

Annual report 2016

Management report (extract) Balance Sheet Income statement

The complete annual financial statements of Sparkasse Saarbrücken have been published in the Federal Journal and have been given an unqualified auditor's opinion by the auditors of the Saarland Savings Banks Association.

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Management report for fiscal 2016

1 Principles of the Sparkasse

1.1 Business model

Sparkasse Saarbrücken is a legal entity organised according to public law and domiciled in Saarbrücken. As independent commercial business, it offers, together with its partners from the Sparkassen Financial Group, financial services and financial products to private as well as commercial customers and to local authorities.

Locally present and therefore close to its customers, Sparkasse makes fast decisions that are based on the interests of our customers and that take the economic and social circumstances of the region into consideration. That brings proximity to customers, efficiency and expertise together. Against the background of market and competitive requirements, Sparkasse has the special legal task of strengthening competition in its home territory and of providing all layers of the population, commerce as well as the public sector with appropriate and adequate banking and commercial lending services. In order to properly discharge those functions, as at 31 December 2016 we maintained a head office and 61 branches in our catchment area and employed altogether 1,188 staff. Measured by balance sheet total, it is the largest Sparkasse in Saarland. In Germany as a whole, it ranks 33rd.

As a member of the Savings Bank Support Fund of the Saar Savings Bank Association, our Bank is affiliated with the guaranty system of the German Savings Bank Organisation. This ensures that all savings deposited by our customers are guaranteed in full.

Additionally, the security system of Sparkassen-Finanzgruppe also meets the requirements of the statutory investment protection. This secures customer deposits up to 100,000 euros per customer. If the BaFin (Bundesanstalt für Finanzdienstleistungsaufsicht [Federal Financial Supervisory Authority]) determines a compensation case for any institution, customers have the right of being compensated within seven working days.

Sparkasse Saarbrücken's management bodies comprise the Supervisory Board and the Board of Directors.

The Supervisory Board issues instructions to the Board of Directors, the Credit Committee and Internal Audit and monitors the activities of the Board of Directors. It comprises a total of 19 members.

The Credit Committee, consisting of seven members, decides on approving loans in accordance with Article 9 of the business policy for the Board of Directors and on approving the granting of loans to related parties, within the meaning of Article 15 of the banking law.

The Board of Directors, consisting of four members, manages the Sparkasse under its own responsibility, within the framework of the applicable legislation. It represents the Bank in and out of court and conducts its business.

The business areas of market / trade and back office / monitoring make up the superordinate organisational structure of the Sparkasse.

On 12 July 2016 respectively on 7 July and 24 November 2016, the representatives of the responsible authorities of Sparkasse Saarbrücken and Stadtparkasse Völklingen have decided to merge both Sparkassen institutions with effect from 1 January 2017. In its capacity of supervisory authority for the Sparkassen institutions, the Ministry of the Economy, Labour, Energy and Mobility of Saarland (formerly the Saarland Ministry of Finance) gave its consent to the amalgamation on 28 November 2016. By way of universal succession, the assets of Stadtparkasse Völklingen have passed to Sparkasse Saarbrücken on 1 January 2017. The new Sparkasse bears the name of "Sparkasse Saarbrücken" and has its statutory seat in Saarbrücken.

Upon the amalgamation taking effect, the special purpose association of Sparkassen [Sparkassenzweckverband] Saarbrücken has acceded to all rights and obligations of the previously responsible authority for the Stadtparkasse Völklingen, the medium-sized City of Völklingen. At the same time, the City of Völklingen joined the Sparkassenzweckverband. The state capital of Saarbrücken, the Saarbrücken Regional Association and the City of Völklingen make up the Sparkassenzweckverband.

1.2 Goals and strategies

In future, Sparkasse wishes to be market leader in all financial matters in its catchment area and to be the major partner of private and commercial customers as well as of the local authorities. The main focus is on organic growth, which should be achieved through intensifying business with existing customers, but also through acquiring new customers in the private, business and local authorities sectors.

Our goal is strengthening our market position in our catchment area. We will have sufficient financial scope for future business growth if we can ensure reasonable profitability. We are thus seeking a stable profitability on the basis of equity resources that exceed statutory requirements.

We try to bring this mission about through target agreements with managerial and other staff, in compliance with our business and risk strategies. We aim to achieve the required productivity by making efficient use of existing resources and by continuously enhancing our processes. Therefore, in that connection we are expecting from all staff members that they actively participate in looking for possibilities for improvement in all processes and products by contributing through the ideas management system.

In our business strategy for 2016, targets were formulated that were aimed at increasing the growth and profitability of the Sparkasse. In consideration of our public mandate, we have set as targets to hold and expand market shares, to operate economically and to strive for the most efficient risk-return relations possible in the scope of risk acceptability. Growth targets for balance-sheet items on the one hand and expense and income goals on the other have been defined, in order to generate appropriate profits and to safeguard the resistance to risk of the Sparkasse.

In addition to our business-management and market-political targets, we pursue a strategy of sustainability, i.e. we connect the main criteria of social responsibility, ecology and economic performance in a harmonious balance.

1.3 Control system

Achieving the goals is monitored on a regular basis by comparing actual against the agreed required figures. For carrying out the controls, the operative figures of the profit-and-loss account, the operational comparison of the Sparkasse organisation and the financial ratios of banking supervision are used. Every year, the Board of Directors lays down targets for the various performance indicators. They are then allocated to the business units. It is of major significance that the risks that are entered into will be consistent with our risk capacity and that sustainable profits will be generated in the long term. The Senior Control Committee continuously monitors adherence to the business plan.

1.4 Internal control system for accounting process

To ensure proper bookkeeping and accounting, the Sparkasse has an internal control system (ICS) for the accounting processes. To objective is the correct and complete presentation of the assets, financial and earnings positions of the Sparkasse in the annual accounts.

For the most part, the monitoring department of the back office takes care of accounting. The department head is responsible for the accounting process and the effectiveness of the backup and control measures that are integral components of the accounting process. He must ensure that risks in the accounting process are recognised at an early stage and that appropriate backup and control measures are taken at once.

In particular use of the following equipment ensures an evenly high level in accounting:

- Work directives and process descriptions for the individual processes in accounting exist, including for drawing up the annual accounts, and continuously kept up-to-date and captured in a database.
- The chart of accounts of the German Savings Banks Organisation is used as basis for the uniform booking of transactions and is, in respect of composition and structure, designed for deriving the annual accounts from the bookkeeping. It ensures a uniform standard for the process and drawing up of the annual accounts.
- IT processing for accounting is essentially done by Finanz Informatik (FI) in Frankfurt on Main, as service provider to the Sparkassen Financial Group. FI uses the "KORE" application for handling the financial bookkeeping and the IT system "OBR" for drawing up the annual accounts. By processing the accounts of the financial bookkeeping and by automatically processing possibly required balancing entries for individual balance sheet items, the "OBR" system makes the drawing up of the balance sheet and the profit-and-loss account a largely automated process.

