemployment figures or spending on research and development. But we cannot afford to rest on our laurels. Because markets are not stagnating – quite the opposite, in fact. They are in a state of constant, dynamic development – especially during an era of digitisation.

We have also been busy on the start-up front: partnerships with Israel (the home of Silicon Wadi) and California (the home of Silicon Valley), international events such as the second Start-up BW Summit on 1 February 2019 at the Stuttgart Landesmesse, the new.New Festival showcasing local innovations, and Daimler's Startup-Autobahn, involving a host of national and international joint-venture partners, all clearly show where Baden-Württemberg wants to be: right at the top. But we are still a long way from achieving our goal and must stay on the offensive. And this is where we in Baden-Württemberg can depend on our most important resource: our traditional, successful companies and our creative citizens, who – with great courage and determination – are transforming their visions into reality by setting up new businesses.

Of course, business start-ups are always associated with investment and financing needs. And as the State Bank of Baden-Württemberg, this is where L-Bank is a key partner. By providing customised development funding, the Bank assists many start-ups on their challenging and often arduous journeys. The positive response to the Bank's various start-up programmes shows how successful this assistance is.

I would like to thank L-Bank and all its employees for showing such enormous commitment, and wish them every success in the 2019 fiscal year – so that successful businesses in this state of inventors can continue to enrich the marketplace.

Winfried Kretschmann MSP
State Premier of the State of Baden-Württemberg

Outlook for Europe

Uncharted territory? Europe's future in the world

By Wolfgang Ischinger

In recent years, the entire established liberal world order appears to have been thrown off balance – nothing is the same as it once was. For many of us, 9/11, or the Iraq War, or the bloody wars in Syria and subsequently in Yemen had already made it clear that the world is becoming a more dangerous place. When Putin annexed the Crimea in 2014 and instigated the bloody conflict in Eastern Ukraine, many saw him as the great destabiliser. But alarming and unexpected as it was, the situation still somehow fitted into the overall picture. Today, things are different: Putin is no longer alone in questioning the established order – now the U.S. President is doing so, too. Not only has he cast doubts on free trade, but also on Western values and the collective self-defence principle enshrined in Article 5 of the North Atlantic Treaty (NATO).

Of new, old and forgotten dangers

'Today, the global security situation is more hazardous than at any time since the collapse of the Soviet Union.' I have reiterated this warning in lecture after lecture. German Federal President Frank-Walter Steinmeier expressed a similar view while he was still Foreign Minister: 'The world has turned upside down.' It appears that we are on the verge of an epochal break, that an era is coming to an end, that the outlines of a new global political reality are just beginning to emerge. No matter where we look, the world is full of countless conflicts – many of them crises that are resonating in the heart of Europe. The result – about 70 million refugees worldwide – sets a tragic record.

In Syria, a mere 125 kilometres away from EU member Cyprus, hundreds of thousands of people have been killed in the last few years. Now the United Nations no longer keeps count of the deaths, because lack of access means the figures cannot be verified – but recent estimates suggest that about half a million people have died. This is equivalent to the population of Dresden or Nuremberg. And still we regularly hear news of atrocities such as the use of barrel bombs or chemical weapons in residential areas.

Syria is only the most terrible example of today's many internationalised civil wars – by which I mean wars that begin as disputes between local actors, but gradually expand to involve more and more third parties. A similarly dreadful war is raging in Yemen, with the heavy involvement of regional powers – Iran on one side, Saudi Arabia on the other. On our neighbouring continent of Africa, a number of countries simmer in a state of permanent bloodshed: think of Mali, think of Sudan, Congo or Somalia. Another military conflict is seething right on the European Union's doorstep, at about the same distance from Berlin as Paris – in Ukraine, where more than 2,500 civilians have been killed since 2014.

To these more recent crises we should add the many longstanding conflicts, such as the many almost entirely military clashes between Turkey and the PKK since 1984, the Somali civil war that has been raging for the last 30 years, the dispute between Tibet and China that has been fermenting since 1950, and the territorial disputes in the South China Sea. Other unresolved conflicts include the situation in the breakaway (and occupied) regions of Nagorno-

Karabakh, Transdniestria, South Ossetia and Abkhazia; the ongoing strife between Russia and Chechnya; the inter-ethnic tensions in the Western Balkans (including the still disputed status of Kosovo); the clashes over Iran's nuclear programme; the crisis-ridden relationship between North and South Korea, and last but not least, the Israeli-Palestinian conflict.

And finally, there are those countries which, having emerged from traumatic civil war into laboriously negotiated peace, are now struggling to rebuild stable nations – but where old conflicts could flare up again at any time: Rwanda, Côte d'Ivoire, Chad, Congo and Sri Lanka are just a few examples. And we should also look with mounting concern to countries where, although the shooting has not yet started, the situation is by no means stable. Turkey was on the verge of civil war during the attempted coup in the summer of 2016; since then, the country has gradually subsided into an increasingly authoritarian state of emergency, and is also deeply implicated in the chaotic war in Syria. But even within the EU, political stability is by no means guaranteed: in Spain, the Catalonia crisis has evolved into a potentially explosive situation.

Alongside crises, military conflicts and political instability, we should also mention global terrorist attacks. Among the best-known perpetrators are the Islamic State (Daesh), Boko Haram and al-Qaeda. The vast majority of attacks in recent years have taken place in Iraq, Afghanistan, Pakistan, Nigeria and Syria. Fortunately, Germany has not yet become a major terrorist target. Even so, we have already seen a range of assassination attempts by terrorist organisations, ranging from malicious robberies and murders by NSU right-wing radicals to devastating Islamist attacks with knives or trucks. In this country, fear of terrorism outweighs the actual danger – and yet Germans' increasingly anxious view of the chaotic global situation is entirely justified. And if we wished to extend our list of anxieties above and beyond conventional security issues, we could also cite examples such as Fukushima, the Zika virus, avian influenza, climate change, Brexit, WikiLeaks or the Snowden affair. All of which should be enough to darken even the most unquenchable optimist's day.

Crowning this unusually long list of dangerous and bloody crises and conflicts is an ongoing nuclear threat that has become so much a part of everyday normality that it scarcely merits serious political attention. In Germany – the country where, back in the 1980s, hundreds of thousands of people marched through the Hofgarten in Bonn to protest against the new cruise missiles and demonstrate for peace – few people now stop to consider a simple fact: that the danger of a confrontation between major world powers, hence also of nuclear escalation, has by no means disappeared.

Many regard nuclear war as a mere spectre of past horrors, or a melodramatic but unrealistic scenario from a James Bond film. But the nuclear threat is real, and around the world, some 1,800 nuclear warheads are on standby day and night – with very, very short fuses.

The danger of international war between major and secondary powers has clearly increased again in recent times. My concern over this is what prompted me to entitle the 2018 Munich

Security Conference: 'To the Brink – and Back?' Because what we observed last year, in many parts of the world, was in fact nothing less than what the Americans call brinkmanship, meaning to advance to the very brink of extreme action – the brink of war.

War and violence are clearly playing a more central role – but they are not alone. We appear to be witnessing the evolution of a new, system-level competition. In stark contrast to the early 1990s, liberal democracy and the open-market principle are no longer the only conceivable models of legitimate political and economic order. A worrying trend has become apparent – towards greater inequality and less freedom. In China, the Communist Party has developed a system of authoritarian state capitalism that has succeeded in raising large sections of the country's population from poverty to moderate prosperity. This has turned China into a role model for many authoritarian states. This despite the fact that democracies are much more capable of fighting corruption, social exclusion, or barriers to fair economic competition. Autocratic states have a much worse record in this respect – without touching upon the whole issue of human rights. Even so: primarily because of this economic success, the Chinese leadership has gained enormously in self-confidence and has even taken to praising its system as an export model for other countries to imitate.

Russia has long since abandoned its efforts to become a liberal and democratic constitutional state. The government will not even permit genuine political opposition, free media or a lively social discourse. And yet the idea of strong leadership seems to be increasingly seductive not just among Russians, but also elsewhere in the world. Even in the European Union we find advocates of what has been termed 'illiberal democracy'. They seek to restrict freedom of the press and freedom of opinion, utter dire warnings about the Brussels 'Eurocracy', and encourage rampant xenophobia. They are building an axis of fear that seeks salvation in a retreat back to outdated nationalism. And now – even in the USA, formerly the stronghold of democratic freedoms – defenders of democracy must fight daily to maintain standards previously regarded as unassailable.

Strengthening Europe's foreign and security policies

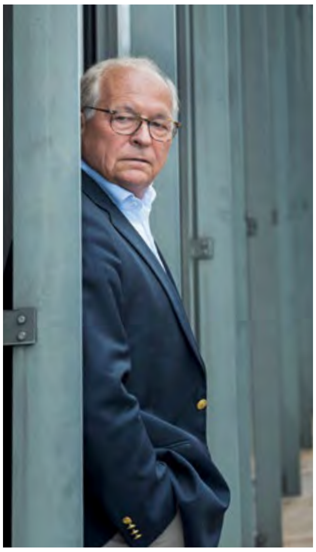
In view of the world's current situation and prospects for the future, it is easy to become anxious and afraid. Which way should we turn in this fog if we are not to run aground? First, we must acknowledge that it is no longer enough to do as we have always done. It is time to reflect on what really makes us strong: Europe!

Business and finance have always been dear to Europe. Security, on the other hand, is something we have long believed we could safely neglect. After the Cold War, we talked about the peace dividend – we reduced our defence budgets; today's Bundeswehr is in a lamentable state. And a few days into the Libyan intervention in 2011, we heard that French and British soldiers had run out of ammunition; they had to borrow from the Americans.

So now we must make very rapid, very significant progress in developing Europe's foreign and security policy. Europe must – as the President of the EU Commission, Jean-Claude Juncker, rightly asserted at the last Munich Security Conference – become 'capable of global politics'. More and more of us are realising that for Europe to become a truly capable player on the world stage, we must strengthen Europe's foreign and security policy.

Individual European nations are too small to credibly assert their own international and security-related interests at global level. A number of smaller European countries such as Portugal and the Netherlands are former world powers. But today, there is no longer a single European nation that could be described as a world power. Despite their seats on the UN Security Council, despite their nuclear arsenals, the UK and France are only second-rate by global standards. Consequently, foreign and security policy can and must become one of the areas in which the EU has something to offer.

Further development of Europe's common foreign and security policy is the most promising solution for a secure future. Because the EU is far more than a bloated bureaucracy and a never-ending stream of legislation. The EU preserves peace in Europe and, as an influential international power, is the most effective instrument for representing the interests of 500 million Europeans at global level. Consequently, we must intensify our efforts to develop a common foreign, development and defence policy. We cannot expect to preserve the cohesion of the EU and its internal and external security without cost. But future generations will be unable to afford anything at all if we allow the most vital foundation of our affluence – a peaceful, prospering Europe – to erode away to nothing.



This text is a slightly modified excerpt from the book 'Welt in Gefahr: Deutschland und Europa in unsicheren Zeiten' (World in danger: Germany and Europe in uncertain times) by Wolfgang Ischinger, published by Econ Verlag in September 2018.

'Our response to greater uncertainty must therefore be a greater Europe, in every sense.'

Baden-Württemberg:

attractive lifestyle, strong economy

PRETZELS

Baden-Württemberg's favourite bread product is made in Bad Urach.

People enjoy living in Baden-Württemberg. The region's hard work and ingenuity have transformed it into a prosperous federal state offering an attractive lifestyle.

The pillars of Baden-Württemberg's economy are solidly rooted in a combination of quality, experience and innovation. State rankings published by independent institutions always put Baden-Württemberg somewhere near the top. The Bertelsmann Foundation's annual surveys on 'Die Bundesländer im Standortwettbewerb' (How Germany's Federal States Compare as Business Locations) attest to the fact that Baden-Württemberg is one of Germany's most active and successful federal states, earning top ratings against multiple target metrics, including low unemployment, high social security and high economic growth. The predictive atlas of 'Germany's Top Regions', compiled by economic research institute Prognos, identifies Baden-Württemberg as a major German powerhouse. Of the 25 leading German regional centres hosting the most promising industries, eight are located in Baden-Württemberg.

A number of benchmark figures illustrate the state's current success: economic output – defined as nominal gross domestic product – came to around EUR 493 billion in 2017. This amounts to EUR 44,900 per inhabitant, or EUR 78,700 per wage earner. At EUR 23,947 per inhabitant, disposable income also puts the state in the top tier of German territories. And last but not least, labour productivity demonstrates the high performance achieved by Baden-Württemberg's businesses: across Baden-Württemberg's economy as a whole, gross domestic product per hour worked came to EUR 58.27 in 2017. This figure is 7.1% higher than the national average of EUR 54.42. Whether a federal state can improve its standard of living over time largely depends on whether it succeeds in increasing output per employee. Germany's southwestern province has previously set benchmarks here, as well.

Facts and figures

on Baden-Württemberg's key industries

Industry	Companies	Employees	Turnover in EUR bn
Mechanical engineering	6,668	321,193	92.91
Mobility	16,964	398,941	202.38
Healthcare industry			
Medical technology	840	48,817	12.97
Biotechnology	147	18,741	4.22
Pharmaceutical industry	86	20,458	6.69
Information and communication technology, plus creative industries	43,242	254,261	60.66
Environmental technology	958	32,000	11.3

Source: Baden-Württemberg Investment Guide; additional data: statistik-bw.de

Baden-Württemberg's economy is dominated by five key industries, all of them strong: mechanical engineering, mobility, information and communication technology (ICT), healthcare, and environmental technologies. This industrial diversity is an important factor in the federal state's economic strength.

1. Mechanical engineering:

Baden-Württemberg is a global centre of mechanical and systems engineering and a leading international developer and manufacturer of high-potential process technology. No other federal state bundles more expertise in cutting-edge technology for industrial production: over 40% of German machine tool and precision tool manufacturers are based here.

2. Mobility technology:

Whether in automotive manufacturing or the aerospace industry, Baden-Württemberg covers the entire mobility value chain – from innovative research and development to a strong supplier industry right through to competitive production capabilities.

3. Healthcare industry:

The healthcare industry – including sub-sectors medical technology, biotechnology and the pharmaceutical industry – is the innovative growth driver of the healthcare economy. Baden-Württemberg is the most important centre of healthcare-related activities in Germany. In a nationwide comparison, Baden-Württemberg ranks first in terms of working population, gross value added and export volume.

4. ICT and creative industries:

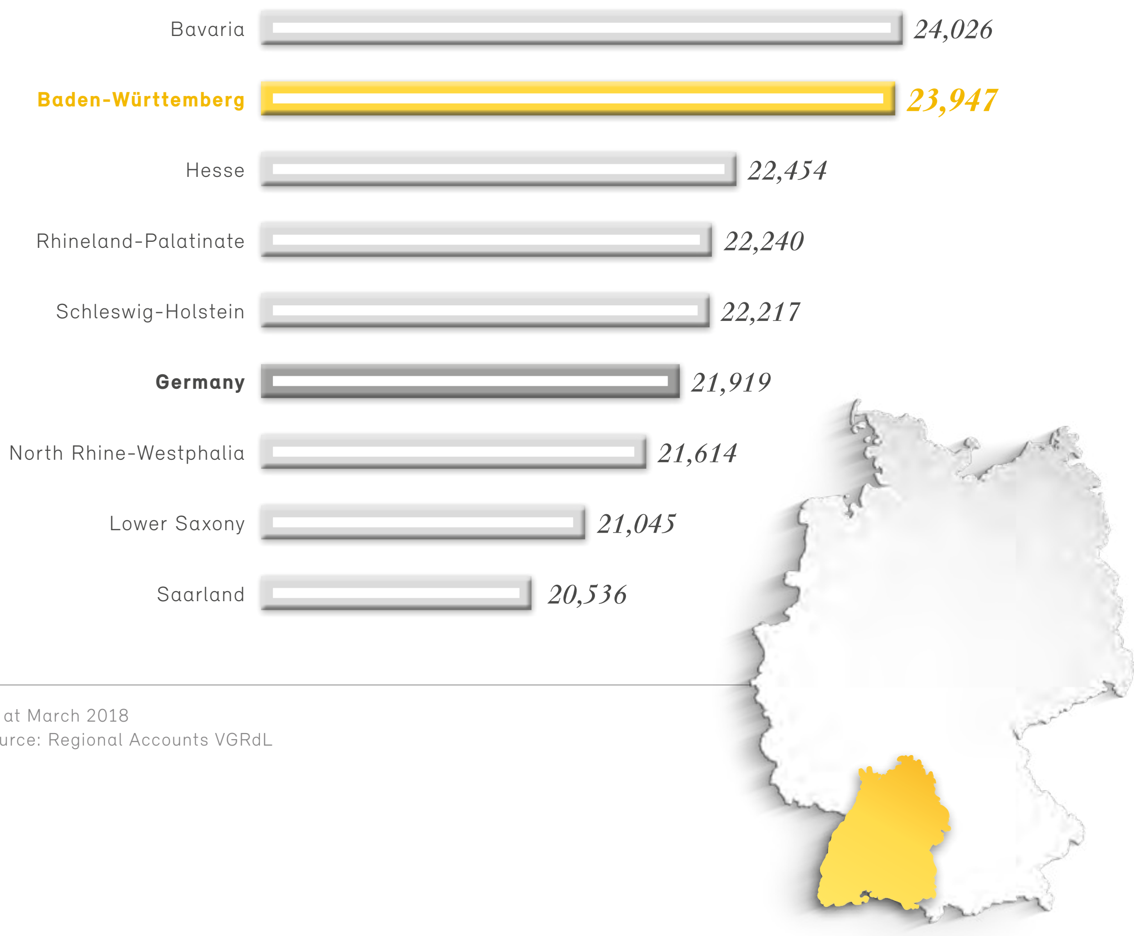
Baden-Württemberg has a top-ranking position in information and communication technology, with excellent prospects in all areas. Strong clusters are one of the state's biggest advantages; thus the Karlsruhe region is one of the three most productive IT clusters in the whole of Europe. A large proportion of the industry's small and medium-sized businesses are also based here. Often they are also very successful at international level and belong to the state's so-called 'hidden champions'. Enterprise software is one of Baden-Württemberg's special strengths.

5. Environmental technology:

Baden-Württemberg is a pioneer in the development of renewable energies, environmentally friendly production technologies and innovative technologies for improving resource efficiency. Environmental technologies are cross-sectoral technologies, playing a role in many different industries as key aspects of the actual core business. Many companies in Baden-Württemberg concentrate on energy-efficient processes, but also on saving energy and avoiding emissions by using in-process or downstream methods.

Prosperity levels in 2016

Disposable income per inhabitant in EUR

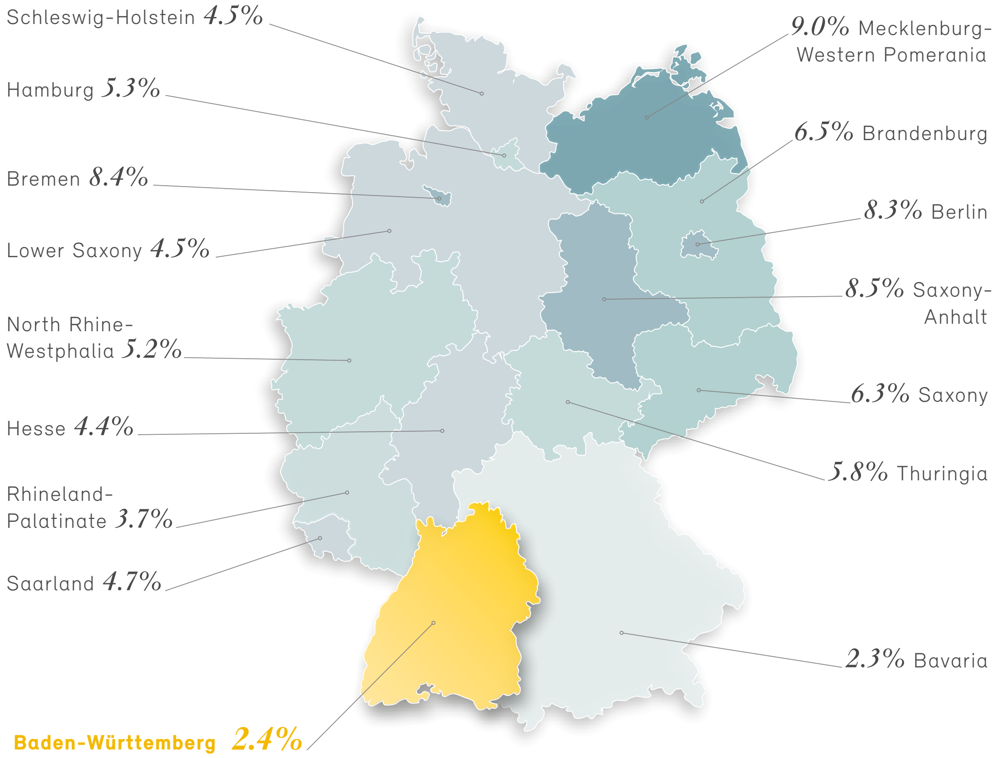


As at March 2018
Source: Regional Accounts VGRdL

The state's all-round positive economic development is also the result of an intact labour market and a good supply of skilled workers. Without them, orders could not be fulfilled, and investments could not be made. However, due to demographic change and many years of positive cyclical trends, some sectors are currently experiencing difficulty in meeting their demand for skilled workers and trainees. Good education and low unemployment are good prerequisites for personally satisfying careers. In Baden-Württemberg, young people are not the only ones with good prospects!

Youth unemployment levels (ages 15 to under-25)

in Germany



As at October 2018
Source: Federal Employment Agency

The people of Baden-Württemberg have always known how to make a virtue out of necessity. A federal state with few natural resources needs people with good ideas.

Baden-Württemberg is a wellspring of inventions that have changed the world: first and foremost the automobile (invented in 1886), but also everyday things like ring binders, matches, dowels, the electric drill – and even the perm! Baden-Württemberg's inventiveness and passion for research is still clearly in evidence today: With 132 patent applications per 100,000 inhabitants, the federal state is well ahead of the rest (which average a mere 58 patent applications per 100,000 inhabitants). This does not just happen by itself – in Baden-Württemberg, research has value. With R&D expenditure accounting for 4.92% of gross domestic product, Baden-Württemberg is significantly ahead of Berlin (3.49%) and Bavaria (3.17%), which are ranked two and three respectively in the comparative table of federal states.

But Baden-Württemberg is not just good at inventing and patenting things – here, ideas are also put into practice. Baden-Württemberg is the leading region for innovation – in both Germany and Europe as a whole. The federal state's unique innovative strength is also clear in a global comparison.

Innovation index[1]

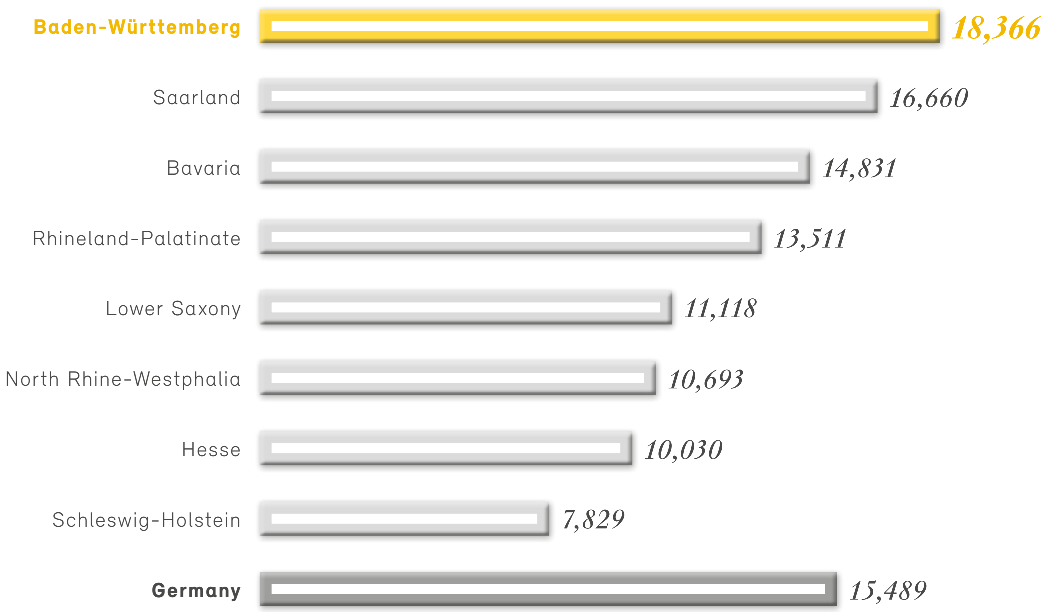
EU federal state or region – top 10	Value 0–100	
Baden-Württemberg (DE)	*82.4*	RANKED *1*
Bavaria (DE)	*64.9*	*2*
Île de France (FR)	*64.4*	*3*
Berlin (DE)	*62.4*	*4*
Sweden	*61.4*	*5*
Denmark	*58.1*	*6*
Hesse (DE)	*56.6*	*7*
Finland	*56.6*	*8*
Zuid-Nederland (NL)	*55.2*	*9*
Hamburg (DE)	*54.4*	*10*
European Union (28 countries)	*37.3*	

As at 2018
Source: Baden-Württemberg State Statistical Office
1 The innovation index is based on the following innovation-related indicators: expenditure on research and development (R&D); R&D personnel; employees paying social security contributions in high-tech industries; employees paying social security contributions in knowledge-intensive service sectors; start-ups in high-tech industries; number of patent applications by businesses and research institutions.

It comes as no surprise that this innovative strength results in exciting and globally sought-after products. Baden-Württemberg is consequently the leading exporter among Germany's federal states. In 2017, the value of Baden-Württemberg's exports exceeded the EUR 200 billion mark. The federal state's intensive export activity is clearly reflected in the export ratio – export volume as a percentage of gross domestic product – which comes to 40.6%. The federal state average is 30.9%.

Exports per inhabitant in 2017

in euros



As at March 2018
Source: Regional Accounts VGRdL, Federal Statistical Office

THAT'S CUCKOO!

The world's largest cuckoo clock was built to a scale of 60:1 and can be found in Triberg in the Black Forest.

Baden-Württemberg:

the future starts *now*

Our prosperity is not something to take for granted. Only through sustained effort and a willingness to embrace new ideas and ways of doing things will Baden-Württemberg remain successful. The aim of the state government is to work together with the people of Baden-Württemberg to make it fit for the future. Sustainability, justice and economic strength are the basis for this effort. Digitisation, start-ups, sustainability and housing are areas where dominant trends are easy to discern.

Living the life. Housing construction builds vital foundations.

Housing development takes priority in Baden-Württemberg. The home–commute–work cycle governs our lives. Thus residential infrastructure is a key factor in achieving quality of life. There is a scarcity of affordable living space close to workplaces in Baden-Württemberg, and not just in the big cities. So one of the state government's highest priorities is to increase the supply of reasonably priced accommodation. This requires, on the one hand, suitable building plots and, on the other, tailormade development funding offers that enable people on lower incomes and/or with families to rent or buy residential accommodation.

The job of policy-makers is to create favourable conditions for this. At the same time, it is important that all partners involved in construction initiatives perceive housing construction as a macrosocial necessity. Consequently, the state government set up the Housing Alliance with the aim of developing common guidelines and a coordinated procedure for creating more and better housing.

Energy is the second most important factor in this initiative. The state government has ambitious goals for climate protection and energy supply in Baden-Württemberg. By 2050, energy consumption should be 50% lower than in the baseline year, 2010, and energy-related greenhouse-gas emissions 90% lower than in 1990. The state's residential and non-residential building stock is an important starting point. Accounting for one-third of Germany's end-consumption of energy, it offers enormous potential for energy savings (both heat and electricity). To achieve these ambitious climate-protection targets, it is vital to exploit potential efficiencies in new builds and renovated buildings. The aim is to bring about a significant improvement in the efficiency of the building envelope and a clear increase in the energy efficiency of systems engineering.

Baden-Württemberg needs innovative and committed start-ups which can help to shape the future of our SME-focused economy so that it remains strong and competitive.

Baden-Württemberg's successful history of innovation and entrepreneurship continues.

There is a range of very different start-up scenes in Baden-Württemberg, stretching from Mannheim to Lake Constance and embracing very different industrial and technological priorities. The focus is on business-to-business (B2B) business models. Here, our federal state is the national leader, and even competes successfully at international level.

The new state initiative 'Start-up BW' should help to ensure that this remains the case in the future. To underscore the attractiveness of the state's business zones and enhance their visibility at both national and international level, the campaign intends to package the state's regional start-up diversity with Baden-Württemberg's overall strengths.

As innovative solutions become ever more complex, they require ever more intensive collaboration between different kinds of specialists. Taking a cooperative approach to solutions is an increasingly important trend. Baden-Württemberg's state government recognised this at an early stage and provides systematic support for the initial and ongoing development of clusters, cluster initiatives and state-wide networks with regional, national and international visibility.

Natural resources are the basis for life. But their exploitation in value chains is always associated with environmental impacts. As the use of natural resources continues to intensify worldwide, not least as a result of demographic trends, boosting resource efficiency is becoming an increasingly high priority. Both to protect the environment, and because it makes economic sense.

Scarcity is the fundamental principle of economic activity – consequently, resource efficiency is just as easy on the wallet as it is on the environment.

Among the changes that are expected to affect humanity as a whole in the longer term, scarcity of basic commodities coupled with rising prices will have the greatest strategic relevance. Rising prices reflect the fact that demand for raw materials is growing faster than supply. Fluctuations resulting in significant price drops can only be expected in the short term. So it is not surprising that the upward curve in commodity markets is regarded primarily as a risk factor. At the same time, competitive opportunities are also appearing: New, eco-friendly, energy-saving and resource-efficient products and production technologies are giving entrepreneurs long-term competitive advantages.

The state's resource efficiency strategy provides a conceptual framework for all these developments. The objective is to make intelligent use of scarce raw materials and energy sources. It bundles and networks existing campaigns and acts as the basis for new initiatives for improving resource efficiency. The aim is to gradually decouple economic growth from resource and energy consumption while maintaining and expanding our already high share of the manufacturing industry, and to develop Baden-Württemberg into the lead market and lead supplier of resource-efficiency technologies.

Baden-Württemberg aims to become a key region for digital transformation. In 2017, the federal state set up the 'digital@bw' digitisation strategy, launching a large number of practical but innovative projects and campaigns. 'Economy 4.0' is the label describing the comprehensive digitisation and networking of the economy. It affects all industries and companies of all sizes. Consequently, we are guided by the concept of 'Economy 4.0' rather than just 'Industry 4.0'. All businesses are affected – from industrial enterprises, SMEs, trades, crafts and retail through to services, including the information, communication and data industry. The impact is universal. Digitisation is changing the way we live and work. Employers are facing major changes, just as much as employees.

Investing in the future – digitisation is the megatrend par excellence.

As a high-tech federal state with strong industrial sectors and highly qualified specialists, Baden-Württemberg is in an excellent starting position to make the most of a digital future. Here, approximately 492,000 small and medium-sized enterprises (SMEs) – responsible for creating about 62% of jobs and generating 58% of taxable sales in Baden-Württemberg's economy – have an important role to play. The state has also become a leader in Industry 4.0 systems due to its strengths in mechanical engineering and automation technology, as well as the supply of industrial information and communication systems.

In order to cope with these changes and take advantage of the associated opportunities, the state government has launched the 'Baden-Württemberg Economy 4.0 Initiative'. The participating associations, chambers and umbrella organisations aim to help businesses in the state, as well as their employees, to implement digitisation across all industries and make Germany's Southwest even more visible as a premium international location for the digitised economy.

Our mission and our contribution:

inspired by our regional heritage

CYBER VALLEY

Artificial intelligence finds a lynchpin. Partners in research and industry are exploring and developing intelligent systems.

As the development bank of the State of Baden-Württemberg, we support the state government's political objectives by becoming involved in areas of business where the market is not producing the desired results. Political and social objectives determine our actions.

The Bank's legal basis is the L-Bank Act of 11 November 1998. L-Bank's remit is to support the federal state in the fulfilment of its public duties, especially in terms of structural, economic and social policy. As an independent public-law institution, L-Bank is part of the indirect state administration of the State of Baden-Württemberg. Our business activities are based on our statutory public-service mandate and the concomitant restrictions on our business activities, the statutory liability mechanism provided by the state to safeguard the refinancing of our business activities, our prioritisation of the common good, and the resulting non-profit character of our business activities. Following the debate about public guarantee and maintenance obligations as they pertain to public-sector banks, in 2002 ground rules were drawn up for German development banks which expressly confirmed the guarantees provided by federal states (MoU II).

Our public-service mandate defines our activities.

L-Bank's duties, which determine the scope and content of our business activities, are definitively regulated by the L-Bank Act. To compensate for the fact that the federal state specifies L-Bank's duties and thus the Bank's risk profile, and to enable the Bank to obtain the liquidity required to issue loans, the State of Baden-Württemberg has assumed full liability for L-Bank's liabilities. The liability mechanism – a combination of public guarantee, maintenance obligation and statutory guarantee – complies with EU law on state aid, since the inherent advantages may only be exploited in those areas of activity agreed with the European Commission and precisely defined by L-Bank's principal, the State of Baden-Württemberg, in the regulations and statutes that govern L-Bank.

Secured funding is the basis for the performance of our duties.

L-Bank's business activities focus on the common good and are consequently of public utility. Our business, while complying with this non-profit status, is nevertheless conducted in accordance with commercial and economic principles. Our statutory development finance mandate is also based on strict competitive neutrality as an implementation principle. We must avoid crowding out private-sector offers and other market participants. Unless our statutory public-service mandate explicitly provides otherwise, L-Bank acts as a complementary service: development loans are generally granted through, or together with, other lending or finance institutions. Thus the borrower's business bank provides the initiative to involve L-Bank. This ensures that our funding activities remain competitively neutral.

