# RISK AND OPPORTUNITY REPORT

## *Risk report*

### Risk management system

MLP considers risk management as the use of a comprehensive array of instruments for managing risks in line with the strategy set out by the Executive Board in addition to the risk bearing ability process. Due to the potential growth and extra earnings they can offer, risks should be addressed and taken in a conscious and controlled manner within the scope of internal control/monitoring procedures.

The operational and organisational structure, the risk management and controlling processes, in addition to the special Risk Controlling, Compliance and Internal Audit functions are key components of the Group-wide risk management system.

Group-wide risk management

MLP SE, Wiesloch, MLP Banking AG, Wiesloch, MLP Finanzberatung SE, Wiesloch, MLPdialog GmbH, Wiesloch, FERI AG, Bad Homburg v. d. Höhe, FERI Trust GmbH, Bad Homburg v. d. Höhe, FEREAL AG, Bad Homburg v. d. Höhe, FERI Trust (Luxembourg) S.A., Luxembourg, in addition to DOMCURA AG, Kiel, NORDVERS GmbH, Kiel and nordias GmbH Versicherungsmakler, Kiel, are included in the Group-wide risk management (scope of consolidation pursuant to Section 25a of the German Banking Act (KWG) - Germany's "MaRisk consolidation scope").

**Scopes of consolidation – differences between the IFRS and MaRisk scope of consolidation**

| Segment | Comapny | | IFRS scope of consolidation | MaRisk scope of consolidation (§25a German Banking Act, KWG) |
|---|---|---|---|---|
| Holding | MLP SE | | X | X |
| Banking | MLP Banking AG | | X | X |
| Financial consulting | MLP Finanzberatung SE | | X | X |
| | | TPC GmbH | X | |
| | | ZSH GmbH | X | |
| | | MLPdialog GmbH | X | X |
| | | MLP Hyp GmbH * | X | |
| FERI | FERI AG | | X | X |
| | | FERI Trust GmbH | X | X |
| | | FEREAL AG | X | X |
| | | FERI Trust (Luxembourg) S.A. | X | X |
| DOMCURA | | DOMCURA AG | X | X |
| | | NORDVERS GmbH | X | X |
| | | Nordias GmbH Versicherungsmakler | X | X |
| | | Willy F. O. Köster GmbH | X | |
| | | Siebert GmbH Versicherungsmakler | X | |

* accounted for using the equity method

Pursuant to Section 25a (3) of the German Banking Act (KWG) and in conjunction with Section 4.5 of Germany's Minimum Requirements for Risk Management (MaRisk), the Executive Board at MLP Banking AG, which as per Article 11 of the Capital Requirements Regulation (CRR) is the controlling body of MLP Financial Holding Group (MLP FHG) as the depository institution, ensured appropriate control and monitoring of the significant risks at Group level through suitable processes. This approach encompasses in particular

- defining Group-wide strategies,
- securing the Group's risk-bearing ability,
- establishing structural and organisational regulations for the Group,
- implementing Group-wide risk management and controlling processes and
- setting up an Internal Audit department, which will operate throughout the Group.

In the context of the strategy process and the risk inventory MLP Banking AG, acting as a controlling company of the Financial Holding Group, obtains an overview of the risks in the Group on a regular and ad hoc basis. Based on the risks identified in the individual companies and their relative weighting, the MaRisk scope of consolidation is formed which defines the scope of the Group-wide risk management system. In principle, all risks identified as significant within the Group by the controlling company are taken into account. Group-wide regulations and policies for establishing Group-wide risk management at MLP Financial Holding Group are defined taking into account the type, scope, complexity and risk content, in addition to the different application options provided by corporate law on a case-by-case basis.

## Risk policies

The Executive Board of the controlling company defines the business strategy and a consistent risk strategy for MLP Financial Holding Group. The Group-wide risk propensity is derived from the risk strategy, taking into account the risk-bearing ability. On this basis, framework conditions for risk management at MLP Financial Holding Group are then defined. The readiness to take risks is regularly checked and adjusted as necessary.

The following basic principles are consistent with the business strategy and describe the central framework conditions for the risk management at MLP Financial Holding Group:

**The Executive Board is responsible for the proper organisation of the business and its further development:**

This responsibility includes defining appropriate strategies and setting up appropriate internal control procedures in particular - thereby assuming responsibility for all significant elements of risk management. The task of defining the business and risk strategy cannot be delegated. It is the responsibility of the Executive Board to implement the strategies, assess the risks associated with them in addition to putting them in place and monitoring measures to ensure that these risks are limited.

**The Executive Board bears responsibility for the risk strategy:**

The Executive Board of the controlling company defines the risk strategy for MLP Financial Holding Group, including the significant elements and assumptions on risk-bearing ability. The risk strategy reflects the risk propensity or "risk tolerance" based on the targeted risk/earnings ratio. The Executive Board ensures that a comprehensive approach, incorporating all key risk types, is incorporated in the companies and that suitable steps are taken to implement the risk strategy.

**MLP promotes a strong awareness of risks and a pronounced risk culture:**

Risk awareness that goes beyond each department's or person's own field of responsibility is essential. A strong awareness of risks across all divisions and a corresponding risk culture are encouraged through appropriate organisational structures. The appropriateness of the risk management and controlling system is continuously monitored and any adjustments that become necessary are implemented as quickly as possible. Appropriate quality standards are established and subjected to continuous checks.

**MLP pursues a strategy of comprehensive risk communication and risk reporting:**

Detected risks are reported to the responsible management levels openly and without restriction. The Executive Board is informed in a comprehensive and timely manner (if necessary ad hoc) of the risk profile of the relevant risks, and profit and losses at MLP Financial Holding Group. The Supervisory Board receives the information required to perform its legal obligations. Internal risk communication and risk reporting is supplemented by comprehensive, external publications that cater to the interests of MLP SE shareholders and the capital market and also comply with the supervisory requirements.

