

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, as well as 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, as well as the special Risk Controlling, Compliance and Internal Audit functions represent key components of the Group-wide risk management system.

The following companies are examined within the scope of Group-wide risk management (scope of consolidation pursuant to § 25a of the German Banking Act (KWG) – Germany's "MaRisk" minimum risk management requirements consolidation scope): MLP AG, Wiesloch, MLP Finanzdienstleistungen AG, Wiesloch, ZSH GmbH Finanzdienstleistungen, Heidelberg, FERI AG, Bad Homburg v. d. Höhe, FERI Trust GmbH, Bad Homburg v. d. Höhe, FERREAL AG, Bad Homburg v. d. Höhe, FERI Trust (Luxembourg) S.A., as well as Schwarzer Familienholding GmbH, Kiel, DOMCURA AG, Kiel and NORDVERS GmbH, Kiel.

Group-wide risk management

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

Segment	Company	IFRS scope of consolidation	MaRisk scope of consolidation (§25a German Banking Act (KWG))
Holding	MLP AG	x	x
	MLP FDL AG	x	x
	TPC GmbH	x	
	ZSH GmbH	x	x
	MLPdialog GmbH	x	
Financial services	MLP Hyp GmbH *	x	
	FERI AG	x	x
	FERI Trust GmbH	x	x
	FERREAL AG	x	x
FERI	FERI Trust (Luxembourg) S.A.	x	x
	Schwarzer Familienholding GmbH	x	x
	DOMCURA AG	x	x
	NORDVERS GmbH	x	x
	nordias GmbH Insurance Broker	x	
	Willy F. O. Köster GmbH	x	
	Siebert GmbH Insurance Broker	x	
DOMCURA			

* accounted for using the equity method

In the sense of § 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 Finanzdienstleistungen AG, which as per Article 11 of the Capital Requirements Regulation (CRR) is the controlling body of the MLP Financial Holding Group 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 order to evaluate the risks of the MLP Financial Holding Group, MLP Finanzdienstleistungen AG, acting as a controlling company, obtains an overview of the risks in the Group on a regular and ad hoc basis within the scope of the strategy process and the risk inventory. 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 the MLP Financial Holding Group are defined taking into account the type, scope, complexity and risk content, as well as the different application options provided by corporate law on an individual basis.

Risk policies

The Executive Board of the controlling company defines the business strategy, as well as a consistent risk strategy for the 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 in the 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 the MLP Financial Holding Group:

The Executive Board is responsible for 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 and also put in place and monitor 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 the 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 the 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 AG 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 attributable 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 the 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 in the 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 and stress tests

Risk capital management is an integral part of the Group management system in the 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.

Risk capital management –
risk-bearing ability

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 the 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 standardized procedures are compared against 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 § 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 strategic risks and reputation risks (other risks) also represent significant risk types, although these are currently not quantified. These are incorporated via additional buffers when calculating the risk bearing ability.

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 applied within the scope of stress scenarios.

In the going-concern approach, the focus is on securing continued existence of the bank. 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.

As it has the largest business volume and greatest earning potential, MLP Finanzdienstleistungen AG bears the greatest risks within the Financial Holding Group. This is also reflected in the allocation of 75% of the risk coverage fund to the financial services segment.

Stress tests are also performed on a regular and ad hoc basis for 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.

Stress tests

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 the 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 connection.

Organisation

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

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.

Functional separation

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

The Group Risk Manager is responsible for the risk monitoring and control activities in the 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.

Group Risk Manager

To be able to address risk topics early on 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 controlling function

Risk management in the 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.

Risk management and controlling processes

The Risk Controlling unit in particular is responsible for the identification and assessment of risks, as well as for monitoring of 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, identify potential problems early on and 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 the 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 on the basis of the risk models are entirely suitable for controlling the risks. Quantification methods are subject to regular checks by risk controlling, as well as 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 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.

Controlling monitors earnings trends

To monitor planned and target variables, the sales 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 the Management.

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, financial position and results of operations at MLP Finanzdienstleistungen AG and the 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.

Internal controlling system
in the accounting process

MLP excels through its clear organisational, corporate and control structure. The departments of all Group companies 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 contact for all questions in connection with accounting issues, both at individual company and Group level.

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), as well as 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, as well as 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 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.

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

Compliance function

The internal audit department, which assumes audit tasks in major Group companies on the basis of outsourcing contracts, as well as MLP Finanzdienstleistungen AG in the form of a controlling company in accordance with § 10a (2) of the German Banking Act (KWG), constitutes an important element of the internal control/monitoring system. The internal audit department performs regular, systematic risk-oriented inspections with regard to compliance with legal, supervisory and internal specifications. The department monitors the functional separation and effectiveness of the risk management system, and performs follow-up procedures on audit recommendations. 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.

Internal audits

The internal audit department operates in an independent capacity throughout the Group on behalf of the Executive Board.

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 provides the key decision-makers with prompt 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 reporting

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

Statement of risks

The MLP Financial Holding Group is exposed to various financial risks. These in particular comprise counterparty default, market price and liquidity risks. Alongside financial risks, there are also operational and other risks, such as strategic risks and reputation risks.