The current situation in the financial sector is characterised by sweeping new regulatory requirements and a transformative process of structural change. As both development institution and bank, we are directly affected by these developments. In accordance with MoU II and the L-Bank Act, we constantly review all our development finance instruments and adapt them to the needs of the federal state and our development customers, as well as to changes in market circumstances.

OUR DEVELOPMENT FRAMEWORK

For L-Bank, as the federal state's development bank, Baden-Württemberg acts as the reference and starting point for everything we do. Exactly what this means for our programme-related development business is defined in our programme guidelines; the scope of application of any development business falling outside our programmes is constrained by parameters based on similar priorities. We derive our target markets from our statutory duties. Basically, we distinguish between four customer groups: private customers, companies (including housing companies and the self-employed), the public sector (federal, state and local government agencies, for example), as well as banks and other finance institutions. While the first three groups represent development customers, the group of 'banks and other finance institutions' is especially important. Since much of our development funding is distributed according to the 'borrower's bank' principle, customers in this group are effectively both sales and credit risk partners. On the one hand, they distribute our development finance to end-borrowers, and on the other, they assume the associated liabilities themselves.

Baden-Württemberg is both our reference and our focal point.

Our business is driven by customer diversity.

Wherever possible, we use defined exclusion criteria to ensure that we achieve our objectives. To carry out our development activities, we make use of all the banking instruments available under the L-Bank Act, such as loans, guarantees, warranties and other methods of risk assumption, as well as equity investments, grants and other forms of financial assistance. In our non-programme-related development business, we may combine all these instruments. In our programme-related development business, the programme specifications determine which instruments we use.

Exclusion criteria for non-programme-related development business

- → Violation of human rights
- → Dissemination of xenophobia and racism
- → Controversial business practices
- → Corruption, money laundering and bribery
- → Violation of fundamental or employment rights
- → Animal testing, animal trade
- → Controversial environmental behaviour
- → Pornography
- → Weapons and armaments
- → Addictive substances
- → Gambling

L-Bank's 4-pillar model

Thanks to our banking infrastructure, we are an important partner to the State of Baden-Württemberg.

L-BANK
A self-sustaining banking infrastructure

Development loans for **enterprise, housing and infrastructure finance**	Development through **equity investment**	Development through **business zone development**	Development through **financial assistance**

OUR DEVELOPMENT SERVICES

Development through loan finance

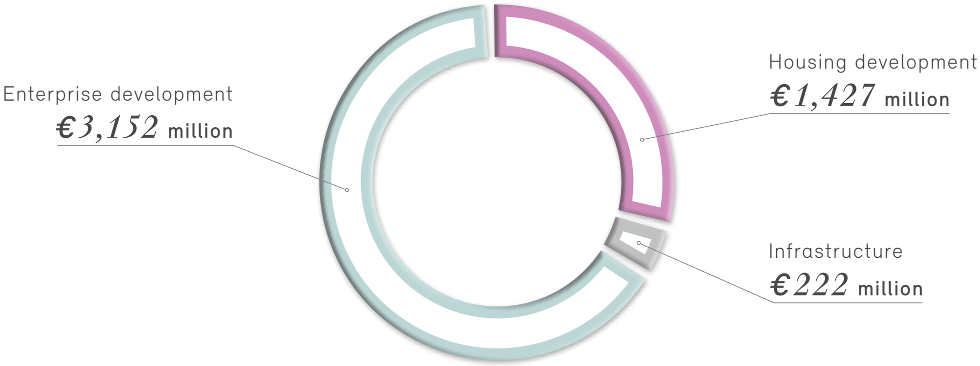
The L-Bank grants development loans in two major areas in particular: enterprise development and housing development – both within and outside the Bank's programme-based development activities – as well as infrastructure development. We attach great importance to integrating existing federal funding programmes and optimising them to meet our customers' needs. For refinancing, L-Bank makes use of funds from, among others, the KfW banking group, Landwirtschaftliche Rentenbank and the European Investment Bank. Through our close cooperation with development banks in Germany and the EU, we channel federal and EU funding to Baden-Württemberg. More than 20% of the funding offered nationwide by KfW flows into our federal state. Baden-Württemberg's development customers benefit from this in two ways: first, access to finance is easier because the whole process is more transparent, and second, finance is provided on particularly attractive terms because we can bundle the various funds.

Our collaborative partnerships add value.

In 2018, our lending activity continued to build on the success we have enjoyed in previous years: at EUR 4.6 billion, we surpassed the high level of lending-related core business in enterprise and housing development achieved in 2017 (EUR 4.5 billion).

Allocation of development loans

Total volume: EUR 4,801 million

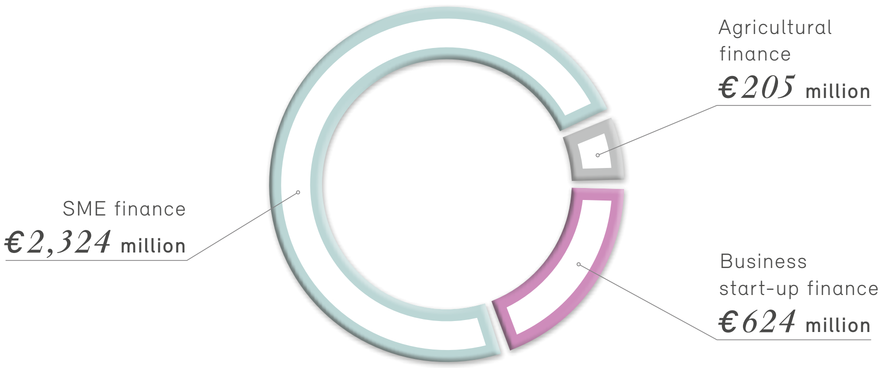


Enterprise development

New lending business for enterprise development purposes was brisk in 2018. Ongoing (very) low interest rates for corporate loans and attractive lending conditions resulted in a dramatic surge in the demand for credit. Our development loans help to ensure that SMEs continue to have no problem raising capital for upcoming investments. We made loans totalling more than EUR 3.15 billion (2017: EUR 3.06 billion) available to businesses. They helped to support around 8,600 companies, created some 11,800 new jobs and protected 343,000 existing jobs. At EUR 624 million, the volume of approvals for start-up development finance remained high (2017: EUR 660 million).

Proportional breakdown of enterprise development finance

Total volume: EUR 3,152 million

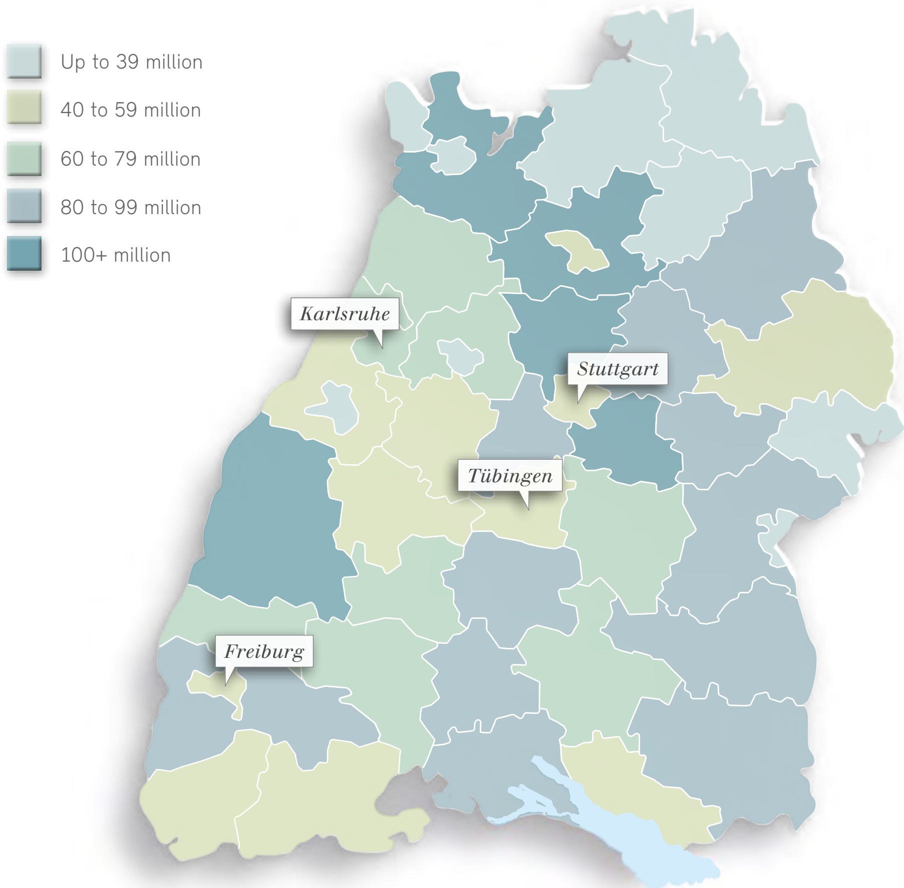


More than 2,750 fledgling companies benefited from our support. Finance for established SMEs rose to a total of EUR 2.32 billion (2017: EUR 2.26 billion). More than 5,100 companies benefited from this funding. At EUR 205 million, the level of agricultural development finance was significantly higher than in the previous year (2017: EUR 140 million).

Over 99% of all companies in the federal state have fewer than 250 employees and many of them – even larger companies – are only known to insiders. However, they enjoy a good reputation among their international customers. Around 400 so-called 'hidden champions' are currently based in Baden-Württemberg. And they are not confined to the state's cities – they are also creating highly skilled jobs in rural areas and exerting a profound influence on the regions in which they are based. Our equitable economic structure and well-balanced regional development are reflected in the regional distribution of our development funding.

Regional distribution of enterprise development finance

in euros

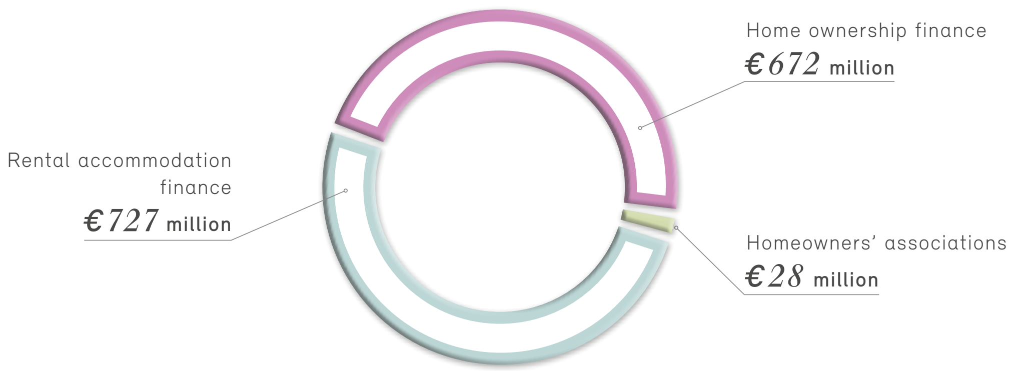


Housing development

L-Bank's housing development efforts focus on two main objectives: first, the creation of new, needs-based but at the same time affordable housing, and second, the renovation or modernisation of existing housing. Overall, we were able to maintain the volume of our development loans at EUR 1.43 billion (2017: EUR 1.46 billion).

Proportional breakdown of housing development finance

Total volume: EUR 1,427 million



Enterprise development through equity investment

Those hoping to tackle something fundamentally new – take advantage of the opportunities offered by digitisation, develop some other disruptive process or product innovation – need capital to support their entrepreneurial vision. In such cases, debt capital is only the second option of choice for start-ups and SMEs.

Private equity for all phases in a company's life cycle

Not only does this make equity capital more important, it also makes the task of offering sufficient equity capital in the future more challenging. Consequently, we have restructured L-Bank's funds. New commitments associated with L-Bank's SME and venture capital activities are made via the SME fund that was launched in spring 2016 and the venture capital fund launched in the following year. L-Bank deliberately holds a minority stake in both funds. The aim is to attract private investors as partners and use the invested funds to leverage the Bank's own resources. By taking this approach, we mobilise private capital while at the same time limiting our liability risk to the amounts we invest in the funds.

Our L-EA Mittelstandspartner SME fund focuses on companies in the industrial and IT sectors with the aim of accelerating their growth by tackling the major, capital-intensive challenges of digitisation and business globalisation through an active, partnership-based investment approach. The fund has far exceeded its original target volume of EUR 100 million, closing with a final subscription of EUR 200 million. With four investments and a total injection of (to date) EUR 55.5 million, the fund has made a good start. This fundraising success demonstrates what an attractive model this is: as initiator and anchor investor, L-Bank is attracting inward investment from beyond Baden-Württemberg's borders. Institutional venture partners from the financial and insurance sectors are also on board, as are family offices, pension funds and Bürgschaftsbank Baden-Württemberg. L-EA Mittelstandspartner is now one of the five largest funds in Germany, specialising in medium-sized growth companies involved in Industry 4.0 activities.

Our L-EA Venture Partners fund for young companies, launched in 2017, is transferring the template so successfully applied to SME finance to start-up funding. Again, L-Bank is the anchor investor, with the State of Baden-Württemberg also taking a significant interest. With the involvement of Bürgschaftsbank Baden-Württemberg, this sets the scene for acquisitions that will attract private venture partners. Thanks to this model, the public funds used for VC purposes can also be leveraged by institutional investors in Baden-Württemberg's finance industry, as well as private venture partners. The target volume for the final closing – scheduled for 2019 – is EUR 50-60 million. The fund focuses on high-tech start-ups with growth potential specialising in the IT, Internet, Industry 4.0 and digitisation sectors, and invests primarily in seed funding and the first major financing round. To date, two investments have been made and EUR 3.1 million invested.

But L-Bank is also an important partner elsewhere in the investment environment. Partly through direct involvement, partly through the involvement of companies in which we have a stake.

Enterprise development through business zone development

Business zone development is currently carried out by L-Bank's four real-estate subsidiaries. Our four subsidiaries – Karlsruhe Technology Park (TPK), Stuttgart Engineering Park (STEP), Tübingen-Reutlingen Technology Park (TTR) and Mannheim Technology Park (TPMA) – have created a wide range of buildings for technology-focused companies over the last few years. The technology parks are managed according to commercial and economic criteria. L-Bank has already invested around EUR 85 million in TTR, including the new building, since it was founded in 2001. Today, more than 50 companies work there, employing almost 1,500 people.

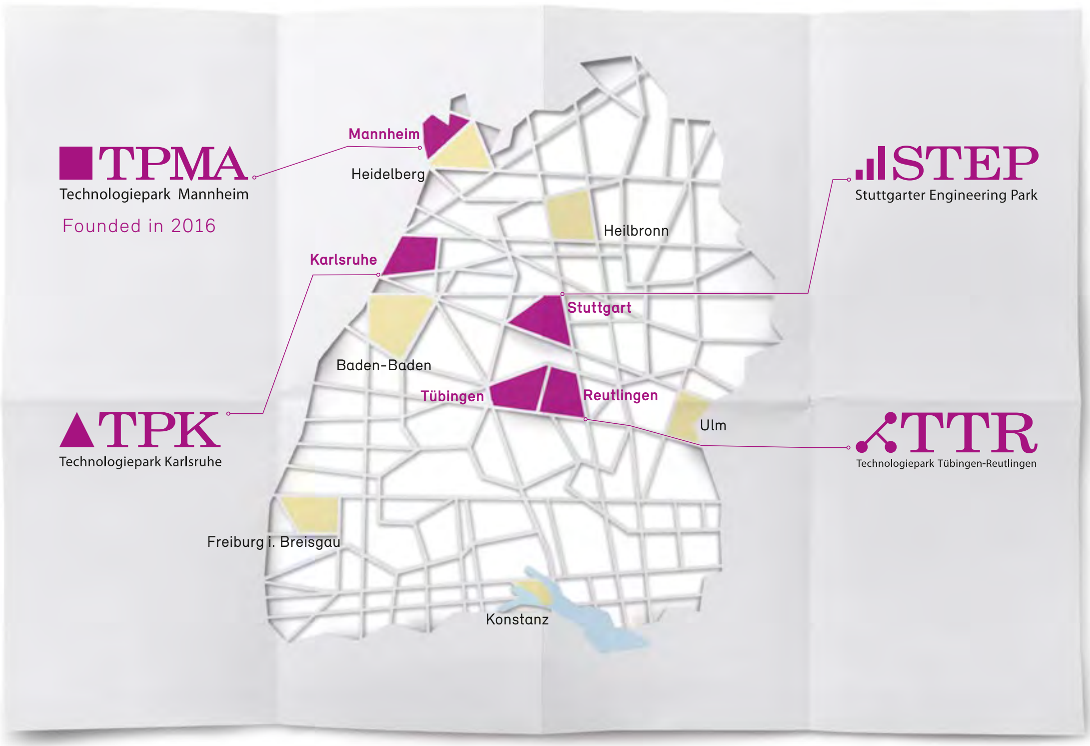
Developing existing and new technology parks

Once 'TÜ 02' has been completed, the park – which already has a 100% occupancy rate – will have a total floor area of 54,000 square metres. TTR focuses on nanotechnology, biotechnology and sensor technology.

Our technology parks offer an environment which makes it easier for the companies located there to concentrate on their corporate objectives. Because the technology parks are located so close to universities, they also support technology transfer from academia to industry.

To maintain the stable, ongoing development of our existing sites, we are planning further investments – as well as the simultaneous sale of existing properties, especially on our Tübingen site – in support of the state government's Cyber Valley project. Furthermore, as part of our strategy for further developing our technology parks, we are examining potential sites for new parks. Negotiations for the construction of another site in Freiburg are furthest advanced.

Overview of the Bank's technology parks



Development through financial assistance

When distributing financial assistance, L-Bank acts as the State of Baden-Wurttemberg's service provider and runs a large number of development programmes that are involved in making grants or subsidies. This means that we take partial or complete charge of administering the funding process on behalf of the state, in return for cost-covering remuneration. From advising on, reviewing and approving applications, right through to disbursing funds, we act in accordance with the state's wishes. L-Bank makes its infrastructure available for all the different variants, so that funding is distributed with minimal administrative overhead. Wherever possible, this means working closely with the federal state's administrative resources. Grant funding is not provided by L-Bank itself; it is made available to the Bank by the federal state or third parties for processing under the Bank's administrative contract.

L-Bank is an end-to-end provider of grant-related services.

Distribution of financial assistance

Total volume: EUR 2,720 million

In total, L-Bank is involved in more than 70 financial assistance programmes as the development services provider for state, federal and EU funding. The sharp rise in financial assistance to a total volume of EUR 2.72 billion (2017: EUR 2.12 billion) was driven by higher volumes of family allowances, school construction finance and hospital finance.

SELECTED DEVELOPMENT PRIORITIES

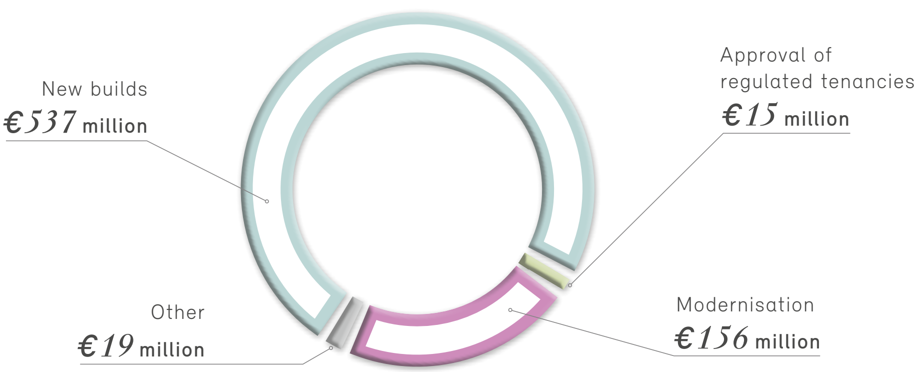
Social stability

Social harmony and equilibrium are core components of the social market economy. This is where housing development plays a very important role in supporting both home ownership and rental accommodation. New build or conversion, extension or age-appropriate upgrade – quality of life begins at home. Rents and real-estate prices in Baden-Württemberg have risen, in some cases significantly; these increases are not confined to urban areas. There is a scarcity of affordable housing throughout the state. To counteract this shortage, all businesses involved in housing construction must work together as partners. For this reason, the Ministry of Economic Affairs, Labour and housing set up the Baden-Württemberg Housing Alliance in July 2016. It comprises some 50 representatives of the housing and lending industries, leading municipal associations, nature conservation and environmental protection groups, and parliamentary groups represented in the State Parliament (Landtag). While proposals put to the state government by the Baden-Württemberg Housing Alliance have no binding force, the Housing Alliance has developed a number of key recommendations over the last two years which the state government has seen fit to implement in, for example, the 'Housing Construction BW 2018/2019' development programme. Launched in April 2018, the 'Housing Construction BW 2018/2019' development programme has made the state's housing development finance even more attractive. The state's housing development efforts are channelled through L-Bank's 'Eigentumsfinanzierung BW – Basisforderung' programme (Ownership Finance BW – Basic Development), whereby the State of Baden-Wurttemberg assists families with children to buy or acquire their own homes by granting long-term low-interest loans.

Quality of life begins at home.

Rental accommodation finance

Total volume: EUR 727 million



At the same time, the 'Housing Construction BW 2018/2019' development programme has created a standardised, state-wide instrument for financing rental accommodation that benefits lower-income households and thus households entitled to social housing. In addition to the construction of new social housing for rental, the programme funds alteration or extension projects that create new social accommodation for rental. The programme also assists with the modernisation of state-subsidised rental accommodation, and the constitution or extension of regulated tenancies in existing rental housing. And because social rent rebates have been made more flexible, subsidies can be precisely tailored to the varying circumstances in rural areas.

Family policy aims to support and financially assist families with children. Increasingly, the focus is on reconciling work and family life. Social support payments such as child benefits and family allowances expand the horizons of young families. During the especially formative first years, this financial security means parents can spend more time with their children. In 2018, L-Bank approved more than 147,000 family allowance applications on behalf of the state (2017: 142,453) and authorised family allowance payments totalling EUR 993 million (2017: EUR 944 million). One non-monetary effect is particularly noteworthy: the increased paternity quota, which reached 42.7% compared with 40.6% in the previous year. Last year, more than 46,000 fathers decided to take parental leave with their children. The various types of family allowance require high levels of information and advice. More than 315,000 telephone consultations conducted by our Family Support Service Centre last year underscore our efficiency in this respect.

Aid payments strengthen families.

Long-term competitiveness

L-Bank's remit is to strengthen the competitive and innovative strength of Baden-Württemberg as a business location. For this purpose, we provide start-up finance and development finance to small and medium-sized enterprises, carefully tailored to the specific projects for which the funding is required – preserving successful structures while at the same time paving the way to a successful future. Start-up finance must fulfil both purposes. Start-up entrepreneurs and corporate successors both need the same thing: to develop or further develop their own businesses.

With respect to succession financing, the initial focus is on a smooth intergenerational transition – a vital prerequisite for preserving the substance of the existing business, as well as the valuable networks and links with customers and suppliers that are so important for the flexibility of Baden-Württemberg's economy. In recent years, we have paid a great deal

Renewing business structures, supporting inventive energy.

of attention to this area: more than one-third of the funding from our lending programmes for start-ups is taken up by corporate successors. Since 2015, L-Bank lending programmes have financed more than 5,000 corporate takeovers, representing a lending volume of EUR 1.2 billion. The challenge remains high. This is primarily due to demographic trends. Over the next few years, entrepreneurs in the baby boomer generation will reach retirement age. The proportion of older business owners in Baden-Württemberg is comparatively high. Around 41% of them are 55 years old or more. By comparison, the cohort of 25 to 45-year-olds is less numerous; furthermore, the competition for this target age group is high: large companies, SMEs, research institutions and state agencies all offer attractive career opportunities. At the same time, the automatic assumptions that governed family businesses in bygone days – that the next generation would take over the business as a matter of course – can no longer be taken for granted.

Furthermore, it is essential to constantly review business structures and keep the dual goal of innovative, entrepreneurial dynamism firmly in mind. Here, the key factors are ideas, entrepreneurial personalities and suitably adapted financial instruments. Innovation and business start-ups are two sides of the same coin. In many cases, a well-developed innovation dynamic leads to a high start-up dynamic – in Baden-Württemberg in particular, the potential for innovative thinking often evolves in large companies and medium-sized businesses, but without agile start-ups, many opportunities remain untapped. This is why business start-ups are an important engine of acceleration and structural renewal for the innovation system as a whole.

Baden-Württemberg's financing ecosystem covers a very wide variety of needs – differing levels of finance, varying security and risk situations, widely varied purposes and projects. This is how we respond to the fact that in Baden-Württemberg, new businesses are not just founded out of necessity, nor are existing businesses taken over simply due to a lack of alternatives. Only carefully tailored development programmes provide effective support to those with a passionate desire to set up a new business.

The whole is more than the sum of its parts – and if the instruments are properly coordinated, this also applies to the financing ecosystem.

Our lending programmes – with or without mandatory guarantees – are having a broad impact. Our 'Start Finance 80' programme combines a low-interest loan with a compulsory guarantee, and is intended for smaller start-ups. Last year, we were able to support almost 900 companies with loans totalling just under EUR 58 million. Our 'Start-up Finance' programme is suitable for larger commitments. If necessary, it can also be combined with a guarantee.

With our ‘MikroCrowd’ programme, launched jointly with the Ministry of Economic Affairs in April 2017, we were the first development bank to incorporate the relatively recent concept of crowdfunding into a development programme. We started with a question: How could we best generate added value for tried-and-trusted development finance concepts using digital financing techniques? The answer lay in linking together new and established forms of start-up finance. By combining crowdfunding with a development loan, we reap the benefits of both systems: crowd funders take care of early market testing and, in addition, boost the business concept by promoting it over social media. Meanwhile, the direct loan from L-Bank provides the necessary reliability and flexibility. MikroCrowd is our response to trends such as serial and creative start-ups; at the same time, it creates opportunities for integrating immigrants more smoothly into the labour market. At the end of the lending term, we automatically refer the business to commercial banks for follow-up financing, with the aim of ensuring that all further growth takes place with proper commercial banking support. Effectively, we have built a development finance bridge between the new world of crowdfunding and the well-established ‘borrower’s bank’ principle. The demand speaks for itself: the mikrocrowd.de platform alone was visited more than 370,000 times during its first year. In 2018, L-Bank received more than 435 practical financing applications for the ‘MikroCrowd’ programme. This response has met with nationwide interest – other state development agencies have launched similar products on the market over the past year.

We have also set a new benchmark in the venture capital arena. Through our investment in First Momentum Ventures, the student venture capital fund, we hope to supplement existing options with an instrument that aims to assist high-tech university start-ups by providing investments of between EUR 25,000 and EUR 100,000.

Support 4.0 – with the technology parks, L-Bank goes the extra mile.

But we do not just want to support individual entrepreneurs or individual businesses, no matter how innovative. As we seek to support the innovative capacity of the economy as a whole, we are becoming increasingly interested in the infrastructural framework required for innovation. This includes our technology parks, which we are using to supercharge the creation of synergistic networks in support of the federal state’s cluster policy. Our investments in existing technology parks are helping to boost the growth of emerging technology companies. In Tübingen, for example, we celebrated the topping-out ceremony for the new multifunctional TÜ 02 building in our Tübingen-Reutlingen (TTR) Technology Park just eight months after construction began, as part of the state government’s Cyber Valley project.

By deliberately locating technology parks in university towns, we hope to systematically encourage collaborative exchange and sharing between researchers and businesses. In addition to our MMT Campus in Mannheim, which is currently under construction, negotiations for the construction of another site in Freiburg are the furthest advanced.

Protecting the environment

Resource efficiency and energy efficiency are key concepts in L-Bank's development philosophy. We are helping to optimise consumption of resources and energy by offering high-volume financing programmes and targeted grants and subsidies. In order to achieve the targets specified in the Baden-Württemberg Climate Protection Act, the federal state is aiming to halve its energy consumption and cover 80% of its remaining energy requirements from renewable energy sources. While the year-on-year proliferation of photovoltaic systems is going well, integrating them with the grid is proving problematic. Finance for stationary, grid-connected battery storage systems in conjunction with a newly installed photovoltaic system will reduce the load on power distribution grids, and hence increase the efficiency of the power supply chain. In 2018, we were able to fund around 1,800 grid-connected battery storage units with a budget in excess of EUR 3 million.

Our housing finance addresses energy use both directly and indirectly through modernisation loans and specific programmes such as 'Supplementary Finance – Energy Efficiency', while programmes such as 'Living for the Future' promote investments in, for example, solar thermal systems, heat pumps, and combined heat and power systems for households, thus ideally supplementing BAFA heating subsidies with renewable energy solutions.

Optimising the use of resources and energy.

With respect to enterprise development, our family of programmes for financing resource efficiency offers a broad range of funding options. We offer loans to SMEs that invest in energy-efficient machinery and equipment, use resources more efficiently by making appropriate investments, conserve materials, build or renovate buildings in energy-efficient ways, or invest in energy-saving building technology. Since February 2018, our 'Resource Efficiency Combined Loan' has also been available to non-SMEs. For example, larger medium-sized companies and enterprises (non-SMEs) can also take out a Resource Efficiency Combined Loan of up to EUR 25 million for refurbishing company buildings.

At EUR 629 million, we once again achieved a fantastic result (2017: EUR 643 million). In terms of volume, our 'Resource Efficiency Finance' programme continues to be our largest development programme, providing powerful support for the State of Baden-Wurttemberg's ambitious climate goals. Since we first introduced energy efficiency finance in 2012, we have been able to provide SMEs with loans totalling EUR 4.22 billion.

Our 'New Energy – Energy from the Countryside' and 'New Energy – Wind Power' programmes also made a significant contribution to environmental protection and can be used, among other things, to finance the generation of bioenergy from renewable raw materials and the construction of photovoltaic or wind power plants. Our 'Agri-Food Industry – Environmental and Consumer Protection' programme focuses on supporting investments for improving energy efficiency and reducing emissions.

It also provides favourable terms for financing investment projects for improving consumer protection. By distributing a total funding volume of EUR 134 million, these programmes significantly exceeded the previous year's result (2017: EUR 73 million).

Targeted grants or subsidies often bring about immediate changes in behaviour – especially when it comes to mobility. With the 'State Initiative III: E-mobility Market Growth BW', the Ministry of Transport is seeking to stimulate take-up of electric mobility. When purchasing electric cargo-bikes, companies, public-sector organisations, freelancers, non-profit organisations and municipalities can obtain grants subsidising 30% of the eligible procurement costs (up to a maximum of EUR 3,000). Baden-Württemberg's Ministry of Transport commissioned L-Bank to administer this development finance programme. In 2018, we helped to finance 885 cargo-bikes, providing further support for an eco-friendly transport system.

Exploiting competitive opportunities – tracking the digitisation megatrend

In recent years, companies in Baden-Württemberg have strengthened their competitive position. In 2018, businesses showed that once again, they were actively addressing market gaps identified in domestic and international markets, and exploiting the resulting opportunities by making appropriate investments. L-Bank responded to this demand by providing carefully tailored offerings in the form of differentiated investment loans. The Bank succeeded in maintaining the high level of development finance achieved in the previous year, with a lending volume of EUR 2.32 billion (2017: EUR 2.26 billion).

Encouraging investment and digitisation.

The various aspects of digitisation are becoming especially important. As a business location, if Baden-Württemberg wishes to continue playing in the global Champions League, the state must take an active part in influencing revolutionary or disruptive developments. Here it is important to consider the relative differences between small and medium-sized enterprises. The spectrum ranges from 'digital natives' – who deal with digital technologies as a matter of course – to companies that have already engaged with digitisation, through to digital newcomers who are often somewhat sceptical about the promises of digitisation. With our newly launched 'Digitisation Premium' programme, we have succeeded in addressing all of them. Not least because the 'Digitisation Premium' provides a wide range of development finance options – the programme supports investment in the digitisation of production and processes (such as 3D printing, mobile operating devices for production management, e-commerce, e-procurement), the digitisation of products and services (such as digital platforms, remote maintenance, application of digital standards) and the implementation of digitisation strategies and concepts.

The Digitisation Premium bundles the financial incentives of KfW's ERP Digitisation and Innovation Loan with state funding from the Ministry of Economic Affairs, Labour and Housing. By combining a reduced-interest loan with an attractive repayment subsidy, it is also possible to support companies that have limited equity available for financing digitisation initiatives. This has removed a significant barrier to investment in digitisation projects by small and medium-sized enterprises.

Last year, more than 900 companies took advantage of this financing instrument, showing that the structure of the Digitisation Premium meets the needs of target businesses.

How we work: close to our customers, aware of our responsibilities

Creating added value through digitisation at L-Bank

Access channels are changing; new sales and service platforms enable businesses to respond faster and more flexibly to customers' wishes. To further improve the quality of our services and take account of changing customer requirements, we have systematically exploited the possibilities and opportunities offered by digitisation and steadily opened up to new market standards for user experience and administrative processes. Digitisation efforts are given a high priority across all our development finance activities. Customer interfaces and processes are digitised wherever it makes business sense to do so and sends a clear signal concerning our business policies. At the same time, we factor in the considerations and needs of our owner, as well as those of our business and joint-venture partners, on whose cooperation the efficiency of the package as a whole so often depends.