## Objective

Entrepreneurial activity invariably involves taking risks. For MLP Financial Holding Group, "risk" means the danger of possible losses or lost profits. This danger can be attributed to internal or external factors. Since it will not be possible to eliminate all risks, a risk that is commensurate with the expected return must be targeted. The aim is to identify risks as early as possible in order to react to them quickly and appropriately. Our risk management system currently records risks in particular. In addition to this, we also focus on business opportunities. Particularly in Product Management and Purchasing, business opportunities in the market are identified in a targeted process for the individual product segments. Implementation is then tested and initiated, taking into account the chances of success and the associated risks. You can find a detailed description of the significant opportunities for MLP Financial Holding Group in the separate → opportunity report.

MLP's group-wide early risk detection and monitoring system is used as the basis for a group-wide active risk management. This system ensures appropriate identification, assessment, controlling, monitoring and communication of the major risks. Risk management is a key component of the value-driven management and planning system at MLP Financial Holding Group. Moreover, the Group's risk culture is continuously consolidated and efforts are made to communicate information relevant to risk across all business segments.

### Risk capital management, liquidity management and stress tests

Risk capital management - risk-bearing ability

Risk capital management is an integral part of the Group management system at MLP Financial Holding Group. Active control of the economic capital adequacy based on the results of risk assessments and in compliance with the supervisory requirements ensures that risk-taking is always in line with capital backing.

Risks are only accepted within limits derived from aspects of the risk-bearing ability to achieve adequate returns, taking into account risk/earning factors. In particular, this prevents risks that could threaten the continuity of the business model.

The Executive Board defines the risk capital based on business policy targets and controls the risk profile in an appropriate ratio to the risk coverage fund. The focus is on the key risks for MLP Financial Holding Group, which are identified at least once a year within the scope of a risk inventory (risk profile) performed throughout the Group. Here, the key risk indicators determined using standardised procedures are compared with threshold values applied throughout the Group. The Group-wide risk profile represents the basis for both risk capital management and the risk management and controlling processes. With reference to the minimum requirements of risk management systems (MaRisk), we take into account the proportionality principle with regard to implementation of Section 25a of the German Banking Act (KWG).

The key risk types of counterparty default, market price, liquidity and operational risks are in particular quantified within the scope of the risk-bearing ability. The general business risks and reputation risks (other risks) also represent significant risk types, although they are currently not quantified. Amongst other things, they are taken into account when calculating the risk-bearing ability in the form of additional buffers.

In managing the financial risk capital, the minimum regulatory capital adequacy requirements (as per the Capital Requirements Regulation (CRR)) represent supplementary conditions which must be strictly adhered to.

In accordance with the guideline entitled "Prudential assessment of internal banking risk-bearing capacity concepts" (published on December 7, 2011 by the Federal Financial Supervisory Authority), the internal assessment of the appropriateness of equity capital backing is performed based on the going-concern approach in the standard scenario. In addition, the liquidation approach is looked at and is applied inter alia in stress scenarios.

In the going-concern approach, the focus is on securing continued existence of MLP FHG. In the liquidation approach, the objective is to protect the bank's owners and external providers of equity.

Furthermore, MLP implemented a process for planning future capital requirements. The instrument supports MLP in identifying and planning future capital requirements, as well as in implementing suitable measures to cover requirements. Unlike the one-year review period of the risk-bearing capacity concept, this is based on a multi-year time frame. This component, which stretches further into the future, is intended to supplement the risk-bearing capacity concept in a sensible way to secure early identification of any necessary capital increases.

At 39.5%, the largest portion of the risk coverage fund in MLP Financial Holding Group is allocated to the banking segment due to the risk inherent to the banking business.

Liquidity capacity

Securing appropriate liquidity capacity is based on the notion of establishing an appropriate risk-return structure, while at the same time ensuring solvency of the companies in MLP Financial Holding Group at all times. The concept of and compliance with the liquidity capacity are also derived from Pillar 2 of the Basel Accord.

Stress tests

Stress tests are also performed on a regular and ad hoc basis for the special analysis of the effects of unusual, yet still plausible, events. Comprehensive analyses have therefore been implemented, both at the level of the individual risk types and across all risk types. The effects of potential concentrations of risks are also taken into account here.

When performing the standardised stress tests, the key risk drivers are scaled in such a way that they reflect disproportionately negative economic situations. The implemented stress tests can then be used to check whether the risk-bearing ability of MLP Financial Holding Group can still be secured even under unfavourable economic framework conditions. The market value effects on the financial situation, the liquidity situation and the results of operations are also investigated in this context.

### Organisation

The Executive Board is responsible for establishing an appropriate and effective system of risk management at MLP Financial Holding Group. Set against this background, operational and organisational precautions are put in place.

Functional separation

Our risk management concept follows clearly defined basic principles that are applied as binding throughout the entire Group and whose compliance is continuously checked. A crucial element of these principles is a clear organisational and operational distinction between the individual functions and activities of risk management.

The operational and organisational structure is regularly checked and assessed through internal audits and adapted to internal and external developments as they happen.

Group Risk Manager

The Group Risk Manager is responsible for the risk monitoring and control activities in MLP Financial Holding Group. He is kept continuously informed of the risk situation in the Financial Holding Group and gives regular reports on this to the entire Executive Board and Supervisory Board.

Risk controlling function

To be able to address risk topics at an early stage and sustainably throughout the Group, while also increasing risk awareness, a risk controlling function has been set up at MLP. This function is responsible for independent monitoring and communication of risks.

Risk management and controlling processes

Risk management in MLP Financial Holding Group and its local operating implementation in the business units is performed on the basis of the risk strategy. The units responsible for risk management reach decisions for conscious acceptance, reduction, transfer or avoidance of risks, observing the framework conditions specified centrally.