The processing instructions and descriptions are regularly checked for being up-to-date. The chart of accounts is also constantly updated. The relevant staff have access to the available information and inform themselves that way about the prevailing regulations.

Within the framework of taking new and changing accounting standards into consideration and the introduction of new products or procedures, the Business Administration Department is responsible for analysing the effects and for introducing suitable measures in respect of the rendering of accounts.

For laying down parameters for the institution that determine a significant part of steering the ICS, a procedure has been implemented that ensures that changes are properly authorised, checked and traceably documented.

The tasks and responsibilities are clearly allocated within the organisational structure, are precisely defined and are subject to the principle of separation of duties. Activities that may pose conflicts of interest, such as changing master data and making payments, are fully separated. The ability to post entries on general ledger accounts is regulated by means of granting special authorisations. Transactions are captured on the general ledger resp. on the relevant sub-ledger, on the basis of the chart of accounts. The four-eyes principle applies to the booking of closing entries and the drawing up of the annual accounts.

The processes, systems and controls that exist at Sparkasse do sufficiently well ensure that the accounting processes are in conformity with the prevailing accounting principles and legislation. The Board of Directors is regularly informed about the effectiveness of the internal control system in relation to the accounting process.

2 Report on economic situation

Our Sparkasse may look back at an altogether successful fiscal 2016. The performance as well as the capitalisation, financial and earnings positions may be considered to be satisfactory in the light of the general economic conditions as well as the state of development in the banking sector. The result before valuation was characterised by lower net interest income, largely stable staffing and administrative

costs and falling other ordinary income. After extraordinary effects on the valuation results and slightly higher fiscal costs, the fund for general banking risks as per Article 340g, Commercial Code, could clearly be added to. The result for the year was slightly higher than in the previous year. The Cost-Income ratio has reduced.

The development of the business year of 2016 is reflected in the following overview:

Presentation in figures of the balance sheet	Existing		as % of business volume		Changes			Prognosis
	31/12/2016 €million	31/12/2015 €million	31/12/2016 %	31/12/2015 %	2016 €million	2016 %	2015 %	31/12/2016 €million
Balance sheet total	6,930.1	6,822.1			108.0	1.6	0.9	6,950.0
Business volume ¹⁾	7,085.5	6,960.7			124.8	1.8	0.8	7,100.0
Lending business ²⁾								
Volume of loans to customers	4,819.1	4,485.4	68.0	64.4	333.7	7.4	3.0	4,810.0
Of which:								
Loans to public sector	1,290.0	1,269.1	18.2	18.2	20.9	1.6	-6.9	1,285.0
secured with liens on real estate	1,563.4	1,485.6	22.1	21.3	77.8	5.2	5.2	1,570.8
Loans to banks	138.8	116.4	2.0	1.7	22.4	19.2	-35.3	150.0
Investments in securities	1,986.7	2,201.7	28.0	31.6	-215.0	-9.8	0.4	2,000.0
Fixed assets	71.9	72.9	1.0	1.1	-1.0	-1.4	-3.4	60.0
Other assets	69.0	84.2	1.0	1.2	-15.2	-18.1	-19.3	80.0
Deposit-taking business								
Deposits from customers	4,168.3	4,386.3	58.8	63.0	-218.0	-5.0	-3.2	4,180.0
Of which:								
Savings deposits	2,148.8	2,193.1	30.3	31.5	-44.3	-2.0	-2.4	2,150.0
Non-certificated liabilities	1,986.0	2,159.7	28.0	31.0	-173.7	-8.0	-4.0	1,995.0
Securitised liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Subordinated liabilities	33.5	33.5	0.5	0.5	0.0	0.0	0.0	35.0
Liabilities to financial institutions	2,262.6	2,011.8	31.9	28.9	250.8	12.5	10.3	2,250.0
Other liabilities (including contingent liabilities and provisions)	189.7	175.5	2.7	2.5	14.2	8.1	-4.6	205.0
Shareholders' equity	464.9	387.1	6.6	5.6	77.8	20.1	4.5	465.0
Of which:								
Contingent reserve	290.3	282.1	4.1	4.1	8.2	2.9	2.5	290.0
Fund for general banking risks	174.6	105.0	2.5	1.5	69.6	66.3	10.5	175.0

¹⁾ Business volume = balance sheet total plus contingent liabilities (guarantee loans, collateral for third-party liabilities)

²⁾ (including liability item 1 below the line)

The economic development and positive basic attitude in our business area have led again to a further increase of the credit demand among private individuals. Business with public bodies and private individuals also developed satisfactorily. On the liabilities side, call monies and obligations towards financial institutions have increased, whilst fixed deposits from customers have fallen.

The total and volume of business have increased according to plan in the reporting year. Against the background of general economic development, the assets and financial positions could be described to be favourable.

Presentation on the basis of the figures of the profit- and-loss account:	Result		Changes		
	1.1. – 31/12/2016 €million	1.1. – 31/12/2015 €million	2016 €million	2016 %	2015 %
Interest surplus ¹⁾	133.5	141.1	-7.6	-5.4	4.1
Net commission income	27.3	24.9	2.4	9.6	2.0
Administrative expenses	102.3	102.0	0.3	0.3	3.1
Other ordinary result	-14.3	-8.1	-6.2	-76.5	68.5
Result before provisioning	44.2	55.9	-11.7	-20.9	58.4
Net provisioning result	49.9	-23.7	73.6	310.5	-51.9
Result after provisioning	94.1	32.2	61.9	192.2	63.5
Taxation	14.6	13.7	0.9	6.6	22.3
Allocations to the fund for general banking risks	69.6	10.0	59.6	596.0	100.0
Net income and unappropriated surplus	9.9	8.5	1.4	16.5	0

¹⁾ Interest surplus = P&L positions 1, 2, 3, 4 and 17

Presentation on the basis of the figures of the profit-and-loss account:	Result		Changes		Prognosis
	1.1. – 31/12/2016 %	1.1. – 31/12/2015 %	2016 % points	2015 % points	1.1. – 31/12/2016 %
Profit ¹⁾	0.14	0.13	0.01	0	
Cost-Income Ratio ²⁾	67.4	65.3	2.1	-0.9	69.7

¹⁾ Annual income/total

²⁾ According to operational comparison

The earnings position, which saw satisfactory development compared to the previous year, was characterised in 2016 by falling net interest income, largely stable administrative expenses and lower other ordinary income.

After consideration of the evaluation result, taxes and an increase in the special item for general banking risks as per Article 340 g, HGB (Handelsgesetzbuch [Commercial Code]), a surplus for the year resulted that corresponds to our planning.