The digital transformation of the federal state's state administrative functions is making steady progress; e-files and e-government are key issues in the modernisation of public administration. An important component is the development of a joint service portal for all state agencies and municipalities. By networking the federal state's e-government services with those of the municipalities, the service-bw.de portal is to be transformed into the main interface between citizens and administration, hence into a comprehensive e-government platform that will provide unrestricted access to as many of the state's administrative services as possible. We are supporting these digitisation efforts by the state and jointly leveraging IT-related synergies. For example, in consultation with Baden-Wurttemberg's Ministry of Social Affairs, we are currently implementing an online application process for family allowances. The key to further development of the already partially automated process, on which the Bank and the Ministry of the Interior are working together as partners, is the integration of service-bw.de's service account into the application process.

This makes it easier for young parents to submit applications, reduces the flood of paperwork, and also makes it easier for us and the municipalities to process applications. In the future, the service-bw.de portal will also be used for other administrative services provided by L-Bank. By taking these steps, we hope to contribute to the portal's success and increase awareness and utilisation of the portal. But we are also optimising potential efficiencies in other areas of our administrative processes through digitisation. Last year, for example, the disbursement procedure in the Bank's brokering business with central institutions was transferred to web-service technology, and the in-house process was also prepared for automation.

As a pilot partner among Germany's state development banks, L-Bank, together with housing development programmes offered via borrowers' banks, was connected to KfW's digital sales and service platform (BDO) back in the second half of 2016. Since then, we have been working successfully – meaning: fast and efficiently – with KfW and central banks LBBW and DZ Bank, jointly processing some 12,700 development applications totalling around EUR 609 million through an entirely web-based system. Eligibility for funding is checked automatically and a binding finance agreement is drawn up immediately. The degree of automation has reached 99%. Bank advisers and customers alike benefit from the system's exceptional transparency and speed. In 2018, we initiated the next step: once L-Bank's brokering products for housing development have been incorporated into KfW's development finance portal in 2019, it will be possible for all borrowers' banks to obtain digital funding approval.

Target-market focus makes it easier to access relevant information.

The more precisely and swiftly we can provide our partners with information, the better they can serve their end-customers. More than 900 financing partners are now actively using the expert portal launched by L-Bank in 2017 as part of the initial development phase. This expert platform provides comprehensive answers to questions about our various development finance offers. Since last year, access to the relevant information has become even easier: separate information channels are now available for the Bank's various target markets – financing partners, financing intermediaries, state housing development agencies and multipliers.

Our video advisory days have opened a new chapter in our customer support. For many years, L-Bank's financing advisory days have been very successful in explaining to business start-ups, fledgling companies and SMEs how to make best use of our development programmes. Last year, we once again organised more than 290 advisory sessions at Chambers of Commerce throughout Baden-Württemberg. Following a pilot project in 2017, we launched a new service in early May 2018 for customers wishing to consult us online. Experts from Bürgschaftsbank and L-Bank are connected to the Chamber by a videoconferencing system. This means that customers' questions about business start-ups, self-employment and corporate finance can be answered immediately. In the course of the year, we teamed up with seven Chambers of Commerce to offer this service. We have already agreed to extend the service to other Chambers of Commerce, and are planning to develop new areas of application, especially in housing construction.

In 2018, we started making arrangements to collaborate with an online intermediary's portal. Brokered commercial and agricultural development loans from L-Bank can be incorporated into attractive financing solutions. Financing partners submit a bid during the tendering process. Successful mediation results in a business transaction between the financing partner and the business concerned. This gives companies even greater transparency and reinforces the well-established 'borrower's bank' principle.

The economically sustainable orientation of L-Bank's business activities is supported by ecologically and socially sustainable action. According to the state constitution, all public institutions in Baden-Württemberg are responsible for conserving life's natural resources for future generations. The key concerns here are environmental and climate protection. For companies in which the state has a stake, the relevant responsibilities are embedded in the State of Baden-Württemberg's sustainability strategy: economic, ecological and social matters are given equal weighting, based on an end-to-end interpretation of sustainability. This attitude to sustainability governs our processes, our products, and everything we do.

DEVELOPMENT THROUGH LOAN FINANCE: 1 JANUARY TO 31 DECEMBER 2018

DEVELOPMENT FINANCE ACROSS ALL LINES OF BUSINESS	VOLUME OF COMMITMENTS	COMMITMENTS
	4,800,668,256.81	**19,182**

	VOLUME OF COMMITMENTS	COMMITMENTS	RESIDENTIAL UNITS*
HOUSING DEVELOPMENT	**1,426,690,388.16**	**9,333**	**16,812**
Home ownership assistance	**672,104,045.98**	**8,239**	**6,825**
Home Ownership Finance – BW including finance for growing families – Structured loans (state housing development)	322,910,307.32	2,190	1,564
Top-up and miscellaneous loans	103,591,200.00	904	
Living with Children	231,570,500.00	4,738	4,738
Living for the Future	11,762,938.66	371	487
Other programmes	2,269,100.00	36	36
Rental accommodation assistance	**726,928,721.02**	**796**	**6,572**
Rental Accommodation Finance – BW – New builds – MW15/MW25 (state housing development)	245,907,600.00	133	1,758
Rental Accommodation Finance – BW – Approval of regulated tenancies (state housing development)	14,603,600.00	266	461
Rental Accommodation Finance – BW – Modernisation (state housing development)	41,217,800.00	70	1,045
Rental Accommodation Finance – L-Bank – New builds	179,190,600.00	121	1,231
Rental Accommodation Finance – L-Bank – Modernisation	80,701,169.44	100	2,077
Top-up loans (new builds/modernisation)	165,307,951.58	106	
Support for homeowners' associations (state housing development)	**27,657,621.16**	**298**	**3,415**

* The total includes multiple counting, as the various home ownership finance programmes may be combined in certain cases.

	VOLUME OF COMMITMENTS	COMMITMENTS
INFRASTRUCTURE DEVELOPMENT	**221,620,150.00**	**96**
Municipal investment loan, direct	79,845,150.00	90
New Energy – Community wind farms	11,775,000.00	2
Other financial instruments	130,000,000.00	4

	VOLUME OF COMMITMENTS	COMMITMENTS	COMPANIES
ENTERPRISE DEVELOPMENT	**3,152,357,718.65**	**9,753**	**8,573**
Business start-up finance	**623,592,592.41**	**3,049**	**2,764**
Start Finance 80	57,574,428.67	894	892
Start-Up Finance	565,418,163.74	2,152	1,869
Pre-Seed Finance Grant	600,000.00	3	3
SME finance	**2,324,118,357.24**	**5,937**	**5,119**
Growth Finance	361,792,224.01	1,538	1,383
Local Transit Finance	18,915,500.00	429	168
Tourism Finance	80,000.00	1	1
Liquidity loans	78,906,750.00	348	338
Investment Finance	628,421,393.05	949	754
Rural Area Development programme	43,294,602.00	304	294
Resource Efficiency Finance	628,812,335.03	732	666
Direct loans and syndicated finance	149,000,000.00	22	19
Surety and guarantee programme/ Sureties for refinancings	17,232,895.00	11	9
Loans to associated companies	8,050,000.00	3	2
Refinancing of associated companies	5,325,000.00	10	9
Innovation Finance	352,083,005.00	622	510
CPD Finance	3,542,000.00	29	27
Digitisation Premium	28,535,553.15	924	924
Microfinance	127,100.00	15	15
Agricultural development finance	**204,646,769.00**	**767**	**690**
Agricultural Liquidity Assurance BW	6,518,000.00	85	84
Agricultural Growth	50,805,959.00	338	311
Loans for environmental and consumer protection, sustainability, new forms of energy	134,065,050.00	300	253
Working capital loans – Growth in the agri-food industry	13,257,760.00	44	42

CORPORATE GOVERNANCE REPORT 2018

L-Bank, in its capacity as the State of Baden-Württemberg's development bank, has a statutory remit to support the federal state in the performance of its public duties and, in doing so, to implement and manage various development initiatives. A sound and responsible approach to corporate governance is a natural component of the Bank's approach to these non-commercial activities. L-Bank has incorporated the Public Corporate Governance Code of the State of Baden-Württemberg into the Bank's standard operating procedures by resolutions of both the Board of Management and Supervisory Board, and observes all the prescriptions of the latest valid version of the Code. This Corporate Governance Report covers fiscal year 2018; the following declaration applies in full as at the reporting date, 31 December 2018.

DECLARATION OF COMPLIANCE

The Board of Management and Supervisory Board of L-Bank declare that:

We have observed, and continue to observe, the recommendations of the Public Corporate Governance Code of the State of Baden-Württemberg (PCGK BW) to the extent that such recommendations apply to L-Bank in its capacity as a public-law institution.

PROPORTION OF WOMEN ON THE BOARD OF MANAGEMENT AND SUPERVISORY BOARD, AND IN EXECUTIVE MANAGEMENT POSITIONS

As at 31 December 2018, one woman was represented on the four-strong Board of Management. As at the reporting date, five of the 18 members of the Supervisory Board (27.8%) and 74 of the 211 employees in executive management positions (35.1%) were women.

REMUNERATION PAID TO MEMBERS OF THE BOARD OF MANAGEMENT AND SUPERVISORY BOARD

REMUNERATION PAID TO MEMBERS OF THE BOARD OF MANAGEMENT FOR 2018 in EURk

Name	Membership period	Fixed remuneration	Other non-cash benefits	Payments from third parties in relation to Board of Management activities	Total
Dr. Axel Nawrath Chair	01.01.–31.12.	682	25	8	714
Dr. Ulrich Theileis Vice-Chair	01.01.–31.12.	525	28	21	574
Dr. Iris Reinelt	01.01.–31.12.	425	31	9	465
Johannes Heinloth	01.01.–31.12.	425	27	5	457
Total		**2,057**	**112**	**42**	**2,210**

An occupational pension scheme is in place for members of the Board of Management based on the rules applicable to L-Bank employees.

REMUNERATION PAID TO MEMBERS OF THE SUPERVISORY BOARD FOR 2018 in EURk

Name	Membership period	Membership of Supervisory Board	Membership of committees	Attendance fees	Total
Edith Sitzmann[1] Chair	01.01.–31.12.	9.0	3.9	1.7	14.6
Thomas Strobl[1] 1st Vice-Chair	01.01.–31.12.	7.5	3.9	1.4	12.8
Dr. Nicole Hoffmeister-Kraut[1] 2nd Vice-Chair	01.01.–31.12.	7.5	2.4	0.9	10.8
Dr. Jürgen Bufka	01.01.–31.12.	6.0	–	0.5	6.5
Dr. Maximilian Dietzsch-Doertenbach	01.01.–31.12.	6.0	3.9	2.1	12.0
Martin Gross	01.01.–31.12.	6.0	–	0.6	6.6
Roger Kehle	01.01.–31.12.	6.0	–	0.5	6.5
Gabriele Kellermann	01.01.–31.12.	6.0	3.9	1.4	11.3
Dr. Peter Kulitz	01.01.–30.11.	5.5	2.2	0.9	8.6
Andrea Lindlohr	01.01.–31.12.	6.0	–	0.5	6.5
Klaus-Peter Murawski[1]	01.01.–31.08.	4.0	1.6	–	5.6
Rainer Reichhold	01.12.–31.12.[2]	0.5	–	0.2	0.7
Prof. Dr. Wolfgang Reinhart	01.01.–31.12.	6.0	–	0.6	6.6
Dr. Dieter Salomon	01.01.–30.11.	5.5	–	–	5.5
Dr. Florian Stegmann[1]	01.12.–31.12.[2]	0.5	0.3	0.2	1.0
Prof. Dr. Dr. h. c. Harald Unkelbach	01.12.–31.12.	0.5	0.2	–	0.7
Franz Untersteller[1]	01.01.–31.12.	6.0	2.4	0.9	9.3
Joachim Walter	01.12.–31.12.[2]	0.5	–	0.2	0.7
Joachim Wohlfeil	01.01.–30.11.	5.5	–	0.5	6.0
Clemens Meister	01.01.–31.12.	6.0	–	0.8	6.8
Barbara Bender-Wieland	01.01.–31.12.	6.0	–	0.5	6.5
Thomas Dörflinger	01.01.–31.12.	6.0	–	0.8	6.8
Total		112.5	24.7	14.6	151.8

1) Subject to a duty of surrender to the State of Baden-Württemberg.

2) As a regular member. Previously held a membership as an alternate member.

MANAGEMENT REPORT – REPORT OF THE BOARD OF L-BANK FOR FISCAL YEAR 2018

BACKGROUND

Landeskreditbank Baden-Württemberg – Förderbank – (L-Bank) is the development bank of the German federal state of Baden-Württemberg. Its business activities are governed by its statutory remit, namely to support the state government of Baden-Württemberg in the fulfilment of its public duties, especially in terms of structural, economic and social policy, by implementing development programmes that comply with European Union (EU) regulations governing state aid.

The Bank has its head office in Karlsruhe, with a branch office in Stuttgart. L-Bank is wholly owned by the State of Baden-Württemberg and, as a public-law institution, is subject to the supervision of the federal state government. In the context of the Single Supervisory Mechanism (SSM) introduced within the European Union, L-Bank is also one of the credit institutions that comes under the direct supervision of the European Central Bank (ECB).

L-Bank's development goals and operational targets – such as the Bank's target customers and development priorities – are determined by the Bank's owner in accordance with the provisions of the L-Bank Act, relevant political priorities and, with respect to activities relating to development programmes, the specific terms of each individual programme. Consequently, L-Bank's main business activities are largely influenced by external factors and can therefore only be controlled by the Bank to a limited extent.

ECONOMIC REPORT

BASIC PARAMETERS

In 2018, Germany's economic boom continued, as it has done over the past nine years. However, the 1.4% increase in real gross domestic product (GDP) – as estimated by the Federal Statistical Office – represents a cyclical downturn compared with the two previous years (2.2% respectively). Although economic development was robust during the first half of 2018, the third quarter saw a decline in GDP compared with the preceding quarter for the first time in more than three years, in part due to production difficulties in the automotive industry. The short-term recovery expected in the final (year-end) quarter failed to materialise; GDP remained at the previous quarter's level. From an economic perspective, the year was strongly characterised by growing geopolitical risks. Meanwhile, the labour markets continued to show positive development. According to the Federal Employment Agency, the average unemployment quota in 2018 was 5.2% – the lowest level since reunification. The inflation rate rose slightly year-on-year, mainly due to higher energy costs; at 1.9%, it was only slightly below the 2% target set by the ECB.

Because Baden-Württemberg's economy is primarily focused on exports, it is more broadly exposed to a wide variety of geopolitical risks than Germany's other federal states. In particular, the protectionist measures taken by the USA, the political uncertainties surrounding the UK's forthcoming Brexit, and the budget-related conflict between the EU and Italy are all factors that are having a negative impact. Consequently, external demand over the past year was less dynamic than in 2017. A further significant decline in exports of goods to the United Kingdom was narrowly offset by higher demand from the USA, China and the Netherlands. Despite these somewhat unfavourable conditions, Baden-Württemberg's manufacturing industry once again succeeded in improving revenues, primarily due to dynamic growth in the first half of the year. However, the growth in demand for industrial products manufactured in the federal state lost momentum over the course of the year. Despite this, the historic boom in Baden-Württemberg's construction industry continued apace, driven by the ongoing demand for residential accommodation coupled with low interest rates. Overall, Baden-Württemberg's economy grew by between 1.6% and 1.8% (according to state government estimates); while this was well below the previous year's figure, it was slightly above the figure for nationwide growth. With an average unemployment rate of 3.2% (December 2018: 3.0%, source: Federal Employment Agency), the federal state is currently approaching the threshold of full employment. In view of the labour market situation and a level of prosperity that has persisted for many years, capacity bottlenecks and a shortage of skilled workers are increasingly becoming the limiting factors for businesses in the federal state.

BUSINESS PERFORMANCE

As before, L-Bank's business operations in 2018 were affected by persistently low market interest rates. Thanks to the robust investment activity of Baden-Württemberg's small and medium-sized enterprises and the consistently high demand for housing finance, the Bank distributed a high volume of funding. During the second half of the year, the demand for development finance showed a clear trend towards consolidation.

The Bank's development activities in the year under review focused on SMEs, start-ups, and housing development initiatives. New business figures show increases in agricultural development funding, SME finance and state housing assistance in particular. New business in other housing development segments and in infrastructure development declined.

Enterprise development

To achieve sustainable economic growth in Baden-Württemberg, and to safeguard jobs in the long term, L-Bank works closely with commercial banks to support start-ups, small and medium-sized enterprises (SMEs) and agricultural firms. This support is provided mainly in the form of low-interest loans and grants, as well as the systematic assumption of risks. In the year under review, persistently good conditions in the economy as a whole and increased demand for individual development programmes resulted in a new record for the volume of new enterprise development business. Compared to the previous year, the volume of new business rose in line with expectations, increasing by 6.2% to a total of EUR 3,568.0 million (2017: EUR 3,359.6 million).

As in the previous year, L-Bank supported start-ups and fledgling companies with the 'Start-up Financing' programme in particular; this helps them to achieve commercial autonomy, but also to expand and acquire existing companies. The volume of new business came to EUR 623.6 million (2017: EUR 659.7 million).

Financing commitments for SME development rose by EUR 66.9 million to a total of EUR 2,324.1 million (2017: EUR 2,257.2 million). The volume of new business in the Bank's 'Investment Finance' programme also showed very positive development. The total volume of commitments increased significantly to EUR 628.4 million (2017: EUR 519.3 million). The programme supports business investments in rural areas in Baden-Württemberg. In the Bank's 'Growth Finance' programme, which provides funding for corporate investments of all kinds, the volume of lending commitments came to EUR 361.8 million (2017: EUR 538.6 million). There was a slight decline in new business figures for the Bank's 'Resource Efficiency Finance' programmes. L-Bank specifically promotes investments that result in the more efficient use of energy and materials in corporate value creation. The volume of new business totalled EUR 628.8 million (2017: EUR 642.9 million). Commitments under the 'Liquidity Facility' programme rose by 15.1% to EUR 78.9 million (2017: EUR 68.5 million). Once again, the Bank's 'Innovation Finance' development programme saw exceptionally high demand. At EUR 352.1 million, financing commitments were 70.8% up on the previous year (2017: EUR 206.2 million). Under the 'Innovation Finance' programme, small and medium-sized enterprises receive low-interest loans and grants for developing new products and production processes. The development programme expired in mid-2018.

The volume of new agricultural development business rose by 45.9% to EUR 204.6 million (2017: EUR 140.2 million). This growth was driven primarily by the 'Agri-Food Industry – Environmental and Consumer Protection' programme, which finances investments for increasing energy efficiency and reducing emissions, as well as investment projects for improving consumer protection. New business in this programme rose strongly to EUR 134.1 million (2017: EUR 72.6 million). The 'Agriculture – Growth' programme funds agricultural investments that reduce production costs or help to improve production and working conditions. During the year, finance totalling EUR 50.8 million (2017: EUR 52.0 million) was approved under the programme.

Housing development

L-Bank uses low-interest loans and subsidies to assist private individuals and businesses in Baden-Württemberg with the construction, acquisition and modernisation of both rental and owner-occupied housing. The Bank also helps to facilitate physical access to existing properties. Contrary to expectations, the overall volume of new business fell slightly to EUR 1,426.7 million (2017: EUR 1,455.8 million).

As part of its statutory mandate, L-Bank is committed to the creation and modernisation of affordable rental housing. The federal state's housing assistance programme showed very pleasing growth, with the volume of new business rising by EUR 109.1 million to EUR 301.7 million (2017: EUR 192.6 million). In the year under review, the programme's funding conditions were optimised and made more flexible. Costs eligible for funding under the new build development programme were increased. The Bank also separated out development funding for real-estate costs and construction costs. As a result, the demand for finance for new construction projects rose from EUR 135.6 million to EUR 245.9 million. At EUR 41.2 million, funding for modernisation projects remained at the same level as in the previous year (2017: EUR 41.6 million). Commitments under the Bank's own development programme supplementing the federal state's rental social housing programme fell to EUR 425.2 million (2017: EUR 559.6 million). The volume of new business across all rental housing development programmes totalled EUR 726.9 million (2017: EUR 752.2 million) and was thus in line with expectations.

Financing commitments under home ownership development programmes rose from EUR 632.5 million to EUR 672.1 million. As expected, the federal state's housing assistance programmes continued to show positive development in line with the previous year. At EUR 322.9 million, the volume of new business was 29.2% up on the previous year (2017: EUR 249.9 million). The main reasons for this increase include the raised income thresholds and more favourable terms and conditions, causing a discernible rise in demand. The volume of approvals under the 'Living with Children' development programme declined to EUR 231.6 million (2017: EUR 265.5 million), thus below forecasts suggesting that new business would increase slightly. The reasons for this were less favourable terms and conditions and fewer options for combining the programme with other development programmes. Similarly, the volume of lending under the 'Living for the Future: Renewable Energies' programme also declined. The programme provides finance for installing heating and hot-water systems that use renewable energy (EUR 11.8 million; 2017: EUR 25.4 million).

Assistance for homeowners' associations, in the form of finance for energy-efficient renovation projects or modernisation of residential buildings to improve physical access, also saw a decline in the volume of new business to EUR 27.7 million (2017: EUR 46.6 million). While the number of applications remained more or less unchanged from the previous year, much of the development finance went to smaller properties with fewer residential units.

Other developments

L-Bank strengthens Baden-Württemberg as a business location by providing solutions for financing municipal and social infrastructure projects. The Bank also assists the public sector with the implementation of infrastructural undertakings by providing loans or other funding instruments. Due to a slight decline in public-sector demand, the volume of new business in the year under review came to a total of EUR 1,128.7 million (2017: EUR 1,224.2 million).

As a service provider for the State of Baden-Württemberg, L-Bank is responsible for awarding and administering a wide variety of financial assistance. The Bank distributes funding provided by the state government, the federal government and the European Union. In 2018, the Bank processed a total of 11,068 new approvals amounting to EUR 1,723.1 million (2017: EUR 1,166.0 million). The volume was significantly higher than in the previous year, primarily due to increased demand for hospital finance (EUR 660.7 million; 2017: EUR 387.8 million) and school construction finance (EUR 462.4 million; 2017: EUR 90.5 million). A volume of EUR 106.5 million (2017: EUR 69.1 million) was approved for technology and enterprise development. Financial assistance for investments in water, waste water, flood protection, decontamination and hydropower projects totalled EUR 115.5 million (2017: EUR 120.7 million); assistance for urban development projects came to EUR 83.3 million (2017: EUR 114.8 million). L-Bank also supported families on behalf of the federal and state governments, in particular by distributing family allowances. Due to rising birth rates and general wage increases, the volume of funding approved for family allowances was up on the previous year at EUR 993.5 million (2017: EUR 944.1 million).

As at the balance sheet date, L-Bank's corporate shareholdings had a book value of EUR 231.2 million (2017: EUR 189.7 million). The bulk of L-Bank's investment portfolio consists of strategic and credit-equivalent shareholdings, as well as shareholdings in subsidiaries involved in the regional development of Baden-Württemberg.

The book value of strategic investments held by L-Bank on behalf of the State of Baden-Württemberg totalled EUR 178.0 million at year-end 2018 (2017: EUR 125.9 million). The year-on-year increase in book value is attributable to a capital reserve transfer at one associated company.

As a co-investor, L-Bank provides equity capital for strengthening companies in Baden-Württemberg. LEA Mittelstandspartner, the external SME fund with EUR 200.0 million in assets (L-Bank's stake: EUR 50.0 million) helps established companies in particular to overcome the incipient challenges posed by the growing digitisation of products and value chains (Industry 4.0). The external venture capital fund LEA Venturepartner (target volume of up to EUR 60.0 million; L-Bank's stake: up to EUR 29.4 million) provides venture capital to technologically strong companies with growth potential. As expected, the volume of investment increased in the year under review. The other investments in L-Bank's Venture Capital portfolio continued to decline in 2018. Overall, the book value of the Bank's credit-equivalent shareholdings at the balance sheet date was EUR 35.3 million (2017: EUR 46.0 million).

Through subsidiaries, L-Bank operates technology and business parks located close to universities and research institutions. By doing so, the Bank aims to provide a real-estate platform for technology transfers between academia and business. These parks differ from other commercial rental premises by the way they are managed and the additional services on offer, which include conference and training facilities as well as nursery and primary schools. As at 31 December 2018, the book value of the Bank's business zone development subsidiaries remained unchanged at EUR 17.8 million.

As part of the Bank's approach to asset/liability management, L-Bank continues to pursue a conservative investment strategy with a clear focus on borrowers with good and very good credit ratings. Securities with AAA and AA ratings account for around two-thirds of the Bank's portfolio.

MANAGEMENT REPORT

Financial performance

The summary of operational income below provides a clear breakdown of L-Bank's financial performance. Transfers to the development fund, which under commercial law should be treated as interest expenses, commission expenses or other operating expenses, are shown here as payments to the State of Baden-Württemberg, hence as an appropriation of profits. Net interest income, which continues to be L-Bank's most important source of income, improved by EUR 8.0 million to EUR 331.4 million, in line with expectations.

Once again, net commission income, at EUR 41.4 million (2017: EUR 40.0 million), mainly comprised payments from the State of Baden-Württemberg for services provided by L-Bank. These included, in particular, the distribution of family benefits (especially family allowances) and the granting of financial aid (EU structural funds and other instruments).

The Bank succeeded in reducing administrative expenses, which include depreciation on tangible assets as well as personnel and general expenses, to EUR 167.9 million, so down by 16.9% on the previous year (2017: EUR 184.8 million). This was primarily due to the reduction of costs associated with the Bank's buildings and IT systems (following the successful modernisation of the latter); contrary to expectations, this reduction was not offset by higher expenses resulting from regulatory requirements.

The net result from other operating income and expenses was positive at EUR 16.1 million (2017: EUR 6.6 million). This increase was due on the one hand to the gain on the sale of a building not used for banking operations, and to lower expenses on the other. The operating result before risk provisions/valuations improved significantly to EUR 221.0 million (2017: EUR 185.2 million).

As expected, net income from asset revaluation was similar to the previous year (2018: EUR –39.9 million vs. EUR –31.7 million in 2017). Once again, the Bank was able to strengthen its contingency reserves. This brought the operating result to EUR 181.1 million (2017: EUR 153.5 million). The Bank's distributable income totalled EUR 180.2 million (2017: EUR 153.2 million).

Due to the development fund system, L-Bank's current development contributions had no impact on earnings in 2018. EUR 73.4 million of the development fund (provision) set up for the year under review were utilised. As a result, the development fund set up in 2017 for development services in 2019 increased by EUR 6.6 million to EUR 86.6 million. Out of the Bank's earnings for 2018, an amount of EUR 80.0 million was transferred to the development fund for 2020's development contributions. An addition of EUR 50.0 million was made to the fund for general banking risks (2017: EUR 20.0 million).

Net income for the year totalled EUR 50.2 million (2017: EUR 50.6 million). Taking account of the profit carried forward from the previous year, net profit amounted to EUR 51.0 million. The Board is planning to allocate EUR 50.0 million of this income to other retained earnings in order to increase the Bank's Tier I capital ratio, and to carry forward the remaining EUR 1.0 million.

BREAKDOWN OF OPERATING INCOME in EUR millions

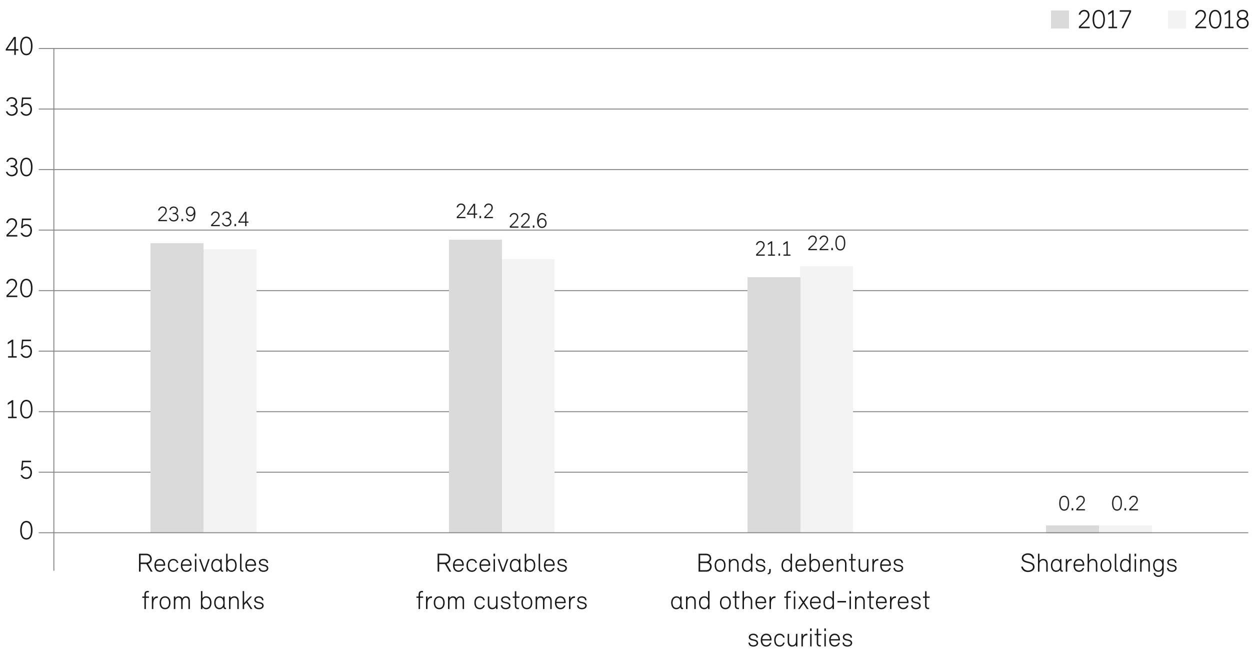
	01.01.2018 to 31.12.2018	01.01.2017 to 31.12.2017	Change	Change in %
Net interest income	331.4	323.4	8.0	2.5
Net commission income	41.4	40.0	1.4	3.5
Net result from other income/expenses	16.1	6.6	9.5	> 100.0
Administrative expenses	167.9	184.8	–16.9	–9.1
Operating result before risk provisions/ valuations	**221.0**	**185.2**	**35.8**	**19.3**
Net income from asset revaluation	–39.9	–31.7	–8.2	25.9
Operating result	**181.1**	**153.5**	**27.6**	**18.0**
Taxes on income	0.9	0.3	0.6	> 100.0
Distributable income	**180.2**	**153.2**	**27.0**	**17.6**
Expenses for interest subsidies and other subsidies	–	2.6	–2.6	–100.0
Addition to development funds (provision)	80.0	80.0	0.0	0.0
Addition to fund for general banking risks	50.0	20.0	30.0	> 100.0
Net income	**50.2**	**50.6**	**–0.4**	**–0.8**

Assets and liabilities

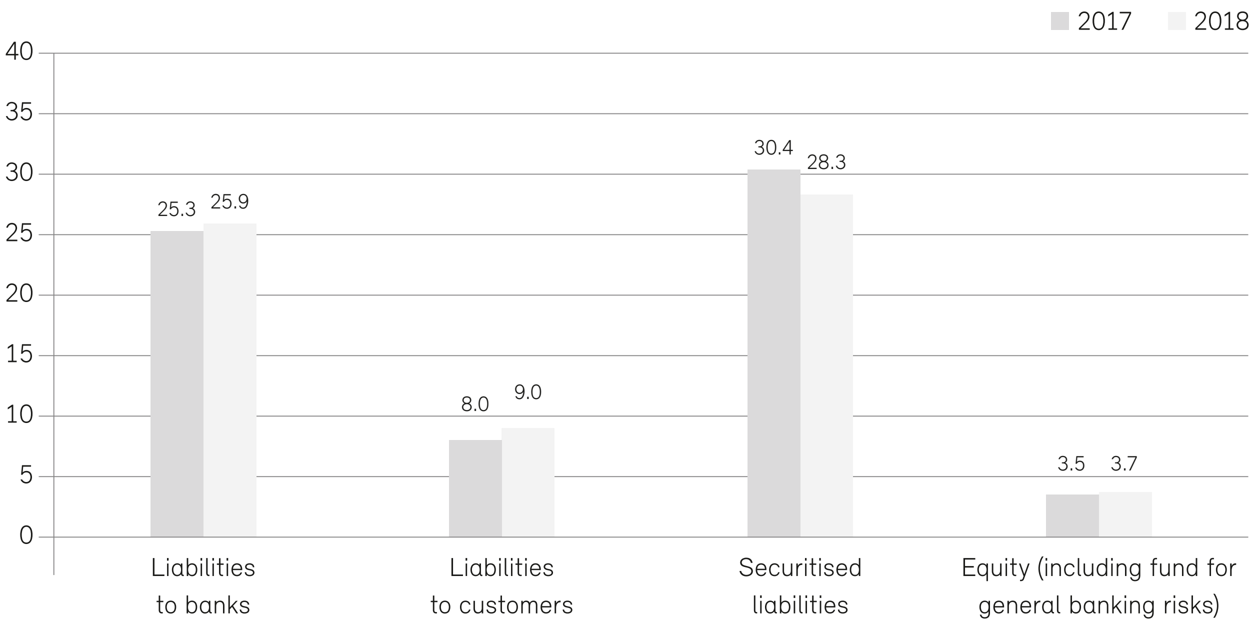
In line with expectations, L-Bank's total assets remained more or less unchanged, totalling EUR 69,608.9 million as at the balance sheet date (2017: EUR 70,670.0 million). On the assets side, slight declines in receivables from customers and banks were almost offset by slightly higher securities receivables. On the liabilities side, maturities of securitised liabilities were almost completely offset by higher liabilities to customers and banks.