The Risk Controlling unit in particular is responsible for the identification and assessment of risks, in addition to monitoring defined limits. This is accompanied by reporting the risks to the Executive Board and the business units that control the risks. Suitable early detection systems support risk monitoring and identify potential problems early on, thereby enable prompt planning of measures.

Appropriate guidelines and an efficient monitoring process also ensure that the regulatory requirements for risk management and controlling are met by the principal Group companies.

The methods used at MLP Financial Holding Group to assess risks are in line with the current level of knowledge and are aligned with practices in the banking sector as well as recommendations of the Federal Financial Supervisory Authority. The results determined based on the risk models are entirely suitable for controlling the risks. Quantification methods are subject to regular checks by risk controlling alongside internal and external audits. However, despite careful model development and regular checks, it is conceivable for circumstances to occur that lead to greater losses than those forecast by the risk models.

Controlling monitors earnings trends

Controlling is responsible for planning processes and continuously monitoring trends in earnings. The planning process is broken down into short-term and mid-term planning horizons with varying degrees of detail.

To monitor planned and target variables, the revenue and earnings figures actually achieved are compared against the corresponding plan figures within the scope of daily, weekly and monthly reporting. This provides continuous transparency for Management.

Internal controlling system in the accounting process

With regard to the accounting and management reporting processes, the Internal Control System (ICS) is used to provide an accurate picture of actual conditions in terms of the net assets, the financial position and results of operations at MLP Banking AG and MLP Group. The objective of the ICS is to secure complete and accurate recording, processing and documentation of all business transactions in accordance with the regulations, standards and guidelines of applicable legislation and the company's Articles of Association.

MLP excels through its clear organisational, corporate and control structure. All units involved in the accounting process comply with their respective quantitative and qualitative requirements. The employees tasked with performing the accounting process receive regular training. Group Accounting is the central point of contact for all questions in connection with accounting issues.

The checks in the accounting process aim to ensure that the individual and consolidated financial statements are drafted in line with the provisions of German commercial law and International Financial Reporting Standards (IFRS), in addition to proper and timely internal and external financial reporting. The scope of the checks and responsibilities integrated into the procedures is clearly regulated.

In addition, financial and risk data, which itself is subject to a comparable internal monitoring system, is also incorporated into the management report.

Functional separation, the dual-control principle and the audit activities of the Internal Audit department represent key control instruments for all accounting-related processes. The processes of the accounting-based ICS are documented and specified in work instructions that are regularly updated and published in the organisation manual.

The bank's separate financial statements, in addition to the consolidated financial statements, are drawn up using standard software. Group Accounting secures the completeness and accuracy of the relevant disclosures on the basis of the information provided.

The adequacy and effectiveness of the accounting-based ICS are regularly checked and monitored.

Compliance function

The Executive Board has also set up a compliance function, the duties of which include identifying and monitoring key legal provisions and requirements, non-compliance with which can potentially jeopardise the assets of MLP Financial Holding Group.

Internal audits

The main duty of the internal audit department at MLP Banking AG is to assess the effectiveness and appropriateness of risk management in general and of the internal control system in particular. Audit tasks are performed throughout the Group based on service level agreements and outsourcing contracts with the key Group companies, in addition to the function of MLP Banking AG as a controlling company pursuant to Section 10a (2) of the German Banking Act (KWG). The focus is on compliance with legislative requirements, supervisory requirements, guidelines, regulations and internal provisions for business processes. To this end, audit procedures are performed using a systematic and targeted approach on the basis of the COSO model to assess the effectiveness and appropriateness of risk management, controls and the management and monitoring processes. Risk-oriented audits are conducted at regular intervals and the results are reported. The internal audit department monitors the rectification of any issues detected. In addition to this, it performs independent advisory services with a view to creating added value and improving business processes.

The minimum requirements for risk management governing the internal audit function are complied with throughout the Group. The internal audit department operates in an independent capacity throughout the Group on behalf of the Executive Board.

Risk reporting

A substantial risk reporting scheme forms the basis for appropriate and successful corporate management. This is complemented by an extensive system of internal reporting which promptly provides the key decision-makers with information on the current risk situation. Risk reports are generated at fixed intervals (monthly or quarterly) or produced ad-hoc, if and when necessary. In addition, planning, simulation and control instruments show possible positive and negative developments to the most important value and controlling parameters of the business model and their effect on the net assets, financial position and results of operations.

Risk reports are submitted to the controlling units, the Executive Board and the Supervisory Board. Comprehensive information is promptly provided on any changes to relevant influential factors.

## Statement of risks

MLP Financial Holding Group is exposed to various financial risks. They in particular comprise counterparty default, market price and liquidity risks. Alongside financial risks, there are also operational and other risks, such as general business risks and reputation risks. The risks are taken into consideration after risk-reducing measures, such as insurances.

**The key risk types in the respective segments are presented below:**

| Segments | Default risks | Market price risks | Liquidity risks | Operational risks | Other risks |
|---|---|---|---|---|---|
| Holding | x | | x | x | x |
| Banking | x | x | x | x | x |
| Financial consulting | x | | x | x | x |
| FERI | x | x | x | x | x |
| DOMCURA | x | | | x | x |

## Counterparty default risks

The counterparty default risk is the risk of a loss due to the defaulting of or deterioration in creditworthiness of a business partner. The credit risk comprises the contracting party risk (re-covering risk and advance performance and counterparty settlement risk), in addition to the risks related to specific countries which, however, are only of secondary importance to MLP Financial Holding Group.

The counterparty default risks of MLP Financial Holding Group are essentially made up of the client credit business under the company's own liability, the company's own business and the commission receivables against our product partners. There are no significant risks related to specific countries, since the majority of lending (more than 96%) is limited to borrowers domiciled in the Federal Republic of Germany.