The regulatory ratios developed as follows:

Key banking supervision figures	Existing		Prognosis
	31/12/2016	31/12/2015	31/12/2016
Equity	€434.0 million	€423.6 million	433.8
Tier I capital	€385.1 million	€368.1 million	384.9
Tier II capital	€48.9 million	€55.5 million	48.9
Risk-weighted item values	€3,401.9 million	€3,359.0 million	3,466.3
Overall ratio	12.8 %	12.6 %	12.5
Core capital ratio	11.3 %	11.0 %	9.3

2.1 Macro-economic and sector-specific environment

Economic environment

The economic situation in Germany was characterised by solid and continuous economic growth in 2016. The gross domestic product (GDP) was by 1.9 % above the prior year's and thus half a percentage point above the average of the last ten years of 1.4 %. Consumption and investments were the most important growth drivers. Because imports (+3.4 %) have risen faster than exports (+2.5 %), to the so-called external balance has had a slightly negative impact on GDP. The number of employed persons once again reached a new maximum for the tenth year in sequence in 2016 at just 43.5 million. This meant 429,000 persons or 1.0 % more than in the prior year.

German banking industry

On the one hand, the problems in the German banking industry may be accredited to the essentially rising costs on account of inflation, which, at times of historically low interest resp. negative rates, is limited in the way that it can be kept pace with. On the other hand, development in the regulatory area as a result means both limitations of the ability to act and cost increases, e.g. for the banking levy, which is not tax-deductible in Germany. Fundamentally though, the pertinent regulations can have the effect of increasing security within the financial sector. Competitive pressure has particularly had an effect on private customers, amongst others because of changes in the ways of communication, demographic developments and changes in customer requirements.

Developments in the savings banks organisation

Contrary to the downgrading of ratings of some other banks, the Sparkassen Financial Group was able to preserve the rating of previous years. The rating agencies FitchRatings, Moody's Investors Service and DBRS Ratings Limited once again confirmed their good rating levels of the previous years.

Regional economic development

During the past year, the Saarland economy has clearly lost momentum. According to current calculations, GDP is estimated at EUR 35,100 million, which is nominally 1.4 % higher than in the previous year. Adjusted for inflation, it virtually means stagnation (+0.0 %). With that, economic activity in Saarland lagged behind the country as a whole, both in nominal terms as well as real terms. Particularly in mechanical engineering, which had grown strongly in earlier years, there were significant setbacks. In that key sector of Saarland industry, turnovers have fallen by around 6.6 % in 2016.

Development in the other large industrial sectors of Saarland was also unsatisfactory. In the automotive production sector, there was only a small rise in orders of, on average, because good demand from abroad (+7.3 %) was largely offset by falling domestic demand (-5.7 %, an rise in orders of 1.2 %). The local steel industry particularly came under strong pressure in foreign markets (-6.3 %), which caused a reduction in the volume of orders of 3.0 %. On the other hand, the Saarland building sector can look back at a rather satisfactory year 2016. With the favourable order book in the main construction sector (+6.5 %), turnovers increased again strongly by about 10%, especially in civil engineering.

Consumer behaviour in private households continued to be composed in a friendly manner and led also in 2016 to a stable development in turnover. The hotels and restaurant industry continued to do well and especially tourism showed new peaks in 2016 in terms of arrivals and overnight stays.

However, the record values for foreign trade that were seen in 2015, could not be further expanded. Although exports rose by another 1.2 % to almost EUR 15,500 million, imports fell back by 2.8 % to EUR 12,700 million. (Source: Saarland Statistical Office).

Competitive situation and market position in the catchment area

Sparkasse was able to hold on to its position as market leader in its catchment area. Major competitors of the Sparkasse are the cooperative banks and for new business the internet banks. Large private banks only have branches in the larger cities and not in rural areas. Internet banks, foreign banks and the Postbank mostly compete with the local banks for short-term deposits. The large banks and private banks especially try to attract private customers through advertising on television. Moreover, established institutions see themselves ever more often confronted with FinTech companies and competitors from other sectors.

2.2 Business development

Total footings and business volume

At EUR 6,930.1 million, total footings are about EUR 108.0 million or 1.6 % higher than the previous year. On the assets side, there was satisfactory growth in the customer lending business, so that the securities portfolio could be reduced. Reducing customer deposits have been refinanced through borrowing from banks.

Business volume rose by around EUR 124.8 million or 1.8 % to EUR 7,085.5 million.

Lending business

Volume of loans to customers

During fiscal 2016, the Sparkasse originated new loans totalling EUR 717.3 million (previous year EUR 844.4 million). The development of the customer lending volume in general was again above that of the prior year, and also above the average of the Sparkassen in Saarland.

They were again especially companies and the self-employed, who contributed to expanding the business, although the local authorities and private individuals did so as well.

Altogether, a total of EUR 1,763.0 million has been disbursed to commercial customers and EUR 1,478.5 million to private customers. There also were publicly subsidised low-interest loans to businesses and private person to the tune of EUR 170.3 million.

Loans to banks

During the year under review, claims on financial institutions have increased to about EUR 138.8 million (EUR +22.4 million, +19.2 %). They concern primarily loans against promissory notes and placements of fixed deposits, whilst the volume of loans against promissory notes has fallen somewhat, when some of them matured.

Investments in securities

The satisfactory growth in the credit portfolio during the year under review has displaced the Deposit A volume in the application of funds. During the course of the year, the volume fell to EUR 1,986.7y million (EUR -215.1 million, -9.8 %) as the result of sales and maturities.

Parts of our securities portfolio are administered in several special funds, of which four have been combined into a master fund during the year under review. Our goal is to achieve value growth with assets managed by third parties, giving due consideration to risk and return profiles.

Equity investments

The net total of the participations and shares in affiliated companies amounted to 46.5 million EUR. The change of around EUR +0.2 million (+0.4 %) is essentially due to value recovery in a holding respectively calling in not yet paid up capital stock.

Deposit-taking business

Deposits from customers

Overall, deposits from customers were lower (EUR -218.0 million; -5.0 %) during the year under review. Particularly, funds for refinancing purposes from institutional customers have been reduced within the framework of ALCO management, whilst deposits from companies and private individuals actually increased. Overall, fixed deposits have been reduced by EUR 380.0 million (-63.8 %). The reduction in savings deposits remained moderate (EUR -44.3 %; -2.0 %).

Liabilities to financial institutions

During the year under review, liabilities to financial institutions have increased to about EUR 2,262.6 million (EUR +250.8 million, +12.5 %). And contrary to the previous year, use has been made again of open-market transactions with the Deutsche Bundesbank (EUR +650.0 million), so that the volumes of call and fixed deposits could be reduced correspondingly (EUR -165.0 million, -28.7 % respectively EUR -226.8 million, -19.7 %).

Consultancy and services

Insurance products and products for old-age provision are offered by the Sparkasse, in cooperation with Pro-Finanz Immobilien-, Beratungs- und Vermittlungs-GmbH, Saarbrücken. A wholly owned subsidiary of Sparkasse Saarbrücken, it also advises our customers on all matters relating to real estate.