The business volume, which also encompasses contingent liabilities and irrevocable lending commitments, was down by 4.1% to EUR 74,512.6 million as at the balance sheet date (2017: EUR 77,724.0 million).

SELECTED ITEMS UNDER ASSETS in EUR billions



SELECTED ITEMS UNDER LIABILITIES in EUR billions



Financial position

As the State Bank of Baden-Württemberg, L-Bank benefits from the federal state's maintenance and public (statutory) guarantee obligation, as well as an explicit state guarantee. The latter means that L-Bank's de facto credit rating is identical to that of the State of Baden-Württemberg. Consequently, credit rating agencies Moody's Investors Service and Standard & Poor's continue to rate L-Bank as Aaa and AAA respectively, these being their top ratings. In addition, banks can count L-Bank bonds towards their short-term liquidity coverage ratios (LCR) as assets with the highest liquidity standing.

During the year under review, L-Bank was once again able to make flexible use of the refinancing options on offer to meet its objectives in terms of funding volumes, maturity profiles and structure. The Bank focused on maturities in the two-year to five-year range. The principal instrument used here is the Bank's Debt Issuance Programme, with a funding limit of EUR 30,000.0 million, of which EUR 14,581.56 million was utilised as at 31 December 2018 (2017: EUR 17,564.3 million). The total volume of medium and long-term refinancing through borrowings on the capital markets amounted to EUR 3,558.85 million (2017: EUR 4,757.1 million). As at the year-end, utilisation of the Commercial Paper Programme, which is used for short-term refinancing and has an upper funding limit of EUR 15,000.0 million, amounted to EUR 10,178.14 million (2017: EUR 9,104.1 million).

For certain development programmes, L-Bank also made use of refinancing products available from other development institutions such as KfW and Landwirtschaftliche Rentenbank, to the extent that such products were compatible with the Bank's own programmes.

During the past fiscal year, the Bank's liquidity was assured at all times, and the Bank complied with all regulatory capital requirements.

Capital adequacy is calculated in accordance with the requirements of the Capital Requirements Regulation (CRR). The following table provides a breakdown of the Bank's equity as at 31 December 2018, prior to approval of the annual financial statements by L-Bank's Supervisory Board.

EQUITY INSTRUMENTS in EUR millions	
Common Equity Tier I capital after deductions	3,555.8
Additional Tier I capital after deductions	0.0
Supplementary capital after deductions	383.8
Total equity	3,939.6

SUMMARY OF THE BANK'S BUSINESS DEVELOPMENT AND POSITION

L-Bank's business development and its financial performance, net assets and financial position were satisfactory in the year under review.

PERSONNEL

As at the balance sheet date, the number of staff employed by L-Bank totalled 1,277 (2017: 1,241). L-Bank pursues a strategy of filling jobs that become vacant from internal resources wherever possible, by applying staff development policies that include in-house professional development such as on-the-job training. However, the external labour market remains indispensable for the recruitment of specialists, especially in IT-related areas. With a slightly higher staff turnover rate of 3.49% compared with the previous year (2017: 1.93%), L-Bank is still below the industry average of 5.12% (source: AGV-Banken; Annual Report 2017/2018, own calculations) and thus continues to have a stable headcount.

Since early 2018, L-Bank employees have been able to tailor their transition to retirement according to their own preferences, thanks to the Bank's phased-retirement programme. This has enabled the bank to actively streamline the changeover from one generation to the next. Given that the average employee age is 46.6 (2017: 47.4), the Bank is able to plan for long-term recruitment as positions become vacant due to demographic factors.

When recruiting employees, L-Bank focuses on the in-house training of junior staff in the first instance. A trainee programme was reintroduced in 2018, and the number of newly recruited work-study students rose by 50% compared with previous years. As at the balance sheet date, 50 people were involved in training programmes. In addition to trainees and students on work-study courses, the Bank also trains apprentice chefs and winegrowers, as well as volunteers and students on internships.

When filling executive positions, L-Bank strives to achieve an appropriate gender balance whilst always taking suitability, skills and performance into consideration. As a rule, this means that male and female candidates are considered in equal proportions. 35.1% of all the Bank's executive managers are women (2017: 35.2%). Overall, L-Bank employs more women than men: female employees accounted for 57.2% (2017: 57.5%) of the workforce as at the balance sheet date.

L-Bank gives high priority to finding a good work-life balance for employees and their families. For example, employees approaching retirement were able to choose to work part-time long before the legal entitlement was introduced in 2019. As at the balance sheet date, a total of 344 employees (2017: 337) were working on part-time contracts adjusted to their individual circumstances.

Because staff development is an especially high priority, L-Bank offers a broad range of continuing professional development options to its most important resource: its personnel. In addition to an emphasis on professional qualifications, the CPD portfolio also includes options for developing methodological, social and personal skills. Junior staff are put through tailor-made development courses in specific areas of study, based on individual analyses of their personal potential.

SUSTAINABILITY REPORT

The basis of all L-Bank activities is the statutory public-service mandate set down in the L-Bank Act. The Bank's business activities are focused on the sustainable development of the Bank and the State of Baden-Württemberg. For this purpose, sustainability aspects are embedded in L-Bank's business strategy, and a sustainability management system was introduced in 2013. At the same time, the State of Baden-Württemberg's sustainability strategy acts as L-Bank's guideline and frame of reference.

Regular reports document the material economic, ecological and social impacts of L-Bank's activities. In 2013, for the first time, L-Bank included a systematic report on the Bank's corporate social responsibility in its annual report. The L-Bank Annual and Sustainability Report 2016 integrated both sides of the Bank's activities in a combined report. Together with the Bank's validation under the Eco-Management and Audit Scheme (EMAS) in the same year, and the associated Environmental Statement, these documents provide a complete picture of L-Bank's performance. We continue to document the discharge of our social responsibility by making regular reports in compliance with EMAS, publishing detailed sustainability reports every three years – based on GRI reporting standards – and by preparing annual reports on selected sustainability aspects according to the WIN Charter framework.

We fulfil our statutory reporting obligations under the CSR Implementation Directive by issuing a non-financial report as a separate part of our annual report, complete with references to the management report. The annual report is published on L-Bank's home page (www.l-bank.de).

OUTLOOK

In Germany, the current economic boom appears to have passed its peak, so that a lengthy period of growth rates far in excess of the growth in production potential appears to have come to an end, at least for the time being. Even so, the domestic economy and the service sector in particular remain in good shape, supported by high employment and rising wages; they are expected to be strong drivers of economic growth in 2019. The Federal Government's expansive fiscal policy is likely to provide additional incentives for private consumption. The construction industry, a vital mainstay of stability, is not expected to slow down at least during the first half of 2019. Germany's manufacturing and export industries, on the other hand, are feeling the impact of increasing risks, which – in addition to a looming Brexit and ongoing trade disputes with the USA – include the political and economic situation in France, the slowdown in China's economic growth, and turbulence in major emerging markets such as Turkey and Brazil. Consequently, it is likely that the cyclical downturn that began last year will continue in 2019. At present, however, we may classify the danger of a recession characterised by long-term negative growth rates over the next two years as low. Overall, L-Bank expects the growth of Germany's real gross domestic product in 2019 to range between 0.9% and 1.3%. The annual report of the German Council of Economic Experts (Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung), published in autumn 2018, predicted an ongoing slight decline in the unemployment rate to just under 5% in 2019.

The monetary environment in Europe remains expansionary despite the discontinuation of net bond purchases by the ECB. Thus there are currently no indications that interest rates will be raised over the period covered by our forecast. This, combined with the expected increase in unit labour costs, some of which companies will pass on to consumers, suggests that consumer prices will rise markedly in 2019. On the other hand, energy and food prices are expected to rise less than in 2018. Overall, Deutsche Bundesbank expects inflation to rise by 1.4% in 2019, compared with 1.9% in the previous year.

The outcome of negotiations between the UK and the EU is important for Baden-Württemberg's economic development in the first half of 2019. The UK is one of Baden-Württemberg's most important trade and cooperation partners, so that the final shape of the country's withdrawal from the EU will have a significant impact on economic development over the coming year. However, the federal state's currently good economic situation is characterised by its broad foundation, underpinned by a multiplicity of business sectors. Thus Baden-Württemberg's growth is highly robust and not solely dependent on the federal state's export business. Furthermore, companies in Baden-Württemberg have already demonstrated great geographical flexibility in managing their foreign business affairs in the past. We can therefore assume that despite all the uncertainties, exports will continue to make a stable contribution to the region's gross domestic product in 2019. Because the unemployment rate in Baden-Württemberg has already reached an extremely low level, stimuli from this side are limited. Based on the Bank's own labour-market surveys, L-Bank is only expecting employment figures to increase very slightly in the coming year, which could cause the unemployment rate to decline further from 3.0% (as of December 2018) to just under 3%. In general, Baden-Württemberg is nearer to reaching supply-side growth limits (in terms of corporate production capacity, limited labour market) than most other federal states. For this reason, and due to the fact that Baden-Württemberg is more affected by various geopolitical risks, the growth of the region's GDP is likely to be slightly below the national average in 2019. In summary, L-Bank expects to see real growth in Baden-Württemberg ranging from 0.8% to 1.2%.

In the coming year, L-Bank will continue to focus its activities on providing support for business start-ups, established SMEs, and housing development. Essentially, the Bank plans to continue its development finance activities through its existing programmes. In light of the economic forecasts described above, the Bank expects to see a moderate improvement in overall demand.

The volume of new business in business start-up and SME financing is likely to remain at roughly the same level as the previous year. The 'Innovation Finance' development programme, which was suspended in mid-2018, is to be relaunched in cooperation with federal development bank KfW and supplemented by a further component. For example, repayment subsidies are specifically intended to promote business investment in innovation. Venture capital activities are to be strengthened. Plans are afoot to increase the subscription volume of the external venture capital fund. The Bank also intends to further expand its business zone development activities, in particular by adding new technology-park sites. The sale of properties in the technology parks remains part of the Bank's overall strategy.

In housing development, we are expecting to see a moderate increase in new business figures overall. With respect to financial support for private home ownership under the federal state's housing development programme, new business figures should at least equal the previous year's level as funding conditions continue to remain attractive. The Bank expects to see a slightly higher demand for the 'Living with Children' and 'Living for the Future' development programmes in 2019. The volume of new business under the rental accommodation programme is expected to remain high. This is due to the consistently high demand for living space, municipal requirements for compliance with social quotas in new construction projects, and the unchangingly high level of state subsidies. With respect to finance for homeowners' associations, the volume of new business is expected to exceed the level achieved in 2018.

Despite the relatively stable economic environment, L-Bank is predicting a lower operating result before risk provisions/valuations for 2019. On the one hand, this is due to the slight decline in net interest income and net commission income, and the absence of one-off earnings from the sale of buildings not used for banking operations. On the other hand, slightly higher costs are expected, especially for IT projects. The Bank is expecting income from asset revaluation to improve over the level achieved in the reporting year.

Total assets in 2019 are likely to be comparable to the previous year's levels.

In terms of refinancing, L-Bank expects to be able to continue to raise funds on the capital market without any problems, thanks to its very good rating. The Bank is well placed on the national and international money and capital markets, with well-diversified sources of funding.

According to resolutions passed at European level, L-Bank – like other legally independent development banks in Germany – will probably be exempted from European banking regulation. It is likely that this exemption will come into force in spring 2019. The direct outcome is that exempted development banks will in future be supervised outside the European Single Supervisory Mechanism (SSM) by the Federal Financial Supervisory Authority (BaFin) in cooperation with Deutsche Bundesbank, on the basis of the German Banking Act (KWG). This does not significantly change the applicable substantive banking supervisory law.

Overall, L-Bank is forecasting a virtually unchanged volume of new business for 2019 compared with 2018. No significant changes in the Bank's financial performance, financial position or net assets are anticipated.

OPPORTUNITIES AND RISK REPORT

To manage the risks associated with L-Bank's business activities, the Bank has installed a risk management system with the aim of enabling it to:

→ ensure the Bank's risk-bearing capacity and solvency at all times,
→ assess the Bank's overall risk exposure at any time, identify, assess, communicate and manage material individual and concentration risks at an early stage, and
→ identify risk-related developments, combined with alternative courses of action.

The Bank's risk management model is based on the premise that, even in the event of unexpected losses, the Bank's survival should be sustainably assured without the support of the State of Baden-Württemberg. It is primarily based on:

→ the formulation of a coherent business strategy and resulting risk strategy,
→ constant monitoring of the Bank's risk-bearing capacity and solvency – also assuming that the Bank is operating under stress conditions – and related reporting to the Board of Management, Supervisory Board and relevant supervisory authorities,
→ the creation of a recovery plan setting out possible courses of action to deal with any events that have a significant negative impact on the Bank's net assets, financial position or financial performance,
→ full documentation in writing of the Bank's organisational structure and all business processes involving risks,
→ the implementation and continuous updating of risk management and risk control processes, and
→ the creation of a compliance controlling and a risk controlling function, as well as an Internal Audit unit.

By devising development programmes, the State of Baden-Württemberg defines the specific market segments in need of financial support, as well as the regional focus of the Bank's business activities. In return, it also explicitly and unconditionally guarantees the Bank's liabilities through a public (statutory) guarantee and maintenance obligation.

From a supervisory perspective, the Bank's business operations are regulated and monitored by the European Central Bank in conjunction with the responsible German authorities. This supervision aims to monitor compliance with the Capital Requirements Regulation (CRR) and Germany's implementation of Directive 2013/36/EU (Capital Requirements Directive IV). Article 97 of this Directive requires the competent supervisory authorities to review the internal processes of financial institutions in order to verify their internal risk-bearing capacity. Until 31 December 2018, this review was carried out on the basis of the guidelines for the 'Supervisory assessment of bank-internal capital adequacy concepts' issued by Germany's financial supervisory authorities on 12 December 2011. The additional cover stipulated by the European Central

Bank through the SREP (Supervisory Review and Evaluation Process) over and above the minimum capital ratios defined in the CRR also covers elements of the Bank's internal risk-bearing capacity. Consequently, where the above-mentioned German guideline is applied, the assessment of internal risk-bearing capacity is governed by both European and German regulations that are not always free of contradictions. These contradictions will be resolved on 1 January 2019 when the ECB Guidelines for the Internal Capital Adequacy Assessment Process (ICAAP) enter into force.

The following disclosures relating to the Bank's internal risk-bearing capacity are based on the above-mentioned guidelines issued by the German Federal Financial Supervisory Authority (BaFin) in December 2011, which were valid until 31 December 2018. The Bank's internal capital adequacy was calculated on the assumption that counterparty default risks and operational risks should be covered twofold. This was achieved by using only Common Equity Tier I capital that was not required to satisfy the CRR's minimum capital adequacy requirements, including the combined capital buffer.

HOW RISK MANAGEMENT IS ORGANISED

The core elements of the Bank's risk management approach are defined by senior management in the form of internal guidelines (operational directives). In particular, the Board of Management regulates the implementation of risk inventories, methods for determining the materiality of risks, risk quantification methods, validation methods, the performance of internal stress tests, procedures for reviewing risk-bearing capacity, the capital planning process, the definition of risk tolerances, risk reporting, and the processes and powers for controlling and monitoring risks. The senior management team has delegated the implementation of internal guidelines to various risk managers, as well as to the risk controlling function, the compliance function, the head of the Internal Audit unit and the Security Office. Within the L-Bank hierarchy, these functions report directly to the senior management team. To assist them in fulfilling their remits, they have set up a Stress Testing Committee, a Recovery Planning Working Group and a Regulatory Compliance Committee. The Chief Risk Officer (CRO) bears overall responsibility for assessing and monitoring all counterparty default, market price, liquidity and operational risks for the Bank as a whole. He reports exclusively to the Board of Management on these risks.

The senior management team regularly briefs the Supervisory Board on the risk situation, risk management, risk controlling and any other risk-related issues, and – where necessary – reports on specific incidents. The Supervisory Board also approves the recovery governance principles set down in the Bank's recovery plan. The Supervisory Board has set up various committees to deal with specific subject areas. At meetings of the Risk Committee, the senior management team reports on counterparty default, market price, liquidity, operational and reputational risks. The Risk Committee is also briefed on the Bank's risk strategies and on any matters which, in view of the associated risks, are especially significant. For its part, the committee advises the senior management team on questions relating to the Bank's overall risk appetite and risk strategies.

The Audit Committee is primarily responsible for discussing the audit report with the auditor and for preparing the Supervisory Board's adoption of the annual financial statements and the Board of Management's proposal for the appropriation of profits.

Until 30 November 2018, the Personnel Committee performed the duties of an appointments committee and remuneration control committee. An independent Remuneration Control Committee was set up on 1 December 2018. The Personnel Committee is primarily responsible for the preliminary discussion of Supervisory Board resolutions relating to appointments to the Board of Management. It adopts resolutions setting out contractual and other formal matters for members of the Board of Management, with the exception of remuneration. The Remuneration Control Committee performs the duties set out in Section 25d (12) KWG.

The senior management team defines an interest rate and currency-risk profile for the investment book; the Treasury department is responsible for implementing this profile. The Treasury department is also responsible for liquidity management, while observing the control parameters specified by senior management. Counterparty risk is managed by establishing limits approved by senior management; these may be set by the Bank's individual lending departments according to a system of competencies. 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. Operational risks resulting from unlawful actions detrimental to the Bank are assessed by means of a threat analysis. Risks arising from outsourced services that fail to comply with contractual terms are accounted for in the materiality analysis of outsourced contracts. 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 is responsible for the quantitative and qualitative assessment and communication of risks. These assessments are based on a company-wide database containing standardised records detailing all the Bank's transactions and business partners. The evaluations produced as part of the risk management process are regularly compared against balance sheet-based evaluations and data used for reporting purposes (e.g. the CRR). The Controlling department is also responsible for monitoring compliance with all risk management policies, and for reporting on the risk situation to senior management.

The Bank takes a highly controlled approach to counterparty default risks, market price risks and liquidity risks, managing such risks in accordance with the relevant regulatory requirements and the Bank's internal policies. With regard to operational risk, L-Bank pursues an avoidance strategy, whilst adhering to the principle of profitability.

The Credit Analysis department assesses the credit standing of individual borrowers and specific portfolios, and proposes appropriate borrower-based lending limits to senior management, as well as lending limits for portfolios and countries. The Credit Analysis department also acts as the back office and casts the back-office vote on business decisions involving risk.

In order to comprehensively assess risk exposure, the Stress Testing Committee carries out regular stress analyses. When doing so, they pay particular attention to risk concentrations.

Taking a risk-focused, process-independent approach, the Internal Audit unit 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 material activities and processes, on behalf of senior management. The unit reports directly to the senior management team. The Internal Audit unit carries out its duties independently and impartially, and is not required to accept instructions regarding the evaluation or reporting of audit results.

The Compliance unit is responsible for regulatory compliance, money laundering and fraud prevention, as well as securities compliance.

The Security Office assists senior management with all security policy issues. In addition to building security, the Security Office is also responsible for information security policy, coordinating information security and all associated measures, monitoring the effectiveness of security measures, ensuring the continuous improvement and further development of the security process, and regularly reporting on information security.

L-Bank's risk management takes account of the Bank's equity investments (shareholdings) insofar as losses directly or indirectly caused by or arising from the latter could have a long-term negative impact on the Bank's net assets, financial position or financial performance.

BUSINESS AND RISK STRATEGIES

In the Bank's business strategy, the senior management team sets a target for, among other things, the Bank's Tier I capital ratio, and decides which products should be used to meet the Bank's public-service mandate through development programmes and other development business. The Bank's statutory public-service mandate results in concentrations of counterparty default risks (cluster risks) in particular industries, types of collateral and regions.

In order to achieve a balanced aggregate risk profile, the senior management team defines quality requirements for the portfolio structure as a whole in the Bank's business strategy. These include policies defining 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 its business strategy. In its risk strategy, senior 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 senior management team defines the Bank's risk appetite in the risk strategy by specifying the scope of risk coverage capital that should be set aside as cover for losses.

For this purpose, based on a regularly implemented and updated risk inventory coupled with the new product process, any risks to which the Bank is exposed are identified and, in a further step, categorised in terms of their materiality. All material risks are quantified using appropriate methodologies (especially value-at-risk). The quantitative assessment of the Bank's risk-bearing capacity is supplemented by stress analyses, with a particular emphasis on risk concentrations.

With respect to managing credit risk, the risk strategy includes policies specifying borrowers' minimum credit ratings and risk margins, and obliges business units to secure loans against collateral that is deemed to be recoverable. In addition, the budgets and ceilings for aggregate lending by each business unit are defined for 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 are based primarily on levels of demand from the commercial banks with which L-Bank cooperates. Lending business associated with development aid business is primarily determined by the refinancing options available. Any investments made for this purpose must meet exceptionally high standards of creditworthiness. In conformance with the Bank's risk-bearing capacity, the risk strategy duly shows – after making proper allowance for existing risk concentrations – the projected scope of future counterparty default risks.

With respect to market price risks, the Bank pursues a strategy of following projected interest rate developments to generate predictable levels of income with acceptable levels of risk, primarily within a maturity range of up to 24 months. The underlying projections of interest rate developments are derived from capital market parameters. Due to the current volatility, these transactions are intensively monitored on a daily basis, with ongoing reviews being conducted at least weekly by senior management. Additionally, the banking supervisory authorities assume the existence of market price risks associated with the investment of equity capital in longer-term securities.

The Bank makes use of the national and international capital markets to obtain refinancing on optimised structural and cost terms. The public guarantee and maintenance obligation provided by the State of Baden-Württemberg means that the Bank benefits from the latter's excellent credit standing on the capital markets. Potential refinancing risks due solely to a substantial downgrade of the federal state's credit rating are permanently classified as negligible.

The Bank controls operational risks by applying the principle of profitability. This means that – regardless of existing comprehensive internal control procedures and regardless of statutory or regulatory requirements – the Bank only takes special mitigation or avoidance measures if the potential loss exceeds the costs of taking such measures.

RISK-BEARING CAPACITY

Risk-bearing capacity represents the highest and most comprehensive level at which the Bank's risk exposure is analysed at L-Bank. It is the basis for the operational implementation of the Bank's risk strategy, because when the risk strategies for all material risks are formulated, risk tolerances are explicitly specified in the form of value-at-risk (VaR) limits. As part of establishing these limits, a conscious decision is made regarding the scope of potential future risks. And because planned new business activities can only be implemented if the resulting risks are covered by the Bank's risk coverage capability, the analysis of risk-bearing capacity effectively determines the maximum scope of potential new business (especially development aid business), providing a timely indication of any capital increase that may be required. The review of the Bank's risk-bearing capacity is supplemented by analyses of the expected shortfall, as well as stress scenarios.

The risk-bearing capacity review process essentially consists of the following subcomponents:

- risk inventory, including determination of risk materiality,
- determination of risk exposures and comparison with existing risk coverage capabilities from both periodic and net present value perspectives,

- performance of a capital planning exercise in a baseline scenario and in stress scenarios with definition of value-at-risk limits,
- validation of risk measurement methods using stress-test analyses.

RISK INVENTORY

The starting point for reviewing risk-bearing capacity is a risk inventory, carried out at regular intervals. During the risk inventory, of the generally conceivable risks that could impact the Bank's net assets, financial position or financial performance, those risks are first selected that present not just a theoretical threat, but also a concrete threat. These risks are described as 'relevant' risks. The materiality of these relevant risks is assessed. If, when considering the Bank's net assets, financial performance or financial position from a given management perspective (periodic or net present value), a relevant risk exceeds at least one of the defined thresholds, that risk is material. The risk inventory is used to check whether the risk management system takes account of all material risks (risk coverage). Then follows a critical analysis to determine whether risk assessment, risk management and risk reporting permit an appropriate evaluation of all risks identified by L-Bank.

The risk management system takes account of all identified risks. During reviews of the Bank's risk-bearing capacity, potential losses are calculated and management limits specified for all material risks as a matter of course. Where these potential losses cannot be meaningfully assessed against the value at risk (VaR), the risks are limited using other management instruments.

If it is not economically feasible to carry out a value-at-risk assessment in view of the risk profile, the potential losses are evaluated using a simplified procedure. The suitability of the simplified procedure(s), as well as the assumptions made and calculation methods used, are reviewed as required, but at the very least as part of the regular risk inventory.

Immaterial risks are accounted for by applying appropriate risk management policies. These risks are generally not taken into account when reviewing the Bank's risk-bearing capacity. If, however, these risks cannot be managed in a sensible way, they are accounted for by reducing the Bank's risk-coverage capability.

The following table provides an overview of risk inventory results. The categorisation of risk (sub)types by materiality is based on the 2018 risk inventory. Disclosures on the risks included in risk management reflect the situation as at 31 December 2018.

POTENTIAL RISKS AND RISK COVERAGE CAPABILITY

The Bank's risk-bearing capacity is monitored from a periodic and a net present value perspective. The results are reported to senior management on a monthly basis. The Risk Committee and the competent supervisory body are informed of the Bank's risk-bearing capacity in the quarterly risk report. The aim of managing (limiting) risks is to ensure the Bank's continued existence over the long term.

Type of risk	Type of sub-risk	Materiality	Managed by VaR limit (periodic)	Included in capital planning	Stress scenarios	Managed by VaR limit (NPV)
Counter-party default risk	Default risk	Yes	Yes	Yes	Yes	Yes
	Migration risk	Yes	No	Yes	Yes	Yes
	Concentration risk – individual borrowers	Yes	Yes	Yes	Yes	Yes
	Concentration risk – industries	Yes	Separate VaR simulation by business segment	No	Yes	Yes
	Concentration risk – collateral	Yes	Included in parameterisation of VaR model or in stress scenarios			
	Country risk/ sector risk	Yes	Yes	Yes	Yes	Yes
	Spread risk	Yes	Write-down on risk coverage capability	No	Yes	Yes
	Collateralisation/ realisation risk	No	No	No	Yes	No
	Settlement risk	No	Managed via settlement risk limits			
Market price risk	Interest rate risk	Yes	Yes	Yes	Yes	Yes
	Option risk	Yes	Managed via interest rate/funding liquidity risk or by write-down on risk-coverage capability			
	Foreign exchange risk	Yes	Yes	Yes	Yes	Yes
Liquidity risk	Funding liquidity risk	Yes	Yes	Yes	Yes	Yes
	Market liquidity risk	Yes	Managed via interest rate/funding liquidity risk			
	Insolvency risk	Yes	Managed via liquidity ratios			

Type of risk	Type of sub-risk	Materiality	Managed by VaR limit (periodic)	Included in capital planning	Stress scenarios	Managed by VaR limit (NPV)
Operational risks	Human error	Yes	Yes	Yes	Yes	Yes
	Technical failure	Yes	Yes	Yes	Yes	Yes
	Behavioural risk	Yes	Yes	Yes	Yes	Yes
	Procedural failure	Yes	Yes	Yes	Yes	Yes
	Fraud	Yes	Yes	Yes	Yes	Yes
	IT risk	Yes	Yes	Yes	Yes	Yes
	Compliance risk	Yes	Yes	Yes	Yes	Yes
	Legal risk	No	Yes	Yes	Yes	Yes
	Transfer risk	No	Managed via country limits			
	Conversion risk	No	Managed via country limits			
	Risks arising from regulatory requirements	No	No	Yes	Yes	No
	Reputational risk	Yes	Managed via complaint management procedures			

Periodic perspective

Calculations of the relevant risk coverage capability are based on profit and loss considerations. Only Common Equity Tier I capital that is not required to satisfy the minimum capital adequacy requirements of the CRR (including the combined capital buffer) is taken into consideration. Given that the risks are calculated on the basis of a one-year holding period, the Bank applies capital requirements based on those that will apply 12 months after the valuation date, in accordance with the phase-in scheme. For reasons of prudence, L-Bank increases the required minimum total capital ratio (including combined capital buffer) by 0.5 percentage points and applies a bank-specific countercyclical capital buffer of 1.0%, which is well above current requirements. In a second step, the Bank supplements this disposable Tier I capital with any reserves that, in terms of their loss-bearing function, are comparable in quality to the available equity capital and – when calculating the Bank's risk exposure as defined by regulatory requirements – have not already been treated as risk-reducing factors. In addition, 'write-up reserves' that stem from the fall in value of interest-subsidised loans and predate the German Accounting Law Modernisation Act (BilMoG) are also taken into consideration.

To ensure that risk-bearing capacity is maintained beyond the reporting date, reviews are carried out to determine how the Bank's risk coverage capability will develop over the next 12 months, ignoring any income from new business, but taking into account any potential losses not included in the respective value-at-risk figures.

Potential losses are calculated for all material types of risk, based on a uniform confidence level of 99.0% and a 12-month risk assessment horizon; they are then compared with the calculated risk coverage capability.

The following tables illustrate the development of the Bank's risk coverage capabilities as well as the specific risks to which they pertain. 'Aggregate risk positions' includes the sum total of the risk exposure to counterparty default risks, market price risks and operational risks, calculated in accordance with CRR. The Bank calculates credit risk using the standardised approach to credit risk, market price risks using the standard method, and operational risks using the baseline indicator approach.

REGULATORY CAPITAL ADEQUACY REQUIREMENTS

Regulatory capital ratios	31.03.2018	30.06.2018	30.09.2018	31.12.2018
Aggregate risk positions in EUR millions	18,968.3	19,092.3	19,440.9	19,131.2
Tier I capital in EUR millions	3,437.3	3,509.8	3,509.1	3,555.8
Equity in EUR millions	3,808.1	3,912.9	3,902.9	3,939.6
Tier I capital in %	18.12	18.38	18.05	18.59
Total capital ratio in %	20.08	20.49	20.08	20.59
Tier I capital requirement in % (incl. combined capital preservation buffer, excl. Pillar II requirement)	7.875	7.876	7.876	7.878
Total capital requirement in % (incl. combined capital preservation buffer, excl. Pillar II requirement)	9.875	9.876	9.876	9.878

Taking into consideration the CRR requirements that will apply 12 months after the calculation date, a bank-specific countercyclical capital buffer of 1.0% and the Bank's own mark-up of 0.5 percentage points on the minimum Tier I capital ratio, the disposable Tier I capital is calculated as follows:

In EUR millions	31.03.2018	30.06.2018	30.09.2018	31.12.2018
Tier I capital	3,437.3	3,509.8	3,509.1	3,555.8
Required for counterparty default risk (incl. CVA)	1,755.5	1,767.3	1,800.4	1,771.0
Required for market price risks	0.0	0.0	0.0	0.0
Required for operational risks	46.5	46.5	46.5	46.5
Required for Bank's own mark-up	94.8	95.4	97.2	95.6
Required for missing supplementary capital	143.4	158.4	178.0	185.0
Disposable Tier I capital	1,397.1	1,442.2	1,387.0	1,457.7

As at the balance sheet date, with disposable Common Tier I capital amounting to EUR 1,457.7 million, accumulated profit of EUR 157.1 million, eligible reserves totalling around EUR 140.0 million, and after the EUR 53.6 million write-down for credit spread risks based on credit ratings, the Bank's P&L-based risk coverage capability amounted to EUR 1,702.0 million, which is offset by the potential risks listed below.

In EUR millions	31.12.2018
Risk coverage capability	1,702.0
Total potential losses	327.9
VaR counterparty default risk	208.4
VaR market price risk (IRRBB)	34.7
Embedded options	2.7
VaR liquidity risk	42.7
VaR operational risks	39.2
Immaterial business transactions	0.2

The Bank carries out capital planning to safeguard its risk-bearing capacity beyond the reporting date. This is integrated into the strategy process. It represents a periodic review of the Bank's risk-bearing capacity over the next three years. This multi-year analysis of the Bank's risk-bearing capacity also ensures that any risks resulting from planned new business activities are covered by the Bank's risk coverage capability and will not lead to capital shortages. The process uses the calculation routines described above.

To manage future risks and safeguard its future risk-bearing capacity while taking business and risk strategies into account, the Bank sets value-at-risk (VaR) limits. In doing so, the possibility that a transaction's VaR may increase for 'technical' reasons despite an unaltered risk position (e.g. unchanged investment of equity but simulated interest rate increase) cannot be ruled out. To ensure that risk-bearing capacity is maintained even if such events should occur, the Bank sets up loss buffers. The sum total of these VaR limits and loss buffers represents the aggregate loss ceiling defined by the Bank, which, in view of the requirement to secure L-Bank's continued existence in the long term, may not exceed 80.0% of the risk coverage capital. When offsetting potential losses against risk coverage capital in this way, the Bank does not take account of any risk-reducing diversification effects between the various risk types.

As at the balance sheet date, the aggregate loss ceiling was distributed as follows:

AGGREGATE LOSS CEILING AND INDIVIDUAL LOSS CEILINGS AS AT 31.12.2018 in EUR millions

	31.12.2018
Aggregate loss ceiling	1,000.0
Counterparty default risks	475.0
Market price risks	165.0
Embedded options	25.0
Liquidity risks	230.0
Operational risks	50.0
Loss buffers for transactions evaluated using simplified method	5.0
Loss buffers	50.0
Proportion of risk coverage capital taken up by aggregate loss ceiling	58.8%

Thus the aggregate loss ceiling accounted for 58.8% of the Bank's risk coverage capability at the balance sheet date. Over the past fiscal year, this proportion has varied between 57.8% and 62.1%.

In addition to the baseline scenario described above, capital planning is also carried out with the help of three (not yet adversely structured as at 31 December 2018) stress scenarios based on earnings risk, operational risk and counterparty default risk. In each of the stress scenarios, the Bank's multi-year risk-bearing capacity is taken as given.