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
Financial services	x	x	x	x	x
FERI	x	x	x	x	x
DOMCURA	x			x	x

Financial 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), as well as the risks related to specific countries which, however, are only of secondary importance to the MLP Financial Holding Group.

Counterparty default risks

The counterparty default risks of the 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 (95%) is limited to borrowers domiciled in the Federal Republic of Germany.

The identification of potential concentrations of risks constitutes another key component of credit risk management. Those 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. To be able 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.

Concentration of risk

To minimise potential concentrations of risk in the proprietary business before they can even occur, the 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 of credit cards and accounts in connection with the targeted 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 the MLP Financial Holding Group. Focusing on the target group of academics and other discerning private clients allows an attractive profit margin to be achieved due to relatively small default risks.

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

Credit management

We also monitor and control any potential default risks from advances paid to consultants and office managers via a layered warning system, in which any incidents are quickly detected and active receivables management is guaranteed.

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 reached by specialized 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, as well as 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). Loans that are recognised as being problematic are transferred to certain specialist departments and managed by experts.

Loan loss provisions

Amount in € million (previous year) *	Opening balance	Allocations	Reversals	Utilisation	Closing balance
Specific allowance for doubtful accounts	6.7 (7.7)	2.1 (1.3)	1.0 (1.1)	0.3 (1.2)	7.5 (6.7)
General allowance for bad debts	4.5 (5.4)	0.4 (0.0)	0.0 (0.1)	1.4 (0.9)	3.4 (4.5)
General allowance for doubtful accounts	4.5 (5.3)	– (–)	1.2 (0.8)	– (–)	3.3 (4.5)
Provisions	0.2 (0.3)	– (–)	0.0 (0.1)	– (–)	0.2 (0.2)
Total	15.9 (18.7)	2.5 (1.4)	2.2 (2.1)	1.8 (2.1)	14.4 (15.9)

* 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 have acquired within the scope of capital investment management through the specified creditworthiness requirements of our capital investment directive. Where available, the 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 the 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 the MLP Financial Holding Group, the internal control system is based on the various supervisory calculation methods.

Market price risks

The MLP Financial Holding Group understands market price risks as 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. The MLP Financial Holding AG continues to hold the status of a non-trading book institute.

Interest rate and price risks represent the sub-categories of the market price risk which are important for us.

Interest rate risks essentially come about from incomplete congruency of interest rate agreements between the loans granted and the 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).

Interest rate risks

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 – a threshold which, if exceeded, would give us the status of an institute with increased interest risk.

Interest rate risks of the MLP Financial Holding Group

Amount in € million	Interest rate shock/parallel shift			
	Change in value +200 BP		Change in value -200 BP	
	2016	2015	2016	2015
Total	-8.4	-15.1	4.5	6.5

Shares, bonds, and funds held can be subject to a share price risk due to fluctuations in the market interest rate or changes in creditworthiness. Through constant monitoring and evaluation of our portfolio, possible effects on results caused by strong exchange rate fluctuations can be addressed early on. We thereby ensure a prompt reaction to market changes. We use a value-at-risk calculation when performing risk measurements. The nominal change in value of share price-based securities is determined for the significant price risks. A holding period of 250 trading days and a confidence level of 97.0% are assumed here.

Price risks

Liquidity risks

The 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, operational and structural.

The central instruments and control variables of operational and short-term liquidity control at the MLP Financial Holding Group include itemisation of financial assets and refinancing sources in the company's own business as per the balance sheet date within the scope of cash management, but also the liquidity and observation ratios of the liquidity regulation. 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. Sufficient funds were available to cover short-term liquidity requirements at any time.

Operational liquidity control

The funding matrix is the central instrument of structural liquidity control at the MLP Financial Holding Group and also a preliminary step towards economic analysis of additional refinancing costs. It indicates for each time frame whether there is a surplus or possible shortfall of financing means and thereby allows open liquidity items to be controlled. The liquidity value at risk (LVaR), which indicates the additional refinancing costs required to close open liquidity items, represents a key instrument of structural liquidity control and is also used in risk capital management. When determining the LVaR as of December 31, 2016, 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 in the MLP Financial Holding Group results primarily from MLP Finanzdienstleistungen AG as the deposit-taking 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.

Structural liquidity control

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

Compliance with the supervisory liquidity KPIs is a key component of risk measurement and risk control. Alongside monitoring the current liquidity coefficient pursuant to current the Liquidity Directive, the MLP Financial Holding Group calculates, checks and reports the liquidity coverage ratio (LCR on the basis of the CRR). The LCR requires maintenance of a liquidity buffer, which must at least cover net cash outflows occurring within 30 days under standard market and idiosyncratic stress conditions. Corresponding measures serve to secure short-term solvency, in particular by maintaining an appropriate liquidity reserve.

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 performed at least once a year. Within this scope, experts from all specialist departments examine and assess the operational risks on the basis of self-assessments. They are broken down into an assessment of risk potential for identification and evaluation of 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 the MLP Financial Holding Group is continuously recorded and analysed. Collecting all loss/damage data allows loss events to be identified and evaluated as a way of detecting 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.