In spite of higher insured amounts, commissions from selling life assurance have fallen by about 3.1 %, because the commission system has been changed.

The intermediary business in the real estate sector developed once again satisfactorily. Commission income rose by about 1.8 %.

In the non-life insurance business, the good result of the previous year (+8.3 %) could be extended. Commission income rose by about 8.6 % in the year under review.

The building savings business consolidated on its high level. However, the sales levels of the previous year – measured by sales volume – could not be reached. And there still is great demand in relation to the Riester programme.

The past year was characterised by a series of macro events, which caused quite some dynamism on the capital markets: fluctuations in the oil price, Brexit, presidential elections in the United States, weakening growth in China. Nonetheless, against the background of better global growth perspectives, shares have mostly risen in value and the Dow Jones Industries, the most important international share index could even reach new highs following the election of Donald Trump as the new president of the United States.

The persistently low level of interest rates has, also in the past year, further enticed many customers to looking for alternatives in which to invest their savings. For example, the volume of the funds and certificates portfolios of our customers at our premium partner, Deka Bank, rose by around 9.7 %.

With a growth of altogether EUR 81 million respectively 8.6 %, the total value of customer's securities portfolios in our bank rose to above a thousand million euros. As in previous years, the main focus was on real estate funds and on share-based investment funds and certificates.

For a savings bank in a border region, the processing of international payments is an important cornerstone of the package of services, whilst the focus is on other EU countries. Documentary collection and credit operations round off the range of foreign business services. We can offer our customers suitable derivatives for hedging interest rate risk.

Trading for own account

Our A Portfolio – essentially a mixture of fixed interest paper, floaters and stocks managed by third parties – makes a positive contribution to the profit-and-loss account of the Sparkasse. Turnovers – purchases, sales and maturities – came to a total of EUR 830.9 million (previous year: EUR 1,372.7 million). The Sparkasse does not engage in proprietary trading within the meaning the CRR.

Derivatives

Most of the products in the derivatives business are interest rate swaps and interest rate futures, bought in order to hedge against interest rate books. The nominal value of contracts outstanding at year end was EUR 1,900 million (previous year: EUR 1,700 million).

Investments

During the year under review, conversion work in our Financial Centre in Malstatt and in the building on Rathausplatz has been completed. Further work is under way in our Financial Centre in Quierschied.

2.3 Capitalisation, financial and earnings positions

2.3.1 Financial status

The financial status of our Sparkasse is characterised by relatively lower claims on customers, higher depot-A-stocks and lower customer liabilities than the association average.

Altogether, there was no significant change in structural shareholdings.

The securities portfolio is recognised under non-current as well as current assets. At balance sheet date, there were provisions for rate fluctuations amounting to EUR 41.6 million. Existing balance-sheet risks were recognised through appropriate revaluations of sufficient provisions.

Undisclosed reserves in the amount of EUR 60.0 million are included in the assets carried on the balance sheet, particularly in securities, landed property and participations. We have also set aside additional contingent reserves as provision for the extraordinary risks that exist in the financial institutions sector, as stipulated in Article 340 f, Commercial Code. The fund formed for general banking risks as stipulated in Article 340 g, Commercial Code, now stands at EUR 174.6 million, after an addition of EUR 69.6 million during the year under review. For our at the close of the year prevailing indirect old-age pension obligations, we refer to the presentation in the Appendix.

On the balance-sheet date of 31/12/2016, the total capital ratio was, at 12.76 %, clearly higher than legally required in the CRR. With a ratio of 11.32 % for Tier I capital, Sparkasse complies with the quantitative capital adequacy requirements that are currently in force. After the Supervisory Board will have resolved on allocating funds from the unappropriated surplus of Sparkasse Saarbrücken and the former Stadtparkasse Völklingen, contingent reserves will increase from EUR 300.6 million to EUR 307.8 million; it means an increase of around 2.4 % compared from the previous year.

It is taken as a given that the security and safety regulations and the fund for general banking risks will form the planned business expansion. This strong capital basis provides the precondition for further efforts to expand business and for achieving the targets of Sparkasse. The already-evident additional requirements to equity (further buffers, SREP) will also be achievable this way.

2.3.2 Financial position

Liquidity management at the Sparkasse falls under the responsibility of Treasury Division. Control of inflows and outflows of short-term and long-term money, planning of cash flows and control of access to the refinancing instruments of the European Central Bank resp. Deutsche Bundesbank are the operational liquidity management tasks of the Cash Management and Trading Department.

Within the framework of the liquidity strategy, the department manages access to the refinancing sources of the money and capital markets as well as the liquidity reserve. Controlling the assets and liabilities with impact on liquidity, within the framework of the legal and supervisory limits, is also a task of strategic liquidity management.

During the period under review, there were no limitations on access of the Sparkasse to the money and capital markets. Solvency of the Bank was assured at all times during the business year on account of carefully planned and executed liquidity management. For monitoring our solvency and refinancing possibilities under stressful conditions, we make use of ladders – broken down into monthly periods – that show the inflows and outflows of money in the short term and medium term, and we also make use of prognoses that are developed on the basis of statistics that are derived from past performance of customer business.

In a further step, the planned data are completed with actual values and target values, where appropriate. Larger variances are analysed in quarterly comparisons of actuals to plan.

On the basis of prognosticated cash flows, Sparkasse determines for various "Survival periods" to which extent outflows are covered by inflows. In the risk scenario that is based on improbable though possible negative developments, the period encompasses around 36 months as at 31/12/2016; under still more serious assumptions (stress scenario) cover would still be adequate, because under that scenario, outgoing liquidity would be restricted by refraining from granting new customer loans until further notice. That ensures that Sparkasse will have sufficient time for reacting to a looming liquidity bottleneck.

At year end, the liquidity coverage level as calculated conform the liquidity ordinance stood at 1.87, indicating that liquidity is sufficient, also during the entire fiscal year. The liquidity coverage figure is a reflection of the relationship between available cash and payment obligations and must be at least 1.0. During 2016, the Sparkasse complied at all times with the requirement of the liquidity ordinance. During 2016, the coverage figure fluctuated between 1.68 and 2.29.

Similarly, the other key figures that must be calculated on the basis of the liquidity ordinance for further periods of observation (maturity bands of up to twelve months) do not give any indication of potential bottlenecks.

Since 01 October 2015, all banks must comply with the "liquidity coverage ratio" (LCR) every day. This is an index specified by the banking supervision that maps the stress situation. The specified minimum ratio was 70 % in 2016.

During the year under review, only partial use was made of the credit facilities at the Deutsche Bundesbank. On balance-sheet date, there were unutilised credit limits and/or refinancing possibilities at the Deutsche Bundesbank to the tune of EUR 752.3 million in total.

On the basis of expected liquidity inflows and the refinancing possibilities of the Sparkasse, solvency is also guaranteed for any time in the future.