In formulating its risk strategy for 2019 and subsequent years, the Bank also reviewed its risk-bearing capacity in accordance with the ECB ICAAP guidelines to be observed from 1 January 2019. On the basis of the Bank's plans for 2019 to 2022, its risk-bearing capacity is still assured over the projected period under review, even when applying the adverse conditions specified by the ECB as part of the EU-wide stress test in 2018.

At its meeting on 2 October 2018, the Board of Management resolved to make a fundamental adjustment to the 2019 system of limits for safeguarding the Bank's risk-bearing capacity (as part of implementing the ECB's new ICAAP guidelines). When applying the normative perspective, the total of maximum permissible risk-weighted assets (RWA ceiling) was set at EUR 25,000 million, rather than using the total of value-at-risk limits (at a confidence level of 99%) as before.

Net present value perspective

In an additional analysis, the net present value of all existing assets and liabilities, less associated administrative expenses, is given as risk coverage capability.

Thus the hidden charges on fixed assets from avoiding depreciation at the lower of cost or market are also taken into account. As well as net present value (NPV) counterparty default risks, market price risks, liquidity risks and operational risks, this risk coverage capability is then assessed relative to credit spread and migration risks. All risks are calculated with a confidence level of 99.98%. Migration risk is assessed using a Monte Carlo simulation, based on the risk of a decline in value due to borrowers' deteriorating credit ratings. Market-wide credit spread risk is assessed with the help of historical simulations, based on the risk of a rating-independent decline in the value of securities due to market-wide credit spread movements.

As at the balance sheet date, the business portfolio's net present value is calculated as EUR 5,587.5 million. This is offset by NPV administrative expenses totalling EUR 314.6 million, plus imputed NPV risk provisioning costs of EUR 247.1 million, resulting in a value-based risk coverage capability of EUR 5,025.8 million. As at the balance sheet date, 68.5% of this was taken up by VaR values totalling EUR 3,442.4 million. Utilisation of NPV risk coverage capital in 2018 ranged between 68.5% and 79.0%.

At its meeting on 2 October 2018, the Board of Management set the Bank's risk appetite for 2019 in the NPV (economic) perspective at EUR 3,800 million, based on the sum total of all value-at-risk limits (aggregate loss ceiling) at a confidence level of 99.9%. The aggregate loss ceiling is distributed across individual risk types as follows:

MATERIAL RISK	LIMIT FOR 2019 In EUR millions
Aggregate loss ceiling	3,800
Default risk	1,600
Spread risk	1,200
Market price risk	200
Embedded options	30
Liquidity risk	500
Operational risk	50
Immaterial business transactions	10
Buffer	210

MODEL VALIDATION

The annual validation activities previously carried out as part of the risk inventory or by Risk Controlling's methods department were transferred to a new, independent body in the course of 2018. The validation methods, scope of the individual validation measures, responsibilities for these methods and the regular intervals at which they should be applied are specifically defined for each type of risk. Standardised report templates are used for all types of risk, in which the key findings of the validation processes are summarised for senior management.

If the findings of these validation exercises result in adjustments to measurement procedures or their underlying assumptions, all such adjustments must first be approved by senior management.

Performing stress analyses

By their nature, the actuarial models used for risk measurement assume, when setting various influencing parameters, a degree of stability in financial market conditions. However, the financial market crisis revealed limits to the predictive powers of quantitative risk models in various areas. In view of the fact that actuarial models cannot by their very nature depict all possible events, the Bank's quantitative risk assessments are continuously supplemented by comprehensive analyses in the form of stress scenarios. By performing these stress analyses, the Bank identifies clusters of risk factors that could have a particularly significant impact on the Bank's net assets, financial position and/or financial performance.

In the course of these analyses, scenarios relating to a single type of risk are first developed and analysed in isolation to establish their impact on counterparty default risk, market price risk, liquidity risk and operational risk. In a second stage, the key risk factors that determine each individual risk type are defined as actual risk bearers (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 in the process, the analysis is based on, inter alia, the Bank's in-house expertise combined 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 and cover all types of risk.

The quantitative impact of the formulated scenarios on default rates, recovery rates, refinancing conditions and losses due to operational risks (the parameters of the Bank's risk factors) are based on expert estimates. The estimated parameters are then used to calculate the Bank's net present value and balance sheet liability (income statement expenses). Of particular importance here is a multi-risk scenario of particular relevance to Baden-Württemberg's economic structure, based on the assumption of a severe economic downturn caused by a slump in automotive industry sales.

With respect to market price risk, various extraordinary changes in yield curves are modelled, based either on standardised interest rate changes such as parallel shifts, or on rare historical interest rate changes over the past 20 years. This means the interest rate scenarios include exceptionally sharp or extreme interest rate rises and falls, as well as changes in the shape of the yield curve. In stress analyses of liquidity risk, underlying criteria for market-wide effects include a change in the central bank's interest rate policy (increase in base rates) and capital market-driven changes in L-Bank's refinancing conditions. The analyses examine the impact of a deterioration in the Bank's own credit rating combined with a change in investors' risk tolerance, both reflected in changing refinancing spreads for a given credit rating.

Stress scenarios used to evaluate operational risks are based on the assumption of a heightened probability that both the loss scenario will occur and the quantitative impact in the event of such a loss will be higher.

The analytical system described above does not entirely preclude the possibility that certain scenarios jeopardising the Bank's continued existence may never be identified. Consequently, in order to establish the limits of the Bank's risk-bearing capacity, the Bank makes certain assumptions regarding charges arising from losses, and retroactively determines the conditions under which such losses might occur (inverse stress tests). Stress analyses performed for purposes of recovery planning are used for this exercise, and the results of recovery planning analysis are incorporated into the risk management system.

RISK MANAGEMENT AND RISK CONTROL

L-Bank's risk management and risk controlling processes include the identification, assessment, management, monitoring and communication of material risks. Material risks include: counterparty default risk, market price risk, liquidity risk and operational risk, as well as any associated risk concentrations.

COUNTERPARTY DEFAULT RISK

Counterparty default risk refers to the risk that a business partner (counterparty) will fail to meet its contractual obligations. These obligations may arise from a lending transaction as defined in the German Banking Act (Section 19 KWG), or from a performance obligation relating to a transaction involving payment on delivery. The reason for non-fulfilment of a contract may be specific, relating to the borrower's credit standing or particular circumstances. The Bank classifies political reasons for non-performance under country risk. Country limits are in place to restrict this type of risk. Country-specific transfer and conversion risks are classified as legal risks and thus under operational risk.

The active management of counterparty default risk begins with the lending process, and involves
- assessment of the borrower's credit rating (including a review of the borrower's capacity to meet principal repayments),
- adherence to the country risk limit,
- the possible use of collateral,
- the calculation of a risk margin based on probability of default, and
- a review of the need for a back-office vote.

When managing counterparty default risk, the Bank stipulates a minimum risk category for each of the individual business segments using a 14-tier system. It is up to senior management to take a decision on any exceptions from these minimum risk categories.

Business segments	Risk category
Loans provided under programmes	The credit ratings required for programme-related activities are stipulated in the development programmes agreed between the State of Baden-Württemberg and L-Bank, and in the Bank's in-house directives
Other loans (including securities and financial investments)	1 to 5
Interest rate derivatives without collateral	1 to 3, no new business
Interest rate derivatives with collateral	1 to 5
Countries (transfer risk)	1 to 12, but no new business in peripheral eurozone countries Development aid business: focusing on risk categories 1 to 2

In order to limit the losses associated with all loan-related decisions that create a new, or increase an existing, counterparty default risk for the Bank, care is taken to ensure that appropriate collateral is provided (to the extent that such collateral is suitable for bank use, given the legal form or credit rating of the counterparty concerned). To limit the credit risk associated with the use of collateral, the value of the collateral provided must not depend on the borrower's credit rating.

The Bank experiences losses when borrowers default on their loans. To compensate for these losses, risk-based margins must be applied. Given L-Bank's business model, however, it is not possible to set individual risk-based margins for development loans issued under the Bank's development programmes. With respect to development aid business, most transactions are conducted with capital market participants. For these borrowers, the Bank mainly trades in credit spreads on the capital markets, meaning that L-Bank only has limited influence on margins. For all loans where margins are not fixed by third parties (programme loans) and conditions are not set on the capital markets, a risk margin is calculated on the basis of the probability of default and incorporated into the decision-making process.

With respect to the Bank's lending business, the front-office and back-office areas at L-Bank are strictly separated at all levels, up to and including senior management level. Divisions I and IV are front-office areas, and divisions II and III are back-office areas. This organisational separation of powers is also consistently guaranteed in the event of deputising. Given that risk-related loan decisions require the approval of the back office (back-office vote) and the back office is responsible, in particular, for controlling credit risks, the organisational separation of lending business into back and front offices avoids any imbalance when making loan-related decisions.

The following table shows the composition of the loan portfolio by product type as at 31 December 2018. When calculating the loan portfolio, outstanding amounts, arrears, irrevocable loan commitments and undrawn, externally approved lines of credit associated with loans, securities and shareholdings are included. Financial derivatives are stated at the respective credit-equivalent amounts, whereby collateral loans that cannot be offset against market values are included as time deposits.

LOAN PORTFOLIO AS AT 31.12.2018 in EUR millions

	Private clients	Companies and self-employed persons	Companies in the financial sector	Public sector	L-Bank total	Allocation in %
Loans	6,034.5	7,603.2	21,092.5	3,232.1	37,962.3	52.9
Promissory notes	0.0	0.0	1,241.9	8,540.1	9,782.0	13.6
Securities (bearer bonds)	0.0	969.0	8,458.5	12,612.4	22,040.0	30.7
Sureties	1.2	247.4	78.8	0.0	327.5	0.5
Financial derivatives	0.0	0.0	882.5	0.0	882.5	1.2
Time deposits	0.0	0.0	21.5	0.0	21.5	0.0
Shareholdings	0.0	24.2	125.5	154.7	304.4	0.4
Current accounts, cash	0.0	0.0	421.5	50.2	471.7	0.7
Total	**6,035.8**	**8,843.9**	**32,322.7**	**24,589.5**	**71,791.8**	**100.0**

Quantitative assessment based on value-at-risk calculations

Risks from unanticipated losses are restricted by applying the VaR limits enshrined in the risk-bearing capacity concept.

As a general rule, losses are estimated using a Monte Carlo simulation, applying probabilities of default based on the external or internal rating category assigned to each customer by the Bank. As well as the customer's credit rating, the sector in which the customer operates and other risk-related characteristics are also taken into account. The calculation is based on a holding period of one year and a confidence level of 99% from a periodic perspective and 99.98% from a net present value perspective. If a sufficient default history is available (in the case of private clients and corporate clients in the rental housing sector), the Bank's own borrower correlations and recovery rates are incorporated into the assessment. Otherwise, the regulatory borrower correlations are applied. When calculating the amount of the loss, security provided in the form of cash collateral and/or loans granted to end-borrowers in accordance with the 'borrower's bank' principle are taken into consideration. For any unsecured portion, the regulatory (IRBA) recovery rate of 55% is applied to ‘Companies in the financial sector’. A recovery rate of 78% is assumed for ‘Public sector’ business lines, based on the results of a benchmark survey. For borrowers in the ‘Other companies’ category, no representative loss history is available. Consequently, based on an expert opinion, a recovery rate of 30% is applied. For all securities eligible for bail-in, a residual debt servicing capability of 25% is assumed, as their servicing is prioritised over any subordinated risk claims (for which the regulatory residual debt servicing capability is 25%).

The value at risk (VaR) for counterparty default risks is calculated on the basis of a Monte Carlo simulation that takes account of borrower correlations, which are used to incorporate individual borrower concentration risks into the assessment. In addition, concentration risks associated with subportfolios are calculated by assessing the VaR for each subportfolio and then using the sum of these individual values as the total VaR in the risk management system.

The following table provides an overview of the proportion of the aggregate loss ceiling taken up by counterparty default risks in the course of 2018.

VALUE AT RISK FOR COUNTERPARTY DEFAULT RISKS IN 2018 in EUR millions

	01.01.2018		31.03.2018		30.06.2018		30.09.2018		31.12.2018	
	Limit	Used	Limit	Used	Limit	Used	Limit	Used	Limit	Used
Aggregate loss ceiling	1,000.0	324.0	1,000.0	325.7	1,000.0	357.6	1,000.0	375.5	1,000.0	327.9
Share of counterparty default risks in %	47.5	66.5	47.5	71.8	47.5	64.5	47.5	62.6	47.5	63.6
Counterparty default risks	475.0	215.6	475.0	233.9	475.0	230.7	475.0	235.0	475.0	208.4
Private clients	60.0	0.0	60.0	7.4	60.0	6.9	60.0	9.4	60.0	0.0
Companies in the financial sector	215.0	128.9	215.0	143.7	215.0	138.7	215.0	144.3	215.0	128.7
Other companies	150.0	86.7	150.0	82.8	150.0	85.1	150.0	81.2	150.0	79.7
Public sector	50.0	0.0	50.0	0.0	50.0	0.0	50.0	0.0	50.0	0.0

Timely and adequate risk provisions

L-Bank makes appropriate allowance for counterparty default risks that have become acute by setting aside risk provisions. For this purpose, the Bank has set up dedicated processes based on various tools used for the early detection of risks, and has issued appropriate guidelines. The following table shows the changes in value adjustments for each business unit, as well as the corresponding risk portfolios. It shows valuation allowances that are deducted from the outstanding loans to determine net positions when calculating the capital required pursuant to CRR. From the periodic perspective, any valuation allowances that are not deducted from book values when calculating the required capital pursuant to CRR remain available to L-Bank as risk coverage capital (e.g. contingency reserves pursuant to Section 340f HGB).

VALUE ADJUSTMENT RATIOS AS AT 31.12.2018 in EUR millions

	Private clients		Companies and self-employed persons		Companies in the financial sector		Public sector		Total		
	Adjust-ment	Portfolio	Adjust-ment	Portfolio	Adjust-ment	Portfolio	Adjust-ment	Portfolio	Adjust-ment	Portfolio	Ratio %
31.12.2011	100.4	7,251.9	567.1	11,659.9	31.6	33,710.5	0.0	20,177.2	699.1	72,799.5	1.0
31.12.2012	88.6	6,771.8	505.8	10,959.8	31.6	31,236.1	0.0	23,941.6	626.0	72,909.2	0.9
31.12.2013	92.9	6,373.7	432.1	10,886.2	31.6	31,300.6	0.0	23,846.3	556.6	72,406.8	0.8
31.12.2014	87.6	6,091.8	373.2	11,006.3	21.9	30,211.3	0.0	23,039.4	482.7	70,348.9	0.7
31.12.2015	88.8	5,873.0	265.4	9,183.5	15.0	30,393.8	35.8	27,784.3	405.0	73,234.6	0.6
31.12.2016	95.6	6,307.2	202.1	8,641.0	15.0	31,621.9	0.0	31,371.6	312.7	77,941.8	0.4
31.12.2017	80.1	6,123.0	123.3	8,482.6	25.6	30,234.5	2.8	28,382.7	231.8	73,222.8	0.3
31.03.2018	68.8	6,119.4	115.4	8,586.5	31.9	37,388.6	2.8	26,924.8	218.9	79,019.3	0.3
30.06.2018	65.3	6,104.6	120.1	8,645.8	31.9	36,646.1	2.8	26,638.0	220.1	78,034.5	0.3
30.09.2018	59.3	6,086.8	121.6	8,808.0	25.6	36,885.8	2.8	25,063.4	209.3	76,844.1	0.3
31.12.2018	71.4	6,035.8	122.6	8,843.9	18.2	32,322.7	0.8	24,589.5	213.0	71,791.8	0.3

Qualitative assessment based on credit rating and collateral classifications

For the qualitative assessment of counterparty default risks, each borrower is assigned a credit rating expressed as a risk category. In assigning individual ratings, L-Bank takes account of the peculiarities of the relevant client's structure. For borrowers involved in development finance for owner-occupied housing, the homogeneity of the customer group means that they are assigned a default rating based on the average probability of default. The following table shows the default probabilities for the individual risk categories and shows internal risk categories against the corresponding external risk categories.

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 probability of default 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 (S&P)		AA+		A		BBB			BB–	B	CCC+	CC		
	AAA	AA	A+	A–	BBB+	BBB–	BB+	BB	B+	B–	CCC	C	Default	Default
		AA–									CCC–			
	Investment grade						Non-investment grade							

Organisational units responsible for extending loans are always obliged to ensure that lending decisions are backed by sufficient collateral, in order to reduce the unsecured portion and thus the loss exposure. 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 of the loan. Collateral that – for material or formal reasons – may not be assigned any explicit collateral value must still be accepted when granting loans if the acceptance of such collateral is standard industry practice and if, in the event of enforced realisation, the Bank can expect to realise recovery proceeds.

To indicate the loss exposure, the risk-mitigating effects of certain types of collateral are taken into consideration. Receivables from regional banks guaranteed by 'grandfathering' and underwritten by public guarantee and maintenance obligations are assigned to risk category 1. Similarly, loans guaranteed by municipalities and real-estate loans secured on residential properties in Baden-Württemberg are also allocated to risk category 1. Where collateral in rem is provided in the form of residential property in Baden-Württemberg – independent of the real-estate loan, but within the relevant lending value – it is assigned to risk category 4. In the case of Pfandbriefe and similar bond issues (e.g. covered bonds), the external issue rating is used.

The following table shows the risk portfolios for each of the Bank's business units.

RISK STRUCTURE OF THE LOAN PORTFOLIO AS AT 31.12.2018 in EUR millions

Risk category	Private clients	Companies and self-employed persons	Companies in the financial sector	Public sector	L-Bank total	Allocation in %
1	3,626.2	4,254.1	6,455.8	19,950.3	34,286.4	47.8
2	7.0	299.7	1,937.2	4,329.6	6,573.5	9.2
3		1,338.5	7,747.9	51.4	9,137.8	12.7
4	1,872.8	1,880.5	13,113.4	1.0	16,867.6	23.5
5	223.2	586.6	1,475.7		2,285.5	3.2
6	219.8	140.7	1,246.3	257.2	1,864.0	2.6
7	61.9	105.8	15.2		182.9	0.3
8	0.0	129.9	192.4		322.3	0.4
9	2.9	13.0	44.9	0.0	60.8	0.1
10	0.3	3.8	13.5	0.0	17.6	0.0
11	0.3	1.0	50.0		51.3	0.1
12	1.0	11.2	29.9		42.1	0.1
13	6.2	61.2	0.0		67.4	0.1
14	14.2	18.0	0.6		32.8	0.0
Total	**6,035.8**	**8,843.9**	**32,322.7**	**24,589.5**	**71,791.8**	**100.0**

The total exposure shown above, amounting to EUR 71,791.8 million, includes securities totalling EUR 22,040.0 million. L-Bank aims to hold securities to final maturity. With the exception of buy-backs of own issues and purchased securities with a residual maturity of less than one year at the time of purchase, all securities are assigned to fixed assets. The Bank consequently treats them as loans and applies a mitigated form of the lower of cost or market principle. No securities have been written down due to permanent impairments. As at 31 December 2018, general value adjustments totalling EUR 13.7 million are in place (2017: EUR 16.1 million). The credit quality of the securities is shown below. Any savings on the lower of cost or market value of securities are reported under hidden liabilities.

RISK STRUCTURE OF THE SECURITIES PORTFOLIO AS AT 31.12.2018 in EUR millions

Risk category	Portfolio	Hidden liabilities	Credit spread risks
1	15,069.9	29.7	769.2
2	3,665.7	4.3	123.0
3	1,060.2	2.3	33.7
4	1,613.2	3.9	55.6
5	156.3	1.2	4.8
6	431.9	6.2	6.1
7	0.0	0.0	0.0
8	0.0	0.0	0.0
9	42.8	10.4	7.0
10	0.0	0.0	0.0
11	0.0	0.0	0.0
12	0.0	0.0	0.0
13	0.0	0.0	0.0
14	0.0	0.0	0.0
Total	**22,040.0**	**57.9**	**999.3**

Monitoring of problem loans

Loans are classified as non-performing exposures (NPEs) if there are strong indications that in order to avert or minimise losses, actions may be necessary that go beyond the normal scope of client support and intensified contact with the client, and may extend to requiring the provision of additional collateral as part of collaborating with the client in an intensive support process. Loans are classified as NPEs according to the following criteria:

→ the client is in material default of payment, i.e. is more than 90 days in arrears with a payable that is greater than 2.5% of the total debt and greater than EUR 100, or
→ the client's internal rating places them in risk category 13 or 14, or
→ an individual risk provision has been made against the client, or
→ collateral provided to L-Bank by the client is being liquidated (by compulsory auction, foreclosure or private sale), or
→ the client is classified as 'forborne' and is under problem-loan processing.

As at the year-end, the NPE portfolio amounted to EUR 156.5 million. The unsecured portion of the NPEs, as determined after prudent valuation of the collateral provided, is fully covered by risk provisions.

When classifying NPEs, the Bank distinguishes between restructuring exposure (risk category 13) and workout exposure (risk category 14). The portfolio is distributed across the Bank's business units as shown below.

NPE PORTFOLIO AS AT 31.12.2018 in EUR millions

	Total risk portfolio	NPE portfolio		Restructuring portfolio		Workout portfolio	
		Total	in %	Total	in %	Total	in %
Private clients	6,035.8	69.4	1.15	44.0	0.73	25.5	0.42
Rental housing customers	5,895.4	15.7	0.27	4.7	0.08	10.9	0.19
Companies in the financial sector	32,322.7	0.6	0.00	0.0	0.0	0.6	0.00
Other companies	2,948.5	70.8	2.40	63.4	2.14	7.4	0.25
Public sector	24,589.5	0.0	0.00	0.0	0.0	0.0	0.00
Total	**71,791.8**	**156.5**	**0.22**	**112.1**	**0.16**	**44.4**	**0.06**

'Forborne loans' are balance sheet assets where the Bank has given a borrower in financial difficulties extra concessions as part of the restructuring process (e.g. in the form of debt deferral agreements, maturity extensions, repayment holidays or debt rescheduling) in order to re-establish or assure the borrower's capacity to meet principal repayments in the event that the said capacity has ceased to exist or is acutely at risk. Such a loan must be reported as an NPE and forborne loan for a period of one year after the financial difficulties have been resolved. The loan must then be classified exclusively as a forborne loan for a further two years (forbearance period). As at 31 December 2018, the forborne loan portfolio amounted to EUR 81.5 million. Of this, an amount of EUR 22.9 million is still in the forbearance period.

Assessing risk concentrations

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

In housing finance, 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 general conditions in the housing development market, a proportion of around 26.6% is secured independently of real-estate loans. The collateral is contractually agreed in the form of land charges.

Because development funding is restricted to the jurisdiction in which the guarantor is located, the Bank's housing finance activities are associated with a concentration risk linked to residential property in Baden-Württemberg. In the event of a severe economic downturn, the default rate would rise and proceeds 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. The Bank also analysed 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 as a function of the regional economy's dependence on exports, as well as the level of unemployment prevailing in the region.

The risk of insolvency decreases if residential property prices in the region are relatively low and the region in question has a well-integrated infrastructure. The risk of insolvency is expressed as the difference between the level of borrowers' risk in a region and the risk associated with an average borrower in Baden-Württemberg. A scoring system was used to determine the relative exposure. This showed that 58.37% of the Bank's housing development finance is committed in regions with above-average sensitivity to economic cycles. Thus, measured in terms of the federal state's economic sensitivity, the economic sensitivity of the loan portfolio rates as slightly above average.

Guarantees are subject to another collateral-related concentration risk. Of the guarantees received (without public guarantee or maintenance obligation) worth around EUR 8,331.1 million, the State of Baden-Württemberg accounts for some EUR 7,116.3 million. Due to the credit standing of the State of Baden-Württemberg, L-Bank regards this risk as negligible. Another EUR 1,005.4 million is associated with sureties/guarantees provided by other local authorities in Germany. A total of EUR 209.4 million is based on sureties/guarantees provided by private individuals, companies, banks, public-sector bodies in Germany other than local authorities, and central and regional governments abroad.

Due to L-Bank's business model, there is a further concentration risk associated with receivables from banks (EUR 29,736.9 million). Also included in this amount are receivables from central banks and other public bodies that are not taken into consideration when determining the degree of interdependency between an institution and the financial system pursuant to Commission Delegated Regulation (EU) 1222/2014 of 8 October 2014. However, the contagion risk to which L-Bank is exposed through receivables from banks is classed as exceptionally low. L-Bank extends loans for business development purposes via the borrowers' commercial banks. The Bank's exposure to these borrowers' bank loans amounted to EUR 20,289.7 million as at 31 December 2018. These lendings to banks are secured by the assignment to L-Bank of claims on end clients. Another EUR 9.8 million is attributable to the fact that L-Bank has underwritten the commercial banks' exposure to end-client risk. EUR 9,437.4 million of the Bank's total lending commitment relates to transactions associated with development aid business, whereby the Bank invests low-cost funds from refinancing in low-risk or risk-free issuers. Of this amount of EUR 9,437.4 million, EUR 5,650.9 million is secured by public guarantee/maintenance obligation, and EUR 93.8 million against Pfandbriefe. After deducting receivables from central banks (EUR 115.2 million) and multilateral development banks (EUR 1,307.6 million), the remaining unsecured volume is EUR 2,269.9 million. Roughly 89% of this is assigned to risk categories 1 to 4 and approximately 11% to risk categories 5 and 6.

In regional terms, the Bank's public-service mandate means that it is exposed to a concentration risk for the region 'Germany'. A total of 91.5% of the risk portfolio is assignable to Germany, of which 68.5% relates to the State of Baden-Württemberg.

REGIONAL STRUCTURE OF THE LOAN PORTFOLIO AS AT 31.12.2018 in EUR millions

	Private clients	Companies and self-employed persons	Companies in the financial sector	Public sector	L-Bank total	Allocation in %
Germany total	**6,035.6**	**8,572.7**	**27,430.3**	**23,679.0**	**65,717.6**	**91.5**
Austria		24.1	77.8	141.7	243.6	0.3
Belgium		0.0	6.0		6.1	0.0
Finland			10.1		10.1	0.0
France	0.1	35.2	505.2	514.0	1,054.6	1.5
Italy			35.1	254.8	289.8	0.4
Luxembourg			42.8		42.8	0.1
The Netherlands		34.0	926.0		960.1	1.3
Portugal		3.6			3.6	0.0
Other eurozone countries	0.0	0.0	0.0	0.0	0.0	0.0
Eurozone total	**0.1**	**97.0**	**1,603.0**	**910.5**	**2,610.7**	**3.6**
Denmark			15.1		15.1	0.0
Great Britain*		2.1	320.5		322.6	0.4
Switzerland	0.0	120.2	213.3		333.5	0.5
Rest of Europe			33.2	0.0	33.2	0.0
Non-eurozone total	**0.0**	**122.3**	**582.1**	**0.0**	**704.4**	**1.0**
Europe total	**0.1**	**219.3**	**2,185.2**	**910.5**	**3,315.1**	**4.6**
USA		49.9	455.9		505.8	0.7
Canada	0.0	0.0	428.0	0.0	428.0	0.6
International organisations**	0.0	0.0	1,342.2	0.0	1,342.2	1.9
Other countries		2.0	481.2		483.1	0.7
Overseas total	**0.1**	**271.2**	**4,892.4**	**910.5**	**6,074.3**	**8.5**
Total	**6,035.8**	**8,843.9**	**32,322.7**	**24,589.5**	**71,791.8**	**100.0**

* Includes Guernsey, Jersey, Isle of Man and Cayman Islands.
** World Bank, European Investment Bank, European Bank for Reconstruction and Development, European Investment Fund.

The Bank's risk exposure in the crisis-affected peripheral eurozone nations stood at approximately EUR 293.5 million as at 31 December 2018. Of this, roughly EUR 254.8 million (86.6%) is payable by national governments. The residual portfolio of exposed commitments in crisis-affected peripheral eurozone countries will amount to EUR 3.6 million as at 31 December 2020.

Managing and monitoring counterparty default risk

Counterparty default risk is managed by setting individual limits for issuers, counterparties and borrowers. The Bank limits concentration risks by establishing budgeted volumes for risk categories, industries and regions. In this respect, L-Bank's public-service mandate imposes tight constraints. Consequently, the representation of concentration 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 may issue to a single borrower incurring a commercial risk outside the Federal Republic of Germany is restricted by appropriate limits set at country level (country limits).

Issuer, counterparty, borrower and country limits are set by the senior management team, based on an internal analysis of credit quality and monitored on a daily basis. When any of these limits are exceeded, appropriate risk response measures are initiated on the same day.

As part of the Bank's risk strategy, the senior management team stipulates the credit rating requirements to be fulfilled by any development business unrelated to development programmes. Such transactions are generally carried out in the context of development aid business, with the Bank seeking to generate income from refinancing rather than by assuming risk. For the purposes of proper risk management, the Board has stipulated that a market-standard, risk-based margin should be set for any transactions where margins are not specified under the terms of a development programme.

The operational management of counterparty default risk is based on first-time, ongoing and incident-related evaluations of credit standing and collateral. The latter are used for managing portfolios when extending credit, and also for initiating risk-response measures at the earliest possible moment, thereby minimising lending losses. As part of this risk early warning system, the Bank analyses deteriorating credit ratings at client level, analyses loans at the intensive processing or problem-loan processing stage, and analyses levels of compliance with Section 18 KWG, as well as changes in the recovery rates of defaulted loans in the housing development sector.

The specified processes for dealing with problem loans and non-performing commitments include a tightly controlled system of warning processes, which ensures that claims are safeguarded and outstanding debts are settled at the earliest possible stage.

Counterparty default risk is strongly influenced by the state of the economy, the low level of interest rates, but also by changes to personal circumstances (e.g. divorce). It is likely that persistently low interest rates will continue to have a positive impact on counterparty default risk. Furthermore, an improvement in the economic situation may have a positive impact on the portfolio's risk structure and lead to reversals of value adjustments.

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). Market price risk mainly exists in the form of interest rate risks and, to a negligible extent, currency risks. The Bank's lending business includes some risks from embedded options.

L-Bank has not separated out funds invested to cover pension provision commitments to employees. These investments form part of the euro bank book. Consequently, for the purposes of assessing market price risk, payments expected to cover pension commitments have been taken into consideration based on the figures used to calculate these pension commitments.

In the case of structured transactions and foreign-currency transactions, market price risk is excluded using micro hedges. Essentially, computed market price risk relates to the investment of the Bank's equity. The Bank avoids other interest rate positions – especially in the medium and long term – primarily by means of interest rate swaps and cross-currency interest rate swaps. As at 31 December 2018, the portfolio of interest rate swaps had a nominal value of EUR 72,137.2 million. Cross-currency interest rate swaps had a nominal value of EUR 12,991.3 million, currency swaps had a nominal value of EUR 10,087.2 million. As a general rule, hedging relationships are reported in the balance sheet in the form of valuation units within the meaning of Section 254 HGB, as well as currency translation within the meaning of Section 256a in conjunction with Section 340h HGB, and the loss-free valuation of the bank book within the meaning of IDW RS BFA 3.

Quantitative assessment based on value at risk

Risks on unanticipated losses are calculated using a VaR model. For this purpose, the Bank uses the historical simulation method. As interest rates are still very low, only absolute (not relative) changes in interest rates are taken into account when calculating the VaR. The calculation is based on historical interest rate changes over a period of 10 or 25 working days over an observation period of 1,250 days. Accordingly, two models are produced for the daily monitoring of limits and the higher risk value is applied.

To monitor risk-bearing capacity (RBC), one model is used for each of the periodic and net present value perspectives with a confidence level of 99% and 99.98% respectively, and a holding period of 250 days. The following table shows the parameters that are being used for the current calculations:

PARAMETERS USED IN HISTORICAL SIMULATIONS

	Holding period (trading days)	Historical observation period (trading days)	Confidence level	Application
Absolute interest rate changes	10 and 25	1,250	99.00%	Daily limit monitoring
Absolute interest rate changes	250	2,500	99.00%	RBC, periodic perspective
Absolute interest rate changes	250	5,000	99.98%	RBC, NPV perspective

In the periodic perspective, the Bank also checks whether the negative impact of a parallel shift of ±200 basis points in the yield curve on net interest income for one year exceeds the period-specific net present value VaR. The higher value is imputed when reviewing the Bank's risk-bearing capacity for market price risks in the euro bank book.

The following table provides an overview of the proportion of the aggregate loss ceiling taken up by market price risks in the course of 2018.

VALUE AT RISK FOR MARKET PRICE RISK IN 2018 in EUR millions

	01.01.2018		31.03.2018		30.06.2018		30.09.2018		31.12.2018	
	Limit	Used	Limit	Used	Limit	Used	Limit	Used	Limit	Used
Aggregate loss ceiling	1,000	324.0	1,000	325.7	1,000	357.6	1,000	375.5	1,000	327.9
Share of market price exposure in %	16.5	12.3	16.5	14.2	16.5	12.4	16.5	15.3	16.5	10.6
Market price risks	165	39.9	165	46.2	165	44.4	165	57.5	165	34.7

Qualitative assessment based on stress scenarios

VaR values allow potential unanticipated losses to be quantified based on certain assumed market continuities. Because – in view of the financial market crisis experience – such steady, linear market trends can no longer be taken for granted, the Bank also systematically simulates stress, extreme and worst-case scenarios.