Concentration of risk

The identification of potential concentrations of risks is another key component of credit risk management. Risks which come about due to an uneven distribution of business partners in credit relations or other business relations or which are caused by sectoral/geographical business focuses and are capable of generating such great losses that the solvency of an institute may be threatened are classed as concentrations of risk in the credit portfolio. In order to identify concentrations of risk in the lending business early on, the portfolio is analysed using various approaches, such as investigations based on sector, size and risk classes or security categories. Concentrations of risk are also given special consideration in the stress tests specific to the risk types.

To minimise potential concentrations of risk in the proprietary business before they can even occur, MLP Financial Holding Group follows a strategy of diversification and risk avoidance. Thus, investments are diversified into bonds, debentures and other financial instruments across various sectors. We have defined binding investment limits for the individual sectors and issuers via our capital investment directive. These limits were observed at all times over the course of the year.

In the private client business, potential concentrations in ratings classes with high failure rates should be avoided. This is achieved by focusing on retail products like credit cards and accounts in association with the target client segments. In addition to this, the minimisation of large individual risks with a low credit rating is a further central component of the credit policy in place at MLP Financial Holding Group. Focusing on specific professional groups enables an attractive earnings margin to be achieved thanks to relatively low default risks.

Credit management

The responsibilities in the credit business, from application to authorisation and completion, including regular monitoring with regular creditworthiness analyses, have been defined and documented in the organisational guidelines. The decision-making authority is laid down in the authority regulations, which themselves are based on the risk content of the transactions.

Loan approval, in particular in the client credit business, takes the form of credit limits being granted for the individual borrower or borrower unit. Individual credit decisions are made by specialised employees that follow clearly defined guidelines based on the size, creditworthiness and collateral of the respective borrower. A special scoring process allows fast decisions to be made, in particular for credit cards and accounts in the retail lending business, while also securing consistently high quality.

The basis of our credit decisions is always the creditworthiness of the borrower. Collateral does not have any influence on the borrower's rating. Depending on the structure of a transaction, collateral can however be of significance for the risk assessment of a commitment.

All forms of traditional loan collateral are essentially used throughout. This specifically includes mortgages on residential and commercial property, warranties, sureties, life insurance policies, financial collateral and assigned receivables.

In addition to this, potential default risks are continuously measured and evaluated by comparing allowances for bad debts with the credit volumes subject to risk. For accounts that are regarded as carrying acute risk, we build up appropriate allowances for bad debt (see table for the development of loan loss provisions). The disposals made as a result of the spin-off comprise impaired receivables from consultants and receivables from the brokerage business. Identified non-performing loans are transferred to specialist departments where they are individually managed by experts. We use deferral in line with Article 178 of the Capital Requirements Regulation (CRR) as the definition of default. As a matter of basic principle, allowances for losses on individual accounts are performed on a case-by-case assessment.

**Loan loss provisions (banking segment)**

| Amount in € million (previous year) * | Opening balance | Allocations | Reversals | Utilisation | Disposals due to spin-off | Closing balance |
|---|---|---|---|---|---|---|
| Specific allowance for doubtful accounts | 7.5 (6.7) | 0.8 (2.1) | 0.5 (1.0) | 1.0 (0.3) | 3.4 (-) | 3.4 (7.5) |
| General allowance for bad debts | 3.4 (4.5) | 0.1 (0.4) | 0.0 (0.0) | 0.7 (1.4) | 0.0 (-) | 2.8 (3.4) |
| General allowance for doubtful accounts | 3.3 (4.5) | 0.2 (-) | 0.5 (1.2) | - (-) | 0.5 (-) | 2.6 (3.3) |
| Provisions | 0.2 (0.2) | - (-) | 0.1 (0.0) | - (-) | - (-) | 0.1 (0.2) |
| **Total** | **14.4 (15.9)** | **1.2 (2.5)** | **1.1 (2.2)** | **1.7 (1.8)** | **3.9 (-)** | **8.9 (14.4)** |

* Due to rounding of these figures, minor differences may arise.

In addition to the above-described risks in the client credit business, there is an issuer's risk from the bonds, debentures and other financial instruments acquired. We reduce the risk of default among issuers whose securities we acquired within the scope of capital investment management through the specified creditworthiness requirements of our capital investment directive. Where available, MLP Financial Holding Group also bases its decisions in the field of financial investments on external ratings.

The credit value at risk is approximated using the formulae of capital adequacy requirements as per CRR for calculating the economic counterparty default risk and for the purpose of internally controlling counterparty default risks. Various methods are available for this in accordance with the CRR. In terms of the calculation methods, differentiation is made between the standardised approach to credit risk (CRSA) and the approach based on internal ratings (IRBA). Depending on the rating status of the receivables due to MLP Financial Holding Group, the internal control system is based on the various supervisory calculation methods.

## Market price risks

MLP Financial Holding Group understands market price risks, the uncertainty regarding changes in market prices and rates (including interest rates, share prices, exchange rates and raw material prices), the correlations between them and their volatility. There are currently only very minor open risk items in foreign currency and commodities. In the year under review, no speculative use was made of financial instruments – such as securitisation transactions – with a view to making profits in the short term, nor is this envisaged for the future. MLP Banking AG continues to hold the status of a non-trading book institute. The subcategory of market price risk, which is important for us, represents the general interest risk.

Interest rate risks

Interest rate risks essentially arise due to incomplete congruency of interest rate agreements between the loans granted and business on own account as well as their refinancing. These maturity transformation risks are continuously monitored and assessed in compliance with supervisory requirements, among others by means of stress scenarios.

Within the scope of the risk-bearing capacity assessment, a simulation is performed in which the net interest for interest-bearing and interest-sensitive items is determined for the interest risk in the event of an ad hoc change in interest rates.

Possible effects of different interest development scenarios are portrayed via planning and simulation calculations. The risks and their effects are made transparent based on assumptions of multilayer interest scenarios. In this context, cash value changes of all items in the asset ledger are shown in relation to the equity, with the application of the changes in interest rates prescribed by the Federal Financial Supervisory Authority. The simulation is performed by automated means for all the interest-bearing and interest-sensitive items. It is in this manner that the controlling of the interest risk is ensured.