2.3.3 Earnings position

Net interest income – the most important item on our profit-and-loss account – was EUR 7.6 million (-5.4 o) lower than in the previous year. Although the low level of interest rates has led to further falls in profits from customer business, in business with financial institutions a slight increase could be achieved.

Because funds released from maturing securities can only be reinvested with significantly lower coupons, earnings from our A Portfolio also show a tendency of falling. Further savings resulted again, in contrast, in the scope of interest

swap agreements entered into in the scope of hedging transactions.

The surplus in fee income rose by around EUR 2.4 million (+9.6 %). Apart from increased fees from giro transfers, the increase can also be attributed to now allocating commission expenses to general and administrative expenses, where they were hitherto deducted from fee income.

Staffing costs have slightly increased to EUR 69.2 million (EUR +0.2 million, +0.3 %). Wage and salary payments that have risen as a result of tariff increase and reclassifications have been partially offset by savings on pension reserves.

The payroll shrunk by 23 staff.

At EUR 33.1 million (EUR +0.1 million; +0.3 %), general and administrative expenses remained, on the whole, virtually constant. The increases in costs are all in relation to the bank levy, the new allocation of credit card expenses from commission expenses to general and administrative expenses and the merger with Stadtparkasse Völklingen, which was legally consumed on 01/01/2017. Savings could be achieved in expenses for premises and as a result of special effects in the previous year (payments into the deposit insurance fund of the savings banks).

The result from the other ordinary income and expenses fell by EUR 6.3 million (-77.6 %). Of decisive importance were the hedging transactions with interest rate futures that were bought in order to hedge interest rate risk.

The result before revaluation was EUR 44.2 million (EUR -11.7 million; -20.9 %).

Overall, the revaluation result was comfortably positive, at EUR 49.9 million (EUR +73.6 million). On the credit side it was particularly characterised by additions and deductions of value adjustments as a result of releasing contingency reserves as stipulated in Article 340 f, Commercial Code. The funds that became available in that way, have been used to bolster the fund for general banking risks, as stipulated in Article 340 g, Commercial Code. Depreciations in the A Portfolio were offset by appreciations respectively exchange rate gains during the course of the year, so that the final result was virtually in balance.

The result after revaluation is EUR 94.1 million (previous year: EUR 32.2 million).

After deduction of the taxation of EUR 14.6 million (previous year: EUR 13.7 million) and an increase in the fund for general banking risks as per Article 340 g, Commercial Code, of EUR 69.6 million, a surplus for the year of EUR 9.9 million results.

The reported annual income and especially the addition to the special item for general banking risks as per Article 340 g, Commercial Code, permit further increase of the core capital of the Sparkasse and appropriate distribution to our local authorities.

For the purpose of further analysing the earnings position of our Bank, we use the so-called "Operational comparison" of the savings banks organisation, which involves a detailed breakdown and analysis of the result of our Sparkasse in terms of average balance sheet total. The operating result before revaluation of our Sparkasse of 0.73 % of DBS (durchschnittliche Bilanzsumme [average total footings]) is lower than the average value for the savings banks in Saarland (0.79 %). That also applies to the operating result after revaluation (0.30 % of average total footings as compared to 0.43 % of average total footings), which is, however, due to the building of new contingent reserves in conformity with Article 340 f, Commercial Code.

2.4 Non-financial performance indicators

Staff

The overall number of staff was slightly further lower in 2016, by 1.9 %. At the end of the year, the Sparkasse employed a total of 1,188 people. Of these, 722 were full-time staff, 384 were part-time staff and 82 were apprentices.

We have developed numerous models allowing employees to combine families and careers. For example, we offer our staff several different part-time working models. In addition to the statutory parental leave, staff are able to apply for sabbatical leave of up to one year with a guaranty of re-employment. The Sparkasse also renders assistance with finding places in after-school care facilities and kindergartens.

The declared aim of our site safety policy is to protect and, where possible, improve our staff's health and to ensure that they are able to work to the best of their abilities with maximum job satisfaction. After an inspection last year of workplaces in terms of ergonomic suitability, concrete follow-up measures have been taken on the basis of the findings and the results of the analysis. For example, seven workshops have been held for staff on the subject of the health of one's back. On the occasion, two sports scientists did each carry out a profound analysis on the backs of 25 participants. Through real-time measuring, valid data have been retrieved and the valuation results were then validated against test data, individual as well as accurate courses of action have been discussed and tips have been given for enhancing or maintaining the prevailing state of health. Apart from participating in workshops, staff have been able to attend to presentations on four different dates of renowned health experts. The presentations dealt with subjects such as nutrition, biomechanics at the workplace and dealing with stress and physical strains. The operational health management is supplemented by classic offers such as flu vaccinations and cancer prevention.

Nowadays, learning throughout life is a necessary precondition for being able to participate in professional life until retirement. Ongoing further training is, therefore, in the interest of both the employer and the employee. Consequently, we are committed to the life-long learning of apprentices up to managerial levels – not only during economic upswings, but also when times are hard. With this in mind, we offer internal and external (e.g. at Saarländische Sparkassenakademie) vocational education programmes that are oriented on specific aspects of our business, such as "Loans Advisor Customers", and help staff in planning their careers. Given the constant changes in the savings bank business as well as new technological developments, target-oriented training and vocational education for employees continued to play a crucial role in personnel development activities last year.

Training of youth has high priority for us. All 18 apprentices, who successfully completed their training, have been offered permanent employment in 2016. Altogether, we employed 100 apprentices and 30 trainees during the year under review. Additionally, there were 11 volunteers, who, apart from being trained at the Sparkasse, pursued studies.

Customer relations

We place our customers' interests at the heart of our activities and systematically align our internal benchmarks to their needs, expectations and wishes. A prudent business plan and a remuneration system that is substantially based on fixed components ensure that no inappropriate incentives might conflict with the interests of customers.

Our complaints handling system plays a central role in ensuring customer satisfaction: Through targeted capturing and assessment of complaints, we obtain good insight into the basic requirements of our customers. Moreover, it ensures that customer complaints are swiftly dealt with. We received 1,436 customer complaints in the reporting year. 35 complaints were still open on balance sheet date. Altogether, payments totalling 48.9 kEUR have been made in respect of goodwill or compensation.

Sustainability

Our sustainability strategy includes internal as well as external activities, which in turn are aligned with the three pillars of sustainability (ecology, economy and social responsibility). Within these fields for action, diverse tasks and opportunities for us and for the customers and business partners who operate with us result.

The result of the sustainability strategy has been that Sparkasse Saarbrücken was the first and only financial institution in Saarland to be awarded the EMAS (Eco-Management and Audit Scheme) certificate. As such, Sparkasse Saarbrücken is one of only twelve financial institutions in the whole of Germany that applies environmental management at the highest European standards. Actual implementation was laid down during the year under review in an environmental management manual.