L-Bank uses the stress tests to investigate potential losses as a result of various, more or less extreme market changes. For example, the impact of a regulatory scenario involving a parallel shift in the yield curve by 200 basis points upwards or downwards is explored, with a view to assessing the impact of any resulting loss on equity capital. Given that the open interest rate risk positions in the medium-term and long-term segments essentially relate to the investment of equity capital, only scenarios with rising interest rates represent stress situations. The risks reported here largely relate to an estimated loss of additional revenue. The following table shows the loss of market value in the event of such a parallel shift of the yield curve.

NEGATIVE CHANGES IN NET PRESENT VALUE DUE TO A SHIFT OF 200 BASIS POINTS IN THE YIELD CURVE

	Year-end 31.12.2018	Maximum 2018	Minimum 2018	Average 2018
Loss of net present value in EUR millions	259.9	390.4	194.2	286.0
Proportion of equity in %	6.6	10.2	5.0	7.4
Loss of net present value with repayment of equity in EUR millions	37.3	63.9	33.7	46.9
Proportion of equity in %	0.9	1.7	0.9	1.2

Managing market price risks

The VaR limits specified by the senior management team are used as the basis for managing market price risks. To further limit interest rate risk in the non-trading portfolio, senior management regularly defines a maturity-based target risk structure. This sets out the target interest rate risk profile. The permissible deviation of actual from target risk structure is restricted by setting a limit for each maturity band.

The Controlling department is responsible for monitoring interest rate risk and currency risk by comparing the VaR figures calculated each day with the specified limits. The senior management team is kept informed of market price risks in a daily risk report, as well as a full monthly report.

The interest rate risks reported relate primarily to the relatively long-term investment of equity capital. Consequently, the only way to reduce the interest rate risk would be to invest equity capital on a short-term basis. To this extent, L-Bank's interest rate risks and earnings risks are diametrically and irresolvably opposed. Any increase in capital market interest rates would have a positive impact on net interest income.

LIQUIDITY RISK

As far as L-Bank is concerned, liquidity risk encompasses the risk that payment obligations cannot be met when they fall due (insolvency risk). It also includes the risk that sufficient levels of liquidity cannot be obtained on the expected terms when required (funding liquidity risk). Market liquidity risk is managed via market price risk and funding liquidity risk.

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 that were favourable to both the Bank and its investors.

Quantitative assessment using value at risk

Funding liquidity risk is the risk of a potential deterioration in the refinancing options available to L-Bank. The relevant VaR is calculated on the basis of historical changes in L-Bank's refinancing conditions. The underlying assumption is that the Bank is only able to refinance net disbursements on less advantageous terms. The resulting additional refinancing expenses within the one-year risk observation period represent the VaR.

VALUE AT RISK FOR FUNDING LIQUIDITY RISK IN 2018 in EUR millions

	01.01.2018		31.03.2018		30.06.2018		30.09.2018		31.12.2018	
	Limit	Used	Limit	Used	Limit	Used	Limit	Used	Limit	Used
Aggregate loss ceiling	1,000	324.0	1,000	325.7	1,000	357.6	1,000	375.5	1,000	327.9
Share of liquidity risks in %	23.0	13.3	23.0	12.7	23.0	11.3	23.0	10.9	23.0	13.0
Liquidity risks	230.0	43.0	230	41.3	230	40.5	230	40.9	230	42.7

Market price and liquidity risks from embedded options that are not included in the VaR for market price and liquidity risks are valued separately and updated annually. In 2018, they were attributed a calculated VaR of EUR 25.0 million.

Quantitative assessment using regulatory ratios

The Bank is also required – pursuant to CRR in conjunction with Commission Delegated Regulation (EU) 2015/61 – to measure its insolvency risk using the LCR and to comply with this ratio. Since 2018, the Bank has been required to maintain an LCR of 1.0.

LIQUIDITY RATIO IN 2018: LIQUIDITY COVERAGE RATIO ACCORDING TO CRR IN CONJUNCTION WITH DELEGATED REGULATION (EU) 2015/61

Month	Liquidity Coverage Ratio (LCR)
January	2.23
February	2.86
March	2.25
April	2.33
May	3.11
June	1.81
July	2.87
August	2.79
September	2.49
October	2.38
November	3.54
December	2.80
Average ratio	**2.62**

Quantitative assessment based on stress scenarios

To safeguard its solvency at all times, the Bank maintains liquidity buffers to cover its liquidity requirements. These liquidity buffers consist exclusively of liquid securities which are classified – according to their assumed convertibility into cash – as: highly liquid (convertible within seven days) or liquid (convertible within 30 days). 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, even under conditions of stress. For this purpose, the Bank analyses stress scenarios based on endogenous (in-house), exogenous (market-wide) or combined causes. An endogenous stress scenario is used to simulate the early outflow of liquid funds as a result of the exercising of all termination rights relating to liability transactions over a one-month period. The following assumptions are made for the exogenous stress scenario: first, a fall in the price of all securities in the amount of the haircut.

Second, an immediate collateral payment in the amount of the largest absolute change in collateral accounts within 30 days of the last 24 months. And finally, withdrawal of all commitments from master accounts at the earliest possible date. Additionally, all three scenarios are considered in combination, without taking any risk-reducing correlation effects into account.

Liquidity buffers are reviewed on a monthly basis. In addition, a monthly forecast calculation based on conservative assumptions, and taking advantage of the maximum liquidity limit required in a single month, is used to check whether the liquidity buffers will also be sufficient to cover refinancing needs under stress conditions for the whole of the following month.

LIQUIDITY BUFFERS SUBJECTED TO STRESS SCENARIOS AS AT 31.12.2018 in EUR millions

	Liquidity forecast	Stress scenario Endogenous causes	Stress scenario Exogenous causes	Stress scenario Endogenous and exogenous causes combined
7-day buffer				
Liquidity buffer	14,298	14,298	13,536	13,536
Liquidity requirement	2,805	2,805	6,180	6,180
Convertible liquidity buffer (at balance-sheet date)	11,493	11,493	7,356	7,356
Minimum convertible liquidity buffer (monthly forecast)	7,996	7,986	3,911	3,901
30-day buffer				
Liquidity buffer	16,036	16,036	14,933	14,933
Liquidity requirement	4,302	4,312	7,643	7,653
Convertible liquidity buffer (at balance-sheet date)	11,734	11,724	7,290	7,280
Minimum convertible liquidity buffer (monthly forecast)	7,145	7,092	2,722	2,669
Minimum convertible buffer (with maximum requirement)	4,036	3,983	1,677	1,641

The very minor variance between the liquidity forecast and the 'endogenous causes' stress scenario is due, firstly, to the fact that the liquidity forecast is drawn up in line with the principle of prudence. Secondly, thanks to L-Bank's business model, in terms of refinancing the Bank only has a negligible amount of indeterminate cash flows; thus even if the termination rights relating to these transactions were exercised within one month, this would only have a minor impact.

In addition to calculating the liquidity buffer, the Bank also calculates a survival time frame. This indicates how long the Bank can meet its payment obligations by using liquid assets, without refinancing and without adjusting its business operations (even under stress conditions). In the stress scenario, it is assumed that all callable refinancing is due on the next call date, that an immediate collateral payout must be made that is equivalent to the largest absolute change in collateral accounts over any 30-day period in the last 24 months, and that all credit lines are revoked with immediate effect (i.e. worst-case assumptions). The survival time frame must not be less than 60 days. This limit serves as an early warning threshold to ensure that the Bank has an adequate liquidity buffer.

Management of liquidity risks

Operational 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 following two months. 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 3 to 10. When producing this liquidity forecast, the Bank assumes that contractual maturities will apply. For future interest rate adjustments relating to housing development, the Bank extrapolates the current nominal interest rate. No assumptions are made regarding the extension 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.

The Bank has formulated a number of policies for managing liquidity risk. In addition to limiting the maximum liquidity requirements for a single month, the Bank also limits funding liquidity risk by restricting the refinancing transactions required per maturity year. Holdings of ECB-eligible securities and securities that can be converted on demand may not fall below a minimum threshold.

Liquidity risk is assessed on a monthly basis. Along with market price risk, compliance with risk management policies is reported to the senior management team on a daily basis.

The Bank continues to be able to obtain refinancing on very favourable terms thanks to the explicit guarantee provided by the State of Baden-Württemberg and the latter's unchanged first-class credit ratings. The ongoing international demand for liquid and safe investments continues to offer the Bank broadly diversified and reliable opportunities to raise capital.

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. The Bank has classed the additional transfer and conversion risks (for transactions in foreign currencies) associated with transactions with business partners abroad as legal risk.

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 loss events. As of 30 June 2018, the Bank's analytical VaR calculation has been supplemented by a comparison with the regulatory baseline indicator approach, in anticipation of new regulatory requirements for ICAAP. Since then, the higher of the two values has been applied to the limit. The analytically calculated VaR from operational risks is based on historical observations and expert estimates of the probability of occurrence of, and extent of the losses resulting from, disruptions in any risk-bearing process at the 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 minimal 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 loss events alone.

The size and scope of operational risks are identified and assessed with the aid of structured interviews across all departments. The identified risks are assigned to five categories. These are measured by the impact on L-Bank's financial position of a potential risk were it to materialise, and also the anticipated frequency of such an occurrence.

VALUE AT RISK FOR OPERATIONAL RISK IN 2018 in EUR millions

	01.01.2018		31.03.2018		30.06.2018		30.09.2018		31.12.2018	
	Limit	Used	Limit	Used	Limit	Used	Limit	Used	Limit	Used
Aggregate loss ceiling	1,000.0	324.0	1,000.0	325.7	1,000.0	357.6	1,000.0	375.5	1,000.0	327.9
Share of operational risks in %	1.0	0.5	1.0	0.4	5.0	11.0	5.0	10.4	5.0	12.0
Operational risk	10.0	1.7	10.0	1.4	50.0	39.2	50.0	39.2	50.0	39.2

In addition to the usual insurance policies taken out to mitigate the business impact of certain loss events, the internal control system acts as the basis for avoiding operational risks. It includes comprehensive implicit and explicit procedures for safeguarding the Bank's process workflows (e.g. two-person verification; random spot checks; procedural requirements in the event of changes to operating processes or structures; an IT permissions management system that excludes conflicts of interest between incompatible activities; rigorous selection criteria for new recruits). The system as a whole is based on the Bank's written documentation, which takes a modular approach to the formulation of the rules governing corporate structure and workflow.

To ensure that the Bank only enters into business transactions that it can process and manage in a manner commensurate with the associated risk, a new product process is applied to all new types of business. Prior to first-time acceptance, test cases are used to determine the extent to which existing processes and procedures are sufficient to map the new type of business. In each case, the result of these test runs is a concept in which all HR, organisational, IT, accounting and fiscal consequences associated with the new business are presented.

Operational risk is also reduced through ongoing monitoring of adherence to relevant legal and regulatory provisions (e.g. compliance, prevention of money laundering and fraud, data protection). The aim of the Compliance department is to exclude risks that could arise from non-compliance with legal requirements. Consequently, it is the role of the department to help implement effective procedures to ensure that L-Bank complies with the statutory regulations and policies that govern the Bank's activities, and to put in place the necessary controls. Compliance with these requirements is assured by suitable organisational measures and the ongoing monitoring of relevant business transactions.

Given the portfolio structure, transfer and conversion risks are generally of very limited significance for the Bank. The risk that L-Bank might suffer losses as a result of restrictions on payment transactions and/or currency convertibility as a result of statutory interventions in or against the countries involved is regarded as negligible.

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 and IT user manuals, on the other hand, 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 (restructuring or workout). Criteria have been established for each stage in the process and must be complied with when a loan is being processed. These processing criteria constitute 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 transactions 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 supervisory activities relating to settlement and controls.

The rules governing corporate structure specify where particular business activities are carried out (organisation chart and schedule of responsibilities). The rules governing 'management and representation' specify who may carry out specific business activities. Statutory requirements pertaining to employment law and industrial relations are managed by service agreements and employment policies.

RECOVERY PLANNING

The European Central Bank asked L-Bank to prepare a recovery plan. The recovery plan was drawn up in compliance with the relevant European regulations and with the German Recovery and Resolution Act (SAG). The recovery plan supplements L-Bank's existing tools for managing risk and the Bank as a whole. These aim to improve the Bank's responsiveness so that future crises can be avoided.

L-Bank's senior management has set up a Recovery Planning Working Group. Under the direction of the Controlling department, this working group prepares L-Bank's recovery plan and is responsible for updating it. The plan contains a strategic analysis, complete with a breakdown of the Bank's significant business transactions, functions and relationships. The plan also presents the methods used to select the recovery indicators, and subsequently describes them in detail. The effectiveness of the selected courses of action are reviewed in the form of stress analyses. Also included in the recovery plan is information on the allocation of responsibilities for the recovery process. The Bank's recovery governance and thresholds have been set by the Board of Management and Supervisory Board.

Recovery governance

Recovery governance is based on existing structures and reporting lines. Where thresholds are exceeded, a Crisis Committee is convened, at which senior management and the relevant specialist departments discuss the cause and likely duration of the aberration and consult on appropriate courses of action. In such circumstances, the senior management team will also decide on the appropriate communication strategy. Because all risk-related decisions at L-Bank are made by the senior management team, the latter also bears sole responsibility for determining the necessary recovery measures.

Findings

Overall, L-Bank has found that its business activities and network of relationships do not pose a threat to the stability of the financial system or real economy. Furthermore, the Bank has recourse to various courses of action that could be used to avoid situations that might pose a risk to the Bank's continued existence.

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 put a comprehensive internal control and risk management system in place that is continuously reviewed and developed. The system includes specific rules relating to corporate structure and workflow management. These rules ensure compliance with existing accounting standards and regulations, as well as the regularity and reliability of the Bank's accounting functions. The accounting process set down in this system covers everything from the booking and processing of a business transaction through to the preparation of the annual financial statements and management report. L-Bank's senior management team 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 department and the Payment Transactions and Trade Settlement department. In addition, the Internal Audit unit carries out regular, process-independent checks 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. The comprehensive management reporting function and the Accounting department's involvement in the standardised process for introducing new products also help to ensure that the accounting treatment of new products is correct.

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

The departments most heavily involved in the accounting process have clearly separated functions. The Payment Transactions and Trade Settlement department manages subledgers for loans, securities, and debt and equity accounting. The data is transferred to the general ledger via an automated interface. 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.

L-Bank uses standard software for its financial accounting. This 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.

At the same time, these measures serve to ensure that assets and liabilities are correctly assigned and reported, and also plausibly valued.

The annual financial statements and management report are derived from the Bank's financial accounting. For the management report in particular, financial and risk control data is obtained from the internal management information system, which is subject to a comparable system of internal controls. The annual financial statements and management report are also subject in their entirety to additional manual controls based on the two-person verification principle (routine double checks).

Up-to-date, reliable and relevant reports on the risk management system as it applies to accounting are regularly submitted to senior management and heads of department. Senior management provides the Supervisory Board and its committees with regular updates on the progress of the Bank's business activities, and also provides ad hoc reports on any exceptional events as and when they occur.

Karlsruhe, 1 March 2019

Dr. Axel Nawrath	Dr. Iris Reinelt
Dr. Ulrich Theileis	Johannes Heinloth

SEPARATE NON-FINANCIAL REPORT – REPORT OF THE BOARD OF MANAGEMENT OF L-BANK FOR FISCAL YEAR 2018

BACKGROUND, CLASSIFICATION AND METHODOLOGICAL APPROACH

The business activities of Landeskreditbank Baden-Württemberg – Förderbank – (L-Bank) are focused on the sustainable development of the Bank and the State of Baden-Württemberg. All the Bank's actions are based on its statutory public-service mandate; to fulfil this mandate, L-Bank's actions must always be exemplary and credible. The L-Bank Sustainability Guidelines and Sustainability Code serve as a frame of reference. The Bank established a bank-wide sustainability management system back in 2013, and the sustainable development model was incorporated into the Bank's business strategy to act as a framework for the Bank's business activities.

Sections 289b to 289e HGB extend the statutory requirements for documenting the impacts of L-Bank's business activities. These requirements are discussed in a separate non-financial report, which forms a chapter in the annual report. The disclosures in the non-financial report were subjected to a limited-assurance audit ('engagement') of business operations by auditing firm PwC in accordance with ISAE 3000 (Revised), and the assurance engagement was awarded an unqualified auditor's opinion.

The way in which the content of the non-financial report is structured reflects the relevant legal requirements. The report is based on the Sustainability Reporting Standards of the Global Reporting Initiative (GRI). These serve as the framework for the non-financial report's descriptions of management approaches and the underlying concepts. In an interdisciplinary, multistage process, the various non-financial criteria or 'aspects' (environmental matters, employee-related matters and social matters; respect for human rights; prevention of bribery and corruption) were assessed for their relevance to L-Bank, and the individual components were then reassessed in terms of their materiality within the meaning of Section 289c (3) HGB. An additional aspect specific to L-Bank was also identified. The results are shown in the table below.

In fiscal year 2018 and as at the reporting date, no material net risks have been identified that are having, or will be very likely to have, severely negative impacts on the above-mentioned aspects. No references to issues associated with the amounts reported in the annual financial statements were required, nor were any additional explanations.

L-Bank's business model and the way it has been implemented in each of the Bank's areas of development activity, as well as the relevant figures, are described in the 'Background' and 'Economic report' sections of the

NON-FINANCIAL ASPECT	COMPONENTS DEFINED AS MATERIAL PURSUANT TO SECTION 289C (3) HGB
Environmental matters	Ecological value added/impact of products
Employee-related matters	Working conditions, personnel development, personnel planning and recruitment
Social matters	Support for entrepreneurship, social value added by development products
Respect for human rights	Protection of personal data – informational self-determination, freedom of assembly and freedom to bargain collectively
Prevention of bribery and corruption	Prevention of money laundering, prevention of terrorist financing
Client matters (additional aspect)	Corporate security, digitisation of business partner relationships, product portfolio/services offered

management report. In accordance with the Minimum Requirements for Risk Management (MaRisk) in banking institutions, L-Bank has installed a risk management system that is bank-specific and optimised to meet the requirements of L-Bank's statutory public-service mandate. L-Bank reports on this in the 'Opportunities and risk report' section of the management report.

ENVIRONMENTAL MATTERS

According to the state constitution, all public institutions in Baden-Württemberg are responsible for protecting the natural environment and its resources for future generations. Climate protection has been firmly embedded in Baden-Württemberg's legislation since 2013. With this in mind, the federal state has set itself the goal of organising the state's administrative bodies so they are largely climate-neutral by 2040. L-Bank has voluntarily adopted this objective for its own business management. In doing so, the Bank regards itself as having a dual duty to protect the environment and the climate; first, as a development bank providing relevant incentives to private individuals, municipalities and businesses, and second, by acting as a role model for other companies and society as a whole. To fulfil this obligation, L-Bank has implemented an integrated environmental management system validated under EMAS and certified to ISO 14001:2015 standard. L-Bank's environmental indicators are recorded and evaluated annually, validated by an independent environmental auditor and published in the environmental statement. The implementation of the EMAS amendment in 2018 will place greater emphasis on organisational context, as well as the identification of interested parties, together with their needs and expectations.

L-Bank's carbon footprint amounted to 1,128 t of CO_2 equivalents (CO_2e) in 2018, breaking down as follows:

Direct greenhouse-gas emissions (GHG emissions) (Scope 1)	313 t CO_{2e}
Indirect GHG emissions from energy supply (Scope 2)	510 t CO_{2e}
Other indirect GHG emissions (Scope 3)	305 t CO_{2e}
Total*	**1,128 t CO_{2e}**

*Increase in Scope 1 emissions due to cooling system leaks that have since been repaired. The allocation of emissions to Scopes 2 and 3 has changed from the previous year as a result of using a new version of the VfU tool.

The Bank's carbon footprint was calculated using the methodology provided by the Association for Environmental Management and Sustainability in Financial Institutions (Verein für Umweltmanagement und Nachhaltigkeit in Finanzinstituten e.V. – VfU), as updated in 2018 (version 1.2). Scope 3 includes GHG emissions from business travel, outsourced activities, water treatment and waste treatment, as well as GHG emissions associated with consumables.

L-Bank uses development programmes to provide investment incentives for greater energy-efficiency, environmentally compatible refurbishment, and the use of renewable energies. Thus the Bank indirectly contributes to reducing carbon emissions. Many of L-Bank's housing development products provide direct incentives for environmental and climate protection. The 'Resource Efficiency Finance' development programme exerts significant influence as an incentive for environmental protection measures, encouraging businesses to save energy and materials. This programme, offered in conjunction with the Ministry of Economic Affairs, Labour and Housing and the Ministry of the Environment, Climate and Energy, awards low-interest development loans, in some cases with repayment subsidies, to small and medium-sized businesses (see also the 'Economic report' section of the management report).

By using webinars to deliver selected training courses to our commercial bank partners, we are digitising the advisory services we provide for our development programmes and making them more environmentally friendly. The technical and infrastructural framework for delivering advisory sessions by video was put in place in 2017; in the course of 2018, this service was offered as a regular service in no less than seven Chambers of Commerce. In 2019, the 'Digital Filing' system already used by individual departments will be rolled out across the whole of L-Bank. The project is in the final stages of implementation.

EMPLOYEE-RELATED MATTERS

L-Bank's long-term success is based on the hard work of its employees. As part of its strategic approach to corporate governance, L-Bank's personnel strategy is based on the Bank's business strategy. Among other things, it includes the Bank's remuneration and recruitment strategy, personnel planning, and a fully integrated personnel development plan. Personnel planning involves analysing how many employees L-Bank needs and which skills sets and abilities these employees should have. The next step involves deciding whether the identified needs should be covered by in-house professional development training or by recruitment. Personnel planning is refined in the light of the specialist departments' objectives, which include planning criteria for staffing. External recruitment needs are established after assessing them against the development options for current L-Bank employees, whose future prospects are always given priority. Working conditions and employee benefits are designed to optimise L-Bank's attractiveness as an employer. This serves to both attract and retain highly qualified employees. As an important part of business planning, personnel planning and recruitment are the subject of reports to the Board of Management. The Personnel department is developing a recruitment strategy. The strategy calls for more recruitment of junior staff through training programmes run in conjunction with the Baden-Württemberg Cooperative State University (DHBW Mosbach), involving the training and retention of DHBW trainees and students. In addition, L-Bank uses a phased retirement programme to structure and systematise the transition from one generation of employees to the next; this makes the planning process more certain.

L-Bank's employee competencies are managed by systematic staff development based on the 360-degree personnel development plan adopted by the Board of Management. Employees' strengths and skills are systematically developed. All training and continuing education initiatives take account of the ever-shortening half-life of knowledge. The design of the personnel development programme is discussed and approved by the interdepartmental Personnel Development committee. The committee is a decision-making body that meets several times a year.

Attractive training schemes are central to L-Bank's development of junior staff. To deliver this training, L-Bank works closely with DHBW Mosbach. L-Bank offers high-school graduates work-study places as students specialising in Business Administration for Banks, and in Business IT. The trainee programme, which was relaunched in 2018, supplements theoretical knowledge with practical experience, thus enabling future managers and specialists to focus on career objectives from the start. Internal talent management is a key element in employees' further development. Based on L-Bank's skills profile, it opens up a wide variety of professional development options for employees by focusing on their strengths. Employees are given the opportunity to participate in the personnel development programme and thus develop new career prospects.

Employees spend a large part of their lives in the workplace, so working conditions have a major impact on their overall physical and mental well-being. The Bank's Code of Ethics and Conduct forms the basis for teamwork and collaboration. The Code formulates binding principles, values and standards of conduct for all bank employees.

L-Bank fulfils its duty of care by protecting its employees from health hazards arising at work or through work. Occupational health and safety are continuously developed with the active involvement of employees and the Staff Council. The central body is the Occupational Safety Committee, which meets quarterly. The committee discusses any issues arising, agrees corrective actions and monitors their implementation. As part of the EMAS audit, an external environmental auditor checks whether the Bank is complying with the relevant environmental protection and occupational safety regulations and standards. The Bank uses risk assessment to ensure that hazards to which employees are exposed in the course of their professional activities are identified, assessed and eliminated by the implementation of suitable measures. As part of the ongoing occupational safety review, L-Bank carried out a risk assessment of mental stress in 2017. The findings formed the basis for the workshops held last year, facilitated by external moderators. The findings are currently being analysed and assessed with the aim of formulating specific recommendations for action.

Of particular importance to L-Bank is occupational health management that focuses on prevention. At the Bank's in-house health centres, for example, employees can train on stamina-building machines and use special back-training equipment.

Further information on employee-related matters can be found in the 'Personnel' section of the management report.

SOCIAL MATTERS

In the economic system favoured by social market economies, companies are the initiators and facilitators of change and progress, thereby safeguarding a society's prosperity. While the economic platform represents one side of the social equation, social cohesion is the other. To build a strongly cohesive society, it is vital to promote equal opportunities. L-Bank's development objectives and operational targets are all guided by the State of Baden-Württemberg's development policy.

L-Bank offers a broad range of social development services, ranging from family benefits to the creation of affordable housing. These include the promotion of equal opportunities, accompanied by the promotion of entrepreneurship and job creation, as the basis of a successful social market economy. In terms of family support, for example, L-Bank is the central issuer of family benefits in Baden-Württemberg. The relative significance of each development programme in terms of volume is discussed in the 'Economic report' section of the management report.

The starting point for all development projects is the provision of development funding. To safeguard its development business in the long term – not least from a regulatory perspective – L-Bank set up the development contribution system described in the 'Financial performance' section of the management report.

So that development funding does not distort competition in the commercial sector, L-Bank ensures that all development programmes are implemented in accordance with European Union rules on state aid. Depending on the development programme, L-Bank carries out contract award and state-aid audits as one of the steps in the development finance procedure. Irrespective of the individual development programme, L-Bank uses appropriate documentary evidence to ensure that public funding is used appropriately.

Entrepreneurship is the foundation of the market economy and the driving force behind economic development. L-Bank supports entrepreneurship by providing advice and training, by raising awareness, and through its development funding programmes. The Bank aims to work with the State of Baden-Württemberg to create attractive conditions for entrepreneurship and thus create and safeguard jobs in Baden-Württemberg. L-Bank supports fledgling companies and SMEs at various stages of development and in every business situation with suitable instruments – from debt financing to quasi-equity financing, and from equity and sureties through to grants awarded on behalf of the federal state. This also includes providing targeted support for the federal state's strategic objectives, such as the digitisation of Baden-Württemberg's SMEs, and launching new development instruments – such as the 'Start-up BW Pre-Seed' programme – which provide financial support for promising start-up projects earlier in the VC process than existing funding programmes, thus helping to make them 'finance-ready' or 'VC-ready' for institutional investors.

L-Bank extends loans for business development purposes using the 'borrower's bank' principle. The commercial banks ensure that funding requirements are met and, once the project has been completed, provide L-Bank with proof that the public funding has been used as intended. L-Bank ensures that the process of extending loans is carried out lawfully by auditing commercial banks on a spot-check basis. To identify changing needs as early as possible, L-Bank commissions studies from specialist third parties. These enable the Bank to further develop the Bank's existing development finance products to meet real-world needs, thereby ensuring that the public funding provided adds the desired social value. L-Bank also runs promotional campaigns to raise public awareness of the importance of entrepreneurship. Competitions such as the statewide Start-up BW Elevator Pitch and the State Prize for Young Companies play an important role here.

RESPECT FOR HUMAN RIGHTS

Human rights are fundamental rights protecting the freedom and autonomy of every individual. Respect for human rights is a central standard for all L-Bank's business activities and part of its self-image as a State-owned company. Thanks to L-Bank's compliance with statutory and legal regulations, and taking into account the fact that the Bank's development business is limited to Baden-Württemberg, there is no material risk that the Bank will violate the rights of indigenous peoples or come into conflict with forced or child labour. With the adoption of the National Action Plan on Human Rights (NAP) in 2016, the German federal government aims to further improve the human rights situation. Building on an impact analysis, companies should assume their share of the responsibility for this. The foundations for further developing L-Bank's human rights due diligence processes have been laid in the form of the Bank's 'FIT FOR NAP' programme. The existing procedure was consolidated by means of an industry analysis.

As a public-sector contracting authority, L-Bank complies with the Public Procurement Directives and all relevant laws when awarding contracts. This ensures that all companies involved comply with their legal obligations when executing commissions.

A complaints management system safeguards the fundamental right to report violations by or make complaints about the Bank. The system was evaluated last year, and further steps were taken towards process standardisation.

The legal basis for the protection of personal data is the General Data Protection Regulation (EU GDPR). This embodies the basic right to informational self-determination: every individual has the right to decide for him- or herself who collects, processes or uses which parts of his or her personal information. It is vital to protect clients' and partners' personal data, as well as employees' personal data. L-Bank safeguards the right to informational self-determination, hence also to data protection, by means of IT systems, clearly defined processes and the conduct of its employees. Upon joining L-Bank, every new employee is given a mandatory training course in data protection.

The Board of Management has appointed a Data Protection Officer. The latter is the main point of contact and information person for data protection issues, and submits regular reports to the Board of Management. In 2018, there was a data protection incident that was duly reported to Baden-Württemberg's State Commissioner for Data Protection, as required by law. The incident did not pose any risks to the rights and freedoms of natural persons. Data processing is subject to internal controls by the Data Protection Officer and external controls by the State Commissioner for Data Protection.

As both employer and contracting authority, L-Bank has an impact on human and labour rights. Freedom of assembly and the right to collective bargaining are fundamental to the protection of workers' rights. Because L-Bank's employees work in Germany, we believe that we comply with and guarantee our employees' rights by complying with Germany's statutory regulations. The State Staff Representation Act (Landespersonalvertretungsgesetz) governs the representation of employee interests at L-Bank, hence also employees' operational participation. Staff interests are represented by a Central Staff Council, responsible for handling issues at all Bank locations, and by two local Staff Councils in Karlsruhe and Stuttgart respectively. Employer and staff representatives work together in a spirit of partnership and trust, in compliance with German legislation and collective bargaining agreements, for the benefit of all employees and to fulfil the duties incumbent upon the Council. The Staff Council exercises its rights of participation through co-determination, collaboration and consultation. In addition, the Chair of the Central Staff Council and the two Chairs of the Karlsruhe and Stuttgart Staff Councils sit on L-Bank's Supervisory Board in an advisory capacity.

PREVENTION OF BRIBERY AND CORRUPTION

L-Bank's credibility and success are directly related to the personal integrity and honesty of all individuals acting on behalf of L-Bank. In view of this, a sound and responsible approach to corporate governance is a self-evident component of the Bank's corporate culture. L-Bank has enshrined the Public Corporate Governance Code of the State of Baden-Württemberg in the Bank's in-house rule book by resolutions of both the Board of Management and Supervisory Board, and observes all the provisions of the Code. L-Bank does not tolerate any form of corruption or any form of bribery. This attitude is also reflected in the Code of Ethics and Conduct. Whenever further regulations and process descriptions are required over and above this set of values, they are supplemented and defined by internal guidelines (operational directives).

The fight against bribery and corruption has many facets. As a financial institution, the prevention of money laundering and the financing of terrorism are material issues for L-Bank. Our management approach is based on compliance with legal and regulatory requirements. The central unit set up within the Bank to prevent money laundering, terrorist financing and other crimes, which forms part of the Compliance unit, enjoys the full support of the Board of Management. The Compliance unit ensures compliance with internal, statutory and regulatory provisions and policies by monitoring compliance with due diligence requirements and other precautionary policies. The Compliance unit reports directly to the Board of Management at departmental level, and all supervisory functions – such as the Compliance Officer, Money Laundering Officer and Compliance Officer for the German Securities Trading Act (WpHG), as well as their corresponding deputies – work out of this unit. All internal security measures required under Section 25h KWG in conjunction with Section 6 GwG have been implemented. Employees who wish to report their suspicions of possible violations of the legal provisions that apply to the Bank can use an internal whistle-blowing system for this purpose, which also allows reports to be made anonymously. The confidential treatment of this information is a top priority for L-Bank.

Risk analyses are used as the basis for devising security measures for preventing money laundering and terrorist financing, tailored specifically to L-Bank. Every two years, Internal Audit checks whether and to what extent laws are being correctly implemented and applied, and also checks compliance with internal guidelines (operational directives).

When new recruits join L-Bank, they are given mandatory in-house training on the prevention of money laundering and fraud, securities compliance, data protection and information security. In departments to which money laundering is relevant, supplementary training courses are compulsory every three years. The Bank monitors participation in these courses. To prevent fraud and other criminal acts, staff are given extended training courses every three years.

Identifying contractual partners pursuant to Section 10 (1) article 1 of the Anti-Money Laundering Act (AMLA) is one of the most important aspects of the Bank's general duty of care towards clients. L-Bank has set up the processes and procedures necessary to fulfil this duty of care. Here, L-Bank's business model as a development bank which does not accept deposits from the general public, and which has neither branches nor cash operations, was considered to mitigate the risks associated with the prevention of money laundering and terrorist financing.

The multiple-control principle applied by L-Bank ensures that important decisions which must be made when e.g. onboarding new clients or engaging in critical activities, are neither made nor implemented by a single individual. In addition to the multiple-control principle, powers of authorisation are clearly defined and regulated in an internal guideline (operational directive).

A comprehensive reporting system ensures that the Board of Management is continuously updated on these issues. The Board of Management is informed, on a monthly basis, of any regulatory risks arising from supervisory regulations or regulatory projects that have been identified as relevant. The Board of Management is informed of the results of ongoing controls in quarterly reports on operational compliance. This quarterly report covers all areas of the Compliance unit's responsibilities, including money-laundering and fraud prevention, corporate compliance and securities compliance. The corresponding annual reports on compliance are submitted to the Board of Management once per calendar year. In addition, ad hoc reports are submitted to the Board of Management if there is any suspicion of serious compliance violations.