The change in value determined in the reporting period always remained significantly below the threshold of 20% of equity.

**Interest rate risks of MLP Financial Holding Group**

| Amount in € million | Interest rate shock/parallel shift | | | |
|---|---|---|---|---|
| | Change in value + 200 BP | | Change in value - 200 BP | |
| | 2017 | 2016 | 2017 | 2016 |
| Total | -3.5 | -8.4 | 0.8 | 4.5 |

## Liquidity risks

MLP Financial Holding Group understands liquidity risks to mean uncertainty in terms of the availability of funds to meet payment obligations or reduce risk items which are either insufficient or which can only be secured by accepting higher rates. Liquidity risks can result from both internal and external risk factors.

The fundamental principles of liquidity control and planning are defined in the internal guidelines. In controlling the liquidity risk, we employ two different approaches - discretionary and structural.

Operational liquidity control

Within the scope of strategic or short-term liquidity control at Group level, the liquidity risk is assessed and controlled in particular using the KPI from the Liquidity Directive and the Liquidity Coverage Ratio (LCR). The LCR represents a stress scenario from the supervisory perspective with a review period of 30 days, during which the interbank market no longer works. In addition to this, within the scope of liquidity control, the volume of daily net cash inflows and outflows is observed and incorporated into the risk assessment based on the liquidity at risk (LaR). The LaR describes the anticipated cash payment surplus (net funding requirement) which will not be exceeded at a defined level of probability within a given period of time. Additionally, an expected shortfall is monitored for the assessment of any outliers. Sufficient funds were available to cover short-term liquidity requirements at any time.

Structural liquidity control

Structural (mid-to-long-term) liquidity control of the Group is performed on the basis of liquidity gap analyses, which highlight the anticipated development of liquidity over various time horizons. In addition to this, the effects of various cash flow scenarios, and thereby also on the liquidity situation of MLP, are analysed using the funding matrix. Additional Liquidity Monitoring Metrics (ALMM) provide extra information alongside the Net Stable Funding Ratio (NSFR), particularly with regard to concentrations.

The liquidity value at risk (LVaR), which indicates the additional refinancing costs required to close open liquidity items, is a key instrument of structural liquidity control and is also used in risk capital management. When determining the LVaR as of December 31, 2017, net cash inflows for the year were in line with forecasts and no additional refinancing costs are thus expected to occur.

If, contrary to expectations, net cash outflows should occur, sufficient cash reserves are available. The liquidity risk at MLP Financial Holding Group results primarily from MLP Banking AG as the custodian bank. The refinancing structure is based largely on client deposits. Appropriate short and medium-term credit lines have also been agreed to safeguard against a possible short-term liquidity shortfall.

Alongside the assumed development in standard scenarios, we have also defined stress scenarios to simulate potential increases in liquidity requirements as a result of a negative change in the market environment. These enable us to introduce any countermeasures deemed necessary in good time.

MLP Banking AG has established a simple allocation system to allow the internal allocation of the respective liquidity costs, liquidity benefits and liquidity risks to be monitored and controlled.

## Operational risks

The management of operational risks is based on the definition of Article 3 of the Capital Requirements Regulation (CRR). As such, operational risk is the risk of losses caused by inadequacy or failure of internal procedures and systems, people or by external events. This definition includes legal risks.

Operational risks are identified and assessed locally throughout the Group in the individual organisational units. To this end, an operational risks inventory is taken at least once a year. Within this scope, experts from all specialist departments examine and assess the operational risks based on self-assessments. They are broken down into an assessment of risk potential to identify and evaluate the main risks and into suggested measures derived from this.

The probability of occurrence and potential extent of damages presented by the risk scenario being examined are determined when assessing an identified operational risk. Both empirical values and projections for the upcoming period of one year are applied here. The risks identified are managed using corresponding risk control strategies.

In addition to this, any loss/damage occurring at MLP Financial Holding Group is continuously recorded and analysed. By collecting damage data, loss events can be detected and analysed in order to identify trends and any concentration of operational risks. The results are collated and checked for feasibility by risk controlling and then made available to the Executive Board and the controlling units.

Risks from internal procedures

The operational and organisational structure of MLP Financial Holding Group is comprehensively documented and set out in internal organisation guidelines and the organisation manual. Operational risks arising from internal processes are primarily managed through continuous improvement of business processes, in addition to the expansion of the internal control/monitoring system. Further safeguarding measures include risk transfer through the conclusion of insurance policies and consciously avoiding risky products. In order to secure the continuation of business operations, comprehensive emergency and business continuity plans are also in place for the most important areas and processes.

A Business Impact Analysis (BIA), carried out within the scope of Business Continuity Management (BCM), is used to identify critical company processes whose disruption or failure can have a significant impact on the Group's business activities. To this end, suitable measures are defined in the form of alternative actions. In the event of an emergency, these measures allow business operations to continue, albeit with reduced performance. The critical processes and the effectiveness of the defined measures are subject to regular monitoring and continuous development. The BCM is documented in the organisation manual and in this way available to the business segments and employees.

When introducing new products or extending activities to include new markets/sales channels, a predefined process ("NPMVP" process for the introduction of new products or entry into new markets) is used to ensure that all affected functions of MLP are involved in the impact analysis prior to the start of planned new business activities.

Human resources risks

MLP Financial Holding Group places great value on having qualified employees and managers, particularly in the back-office areas. Staff resources and sufficient qualification/training of employees are secured by the responsible specialist departments. We reduce the risk of staff shortages through appropriate personnel allocation measures.

Employees working with confidential information undertake to observe the respective regulations and handle the information responsibly. A clear separation of management and control functions restricts the risk of breaching internal and external regulations. Defined substitute and successor regulations secure our business and decision-making processes.