Social responsibility

We have always considered social responsibility a corner piece of our corporate culture in all areas where Sparkasse Saarbrücken operates. With donations, through sponsoring and by funding a foundation, we promote the economic development and attractiveness of the region. Social facilities are supported and cultural and sporting life are being promoted. But our sense of responsibility is not limited to the taking of preventive measures or to sponsoring activities. It is our opinion that nowadays a company only acts socially responsibly when it actively secures employment, helps its staff to obtain qualifications and allows for the future when structuring the company. We do so at all locations in our catchment area.

2.5 Summary and assessment

Sparkasse Saarbrücken's performance, its financial position and cash flows as well as the development of its earning position can be considered to be satisfactory in the light of general economic conditions as well as the state of the banking sector. The customer lending volume could again be noticeably increased (EUR + 333.7 million) – in particular through transactions with companies and individual entrepreneurs, whilst deposits were lower (EUR -218,0 million). The figures document – under consideration of an interest situation that does not exactly encourage investments – the good market position of Sparkasse and affirm the business policy of the Board of Directors. On the profit-and-loss account, a minus in net interest income could be partially offset by higher commission income. Whilst administrative expenses remained mostly constant, hedging transactions for the interest rate book led to higher costs. The revaluation result of the A Portfolio was broadly in balance. Altogether, the revaluation result was characterised by the release of contingency reserves as stipulated in Article 340 f, Commercial Code, which led to a result before taxation of EUR 94.1 million. After consideration of taxation and new allocation in the amount of EUR 69.6 million to the special item for general banking risks as per Article 340 g, Commercial Code, an annual surplus of EUR 9.9 million remains, which corresponds to the planning of the Board of Directors.

3 Risk, opportunities and prognosis report

3.1 Risk report

Because the conscientious accepting, active managing and targeted transforming of risks, whilst applying a risk appetite that does not involve excessive exposure to risk and still leaves room for adequate earnings, or core function of financial institutions, the executive management of the Sparkasse has installed a risk management system as integral part of the overall control system, which is used for identifying, assessing, mitigating and monitoring the risks and for communicating them. The management information with relevance for risk is used as basis for making operational and strategic business decisions. Clear separation of duties and close cooperation between the involved divisions of the Sparkasse make efficient implementation of the risk-political control impulses possible. To enable us to deal with the continuously evolving framework conditions, we continuously adapt our strategies, concepts, procedures, instruments and organisational structure and processing arrangements.

The general part of the business and risk strategy documents the strategy process and strategic guidelines of the Sparkasse, and its special part describes various partial strategies, e.g. on the areas of private customers, business customers, staff, treasury and costs, under consideration of business, commercial-law and supervisory framework conditions. Based on the risk capacity, partial strategies for the individual risk types are determined.

In respect of its strategies and implemented processes, the Sparkasse complies with the Minimum Requirements to Risk Management (MaRisk).

As basis of our risk inventory, we designate as fundamental risks for our institutions: counterparty risks (especially country risk, spread risk, default risk and creditworthiness), market rate risks, (especially interest rate risks), liquidity risk, operational risk and participation risk.

The principles underlying the risk management and monitoring system, the types of risks identified as well as the instruments used are documented in Sparkasse Saarbrücken's risk manual. This additionally includes information on responsibilities as well as the cycles for reporting to the Board of Directors and other managers.

3.1.1 Risk management

The Supervisory Board issues business instructions for the Board of Directors and the Credit Committee and monitors their activities. The business and risks strategies are regularly discussed with the Supervisory Board. The Board of Directors presents a quarterly risk report to the Supervisory Board, on the risk position of the Sparkasse.

The Sparkasse differentiates between operational and strategic risk management. The operational risk management encompasses the implementation of the risk strategy as specified by the Board of Directors by introducing or reducing risks into or in the individual risk-bearing business divisions. The strategic risk management entails the specifying of risk-political guidelines and the coordinating and supporting of operational risk management.

In addition to setting the business-political objectives, the Board of Directors sets the fundamental strategic and methodical orientations and determines the level of risk coverage that is made available for hedging and how that will be spread over the various types of risks. The actual risk managing is actually done by the individual management units in the various divisions.

Controlling and monitoring counterparty risk is done in the Overall Control Division and the Back Office for lending operations. The full Board of Directors decides for every individual case of lending to customers up to EUR 42.3 million and of unsecured lending up to EUR 8.4 million. Below those limits, the Board has delegated approval authorities to qualified staff. Above those levels, approval from the Credit Committee is required. The approval authority level of staff depends on the credit exposure, the unsecured portion and the rating score. In the case of risk-relevant lending decisions, in addition to the opinion of the market division, the opinion of the back office is needed, based on analysis of the case. Decisions and monitoring of repackaging and rescheduling are the responsibility of CreditConsult Division.

Treasury Division manages market rate risk under its own responsibility, within a framework of limits that are set by the Board of Directors. The division also manages counterparty risk in relation to commercial deals and it manages liquidity risk.

The Control and Risk Management Department coordinates the process of determining operational risks, verifies the instruments that are used and analyses resp. monitors the way the risk develop on the basis of the risk map and the damage that has occurred.

In order to be properly able to assess the risks emanating from new products or new markets, their consequences are analysed and displayed to the Board of Directors in a presentation. Before embarking upon regular trading, commercial deals are fundamentally first subjected to a test stage, in which the affected organisational units are involved. Only when tests are completed successfully and suitable risk management instruments are in place, regular trading may commence.

Before planned changes in operational processes and structures are implemented, the effects on the control process and the intensity of controls are verified.

The risk controlling function is performed by the department Controlling and Risk Control. The management is assumed by the area manager integrated bank management, who is directly subordinate to the back office and monitoring director. His main task is to support the management in all risk-political questions, particularly in the development and implementation of the risk strategy and in the design of a system to limit the risks. The head of risk controlling function has all necessary authorisations and unlimited access to all information required to perform his task. Before decisions with essential effects on the risk and income situation, the head of risk controlling function must be informed.

It is the responsibility of the Control and Risk Management Department, as organisational unit that is, in terms of construction and process organisation, independent of the divisions that are responsible for the actual transactions, to assess, monitor and report the functions that have been identified as carrying significant risks. Risk Control is responsible for testing the suitability of the methods and processes that are used. Risk Control is also responsible for the implementation of regulatory and statutory requirements, calculating the risk capacity and monitoring the adherence to risk limits.

The MaRisk compliance function has been set up with the objective of counteracting risk that may be the result failure to comply with legal regulations and specifications.

As organisationally independent unit, Internal Audit, within the framework of its monitoring function, supports the Board of Directors and other management levels. It is based on a risk-oriented verification plan that has been approved by the Board of Directors. It provides the fundamental basis on which Internal Audit checks and assesses all operational and business processes. That also entails checking risk management and adherence to internal and external regulations. In this connection, the focus is on processes and methods in the light of the principles of security, propriety as well as economic efficiency and appropriateness. It is a significant contribution to adherence to defined processes and supports the further development and enhancement of the risk management processes. No findings of any significance with impact on the financial position, cash flows and earnings were made during fiscal 2016. Improvements suggested by Internal Audit are implemented after mutual discussion.