In short, L-Bank has the resources and internal procedures at its disposal to detect and prevent money-laundering operations involving profits from terrorist activities, organised crime or other serious criminal offences.

CLIENT MATTERS

As the State Bank, L-Bank issues public development funding for the whole of Baden-Württemberg. L-Bank's principal, the State of Baden-Württemberg, as well as its development customers and business partners, expect L-Bank to process their requests swiftly and cost-efficiently while applying a high level of data security.

Digitisation is enabling L-Bank to operate more efficiently and establish new relationships with customers and business partners. In its business strategy, L-Bank has given a high priority to the gradual digitisation of internal processes, as well as the various interfaces with customers and business partners. Together with the Bank's IT strategy, digitisation is the most concrete reflection of the technological direction taken by the Bank. While the IT strategy contains information on the restructuring of IT systems and IT processes, it is also the basis for the ongoing phased development of the Bank's value chain and the configuration of customer contact points. As the basis for this technical renewal, the mainframe replacement project and the project to upgrade core banking software – in particular the subledger system used to manage development loans – were implemented in a series of steps completed in early 2018.

L-Bank's objective is to respond to customer inquiries quickly, simply and flexibly. With this in mind, L-Bank has already linked residential housing products offered via clients' commercial banks to KfW's online sales and service platform 'Bankdurchleitung Online 2.0' (BDO 2.0). With the integration of L-Bank's brokering products for residential accommodation into KfW's development portal, it is now possible to approve development funding digitally. This service will gradually be made available to all brokerage partners working in this development funding area. This fundamental realignment is accompanied by steps to digitise downstream processes. In 2018, for example, the disbursement procedure in the Bank's brokering business was transferred to web-service technology and the in-house process was automated.

By setting up a closed user area (expert portal) in 2017, the Bank improved the delivery of information to financing partners. In a second step, the Bank has further refined its approach: separate information channels are now available for the Bank's various target markets – financing partners, financing intermediaries, state housing development agencies and multipliers.

The Portfolio Management committee coordinates and prioritises the individual digitisation projects, reporting to the Board of Management on the status of the project portfolio at least every quarter. Rules have been defined for the change process. Any operational risks are assessed and managed; the process follows the already defined new product process where appropriate, and the level of protection is determined by a Security Office that is independent of the Bank's operational IT units. In terms of process, scrum methodology is used, following an agile software development approach. The IT security strategy is used to support this approach. Thus L-Bank protects business partners and specialist knowledge from attacks by third parties. In particular, the Security Office is responsible for supporting the Board of Management in all matters relating to corporate security. For this purpose, the office runs a fully integrated management system which, in addition to managing information security, also takes care of emergency planning and physical security, as well as continuous process improvement. Security Office activities are always based on a factually relevant, cross-departmental approach. The office reports to the full Board of Management as and when required, and in any case at least once a year.

Karlsruhe, 1 March 2019

Dr. Axel Nawrath Dr. Ulrich Theileis

Dr. Iris Reinelt Johannes Heinloth

REPORT OF THE *SUPERVISORY BOARD*

During fiscal year 2018, the Supervisory Board and the committees set up by the Board discharged the duties assigned to them by law and by the Bank's articles of association and standard operating procedures. In particular, the Supervisory Board monitored the orderly conduct of the Bank's business. For this purpose, pursuant to the relevant statutory provisions, as well as the Bank's articles of association and rules of procedure, the Board of Management regularly briefed the Supervisory Board and its committees on the development of the Bank's business and risk exposure, as well as major and material business transactions throughout 2018. The Supervisory Board and its committees discussed and made decisions on matters falling within the scope of its/their responsibilities, as well as any business transactions that required its/their approval. To determine the guidelines for business activities, the Supervisory Board discussed business policy issues with the Board of Management and, in particular – following prior discussion in the Risk Committee – approved the Bank's business and risk strategy.

The Supervisory Board met four times during 2018, convening its committees on a total of ten occasions. Four of these committee meetings were held by the Risk Committee, three were held by the Audit Committee, and three by the Personnel Committee. Between meetings, urgent decisions were taken by written circular on a total of three occasions. Following the natural conclusion of the Supervisory Board's five-year term of office, the State Government of Baden-Württemberg appointed a new Supervisory Board with effect from 1 December 2018. The positions of alternate members of the Supervisory Board were abolished by an amendment to the L-Bank Act. The Supervisory Board now consists of 15 voting members and three consulting members. In turn, the Supervisory Board set up a fourth committee, the Remuneration Control Committee, with effect from 1 December 2018. The Personnel Committee continues to perform the duties of the Appointments Committee, as before. In addition, the Supervisory Board adopted various amendments to the Bank's rules of procedure with effect from 1 December 2018, in order to bring them into line with the amended L-Bank Act and the Bank's articles of association, as well as specific regulatory changes.

The Supervisory Board has reviewed the separate non-financial report for fiscal year 2018. PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft was commissioned to carry out an external limited-assurance engagement of the report's content. The auditor's notes on the report were discussed by the Supervisory Board and the Audit Committee with the auditor's involvement. On completion of this review, the Supervisory Board concluded that no objection need be raised to the separate non-financial report for 2018.

PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft carried out the statutory annual audit for fiscal year 2018. An unqualified auditor's opinion was issued. The Audit Committee consulted with the auditor on the starting date of the audit. The auditor provided the Audit Committee with progress reports on the audit, and also took part in discussions of the 2018 financial statements by the Supervisory Board and Audit Committee. In these discussions, the auditors reported on the main findings of their audit activities, answered questions and provided additional information. The Supervisory Board and Audit Committee discussed the auditor's report. In accordance with the outcome of the audit, the Supervisory Board has concluded that the annual financial statements for 2018 prepared by the Board of Management do not give rise to any objections. Accordingly, at its meeting on 16 April 2019, the Supervisory Board took note of and approved the Bank's annual financial statements for 2018.

The Supervisory Board also approved the Board of Management's proposal to allocate EUR 50,000,000.00 of the distributable net profit for fiscal year 2018 (totalling EUR 50,979,750.26) to other retained earnings and to carry forward the remaining amount of EUR 979,750.26.

Stuttgart, 16 April 2019

Edith Sitzmann

Chair of the Supervisory Board
Edith Sitzmann MSP
Minister of Finance
for the State of Baden-Württemberg

L-BANK BALANCE SHEET AS AT 31 DECEMBER 2018

ASSETS	31.12.2018 EUR	31.12.2018 EUR	31.12.2018 EUR	31.12.2017 EUR
1. CASH RESERVE				
a) cash in hand		20,662.12		25,910.77
b) current balances with central banks thereof: with Deutsche Bundesbank EUR 115,106,834.94 (EUR 123,083,040.27)		115,106,834.94		123,083,040.27
			115,127,497.06	**123,108,951.04**
2. RECEIVABLES FROM BANKS				
a) due on demand		4,345,095.94		392,882,262.66
b) other claims		23,388,775,902.51		23,479,072,698.12
			23,393,120,998.45	**23,871,954,960.78**
3. RECEIVABLES FROM CUSTOMERS thereof: secured through real-estate liens EUR 4,639,401,627.23 (EUR 4,753,685,126.34) municipal loans EUR 9,443,632,792.42 (EUR 10,629,127,060.81)			**22,645,318,589.62**	**24,167,522,835.03**
4. BONDS, DEBENTURES AND OTHER FIXED-INCOME SECURITIES				
a) bonds and debentures				
aa) from public issuers thereof: eligible as collateral with Deutsche Bundesbank EUR 5,702,626,767.28 (EUR 5,898,496,964.33)	5,810,502,419.97			6,006,008,473.86
ab) from other issuers thereof: eligible as collateral with Deutsche Bundesbank EUR 13,700,304,026.50 (EUR 13,591,857,334.55)	16,208,291,471.37			15,071,849,240.98
		22,018,793,891.34		21,077,857,714.84
b) own notes nominal value EUR 5,000,000.00 (EUR 62,000,000.00)		5,007,858.22		62,085,724.85
			22,023,801,749.56	**21,139,943,439.69**
Carried forward			68,177,368,834.69	69,302,530,186.54

ASSETS	31.12.2018 EUR	31.12.2018 EUR	31.12.2018 EUR	31.12.2017 EUR
Brought forward			68,177,368,834.69	69,302,530,186.54
5. SHAREHOLDINGS thereof: in financial institutions EUR 1,986,360.52 (EUR 1,986,360.52)			**213,342,241.51**	**171,911,629.99**
6. HOLDINGS IN AFFILIATED COMPANIES			**17,809,201.00**	**17,809,201.00**
7. FIDUCIARY ASSETS thereof: fiduciary loans EUR 28,332,398.06 (EUR 33,456,041.51)			**28,333,004.16**	**33,464,672.32**
8. INTANGIBLE ASSETS a) purchased licences, industrial property rights and similar rights and assets, and licences to such rights and assets			**2,941,149.40**	**3,514,383.30**
9. TANGIBLE ASSETS			**100,338,468.10**	**99,982,396.27**
10. OTHER ASSETS			**212,555,709.19**	**84,911,527.15**
11. ACCRUED ITEMS			**856,184,326.02**	**955,855,257.65**
TOTAL ASSETS			**69,608,872,934.07**	**70,669,979,254.22**

L-BANK BALANCE SHEET AS AT 31 DECEMBER 2018

LIABILITIES	31.12.2018 EUR	31.12.2018 EUR	31.12.2018 EUR	31.12.2017 EUR
1. LIABILITIES TO BANKS				
a) due on demand		8,566,884.64		4,978,230.80
b) with agreed term or notice period		25,854,349,148.30		25,263,754,834.60
			25,862,916,032.94	**25,268,733,065.40**
2. LIABILITIES TO CUSTOMERS				
a) other liabilities				
aa) due on demand		128,775,951.97		135,208,977.24
ab) with agreed term or notice period		8,884,340,932.51		7,873,347,220.23
			9,013,116,884.48	**8,008,556,197.47**
3. SECURITISED LIABILITIES				
a) notes issued			**28,277,890,956.05**	**30,383,417,388.26**
4. FIDUCIARY LIABILITIES			**28,333,004.16**	**33,464,672.32**
thereof: fiduciary loans EUR 28,332,398.06 (EUR 33,456,041.51)				
5. OTHER LIABILITIES			**24,704,683.98**	**598,896,607.93**
6. DEFERRED ITEMS			**1,702,864,474.81**	**1,781,055,432.32**
7. PROVISIONS				
a) provisions for pensions and similar obligations		293,190,920.00		260,248,043.00
b) tax provisions		100,000.00		100,000.00
c) other provisions		362,361,918.79		366,239,011.98
			655,652,838.79	**626,587,054.98**
8. SUBORDINATED LIABILITIES			**118,435,918.91**	**193,063,683.07**
Carried forward			65,683,914,794.12	66,893,774,101.75

LIABILITIES	31.12.2018 EUR	31.12.2018 EUR	31.12.2018 EUR	31.12.2017 EUR
Brought forward			65,683,914,794.12	66,893,774,101.75
9. PROFIT-SHARING RIGHTS OUTSTANDING			**260,975,600.00**	**260,975,600.00**
10. FUND FOR GENERAL BANKING RISKS			**700,000,000.00**	**650,000,000.00**
11. EQUITY				
a) subscribed capital		250,000,000.00		250,000,000.00
b) capital reserve		1,048,002,789.69		999,426,789.69
c) retained earnings				
ca) other retained earnings		1,615,000,000.00		1,565,000,000.00
d) net profit		50,979,750.26		50,802,762.78
			2,963,982,539.95	**2,865,229,552.47**
TOTAL LIABILITIES			**69,608,872,934.07**	**70,669,979,254.22**

1. CONTINGENT LIABILITIES		
a) liabilities from sureties and guarantee contracts	**205,055,661.29**	**1,352,499,036.19**
2. OTHER COMMITMENTS		
a) irrevocable lending commitments	**4,698,672,915.93**	**5,701,505,907.64**

L-BANK STATEMENT OF INCOME FOR THE FISCAL YEAR 1 JANUARY 2018 TO 31 DECEMBER 2018

		2018 EUR	2018 EUR	2018 EUR	2017 EUR
1.	INTEREST INCOME FROM				
	a) lending and money market transactions	1,018,479,754.90			1,069,015,276.71
	b) fixed-interest and book-entry securities	467,710,168.58			481,153,820.04
			1,486,189,923.48		1,550,169,096.75
2.	INTEREST EXPENSES		1,231,867,006.83		1,295,917,668.29
				254,322,916.65	**254,251,428.46**
3.	CURRENT INCOME FROM				
	a) shareholdings			**5,543,706.31**	**1,907,244.34**
4.	COMMISSION INCOME			**43,095,311.04**	**41,893,040.85**
5.	COMMISSION EXPENSES			**5,179,308.40**	**5,391,571.18**
6.	OTHER OPERATING INCOME			**25,613,301.63**	**25,586,194.62**
7.	GENERAL ADMINISTRATIVE EXPENSES				
	a) personnel expenses				
	aa) wages and salaries	77,763,229.10			76,906,174.16
	ab) social security contributions and expenses for pensions and other benefits thereof: for pension provisions EUR 9,448,462.46 (EUR 7,920,359.63)	22,219,136.02			21,005,498.29
			99,982,365.12		97,911,672.45
	b) other administrative expenses		60,087,157.94		70,185,881.19
				160,069,523.06	**168,097,553.64**
8.	WRITE-DOWNS AND VALUATION ADJUSTMENTS ON INTANGIBLE ASSETS AND TANGIBLE ASSETS			**7,859,946.60**	**16,706,097.95**
Carried forward				155,466,457.57	133,442,685.50

	2018 EUR	2017 EUR
Brought forward	155,466,457.57	133,442,685.50
9. OTHER OPERATING EXPENSES	14,352,887.77	30,713,403.41
10. WRITE-DOWNS AND VALUATION ADJUSTMENTS ON RECEIVABLES AND CERTAIN SECURITIES AS WELL AS ADDITIONS TO PROVISIONS FOR LOAN LOSSES	46,542,000.60	0.00
11. INCOME FROM REVALUATION OF RECEIVABLES AND CERTAIN SECURITIES AS WELL AS FROM REVERSALS OF PROVISIONS FOR LOAN LOSSES	0.00	8,843,738.29
12. WRITE-DOWNS AND VALUATION ADJUSTMENTS ON SHAREHOLDINGS, SHARES IN AFFILIATED COMPANIES AND SECURITIES TREATED AS FIXED ASSETS	0.00	40,505,507.29
13. INCOME FROM REVALUATION OF SHAREHOLDINGS, SHARES IN AFFILIATED COMPANIES AND SECURITIES TREATED AS FIXED ASSETS	6,683,998.10	0.00
14. ADDITIONS TO FUND FOR GENERAL BANKING RISKS	50,000,000.00	20,000,000.00
15. INCOME FROM ORDINARY BUSINESS ACTIVITIES	51,255,567.30	51,067,513.09
16. TAXES ON INCOME AND EARNINGS	900,712.96	299,589.72
17. OTHER TAXES NOT STATED UNDER ITEM 9	177,866.86	177,874.30
18. NET INCOME	50,176,987.48	50,590,049.07
19. PROFIT CARRIED FORWARD FROM THE PREVIOUS YEAR	802,762.78	212,713.71
	50,979,750.26	50,802,762.78
20. NET PROFIT	50,979,750.26	50,802,762.78

L-BANK CASH FLOW STATEMENT FOR THE FISCAL YEAR 1 JANUARY 2018 TO 31 DECEMBER 2018

	01.01.–31.12.2018 EURk	01.01.–31.12.2017 EURk
Net profit/loss for the period	50,177	50,590
Depreciation, value adjustments and write-ups on receivables including contingent liabilities and securities	102,766	27,503
Depreciation, value adjustments and write-ups on tangible assets and intangible assets	7,860	16,706
Depreciation, value adjustments and write-ups on financial assets (excluding securities)	8,364	52,039
Change in provisions (excluding loan-loss provisioning)	99,031	126,531
Profit/loss on the sale of tangible and intangible assets	–17,058	–15,402
Profit/loss on the sale of financial assets	–12,648	–14,456
Other adjustments (net)	–98,612	–120,433
Change in receivables from banks	479,715	–1,416,590
Change in receivables from customers	1,435,901	2,692,461
Change in securities	–885,102	1,363,981
Change in other assets from operating activities	–22,842	1,754,180
Change in liabilities to banks	594,183	551,087
Change in liabilities to customers	1,004,561	385,580
Change in securitised liabilities	–2,105,526	–5,842,911
Change in other liabilities from operating activities	–768,208	330,447
Net interest income	–254,323	–254,251
Income taxes paid	901	300
Interest payments and dividend payments received	1,573,682	1,694,275
Interest paid	–1,220,747	–1,319,591
Income tax payments	–901	–300
Cash flow from operating activities	**–28,826**	**61,746**
Proceeds from sales of financial assets	25,612	21,049
Disbursements for investments in financial assets	–62,758	–10,588
Proceeds from sales of tangible assets	18,642	17,998
Disbursements for investments in tangible assets	–6,439	–13,138
Proceeds from sales of intangible assets	0	34
Disbursements for investments in intangible assets	–2,788	–876
Cash flow from investment activities	**–27,731**	**14,479**
Proceeds from additions to shareholders' equity	48,576	0
Cash flow from financing activities	**48,576**	**0**
Cash and cash equivalents at start of period	123,109	46,884
Cash flow from operating activities	–28,826	61,746
Cash flow from investment activities	–27,731	14,479
Cash flow from financing activities	48,576	0
Cash and cash equivalents at end of period	**115,128**	**123,109**

L-BANK STATEMENT OF CHANGES IN EQUITY AS AT 31 DECEMBER 2018

		Reserves				
	Subscribed capital EURk	Capital reserve pursuant to Section 272 (2) art. 4 HGB EURk	Other retained earnings EURk	Total EURk	Net profit EURk	Equity EURk
Balance as at 31.12.2016	**250,000**	**999,427**	**1,515,000**	**2,514,427**	**50,213**	**2,814,640**
Transfer to reserves			50,000		–50,000	0
Net income for the year					**50,590**	**50,590**
Balance as at 31.12.2017	**250,000**	**999,427**	**1,565,000**	**2,564,427**	**50,803**	**2,865,230**
Transfer to reserves		48,576	50,000	98,576	–50,000	48,576
Net income for the year					**50,177**	**50,177**
Balance as at 31.12.2018	**250,000**	**1,048,003**	**1,615,000**	**2,663,003**	**50,980**	**2,963,983**

NOTES TO THE ANNUAL FINANCIAL STATEMENTS OF L-BANK AS AT 31 DECEMBER 2018

GENERAL PRINCIPLES

L-Bank (Landeskreditbank Baden-Württemberg – Förderbank –) was established by a law passed on 11 November 1998, effective as from 1 December 1998. It is the development bank of the German federal state of Baden-Württemberg. The Bank's business activities are governed by its statutory remit, namely to support the state government of Baden-Württemberg in the fulfilment of its duties, especially in terms of structural, economic and social policy, by implementing development programmes that comply with European Union regulations governing state aid.

The Bank has its head office in Karlsruhe, with a branch office in Stuttgart. It is entered in the commercial register of the City of Mannheim under number HRA 104441. Section 2 (1), sentence 1 of the above-mentioned law sets the share capital of L-Bank at EUR 250 million.

The annual financial statements of L-Bank were 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. Additions to the fund for general banking risks are shown in a separate item.

When taken together, the majority shareholdings reported are of secondary importance. Preparation of a consolidated financial statement was thus waived pursuant to Section 290 (5) HGB in conjunction with Section 296 (2) HGB.

The disclosures required pursuant to Section 26a (1) sentence 2 of the German Banking Act (KWG) (country-by-country reporting) are provided in these notes to the annual financial statements. The other disclosures required pursuant to Section 26a (1) KWG and Article 435 et seq. CRR (Regulation (EU) 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) 646/2012) are contained in a separate disclosure report, which is updated annually and published on the L-Bank website shortly thereafter.

ACCOUNTING AND VALUATION METHODS

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

FINANCIAL ASSETS AND LIABILITIES

Receivables from banks and customers are always stated at their nominal value, whereas liabilities are stated at repayment value. Differences (premiums and discounts) with respect to receivables and liabilities are stated under accrued or deferred items and written back pro rata temporis. 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 pro-rated interest accrued at the balance sheet date.

Negative interest from financial investments is reported under interest income, while negative interest from borrowing is reported under interest expenses.

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 are 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. Portfolio or general loan-loss allowances have been set up for latent lending risks. The loan-loss allowances are offset against assets or stated under provisions.

Securities in the liquidity reserve are stated at the lower of acquisition cost or stock exchange/market price at the balance sheet date, in accordance with the strict 'lower of cost or market' principle. Where possible, stock market prices 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 amortised cost, 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 applied in the event of a loss of value that is likely to be permanent. If the reasons for a permanent loss of value no longer exist, the depreciation is reversed accordingly. A general provision has been set up for latent risks.

Holdings and shares in affiliated companies are stated at acquisition cost or, in the event of a likely permanent loss of value, at the lower fair value as at the balance sheet date, analogous to the rules governing fixed assets. If the reasons for a permanent loss of value no longer exist, the writedown is reversed accordingly.

TANGIBLE AND INTANGIBLE ASSETS

Intangible assets and tangible assets are valued at acquisition or production cost, less scheduled depreciation and amortisation. Where necessary, i.e. where it is anticipated that a loss 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 Professor Dr Heubeck's RT 2018 G mortality tables (2017: RT 2005 G). The projected unit credit (PUC) method is used for valuation purposes. Future wage and salary adjustments are included in the calculation, based on a projected average increase of 2% p.a.; future pension adjustments are also included, based on increases of 1.6% or 2%. Pursuant to the specifications of Section 253 (2) sentence 1 HGB, provisions are discounted at the average market interest rate over the last ten fiscal years, assuming a residual term of 15 years. The rate of interest applied is 3.21% (2017: 3.68%). The difference between the recognition of provisions based on the average market interest rate over the last ten fiscal years and their recognition based on the equivalent average market interest rate over the last seven fiscal years came to EUR 42 million as at 31 December 2018 (2017: EUR 35 million). This amount is barred from distribution.

The remaining provisions are stated at the required repayment amount and take into consideration all identifiable risks from doubtful liabilities and anticipated losses from pending transactions.

Provisions with a residual 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.

Expense provisions within the meaning of Section 249 (1) sentence 3, (2) HGB (old version) are 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 apply.

Interest accruing on provisions (including provisions for pensions and similar obligations) totalling EUR 30 million (2017: EUR 22 million) is stated under net interest income.

DEVELOPMENT FUNDS

To fulfil L-Bank's statutory public-service mandate, the Bank provides funds from earned income in the form of a development fund provision.

A total of EUR 73 million was paid out from the development fund for 2018. The remaining balance was carried forward to the following year, increasing the development fund available for the 2019 fiscal year to EUR 87 million in total. On 31 December 2018, L-Bank made a provision of EUR 80 million to cover its obligation to pay out development contributions in fiscal year 2020.

Allocations to this provision in the current year are recognised in the statement of income as follows, taking account of the type of development activity envisaged (interest rate reductions, subsidised sureties or grants):

	EURk
Interest expenses	71,500
Commission expenses	3,500
Other operating expenses	5,000
Total	**80,000**

CURRENCY TRANSLATION

Currency translation has been carried out according to the provisions of Section 256a in conjunction with Section 340h HGB, as well as IDW RS BFA Opinion 4. Assets and liabilities denominated in foreign currencies, as well as all pending foreign currency cash transactions, are translated at the mean spot rate on 28 December 2018. In the case of forward currency contracts, the forward rate is separated out into cash and interest portions.

For currency translation 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 translation within the meaning of Section 340h HGB are included in the statement of income. Any valuation surplus is reported in a balancing item under 'Other assets'.

LOSS-FREE VALUATION OF THE NON-TRADING PORTFOLIO (BANK BOOK)

Reviews of the non-trading portfolio (bank book) within the meaning of IDW RS BFA Opinion 3 with the aim of ensuring loss-free valuation are based on a net present value approach. Calculations are based on book values (as in the balance sheet), discounted cash flows and risk costs, plus future administrative expenses incurred by the unwinding of positions.

The valuation of transactions continued to show that there was no need to make provisions.

TREATMENT OF HEDGING TRANSACTIONS

In order to hedge balance sheet risks, the Bank uses derivative hedging transactions and guarantees. The Bank enters into derivative transactions in order to hedge aggregate interest rate risk exposure and/or individual transactions. Any contributions to earnings by derivatives are stated under net interest income.

Where necessary, hedged transactions and hedging instruments have been grouped together to create valuation units (macro hedges) within the meaning of Section 254 HGB. The parameters used for the valuations underlying these macro hedges match perfectly (perfect hedges). In this case, the accounting treatment is based on the so-called 'freezing method', in which offsetting changes in value (i.e. equal and opposite changes in the fair values attributable to hedged transactions and hedging instruments as a result of the hedged risk) are not taken into consideration in the financial statements.

Hedged transactions in macro hedges within the meaning of Section 254 HGB are presented in the table below. Where applicable, the stated book values have been translated into EUR at the mean spot rate on 28 December 2018.

HEDGED TRANSACTION IN MACRO HEDGE

	Book value in EURk	of which interest rate risk	of which currency risk	of which price risk
Assets	430,387	–	–	430,387
Liabilities	1,710,942	1,463,315	247,627	–
Total	**2,141,329**	**1,463,315**	**247,627**	**430,387**

NOTES TO THE ANNUAL FINANCIAL STATEMENTS OF L-BANK AS AT 31 DECEMBER 2018

BREAKDOWN OF SELECTED BALANCE SHEET ITEMS BY TIME TO MATURITY OR CALL	31.12.2018 EURk	31.12.2017 EURk
RECEIVABLES FROM BANKS		
due on demand	4,345	392,882
up to three months	1,002,999	867,815
more than three months and up to one year	4,309,307	4,786,554
more than one year and up to five years	7,239,599	6,917,378
more than five years	10,836,871	10,907,326
RECEIVABLES FROM CUSTOMERS		
up to three months	465,915	1,286,302
more than three months and up to one year	1,226,937	1,689,249
more than one year and up to five years	3,517,413	3,650,433
more than five years	17,435,054	17,541,539
BONDS, DEBENTURES AND OTHER FIXED-INCOME SECURITIES		
maturing in the following year	761,993	673,617
LIABILITIES TO BANKS		
due on demand	8,567	4,978
up to three months	1,178,040	1,391,210
more than three months and up to one year	1,654,247	1,856,099
more than one year and up to five years	8,945,795	7,780,278
more than five years	14,076,267	14,236,168
LIABILITIES TO CUSTOMERS		
due on demand	128,776	135,209
up to three months	2,107,530	898,020
more than three months and up to one year	58,257	75,109
more than one year and up to five years	600,956	504,505
more than five years	6,117,598	6,395,714
SECURITISED LIABILITIES		
maturing in the following year	13,375,588	15,359,006

EXPLANATIONS OF INDIVIDUAL BALANCE SHEET ITEMS	31.12.2018 EURk	31.12.2017 EURk
RECEIVABLES FROM BANKS		
This item comprises: – receivables from companies in which an equity interest is held	100,000	125,652
RECEIVABLES FROM CUSTOMERS		
This item comprises: – receivables from affiliated companies	56,334	66,092
– receivables from companies in which an equity interest is held	92,366	66,381
– subordinated claims	36	36
BONDS, DEBENTURES AND OTHER FIXED-INCOME SECURITIES		
This item comprises: – receivables from companies in which an equity interest is held	1,715,267	2,126,543
The securities in this item eligible for listing break down as follows: – listed	21,631,656	20,794,722
– unlisted	405,846	361,322
Securities with a book value (excluding prorated interest accrued) of EUR 21,672,014,000 are assigned to investment assets. Of these, securities with a book value of EUR 4,469,829,000 have a market value of EUR 4,411,903,000. No depreciation has been applied to these items, as short-term market fluctuations are not taken into account due to the intention to hold these assets on a long-term basis.		
FIDUCIARY ASSETS		
This item breaks down as follows: – receivables from banks	26,889	30,785
– receivables from customers	1,443	2,671
– other assets	1	9
TANGIBLE ASSETS		
This item comprises: – plots and buildings used for the Bank’s own activities	70,137	72,505
– plant and office equipment	5,702	6,171

NOTES TO THE ANNUAL FINANCIAL STATEMENTS OF L-BANK AS AT 31 DECEMBER 2018

EXPLANATIONS OF INDIVIDUAL BALANCE SHEET ITEMS	31.12.2018 EURk	31.12.2017 EURk
OTHER ASSETS		
of which subordinated	–	7,520
ACCRUED ITEMS – ASSETS		
– Difference between disbursement amount or acquisition cost and lower nominal value of receivables	667,100	749,435
– Difference between issue price and higher repayable amount of liabilities	35,377	45,519
FIDUCIARY LIABILITIES		
Fiduciary liabilities break down into – liabilities to banks	694	1,090
– liabilities to customers	27,638	32,366
– other liabilities	1	9
DEFERRED ITEMS – LIABILITIES		
– Difference between disbursement amount or acquisition cost and higher nominal value of receivables	996	1,394
– Difference between issue price and lower repayable amount of liabilities	29,627	29,177
SUBORDINATED LIABILITIES AND PROFIT-SHARING RIGHTS		
– Interest expenses on subordinated liabilities	3,953	4,461
– Interest expenses on profit-sharing rights	12,995	15,261

The following subordinated liabilities exceed 10% of the total value of all subordinated liabilities:

CURRENCY	Amount in EURk	Interest rate in %	Maturity date
EUR	40,000	2.27	14.11.2023
EUR	20,000	2.27	14.11.2023

EXPLANATIONS OF INDIVIDUAL BALANCE SHEET ITEMS

Profit-sharing rights consist of profit participation certificates and break down as follows:

Amount in EURk	Interest rate in %	Maturity date	Number
10,000	5.000	01.07.2020	2
25,000	5.125	01.07.2020	1
25,000	5.140	01.07.2020	2
5,000	5.160	01.07.2020	2
25,000	5.170	01.07.2020	1
10,000	5.170	01.07.2020	1
3,000	5.170	01.07.2020	1
50,000	5.375	01.07.2025	1
10,000	5.375	01.07.2025	4
5,000	5.375	01.07.2025	3

Under the terms and conditions of the profit participation certificates, the servicing of distribution and repayment claims is linked to the result of the Bank’s ordinary business activities.

Subordinated liabilities and profit-sharing rights are intended for use as supplementary capital and comply with CRR eligibility requirements. The important factor here is the subordinated nature of the Bank’s liability in these cases 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 OF L-BANK AS AT 31 DECEMBER 2018

INDIVIDUAL AMOUNTS THAT ARE MATERIAL IN ASSESSING THE ANNUAL FINANCIAL STATEMENTS	31.12.2018 EURk	31.12.2017 EURk
OTHER ASSETS		
– Balancing item from currency translation	141,199	–
– Receivables from swaps	50,772	57,403
– Works of art	11,791	12,804
– Profit participation certificates	–	7,520
PREPAYMENTS AND ACCRUED ITEMS		
– Single payments made in advance for swaps	146,973	153,987
OTHER LIABILITIES		
– Single (bullet) repayments on swaps	11,620	11,110
– Balancing item from currency translation	–	576,367
DEFERRED ITEMS		
– Single payments received in advance for swaps	1,669,831	1,748,424
PROVISIONS		
under other provisions: – Provisions for development funds	166,595	160,000
– Provisions for development contributions already made	63,945	91,021
CONTINGENT LIABILITIES AND OTHER COMMITMENTS		
Liabilities from sureties and guarantee contracts include: – Loan guarantees to financial institutions	–	5,000
– Credit default swaps	–	991,720
The assessment of utilisation risk is based on the Bank’s risk management approach. The overwhelming proportion of contingent liabilities and other commitments comprise credit risks from borrowers with a first-class credit rating. Acute and latent credit risks are accounted for in the balance sheet by making suitable provisions.		
INTEREST INCOME		
– Negative interest from financial investments	26,792	30,833
INTEREST EXPENSES		
– Negative interest from borrowing	18,878	20,324
COMMISSION INCOME		
– Income from other services	38,535	35,596
OTHER OPERATING INCOME		
– Income from the disposal of land and buildings	17,058	15,404

INDIVIDUAL AMOUNTS THAT ARE MATERIAL IN ASSESSING THE ANNUAL FINANCIAL STATEMENTS	31.12.2018 EURk	31.12.2017 EURk
GENERAL ADMINISTRATIVE EXPENSES		
Other administrative expenses include auditor's fees (excluding sales tax): – for year-end auditing services	394	394
– for other auditing services	92	54
Other auditing services include the audit pursuant to Section 89 (1) of the German Securities Trading Act (WpHG), the limited-assurance engagement related to the non-financial report, the investigations associated with the reporting of the bank levy, and the audit of deductions pursuant to Section 16j para. 2 of the Act Establishing the Federal Financial Supervisory Authority (FinDAG).		
OTHER OPERATING EXPENSES		
– Addition to the provision for development funds	5,000	11,800
TOTAL VALUE OF ASSETS AND LIABILITIES DENOMINATED IN FOREIGN CURRENCIES		
– Assets	4,480,416	3,998,198
– Liabilities	19,872,996	20,708,880
The exchange rate risk from foreign exchange balance sheet items is essentially covered by off-balance-sheet hedging transactions. Currency translation produced: other operating income in the amount of	10	–
other operating expenses in the amount of	–	43

PROVISION OF COLLATERAL

For refinancing purposes, securities in the amount of EUR 3,172 million (2017: EUR 6,388 million) were deposited with Deutsche Bundesbank. Securities in the amount of EUR 304 million (2017: EUR 304 million) were deposited for participation in EUREX (the electronic derivatives exchange).