A possible error in client consulting, investment and acquisition brokerage or finance portfolio management and associated claims for damages can present a consulting and liability risk. We minimise potential consulting risks by maintaining consistently high-quality consulting which we ensure, for example, through IT-supported consulting tools. Consultations with our clients and the results arising from this are comprehensively documented. Our own Corporate University ensures a high standard of consultant training. Indeed, each of our consultants initially attends extra-occupational training here to become a Senior Financial Consultant.

IT risks

To effectively manage IT-related risks, MLP Financial Holding Group operates a comprehensive information security management system.

In terms of our software strategy, we typically rely on sector-specific standard software from well-known providers. However, we bring in qualified specialists for business-specific proprietary IT applications. Prior to commissioning, new IT systems and software components are checked to ensure correct functioning. The availability and consistency of the data is secured through the distribution of data processing operations across multiple locations, backup and recovery processes and a business continuity management system. In addition to this, we use leading service providers to operate our systems. We protect our IT systems from unauthorised access through a system of authorisation management, comprehensive malware protection and security measures at network level.

Risks from external events

Companies operating in the financial services sector are focusing on their core expertise, i.e. producing financial services products, support and information services and specialist consulting and sales expertise. In this market environment, MLP Financial Holding Group makes use of external partners for activities that are not part of its core business. Based on Germany's "MaRisk" minimum risk management requirements, key outsourcing activities are incorporated into risk management within the standard scope of risk controlling and management processes with continuous risk identification, assessment, control and reporting (outsourcing analysis).

Responsibilities for outsourced processes are clearly set out at MLP Financial Holding Group. This ensures that any potential organisational, structural or process-based risks that may occur due to outsourced business activities are closely controlled.

In addition to this, corresponding insurance policies have been concluded where appropriate to minimise risks from external events such as fraud, burglary, theft or damage due to force majeure.

Internal security measures are also used to thwart fraudulent activities, where possible before they even occur.

Risks arising for MLP Financial Holding Group from fraudulent or other criminal conduct are identified and regularly assessed within the scope of the risk analysis performed to identify potential hazards caused by criminal conduct (both internal and external). Both the risk assessment and the individual measures implemented to avoid criminal conduct are conducted by the relevant section at company HQ pursuant to Section 25h of the German Banking Act (KWG) and are also incorporated into the operational risk inventory process.

In 2013, the significant legal provisions and stipulations for MLP Financial Holding Group were identified within the scope of the requirements of the Compliance function in line with Section 4.4.2 of Germany's "MaRisk" minimum risk management requirements. Failure to comply with these provisions and requirements could pose a considerable threat to the assets of MLP Group. In accordance with Germany's "MaRisk" minimum risk management requirements, the Compliance function works towards implementation of effective procedures, alongside corresponding control measures by the competent departments, to comply with the significant legal stipulations and internal regulations and provides regular reports, including ad-hoc reports when and where necessary, on its activities to the Executive Board and the Supervisory Board.

Legal risks

Our legal department controls legal risks. In addition to consulting on corporate decisions and designing business processes, its tasks include following and assessing current legal disputes. Possible legal risks are detected at an early stage and possible solutions for minimising, limiting or preventing such risks are shown. The legal department coordinates the commissioning and integration of external lawyers. Within the scope of risk mitigation, the legal department, in cooperation with product management, checks and monitors the existing insurance coverage for economic loss and initiates any adjustments which may be necessary. According to our review, the legal proceedings pending or threatened against MLP Financial Holding Group do not represent risks which could endanger the Group's continued existence. The Executive Board at MLP AG remains of the conviction that the claims for damages filed against MLP SE in August 2007 due to the provision of allegedly inaccurate capital market information in 2000 - 2002 will not be successful. Indeed, the vast majority of these claims have already been withdrawn. Two claims were dismissed by the court, which ruled in favour of MLP. Dismissals were also issued in favour of MLP in the last two legal actions. However, these legal actions have not yet been finally concluded as the opposing party has started an appeal process.

Taxation risks

Changes emerging in tax law are continually checked and reviewed with regard to the potential effects they may have on the Group. Compliance with fiscal requirements of the controlling company, MLP SE, is verified by internal and external experts in accordance with tax regulations and all accompanying documentation issued by the fiscal authority. Corresponding provisions are formed for subsequent expected payments.

Capital charge according to the basic indicator approach

MLP Financial Holding Group currently uses the basic indicator approach in line with Section 316 of the Capital Requirements Regulation (CRR). On this basis, the capital charge is 15% of the average gross proceeds of the last three financial years, whereby only positive gross proceeds are taken into account.

## Other risks

Reputation risks

Reputation is defined as "the reputation of MLP Financial Holding Group overall or of individual Group companies in terms of expertise, integrity and trustworthiness that results from the perception of different stakeholder groups". These stakeholders, for example, include clients, employees, consultants and office managers, shareholders and creditors, other institutes, ratings agencies, the press and the world of politics. Reputation risk is understood to mean an existing or future risk regarding income, equity or liquidity as a result of reputation damage.

The reputation risks at MLP Group are generally managed using a decentralised organisational structure in line with the management of operational risks. Risk management differentiates between taking action prior to a potential event (preventive management) and taking action directly after damage has occurred (reactive management).

Alongside decentralised control, comprehensive preventive control is in particular carried out by the relevant market segments. In terms of reputation risk controlling, process-based control of reputation risks becomes an extremely important task. The goal here is to provide information regarding reputation risks preventively as a basis for helping to reach risk-relevant decisions.

As is the case with preventive risk management, the reactive management of reputation risks is also organised decentrally. Depending on the circumstances, downstream or multidisciplinary departments/functions will also be involved.

The potential risk of mistakes made while providing consulting services to our clients which also affect our reputation is minimised by securing continuously high-quality consulting. The instruments used to secure this high level of consulting include IT-based consulting tools. In addition to this, comprehensive documentation is provided of consultations with clients.