Stages of the risk management process

With the objective of developing a uniform and integral system for analysing and quantifying existing counterparty, market price, liquidity, participation and operational risks, we have identified four stages in the risk management process. First of all, within the framework of identifying risks, significant current and future risks must be identified and be used as basis for classification. They entail, for example, the risks in conjunction with integrating the risks in connection with new products or complex transactions into the existing system. Risk concentrations associated with significant risks are taken into account within the framework of risk identification. Objective of the risk assessment is the measuring and evaluation of the identified risks. Appropriate risk assessments are performed for essential risks, e.g. by risk models or scenario analyses. Risk management as a whole is aimed at accepting risks, mitigating risks, limiting risks, avoiding risks or transferring risks. The last stage is the monitoring of the limits that have been set by the Board of Directors and reporting on the risk parameters and the analysis results to the Board of Directors and the concerned divisions by Risk Control. Apart from the regular reporting on significant risks in accordance with MaRisk, there is also ad hoc reporting, as and when needed.

Moreover, the methods of the preceding process stages and the quality of the data that were used, resp. of the results are checked and validated.

Risk capacity

Within the framework of the quarterly calculation of risk capacity, the Sparkasse compares its risk coverage potential to the accepted risks. In doing so, the installed processes for measuring and managing the risks ensure that the significant risks are at all times covered by the existing risk coverage potential and that, therefore, all existing risks are contained within the risk capacity. The Sparkasse applies a risks capacity concept, based on periodic, value-oriented and regulatory views. It takes the going concern basis as principle, under which it is assured that also in case the risk coverage potential that is used for covering risks is lost, the minimum capital requirements as per the CRR can still be met. Risk buffers are maintained for expected negative changes in values and risk concentrations that are not taken into consideration within the ordinary risk as well as for significant risks that cannot be quantified with sufficient accuracy. At the end of a current year, the Board of Directors always lays down which part of the maximum available risk coverage potential will be made available for covering the significant risks that exist for the following fiscal year. The maximum available periodic risk coverage potential is made up of the planned operating result before evaluation, the contingent reserves as per Article 340f, Commercial Code, and the fund for general banking risks as per Article 340g, Commercial Code. When needed, the available parts of the contingent reserves that are not used for meeting minimum regulatory requirements might also be used. Subsequently, the quantifiable significant risks are compared with the limits that have been derived from the provided risk coverage potential. From the middle of the fiscal year onward, the Sparkasse also looks at the risk capacity for the following years until the balance-sheet date of the following year. To review the risk capacity, the stress amount used as a basis for the risk case is compared to the provided risk coverage potential as a total bank limit (as per 31/12/2016: EUR 124 million). The overall banking limit was stressed by less than 50 % in the reporting year.

The value-oriented risk coverage potential is derived from marking assets and liabilities to market; as such from the net present value of the Sparkasse.

On balance-sheet date, the value-oriented risk coverage potential was EUR 889 million. EUR 267 million have been made available as risk-taker. The calculated risk for the Bank as a whole that was calculated without taking diversification factors into account stood, for a holding time of one year, at EUR 160 million.

According to the MaRisk, each institute must have a process of planning supervisory and internal future capital demand. The planning horizon must include an appropriately long period of several years. Sparkasse Saarbrücken simulated the capital planning until the year of 2021. Various assumptions were made about future development of results and future capital requirements, such as falling operating results of account of a sustained stage of low interest rates and the minimum Tier I capital that will be required in the future.

Risk strategy

A consistent risk strategy has been formulated for the business activities of the Sparkasse, which has the following characteristics:

- The risk strategy takes the significant business activities that have been laid down in the targets and plans of the business strategy as well as the significant risks that are associated with outsourcing into account and is restrained by the risk capacity. It encompasses also the targets of the risk management of the significant business activities, such as existing risk and earnings concentrations.
- By means of set risk limits and efficient control systems, the earnings and the assets of the Sparkasse must be protected. By settling risk tolerance limits, it has been determined under which conditions Sparkasse will be ready to accept risks.
- Our good reputation as dependable partner of our customers must be consolidated and maintained, even when applying risk management.
- Before embarking upon new business activities, suitable analyses in respect of possibility of implementation in the organisation, legal consequences, risk level and compatibility with risk capacity must be carried out.

- Supervisory and legal standards must be met at all times.
- The competent decision makers receive the required information completely and in real time, within the framework of a strategy process as well as risk reporting that has been set up.
- As a rule, the strategy process and all operating processes must be checked by Internal Audit.
- The risk strategy is reviewed on an annual basis and bit by bit further developed.

3.1.2 Counterparty risks

Counterparty risk is defined as the risk of partial or full default on the part of business partners in the performance of their contractual obligations.

Lending business

Our counterparty risk exposure in the lending business is managed with particular consideration being given to size-classification structure, creditworthiness, industrial sectors, the collateral that is provided and the commitment risk.

To avoid concentration of risks, the Sparkasse has additionally set strict ceilings on credit limits. Details are defined in the credit risk strategy.

The Board of Directors attaches great importance to risk limitation in its customer lending activities. This is reflected in the fact that the corporate objectives continue to focus on quality, i.e. the risk-sensitive granting of loans. If applicable, major risks are accepted with the approval of Credit Committee of the Sparkasse.

In the annual average 2016 the total amounts of receivables, broken down into claims categories (presented on the basis of the measuring fundamentals as per the standard basis for credit risk in accordance with Article 112 of the EU regulation no. 575/2013 (Capital Requirements Regulation) before credit risk reductions plus value adjustment and provisions), are as follows:

Overall amount of risk positions by risk position categories	Average result for the year in thousands of euros
Central governments or central banks	246,982
Regional or local area corporations	1,877,397
Public bodies	207,665
Multilateral development banks	50,102
International organisations	28,984
Institutions	948,063
Businesses	1,746,200
Retail business	1,507,656
Positions secured by real estate	1,157,534
Defaulted items	45,268
Items in the form of covered promissory notes	57,487
Investment funds (OGA-funds)	569,399
Other items	75,867
Total amount	8,518,604

The geographical distribution over main areas as per 31/12/2016 is as follows:

Main geographical areas	Germany €000	EEA €000	Miscellaneous €000
Central states or central banks	44,877	200,180	0
Regional or local area corporations	1,958,057	0	0
Public bodies	138,940	0	0
Multilateral development banks	0	50,102	0
International organisations	0	27,092	0
Institutions	552,183	271,730	17,529
Businesses	1,672,529	96,118	12,675
Retail business	1,424,790	102,944	5,048
Positions secured by real estate	1,126,345	16,903	2,478
Defaulted items	39,229	1,291	0
Items in the form of covered promissory notes	31,079	19,702	0
Investment funds (OGA-funds)	495,010	72,338	0
Other items	74,929	0	0
Total amount	7,557,968	858,400	37,730

The following overviews show the distribution of lending business as per 31/12/2016 over main sectors.