As collateral for OTC transactions, the Bank posted cash surety bonds totalling EUR 3,432 million (2017: EUR 4,143 million), reported under receivables from banks or customers.

OTHER FINANCIAL COMMITMENTS

By acquiring a shareholding in Landesbank Baden-Württemberg (LBBW) with effect from 1 January 2005, L-Bank became a guarantor of LBBW. Even after withdrawing from its role as LBBW guarantor with effect from midnight on 28 December 2015, L-Bank remains liable to third parties for all LBBW liabilities incurred prior to 18 July 2001. However, in the event of claims against L-Bank, the Bank is entitled to hold any guarantors with inter partes liability jointly and severally liable in full.

As at the balance sheet date, there are no transactions within the meaning of Section 285 (3) and (3a) HGB that are significant for the assessment of the Bank's financial position.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS OF L-BANK AS AT 31 DECEMBER 2018

DERIVATIVE TRANSACTIONS

As at the balance sheet date, L-Bank had concluded the derivative transactions (forward transactions within the meaning of Section 36 RechKredV) listed below. They are used as hedges against interest rate and currency risks. For the 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 arrangements 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 (hedged items) are not included in the tables.

The derivative transactions break down as follows:

DERIVATIVE TRANSACTIONS – SUMMARY OF AMOUNTS

in EUR millions	Nominal values 31.12.2018	Nominal values 31.12.2017	Market values positive 31.12.2018	Market values negative 31.12.2018	Market values positive 31.12.2017	Market values negative 31.12.2017
INTEREST RATE RISKS						
Interest rate swaps	72,138	75,025	2,088	–4,676	2,416	–4,972
Interest rate risks – total	**72,138**	**75,025**	**2,088**	**–4,676**	**2,416**	**–4,972**
CURRENCY RISKS						
Forward currency contracts/ swaps	10,087	9,146	146	–46	15	–106
Currency swaps/cross-currency interest rate swaps	12,991	14,139	251	–1,024	192	**–1,552**
Currency risks – total	**23,078**	**23,285**	**397**	**–1,070**	**207**	**–1,658**

On balance, no significant profit or loss on foreign exchange transactions or interest rate valuations is due from interest rate/currency swaps and the corresponding hedged items, especially on bonds or debentures issued in foreign currencies. Market values of interest rate/currency swaps totalling EUR 141 million are due to changes in spot exchange rates. A balancing item from currency translation was set up in this amount on the assets 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 2,588 million as at year-end 2018. These interest rate swaps are not valued in the balance sheet, because both assets and liabilities contain interest-related hidden reserves that are significantly higher than the negative market values of the interest rate swaps.

DERIVATIVE TRANSACTIONS – BY COUNTERPARTY

in EUR millions	Nominal values 31.12.2018	Nominal values 31.12.2017	Market values positive 31.12.2018	Market values negative 31.12.2018	Market values positive 31.12.2017	Market values negative 31.12.2017
Banks in the OECD	83,626	89,089	2,138	–4,833	2,400	–5,834
Other counterparties (including stock-exchange transactions)	11,590	9,221	347	–913	223	–796
Total	**95,216**	**98,310**	**2,485**	**–5,746**	**2,623**	**–6,630**

DERIVATIVE TRANSACTIONS – BY TERM

Nominal values in EUR millions	Interest rate risks 31.12.2018	Interest rate risks 31.12.2017	Currency risks 31.12.2018	Currency risks 31.12.2017
RESIDUAL MATURITIES				
– up to three months	1,727	1,713	8,008	8,112
– more than three months and up to one year	3,810	5,589	3,409	5,419
– more than one year and up to five years	23,509	21,915	7,611	5,785
– more than five years	43,092	45,808	4,050	3,969
Total	**72,138**	**75,025**	**23,078**	**23,285**

There are no trading activities.

VALUING DERIVATIVE FINANCIAL INSTRUMENTS

The market valuation of derivatives is based on market data as at 31 December 2018, including yield curves, exchange rates and CFC, swaption and FX volatilities obtained by the Bank from external providers. 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
Interest rate structures	Interest rate structure models (BGM model, Bachelier model, Hull-White model, modified Hull-White model for multiple currencies)

NOTES TO THE ANNUAL FINANCIAL STATEMENTS OF L-BANK AS AT 31 DECEMBER 2018

INFORMATION ON TAX LIABILITIES

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

COUNTRY-BY-COUNTRY REPORTING PURSUANT TO SECTION 26A (1) SENTENCE 2 KWG

All disclosures in the annual financial statements within the meaning of Section 26a (1) sentence 2 KWG apply exclusively to the Federal Republic of Germany.

L-Bank's turnover for the fiscal year from 1 January to 31 December 2018 breaks down as follows:

in EUR millions	2018	2017
Net interest income (including current income)	260	256
Net commission income	38	36
Other operating income	25	26
Turnover	**323**	**318**

During 2018, L-Bank employed the equivalent of 1,089 full-time salaried employees on average (2017: 1,063).

The Bank's pre-tax profit for fiscal year 2018 was EUR 51 million (2017: EUR 51 million).

After rounding, taxes on income during fiscal year 2018 totalled EUR 1 million (2017: EUR 0 million). These consisted exclusively of non-reimbursable taxes on capital, plus the solidarity surcharge.

The Bank did not receive any public funding (state aid) in the year under review or in the previous year.

HOLDINGS PURSUANT TO SECTION 285, ARTICLE 11 HGB/SECTION 340A (4), ARTICLE 2 HGB

No.	Name	Registered office	Direct shareholding in %	Equity* in EURk	Result* in EURk
1	Austria Beteiligungsgesellschaft mbH	Stuttgart	33.34	38,623	2,627
2	Baden-Württemberg International – Gesellschaft für internationale wirtschaftliche und wissenschaftliche Zusammenarbeit mbH	Stuttgart	24.00	3,328	–5,007
3	BrandMaker GmbH	Karlsruhe	32.72	3,195	–1,695
4	BWK GmbH Unternehmensbeteiligungsgesellschaft	Stuttgart	10.00	252,343	7,151
5	CureVac AG	Tübingen	0.81	107,407	–61,016
6	DBAG Expansion Capital Fund GmbH & Co. KG	Frankfurt	21.77	51,408	1,815
7	European Investment Fund	Luxembourg	0.18	1,957,523	110,121
8	Landesbeteiligungen Baden-Württemberg GmbH	Stuttgart	12.14	378,565	–56,791
9	LEA Mittelstandspartner GmbH & Co. KG	Karlsruhe	25.00	28,872	–3,533
10	LEA Venturepartner GmbH & Co. KG	Karlsruhe	46.73	2,919	–400
11	MBG Mittelständische Beteiligungsgesellschaft Baden-Württemberg GmbH	Stuttgart	26.80	72,488	5,540
12	Micropelt Abwicklungsgesellschaft GmbH	Freiburg	20.10	**	**
13	OnSee Holding GmbH	Bruchsal	47.71	1,170	–8,864
14	ONVENTIS GmbH	Stuttgart	48.91	1,697	248
15	Selbca Holding GmbH	Berlin	36.55	5,595	–2,692
16	StEP Stuttgarter EngineeringPark GmbH	Stuttgart	100.00	9,222	254
17	Strohheker Holding GmbH	Pforzheim	49.50	–988	–570
18	Technologiepark Karlsruhe GmbH	Karlsruhe	96.00	21,315	1,213
19	Technologiepark Mannheim GmbH	Mannheim	100.00	1,800	–142
20	Technologieparks Tübingen-Reutlingen GmbH	Tübingen	100.00	10,147	903
21	Wessel-Werk Beteiligungsverwaltung GmbH	Karlsruhe	35.00	**	**

* As at the last fiscal year for which annual financial statements are available in each case.
** No annual financial statements were prepared due to insolvency.

The Bank opted to apply Section 286 (3) sentence 1 HGB.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS OF L-BANK AS AT 31 DECEMBER 2018

STATEMENT OF CHANGES IN FIXED ASSETS

<table>
<tr><th>Fixed assets</th><th>Acquisition costs 01.01.2018 EURk</th><th>Additions EURk</th><th>Retire-ments EURk</th><th>Transfers EURk</th><th>Write-ups, cumulative EURk</th><th>Depreciation/ amortisation, cumulative EURk</th><th>Book value 31.12.2018 EURk</th><th>Annual depreciation/ amortisation for 2018 EURk</th></tr>
<tr><td>Bonds, debentures and other fixed-income securities</td><td>21,656,089</td><td rowspan="3" colspan="5">Net change pursuant to Section 34 (3) sentence 2 RechKredV: −86,950</td><td>21,672,014</td><td>–</td></tr>
<tr><td>Shareholdings</td><td>310,694</td><td>213,342</td><td>−8,364</td></tr>
<tr><td>Holdings in affiliated companies</td><td>23,332</td><td>17,809</td><td>–</td></tr>
<tr><td>Intangible assets</td><td>35,970</td><td>2,788</td><td>−41</td><td>–</td><td>–</td><td>−35,776</td><td>2,941</td><td>−3,361</td></tr>
<tr><td>Tangible assets</td><td>222,589</td><td>6,439</td><td>−5,431</td><td>–</td><td>–</td><td>−123,259</td><td>100,338</td><td>−4,499</td></tr>
<tr><td>Other assets</td><td>14,067</td><td>32</td><td>−970</td><td>–</td><td>–</td><td>−1,338</td><td>11,791</td><td>−466</td></tr>
</table>

Depreciation/amortisation	01.01.2018	Addition	Write-up	Transfer	Retirement	31.12.2018
Intangible assets	32,456	3,361	–	–	41	35,776
Tangible assets	122,607	4,499	–	–	3,847	123,259
Other assets	1,263	466	–	–	391	1,338

REMUNERATION PAID TO MEMBERS OF THE BOARD OF MANAGEMENT AND SUPERVISORY BOARD

Remuneration paid to members of the Board of Management for 2018 in EURk

Name	Membership period	Fixed remuneration	Other non-cash benefits	Payments from third parties relating to Board of Management activities	Total
Dr. Axel Nawrath Chair	01.01.–31.12.	682	25	8	714
Dr. Ulrich Theileis Vice-Chair	01.01.–31.12.	525	28	21	574
Dr. Iris Reinelt	01.01.–31.12.	425	31	9	465
Johannes Heinloth	01.01.–31.12.	425	27	5	457
Total		**2,057**	**112**	**42**	**2,210**

An occupational pension scheme is in place for the members of the Board of Management based on the rules applicable to L-Bank employees.

REMUNERATION PAID TO MEMBERS OF THE BOARD OF MANAGEMENT AND SUPERVISORY BOARD

Remuneration paid to members of the Supervisory Board for 2018 in EURk

Name	Membership period	Membership of Supervisory Board	Membership of committees	Attendance fees	Total
Edith Sitzmann[1] Chair	01.01.–31.12.	9.0	3.9	1.7	14.6
Thomas Strobl[1] 1st Vice-Chair	01.01.–31.12.	7.5	3.9	1.4	12.8
Dr. Nicole Hoffmeister-Kraut[1] 2nd Vice-Chair	01.01.–31.12.	7.5	2.4	0.9	10.8
Dr. Jürgen Bufka	01.01.–31.12.	6.0	–	0.5	6.5
Dr. Maximilian Dietzsch-Doertenbach	01.01.–31.12.	6.0	3.9	2.1	12.0
Martin Gross	01.01.–31.12.	6.0	–	0.6	6.6
Roger Kehle	01.01.–31.12.	6.0	–	0.5	6.5
Gabriele Kellermann	01.01.–31.12.	6.0	3.9	1.4	11.3
Dr. Peter Kulitz	01.01.–30.11.	5.5	2.2	0.9	8.6
Andrea Lindlohr	01.01.–31.12.	6.0	–	0.5	6.5
Klaus-Peter Murawski[1]	01.01.–31.08.	4.0	1.6	–	5.6
Rainer Reichhold	01.12.–31.12.[2]	0.5	–	0.2	0.7
Prof. Dr. Wolfgang Reinhart	01.01.–31.12.	6.0	–	0.6	6.6
Dr. Dieter Salomon	01.01.–30.11.	5.5	–	–	5.5
Dr. Florian Stegmann[1]	01.12.–31.12.[2]	0.5	0.3	0.2	1.0
Prof. Dr. Dr. h. c. Harald Unkelbach	01.12.–31.12.	0.5	0.2	–	0.7
Franz Untersteller[1]	01.01.–31.12.	6.0	2.4	0.9	9.3
Joachim Walter	01.12.–31.12.[2]	0.5	–	0.2	0.7
Joachim Wohlfeil	01.01.–30.11.	5.5	–	0.5	6.0
Clemens Meister	01.01.–31.12.	6.0	–	0.8	6.8
Barbara Bender-Wieland	01.01.–31.12.	6.0	–	0.5	6.5
Thomas Dörflinger	01.01.–31.12.	6.0	–	0.8	6.8
Total		**112.5**	**24.7**	**14.6**	**151.8**

[1] Subject to a duty of surrender to the State of Baden-Württemberg.
[2] As a regular member. Previously an alternate member.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS OF L-BANK AS AT 31 DECEMBER 2018

REMUNERATION PAID TO MEMBERS OF THE BOARD OF MANAGEMENT AND SUPERVISORY BOARD

	31.12.2018 EURk	31.12.2017 EURk
– Payments to former members of the Board of Management or their surviving dependants	1,681	1,701
– Advisory Board remuneration (including travel costs)	66	127
– Pension provisions for former members of the Board of Management and their surviving dependants	26,537	25,528

LOANS TO ADMINISTRATIVE BODIES (INCLUDING CONTINGENT LIABILITIES)

	31.12.2018 EURk	31.12.2017 EURk
Supervisory Board	9	–

All loans bear interest at market rates.

AVERAGE NUMBER OF EMPLOYEES IN 2018

	Male	Female	Total
Employees*	514	676	1,190
of whom: full-time employees	485	372	857
of whom: part-time employees	29	304	333

* Headcount; excluding vocational trainees and interns.

DIRECTORSHIPS HELD BY BOARD OF MANAGEMENT MEMBERS AND L-BANK EMPLOYEES SITTING ON STATUTORY SUPERVISORY BODIES OF LARGE CORPORATIONS PURSUANT TO SECTION 340A (4), ARTICLE 1 HGB

DR. ULRICH THEILEIS, VICE-CHAIR OF THE BOARD OF MANAGEMENT	
Hypo Vorarlberg Bank AG, Bregenz, Austria	Member of the Supervisory Board
Sächsische Aufbaubank – Förderbank –, Dresden	Member of the Administrative Council

DR. IRIS REINELT, MEMBER OF THE BOARD OF MANAGEMENT	
Investitionsbank Berlin, Berlin	Member of the Supervisory Board

BOARDS OF L-BANK

BOARD OF MANAGEMENT

Dr. Axel Nawrath
Chair

Dr. Ulrich Theileis
Vice-Chair

Dr. Iris Reinelt

Johannes Heinloth

SUPERVISORY BOARD MEMBERS

Regular members

Edith Sitzmann MSP*
Minister of Finance
Chair

Thomas Strobl
Deputy State Premier and Minister of the Interior, Digitisation and Migration
1st Vice-Chair

Dr. Nicole Hoffmeister-Kraut MSP
Minister of Economic Affairs, Labour and Housing
2nd Vice-Chair

Dr. Jürgen Bufka
Managing Director, Amber Infrastructure GmbH

Dr. Maximilian Dietzsch-Doertenbach
Managing Director, Doertenbach & Co GmbH

Martin Gross
Regional Manager, ver.di Baden-Württemberg

Roger Kehle
President, Gemeindetag Baden-Württemberg e.V.

Gabriele Kellermann
Member of the Board of Managing Directors, BBBank eG

Dr. Peter Kulitz
Former President, Ulm Chamber of Industry and Commerce (until 31.11.2018)

Andrea Lindlohr MSP
Vice-Chair, Alliance 90/ The Greens parliamentary group, Baden-Württemberg State Parliament

Klaus-Peter Murawski
Former Secretary of State, Baden-Württemberg Ministry of State (until 31.08.2018)

Rainer Reichhold
President, Chamber of Trades and Crafts, Stuttgart region (since 01.12.2018)

Prof. Dr. Wolfgang Reinhart MSP
Chair, CDU parliamentary group, Baden-Württemberg State Parliament

Dr. Dieter Salomon
Former President, Städtetag Baden-Württemberg e.V. (until 30.11.2018)

Dr. Florian Stegmann
Secretary of State, Baden-Württemberg Ministry of State (since 01.12.2018)

Prof. Dr. Dr. h. c. Harald Unkelbach
President, Heilbronn-Franken Chamber of Industry and Commerce (since 01.12.2018)

Franz Untersteller MSP
Minister of the Environment, Climate and Energy

Joachim Walter
President, Baden-Württemberg Association of District Councils (since 01.12.2018)

Joachim Wohlfeil
Former President, Karlsruhe Chamber of Trades and Crafts (until 30.11.2018)

Consulting members

Clemens Meister
Chair, Central Staff Council of L-Bank, Karlsruhe

Barbara Bender-Wieland
Chair, Staff Council of L-Bank, Karlsruhe

Thomas Dörflinger
Chair, Staff Council of L-Bank, Stuttgart

Alternate members

After 30 November 2018, the positions of alternate members of the Supervisory Board were abolished; effective as at 1 December 2018, the Supervisory Board now consists of 15 voting members and three consulting members.

*MSP = Member of the State Parliament of Baden-Württemberg

EVENTS AFTER THE BALANCE SHEET DATE

No incidents or events of particular significance occurred after the fiscal year-end on 31 December 2018.

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

The Board of Management hereby proposes to the Supervisory Board that out of the net profit for fiscal year 2018 totalling EUR 50,979,750.26, an amount of EUR 50,000,000.00 should be allocated to other retained earnings and the remaining amount of EUR 979,750.26 carried forward to the current fiscal year.

Karlsruhe, 1 March 2019

L-Bank

Dr. Axel Nawrath Dr. Ulrich Theileis Dr. Iris Reinelt Johannes Heinloth

DECLARATION OF THE BOARD OF MANAGEMENT REGARDING THE FINANCIAL STATEMENTS OF L-BANK AS AT 31 DECEMBER 2018

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 financial position, cash flows and financial performance, 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, 1 March 2019

Dr. Axel Nawrath Dr. Ulrich Theileis Dr. Iris Reinelt Johannes Heinloth

INDEPENDENT AUDITOR'S REPORT

for Landeskreditbank Baden-Württemberg – Förderbank –, Karlsruhe

REPORT ON THE AUDIT OF THE ANNUAL FINANCIAL STATEMENTS AND THE MANAGEMENT REPORT

Audit opinions

We have audited the annual financial statements of Landeskreditbank Baden-Württemberg – Förderbank –, Karlsruhe – comprising the balance sheet as at 31 December 2018, income statement, cash flow statement and statement of changes in equity for the fiscal year from 1 January to 31 December 2018, as well as the notes to the accounts, including the descriptions of the accounting and valuation methods applied. We have also audited the management report of Landeskreditbank Baden-Württemberg – Förderbank – for the fiscal year from 1 January to 31 December 2018. In accordance with German statutory provisions, we have not audited the contents of the separate non-financial report pursuant to Section 289b (3) of the German Commercial Code (Handelsgesetzbuch (HGB)).

In our opinion, based on the findings of the audit:

→ the accompanying annual financial statements comply, in all material respects, with German commercial law and, in accordance with German accepted accounting principles, give a true and fair view of the net assets and financial position of the institution as at 31 December 2018, and of the results of its operations for the fiscal year from 1 January to 31 December 2018, and

→ in all material respects, the accompanying management report conveys a true and fair view of the institution's position, is consistent with the annual financial statements, complies with German statutory provisions and suitably presents the opportunities and risks of future development. Our audit opinion on the management report does not cover the contents of the aforementioned separate non-financial report.

In accordance with Section 322 (3) sentence 1 HGB, we declare that our audit has not led to any reservations regarding the legal compliance of the annual financial statements and the management report.

Basis for the audit opinions

We conducted our audit of the annual financial statements and the management report in accordance with Section 317 HGB and EU Audit Regulation 537/2014 (hereinafter 'EU Audit Regulation') and in compliance with German generally accepted standards for the audit of financial statements promulgated by the Institute of Public Auditors in Germany (Institut der Wirtschaftsprüfer (IDW)). Our responsibilities under those provisions and standards are further described in the 'Auditor's responsibilities for the audit of the annual financial statements and the management report' section of our auditor's report. In accordance with European law as well as German commercial law and professional requirements, we are independent of the institution and have fulfilled our other German ethical and professional responsibilities in accordance with these requirements. In addition, in accordance with Article 10 (2) (f) of the EU Audit Regulation, we declare that we have not provided non-audit services prohibited under Article 5 (1) of the EU Audit Regulation. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions on the annual financial statements and the management report.

Key audit matters in the audit of the annual financial statements

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the annual financial statements for the fiscal year from 1 January to 31 December 2018. These matters were addressed in the context of our audit of the annual financial statements as a whole and in the preparation of our opinion thereon; we do not express a separate audit opinion on these matters.

In our view, the following was the matter of most significance in our audit:

1. Loan loss provisions in customer lending business

Our presentation of this key audit matter has been structured as follows:

1. Matter and issue

2. Auditing procedure and findings

3. Reference to further information

We present the key audit matter below:

1. Loan loss provisions in customer lending business

1. Landeskreditbank Baden-Württemberg – Förderbank – is the development bank of the German federal state of Baden-Württemberg. Its business activities are governed by its statutory remit, namely to support the state government of Baden-Württemberg in the fulfilment of its public duties, especially in terms of structural, economic and social policy, by implementing development initiatives in accordance with European Union (EU) rules on state aid. It provides support mainly by issuing low-interest loans and grants. As at 31 December 2018, loan receivables in the amount of EUR 22,645 million (32.5% of total assets) were reported under the balance sheet item 'Receivables from customers' in the institution's annual financial statements.

The measurement of loan loss provisions in customer lending business is determined in particular by the legal representatives' assessment of future credit losses based on the structure and quality of the lending portfolio, as well as macroeconomic factors. Specific valuation adjustments for receivables from customers are equal in amount to the difference between the outstanding loan amount and its lower fair value at the reporting date. Portfolio and general valuation adjustments are also made. Valuation adjustments in customer lending business are potentially of major significance for the institution's financial performance and also involve the legal representatives' discretionary use of judgement. In light of these facts, this matter was especially important in the context of our audit.

2. In the course of our audit, we first assessed the appropriateness of the design of the controls in the institution's relevant internal control system and tested the effective functioning of the controls, taking into account the organisational procedures, the IT systems and the relevant valuation models. We also assessed the valuation of receivables from customers, including the appropriateness of estimates, by examining individual loan exposures on a random basis. In doing so, we assessed the documents available to the institution regarding financial circumstances and the recoverability of associated collateral, among other things. In the case of real-estate collateral for which the institution presented us with valuation reports, we obtained an understanding of the raw data underlying the reports, the valuation inputs used and assumptions made, critically appraised these and assessed whether they lie within a reasonable range. In addition, in order to evaluate the specific, portfolio and general valuation adjustments, we assessed the calculation methods and the underlying assumptions and parameters. Based on the audit procedures we performed, we were able to satisfy ourselves overall of the appropriateness of the assumptions made by the legal representatives in testing the loan portfolio for impairment and of the appropriateness and effectiveness of the processes implemented by the institution.

3. The institution's disclosures on loan loss provisions in customer lending business are contained in the notes to the annual financial statements, in the section entitled 'Financial assets and liabilities' under 'Accounting and valuation methods'.

Other information

The legal representatives are responsible for the other information provided. The other information includes the separate non-financial report pursuant to Section 289b (3) HGB.

The other information additionally includes the remaining parts of the annual report – excluding cross-references to external information – with the exception of the audited annual financial statements, the audited management report and our auditor's report.

Our audit opinions on the annual financial statements and the management report do not cover the other information, and consequently we do not express an audit opinion or any other form of assurance conclusion thereon.

In connection with our audit, our responsibility is to read the other information and, in so doing, to consider whether the other information:

- → is materially inconsistent with the annual financial statements, the management report or the findings we obtained in the course of the audit, or
- → otherwise appears to be materially misstated.

Responsibilities of the legal representatives and Supervisory Board for the annual financial statements and management report

The legal representatives are responsible for preparing annual financial statements that comply, in all material respects, with German commercial law, and for ensuring that the annual financial statements give a true and fair view of the institution's net assets, financial position and financial performance in accordance with German accepted accounting principles. The legal representatives are also responsible for such internal controls as they, in accordance with German accepted accounting principles, determine are necessary to enable the preparation of annual financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the annual financial statements, the legal representatives are responsible for assessing the institution's ability to continue as a going concern and disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting on the going-concern basis of accounting unless there is constructive or legal evidence to contradict the assumption.

Furthermore, the legal representatives are responsible for preparing a management report that, as a whole, provides a suitable understanding of the position of the institution and is in all material respects consistent with the annual financial statements, complies with German statutory provisions, and suitably presents the opportunities and risks of future development. The legal representatives are also responsible for such arrangements and measures (systems) as they consider necessary to enable the preparation of a management report in accordance with the applicable German statutory provisions and to provide sufficient suitable evidence to support the assertions in the management report.

The Supervisory Board is responsible for overseeing the institution's financial reporting process for preparing the annual financial statements and the management report.

Auditor's responsibilities for the audit of the annual financial statements and the management report

Our objectives are to obtain reasonable assurance about whether the annual financial statements as a whole are free from material misstatement, whether intentional or unintentional, and whether the management report on the whole provides a suitable understanding of the position of the institution and is consistent, in all material respects, with the annual financial statements and the findings of the audit, complies with German statutory provisions and suitably presents the opportunities and risks of future development, as well as to issue an auditor's report that includes our opinions on the annual financial statements and the management report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Section 317 HGB and the EU Audit Regulation and in compliance with German generally accepted standards for the audit of financial statements promulgated by the Institute of Public Auditors in Germany (IDW) will always reveal a material misstatement. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic or commercial decisions of users made on the basis of these annual financial statements and this management report.

We exercise our professional judgement and maintain professional scepticism throughout the audit. We also:

→ identify and assess the risks of material misstatement in the annual financial statements and the management report, whether due to fraud or error design and perform audit procedures in response to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our audit opinions. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, falsification, intentional omission, misrepresentation or the overriding of internal controls.

→ obtain an understanding of the internal control system relevant to the audit of the annual financial statements and of the arrangements and measures relevant to the audit of the management report, in order to design audit procedures that are appropriate in the circumstances, albeit not for the purpose of expressing an audit opinion on the effectiveness of these systems at the institution.

→ evaluate the appropriateness of accounting policies used and the reasonableness of estimates and related disclosures made by the legal representatives.

→ conclude on the appropriateness of the legal representatives' use of the going-concern basis of accounting and, based on the audit evidence obtained, on whether a material uncertainty exists in connection with events or circumstances that could cast significant doubt on the institution's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the related disclosures in the annual financial statements and in the management report or, if such disclosures are inadequate, to modify our audit opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the institution to be unable to continue as a going concern.

→ evaluate the overall presentation, structure and content of the annual financial statements, including the disclosures, and whether the annual financial statements present the underlying business transactions and events in such a way that the annual financial statements give a true and fair view of the net assets, financial position and financial performance of the institution in accordance with German accepted accounting principles.

→ evaluate the consistency of the management report with the annual financial statements, its conformity with the law, and the understanding of the institution's position that it provides.

→ perform audit procedures on the forward-looking statements presented by the legal representatives in the management report. On the basis of sufficient appropriate audit evidence, we evaluate, in particular, the significant assumptions on which the forward-looking statements by the legal representatives are based and assess whether the forward-looking statements were properly derived from those assumptions.

We do not express a separate audit opinion on the forward-looking statements or the assumptions underlying them. There is a significant unavoidable risk that future events will differ materially from the forward-looking statements.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in the internal control system that we identify during our audit.

We provide those charged with governance with a statement that we have complied with the relevant independence requirements, and discuss with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, the safeguards that have been put in place.

From the matters discussed with those charged with governance, we identify those matters that were of greatest significance in the audit of the annual financial statements for the current reporting period and are therefore the key audit matters. We describe these matters in the auditor's report unless law or regulation precludes public disclosure of such matters.

OTHER LEGAL AND REGULATORY REQUIREMENTS

Further information pursuant to Article 10 of the EU Audit Regulation

We were appointed statutory auditor by the Supervisory Board on 25 April 2018. We were engaged by the Supervisory Board on 13 September 2018. We have been the statutory auditor of Landeskreditbank Baden-Württemberg – Förderbank –, Karlsruhe, for an uninterrupted period of engagement since fiscal year 2015.

We declare that the audit opinions contained in this auditor's report are consistent with the additional report to the audit committee referred to in Article 11 of the EU Audit Regulation (long-form audit report).

INDEPENDENT AUDITOR RESPONSIBLE

The German public auditor responsible for the engagement is Stefan Palm.

Stuttgart, 1 March 2019
Pricewaterhousecoopers GmbH
Wirtschaftsprüfungsgesellschaft

Stefan Palm	pp. Ralf Steffan
Public auditor	Public auditor

INDEPENDENT AUDITOR'S REPORT ON A LIMITED-ASSURANCE ENGAGEMENT RELATED TO THE BANK'S NON-FINANCIAL REPORTING

for Landeskreditbank Baden-Württemberg – Förderbank –, independent public-law institution, Karlsruhe.

We have performed a limited-assurance engagement on the separate non-financial report pursuant to Section 340a (1a) in conjunction with Sections 289b to 289e HGB for the period from 1 January to 31 December 2018 (hereinafter the 'non-financial report') published by Landeskreditbank Baden-Württemberg – Förderbank –, independent public-law institution, Karlsruhe (hereinafter the 'institution').

RESPONSIBILITIES OF THE LEGAL REPRESENTATIVES

The institution's legal representatives are responsible for preparing the non-financial report in accordance with Section 340a (1a) in conjunction with Sections 289b to 289e HGB.

This responsibility on the part of the institution's legal representatives includes selecting and applying appropriate methods of non-financial reporting, as well as making assumptions and estimates related to individual non-financial disclosures that are appropriate in the circumstances. The legal representatives are also responsible for such internal controls as they determine are necessary to enable the preparation of a non-financial report that is free from material misstatement, whether due to fraud or error.

AUDIT FIRM INDEPENDENCE AND QUALITY CONTROL

We have complied with German statutory provisions regarding independence and other requirements for professional conduct.

Our audit firm applies national statutory requirements and the German profession's pronouncements, in particular the professional statues for German public auditors and sworn auditors (Berufssatzung für Wirtschaftsprüfer und vereidigte Buchprüfer (BS WP/vBP)) as well as the IDW Quality Assurance Standard 1: Requirements for Quality Assurance in Auditing Practice (IDW Qualitätssicherungsstandard 'Anforderungen an die Qualitätssicherung in der Wirtschaftsprüferpraxis' (IDW QS 1)) and accordingly maintains a comprehensive quality assurance system which includes documented policies and procedures regarding compliance with professional conduct requirements, professional standards and applicable legal and regulatory requirements.

INDEPENDENT AUDITOR'S RESPONSIBILITIES

Our responsibility is to express a limited-assurance conclusion on the disclosures in the non-financial report based on the limited-assurance engagement we have performed.

It is not within the scope of our engagement to assess external documentation sources or expert opinions referred to in the non-financial report.

We conducted our limited-assurance engagement in accordance with the International Standard on Assurance Engagements (ISAE) 3000 (Revised) 'Assurance Engagements other than Audits or Reviews of Historical Financial Information', issued by the IAASB. This Standard requires that we plan and perform the assurance engagement in order to obtain limited assurance about whether any matters have come to our attention that cause us to believe that the institution's non-financial report for the period from 1 January 2018 to 31 December 2018 has not been prepared, in all material respects, in accordance with Section 340a (1a) in conjunction with Sections 289b to 289e HGB.

In a limited-assurance engagement, the assurance procedures performed are less extensive than for a reasonable assurance engagement, and therefore a substantially lower level of assurance is obtained. The selection of assurance procedures depends on the public auditor's professional discretion.

In the course of our audit, we performed the following assurance procedures and other activities, including:

- obtaining an understanding of the structure of the sustainability organisation
- inquiries of relevant personnel involved in the preparation of the non-financial report concerning the preparation process, the internal control system relating to this process, and disclosures in the non-financial report
- identification of the likely risks of material misstatement in the non-financial report
- analytical evaluation of disclosures in the non-financial report
- comparison of disclosures with corresponding data in the annual financial statements and management report
- evaluation of the presentation of the disclosures

ASSURANCE CONCLUSION

Based on the assurance procedures performed and assurance evidence obtained, nothing has come to our attention that causes us to believe that the institution's non-financial report for the period from 1 January to 31 December 2018 has not been prepared, in all material respects, in accordance with Section 340a (1a) in conjunction with Sections 289b to 289e HGB.

INTENDED USE OF THE ASSURANCE REPORT

We issue this report on the basis of the engagement agreed with the institution. The assurance engagement was performed for the purposes of the institution and the report is solely intended to inform the institution about the results of the assurance engagement.

The report is not intended for use by third parties as a basis for making (asset-related) decisions. Our responsibility is solely towards the institution. We do not assume any responsibility towards third parties.

Frankfurt am Main, 1 March 2019

PricewaterhouseCoopers GmbH
Wirtschaftsprüfungsgesellschaft

Nicolette Behncke pp. Dieter Horst
Public auditor

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