General business risks

General business risks predominantly arise due to altered framework conditions and can lead to unanticipated dips in earnings or negative budget deviations. These deviations can have many causes, such as changes in client behaviour, changes to general economic conditions and poor strategic decisions. The processes for managing general business risks are largely handled by Controlling within the scope of overall bank management. Controlling also performs regular checks to detect and analyse all changes to economic factors or the industry and competitive situation. This results in stimuli for strategic alignment of MLP Financial Holding Group.

The ongoing period of low interest rates, in addition to the lasting effects of the Life Insurance Reform Act (LVRG), lead to a degree of uncertainty. Alongside this, the ever-advancing regulations with regard to supervisory requirements continue to present a challenge to profitability in the banking and financial services sectors overall. We are still observing a great deal of competitive pressure in the German market for financial services i alongside new and digitally-oriented market actors (fintechs).

You can find more detailed information on the environment, sector and competitive situation in the section entitled "→ Economic report and→ forecast".

No quantification of other risks is currently performed within the scope of internal risk management. However, to adequately control the risks resulting from this, an adequate buffer is included in the risk-bearing ability. This is regularly validated within the scope of back testing and adjusted as and when necessary.

Results of the analysis of risk-bearing ability

The risk-bearing capacity concept ensures that the risks incurred are offset against sufficient risk coverage potential at all times. Within the scope of the risk-bearing capacity concept, MLP Financial Holding Group primarily pursues a going-concern approach with a confidence level of 97% when controlling risks. This is based on protecting the minimum capital backing required by law, thereby ensuring a continuation of the business operations of MLP Financial Holding Group. Free equity capital that is available after meeting the regulatory ratios for minimum capitalisation and an additional buffer are in place to serve as risk coverage potential.

In 2017, the Executive Board made a risk coverage fund available based on the risk coverage potential (sum of free supervisory equity and plan EBT) up to an upper threshold of €100 million to cover the following risk types that MLP categorises as significant: counterparty default risk, market price risk, liquidity risk, operational and other risks.

With a share of 51.3% and 40.8% respectively, counterparty default risks and operational risks take up the majority of the risk coverage fund available.

The risks incurred are covered by the assigned limits in line with the respective risk coverage potential. Consistent surplus coverage is in place.

### Risk bearing ability of MLP Financial Holding Group

| Risk bearing ability | 2017 Utilisation (in %) | 2016 Utilisation (in %) |
|---|---|---|
| Risk and capital commitment | 76.0 | 75.0 |
| thereof: | | |
| Counterparty default risk | 79.0 | 77.8 |
| Market price risk | 60.9 | 71.6 |
| Operational risk | 78.0 | 75.9 |
| Liquidity risk | 0.0 | 0.0 |

Capital adequacy requirements under banking supervisory law

The backing of risk assets with eligible own funds for Tier 1 capital generally requires a minimum ratio of 4.5%. As in the previous year, these requirements have not changed during the 2017 financial year.

Pursuant to Article 25 et seq. of the CRR, the Group's Tier 1 capital includes the following equity items of IFRS capital:

Share capital, capital reserves, statutory reserves and retained earnings. Among other factors, intangible assets, treasury stock and goodwill reduce Tier 1 capital.

As was also the case in the previous year, MLP Financial Holding Group fulfilled all legal requirements relating to minimum capital adequacy throughout the 2017 financial year. The relationship between the risk assets and equity capital on the balance sheet date is illustrated below.

### Supervisory KPIs

| Shareholders' equity (in € million) | 2017 | 2016 |
|---|---|---|
| Tier 1 common capital | 291.0 | 214.7 |
| Tier 1 additional capital | – | – |
| Tier 2 capital | – | – |
| Eligible own funds | 291.0 | 214.7 |
| Capital adequacy requirements for counterparty default risks | 73.8 | 75.5 |
| Capital adequacy requirements for operational risk | 42.4 | 45.8 |
| Core capital ratio (in %) | 20.02 | 14.16 |
| Tier 1 common capital ratio (in %) | 20.02 | 14.16 |

## Summary

MLP's business development is essentially influenced by financial risks, operational risks, reputation risks and general business risks. We use our risk management system for the identification, assessment, control, monitoring and communication of our key risks in terms of both current and future developments. The information provided ensured prompt introduction and prioritisation of risk management measures without exception.

Both MLP Financial Holding Group as a whole and the business segments always acted within the scope of their financial risk-bearing ability in 2017.

Our Business Continuity Management also ensures regulated business operations in the event of any disruptions. Our risk monitoring and control systems and the consistent alignment of our business model to our risk-bearing ability allow us to ensure that the risks taken in our business activities are backed with adequate risk capital.

The risk management system is subject to continuous further development, in particular with regard to developing the volume and complexity of our business. The effectiveness of our risk management system and its supervisory implementation are also checked cyclically, both by external and internal auditors.

The above-mentioned risks, and such risks which are not yet known to us or are currently considered insignificant, could have a negative impact on our forecasts detailed in the outlook.

There are currently no discernible risks that could threaten MLP's continued existence., and we do not expect to see any negative development in the coming year. No appreciable risks which could have a significant influence on the continued existence of MLP Financial Holding Group were present at MLP after the balance sheet date.

# *Opportunity report*

## Opportunity management

The objective of the integrated opportunity management approach employed by MLP Group is to secure the systematic and early identification of opportunities and their assessment.

This takes place within the scope of a standardised business strategy process which is performed by the Executive Board once a year. To this end, assumptions made about relevant influential factors for future development are subject to an ad hoc check. Such reasons can, for example, include major acquisitions, regulatory changes or changes in the market environment. MLP's corporate strategy, and the opportunities associated with this, are derived from its corporate mission, which is examined and updated by the Executive Board on an annual basis. The current internal and external framework conditions, in addition to influential factors, are then analysed and summarised using established processes. A comprehensive analysis of the current environment always forms the basis of this process. Among other things, this includes the macroeconomic and regulatory framework conditions, developments in the product area and also the competition. With regard to client and sales potential, we also use available market data alongside our own assessments. The analysis culminates in a comprehensive SWOT analysis (strengths, weaknesses, opportunities, threats).