The operational and organisational structure at the MLP Financial Holding Group is comprehensively documented and laid down in internal organisation guidelines. Operational risks arising from internal processes are primarily managed through continuous improvement of business processes, as well as 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.

Risks from internal procedures

Within the scope of the Business Impact Analysis (BIA), critical company processes are identified, whose disruption or failure can have a significant influence 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. A documentation by the Business Continuity Management (BCM) is available to the business segments and employees in the organisation manual.

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.

The 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 planning and targeted personnel allocation measures.

Human resources risks

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 coming 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.

To effectively manage IT-related risks, the 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 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, as well as security measures at network level.

IT risks

Companies in the financial services sector are increasingly focussing on their genuine core skills, i.e. production of financial services products, support and information services, specialist consulting and sales expertise. In this market environment, the 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).

Risks from external events

Responsibilities for outsourced processes are clearly set out at the 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 the 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 performed by the relevant section at company HQ pursuant to § 25h of the German Banking Act (KWG) and are also incorporated into the operational risk inventory process.

The significant legal provisions and stipulations for the 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 the MLP Group. As per 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.

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 the 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 pending or threatening legal proceedings against the 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 AG in August 2007 due to provision of allegedly inaccurate capital market information in the years 2000 to 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 proceedings. The processes are currently in the court of appeal.

Legal risks

Changes that emerge in tax law are continually checked and reviewed with regard to potential effects they may have on the Group. The compliance with fiscal requirements of the controlling company, MLP AG, is checked by internal and external experts in accordance with the tax regulations and all accompanying documentation issued by the fiscal authority. Corresponding provisions are formed for subsequent payments to be anticipated.

Taxation risks

The 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.

Capital charge according to the basic indicator approach

Other risks

Reputation is defined as "the public reputation of the 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". Stakeholder groups for example include clients, employees, equity suppliers, other institutes, ratings agencies, the press or politicians. The risk of damage to reputation is classed as reputation risk.

Reputation risks

The potential risk of mistakes made while providing consulting services to our clients also impacting 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 predominantly arise due to altered framework conditions and can lead to unanticipated dips in earnings or negative budget deviations. These can have many causes, such as changes in client behaviour, changes to general economic conditions, as well as 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 impulses for strategic alignment of the MLP Financial Holding Group.

General business risks

The low interest rate environment, which continues to suppress the willingness of German citizens to save, as well as the lasting effects of the Life Insurance Reform Act (LVRG) have introduced a degree of uncertainty. The ever stricter regulations associated with supervisory requirements in the banking and financial services sectors, such as the finalisation of Basel III (some market members are already talking about Basel IV) or MiFID II are having a significant effect. In addition to this, we are facing growing competitive pressure in the financial sector, also from new, innovative and digital market members (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.

Risk-based capital adequacy requirements are of essential importance to ensure availability of sufficient equity to cover unanticipated losses. As underlined by the assessments of the European Parliament, however, the banking and financial crisis has shown that these requirements alone are not enough to prevent institutes from taking leverage risks which are simply untenable in the long term.

Leverage risk

The leverage ratio KPI establishes a connection between regulatory equity and the non-risk-weighted items both on and off the balance sheet. The Group's leverage ratio is integrated into the risk reporting submitted to the Executive Board and to the Supervisory Board to allow any necessary measures to be derived early on.

The established leverage ratio results show that the MLP Financial Holding Group is not currently subjected to any significant leverage risk.

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, the MLP Financial Holding Group pursues a going-concern approach with a confidence level of 97% when controlling risks. This is based on protection of the minimum capital backing required by law and thereby a continuation of the business operations of the 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.

Results of the analysis of risk-bearing ability

In 2016, 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 48%, counterparty default risks and operational risks with a share of 42% take up the majority of the risk coverage fund available. At 75% the financial services segment ties up the majority of risk capital among all risk types.

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 the MLP Financial Holding Group

Risk bearing ability	2016 Utilisation (in %)	2015 Utilisation (in %)
Risk and capital commitment	75.0	75.2
thereof:		
Counterparty default risk	77.8	79.6
Market price risk	71.6	53.7
Operational risk	75.9	80.5
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 financial year 2016.

As per 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 reserve 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, the MLP Financial Holding Group fulfilled all legal requirements relating to minimum capital adequacy throughout the financial year 2016. The relationship between the risk assets and equity capital on the balance sheet date is illustrated below:

Supervisory KPIs

Shareholders' equity (in € million)	2016	2015
Tier 1 common capital	214.7	211.2
Tier 1 additional capital	–	–
Tier 2 capital	–	–
Eligible own funds	214.7	211.2
Capital adequacy requirements for counterparty default risks	75.5	70.4
Capital adequacy requirements for operational risk	45.8	47.5
Core capital ratio (in %)	14.16	14.33
Tier 1 common capital ratio (in %)	14.16	14.33

Summary

MLP's business development is essentially influenced by financial, operational 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 the MLP Financial Holding Group as a whole as well as the business segments always acted within the scope of their financial risk-bearing ability in 2016.

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 enable 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 by both 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 the MLP Financial Holding Group occurred at MLP after the balance sheet date.