Within the scope of MLP's opportunity management, the market and competitive environment is continuously monitored from different company perspectives. This process is organised locally in the responsible departments which regularly report their findings to the respective member of the Executive Board. Product Management is a key player here as it determines opportunities through intensive contact with product providers and industry experts, mostly in the form of product innovations. In addition to this, Customer Management is undertaking extensive market research. Other important protagonists in terms of opportunity management are Controlling, which examines the market to detect potential acquisition opportunities, and the organisational units of Risk Management and Compliance, which examine potential regulatory changes at an early stage.

## Opportunities

The opportunities in terms of the future business development can be subject to both external and internal influences.

Opportunities from changing framework conditions

The economic forecasts for 2018 suggest only limited opportunities for MLP. Although economic experts are assuming that Germany will enjoy further growth, the aforementioned reservations on the part of clients when it comes to signing long-term savings contracts will hinder progress. In the mid to long-term, however, the greater need for private and also occupational pension provision is likely to increase demand for these two products significantly again – particularly among MLP's target groups. Should the German economy enjoy better development than assumed in our forecast, this will only have an indirect influence on short-term operating developments.

The ever-stricter regulation of the financial services sector in Germany, with the objective of stabilising the financial system and increasing investor protection, presents both challenges and opportunities for MLP. Stricter regulatory requirements will initially lead to additional costs and reduced productivity, as administration costs increase and processes in the company have to be adapted. However, the regulation also tightens the quality standards required of market actors. This will accelerate market consolidation as individual brokers will not be able to comply with the stricter requirements. Overall, the number of providers is likely to reduce. With our consulting approach, which focuses on clients and their financial matters, we are able to clearly differentiate ourselves in the marketplace. In addition to this, we were quick to align our operations to the new framework conditions over the last few years, which will enable us to benefit from this development in the mid-term.

Corporate strategy opportunities

We see corporate strategy opportunities primarily in MLP's positioning as a partner for all financial matters, a position which has been particularly strengthened over the last few years. Alongside support for private clients, we are now also increasingly focusing on our business with corporate clients and institutional investors. In cooperation with our Group companies TPC, DOMCURA, nordias and FERI, we will further expand our portfolio for corporate clients and institutional investors in the areas of occupational pension provision, non-life insurance, wealth management and risk management.

Interlinking these areas with one another and with the private client business will furthermore enable us to create associated revenue potential. In the private client business itself, MLP has an important USP thanks to its broad positioning. Further developing these opportunities offers important potential for the next few years. Additional increases are also possible, particularly in the wealth management segment, in which MLP clearly sets itself apart from the market through its highly transparent price model and in the non-life insurance segment where MLP is developing the business of its subsidiary DOMCURA.

Within the scope of opportunity management, MLP examines the market for potential acquisitions. In the event of an acquisition, opportunities can arise which may increase revenue potential.

Business performance opportunities

As a pure service provider, our operational tasks comprise sales, product purchasing/product selection and sales support.

In the field of sales, our client potential in the private client business will increase even further over the course of the next few years. The need for well-trained employees in Germany is increasing, which in turn improves the basic conditions for our client group of academics. At the same time, the number of academics capable of and seeking employment is also set to rise in the mid-term, which will lead to greater new client potential for MLP.

More targeted penetration of our client base, particularly in the wealth management and non-life insurance segments, will also help us achieve further growth. Since our clients are generally very well-trained and thereby have excellent income prospects, they also have a continuous need for sound financial consulting and hold corresponding revenue potential.

The private client business is not the only area in which we see opportunities for winning and supporting new clients. There is also a high demand for independent, professional consulting in the business with corporate clients and with institutional clients, which we have now packaged at our subsidiary FERI. Particularly for institutional investors and high net-worth families, the need for consulting services is on the rise, above all in the field of alternative investments. DOMCURA is the service provider for agents and other brokers in the non-life insurance segment and provides comprehensive solutions for both private and commercial business – in part with a high degree of individualisation.

Over the last few years we have introduced and implemented various measures to increase the productivity of our consultants. This includes further developing our consulting applications, even greater support for our consultants – for example in product selection – and even more effective service from the back-office in Wiesloch. The service centre of our subsidiary MLPdialog also makes an important contribution to this. As an underwriting agency, the DOMCURA Group has also extended the added value chain of MLP Group for standard products in the non-life insurance segment with its processes and expertise and will continue to do so in future. The goal of these measures is to allow our consultants to focus even more on their core task, namely advising and supporting their clients. This provides important revenue potential for the future.

Opportunities from development of asset and risk positions

Positive business/market developments with lasting effects on earnings can be beneficial for the capital/financial situation of MLP and facilitate greater scope for action in terms of the business model and risk profile. Alongside the opportunities already mentioned arising from changing framework conditions, corporate strategy and business performance, further opportunities could also arise from interest rate developments or lower loan loss provisions due to economic developments.

In the banking area, MLP also engages in the current account and credit card business beside the classic lending business. These business activities focus on cross-selling and are subject to acceptance of counterparty default risks. Special profit opportunities arise for MLP through its preferred clientele and their predominantly good credit ratings. In addition to this, positive development of the economic situation in Germany could present opportunities for improved portfolio quality, thereby keeping the need for value adjustments at a low level. Opportunities could also present themselves through a possible expansion of the banking business. However, they can also be associated with risks.

Interest rate developments also influence MLP's interest rate portfolio. Depending on the positioning/alignment and interest rate development, they could potentially lead to risks but also to opportunities. Regardless of this, MLP maintains its interest book with the objective of continuing to secure a healthy liquidity situation.

Summary

MLP sees several significant opportunities. These affect multiple fields, in particular corporate strategy, d business performance factors and the asset and risk position. We believe that the changing framework conditions will only present limited opportunities.