Overall amount of the risk positions by industries – banks and public sector	€000				
	Banks	Open investment assets incl. money market funds	Public sector	Non-profit organisations	Miscellaneous
Central states or central banks	19,159	0	225,898	0	0
Regional or local area corporations	0	0	1,956,669	1,388	0
Public bodies	109,401	0	11,183	12,063	6,293
Multilateral development banks	50,102	0	0	0	0
International organisations	0	0	6,000	0	21,092
Institutions	841,442	0	0	0	0
Items in the form of covered promissory notes	50,781	0	0	0	0
Investment funds (OGA-funds)	0	567,348	0	0	0
Other items	0	0	0	0	74,929
Total amount	1,070,885	567,348	2,199,750	13,451	102,314


Overall amount of risk positions by industries – industrial companies	€000			
	Agriculture and forestry, fisheries and aquaculture	Energy and water supply, waste management, mining and quarrying stones and earth	Manufacturing trade	Building trade
Businesses	2,503	87,397	152,837	20,632
Of which: SME	0	1,733	7,097	7,927
Retail business	5,161	12,964	49,809	56,185
Of which: SME	5,161	12,964	49,809	56,185
Positions secured by real estate	2,408	2,567	14,047	35,872
Of which: SME	2,408	1,439	14,047	35,872
Defaulted items	113	161	5,790	4,452
Total amount	10,185	103,089	222,483	117,141

Overall amount of risk positions by sector – Service providers and private individuals	€000						
	Non-profit organisations	Dealerships, maintenance and repairing of motor vehicles	Traffic, warehousing, message couriers	Financial and insurance service providers	Real estate and housing	Other service providers	Private individuals
Businesses	91,095	86,005	36,959	353,647	471,760	458,522	19,965
Of which: SME	2,507	11,993	4,012	0	14,286	14,582	0
Retail business	14,862	75,948	10,484	14,320	59,591	163,732	1,069,726
Of which: SME	14,862	75,948	10,484	14,320	59,591	163,732	0
Positions secured by real estate	420	35,805	4,909	10,278	83,949	95,939	859,530
Of which: SME	276	35,361	4,909	10,278	40,716	90,594	0
Defaulted items	11	2,469	381	97	4,672	3,745	18,629
Total amount	106,388	200,229	52,733	378,342	619,972	721,938	1,967,850

The breakdown into classifications according to size does not show any abnormalities. With a portion of 31.3 % of mostly smaller commitments with an exposure up to EUR 1 million.

The overview of claims categories at 31/12/2016 according to residual maturities shows that lending is mostly for the longer term:

Overall amount of risk positions by residual maturities	< 1 year and indefinite €000	1 year to 5 years €000	> 5 years €000
Central states or central banks	62,705	106,118	76,234
Regional or local area corporations	822,901	403,968	731,188
Public bodies	11,414	111,213	16,313
Multilateral development banks	20,043	9,950	20,109
International organisations	5,048	11,994	10,050
Institutions	235,695	460,260	145,487
Businesses	377,607	523,652	880,063
Retail business	527,103	137,709	867,970
Positions secured by real estate	55,238	89,460	1,001,028
Defaulted items	5,724	3,953	30,843
Items in the form of covered promissory notes	10,302	24,842	15,637
Investment funds (OGA-funds)	567,348	0	0
Other items	74,929	0	0
Total amount	2,776,057	1,883,119	3,794,922

The credit rating is of crucial importance for assessing counterparty risks in lending business. To manage credit risks in customer lending business, the Sparkasse uses the scoring and rating method of the  Financial Group.

For corporate customers, the quantitative assessment involves a system-based analysis of the annual accounts in conjunction with a mathematical / statistical rating model. The results are supplemented with an assessment of business performance, the ability to service loans as well as the quality and date of the figures furnished. In addition, qualitative factors such as management, market position, the range of products and services as well as the outlook for the sector are considered.

For assessing borrowers' creditworthiness, the Sparkasse uses other systems that are offered by the savings banks organisation (such as the EBIL application for analysing individual balance sheets).

Credit ratings are assessed by experienced credit analysts and corporate customer relationship managers.

In the case of private individuals, credit ratings are determined on the basis of their income and assets as well as their ability to repay loans on the basis of these findings. Information that is relevant for assessing creditworthiness is entered into an integrated scoring model.

If we are privy to information that points at impairment of economic circumstances, we proceed with extraordinary verification. Emerging credit risks that are identified by using effective early warning systems, trigger the reaction of taking intensive monitoring measures in the front and back offices.

Non-performing loans or those requiring restructuring are managed in back-office departments.

The rated customer lending volume is mostly classified in rating classes 1 to 5. The following overview shows the percentage distribution of our rating and scoring procedure:

Risk positions by risk category	€000	%
Risk categories 1 to 5	4,658,555	79
Risk categories 6 to 9	857,075	15
Risk categories 10 to 15	260,879	4
Risk categories 16 to 18	61,003	1
Not rated	64,150	1
Total amount	5,901,662	100%

In addition to the purely economic assessment of a customer's credit rating as such, risk classification in the customer lending business also takes account of the collateral that is available.

Lending commitments are also regularly checked for the eventuality that contingent reserves may need to be set aside. The level of the in individual cases required contingent reserves is, on the one hand, based on the probability

of the borrower not being able to honour his contractual obligations. The basis for that is the assessment of the economic circumstances and the payment history of the customer. On the other hand, the collateral is assessed against its probable realisation value, in order to estimate which payment could still be expected to be received after an event of default occurs. Valuation adjustments, setting aside of reserves and direct write-offs are decided on a case-by-case basis by the competent functionaries. Suitability of the applied measures and the emanating adjustments are checked on a regular basis. If the economic circumstances of the borrower sustainably improve and give evidence of the borrower being able to service his debt or if the loan is redeemed from the proceeds of collateral, the contingent reserve will be released. The setting aside, adjusting and releasing of contingent reserves is done at the Sparkasse in a central system. For latent default risks, the Sparkasse makes lump-sum value adjustments. Additionally, there are provisions for general banking risks, as stipulated in Article 340 f, Commercial Code.

Work instructions regulate the business processes in terms of contingent reserves and the approval process by competent functionaries.

During the year under review of 2016, contingent reserves developed as follows:

	Amount at start	Additions	Releases	Utilisation	Amount at end
	€000	€000	€000	€000	€000
Specific provisions incl. interest adjustment items	23,570	3,058	4,808	3,322	18,498
Provisions sureties and credit basket	1,620	178	956		842
General provisions	8,616		972		7,644

The Board of Directors has defined a risk strategy on the basis of a risk analysis. It is advised every quarter about the development of counterparty risks and adherence to the strategy and it informs the Supervisory Board. The risk report breaks down the portfolio by creditworthiness resp. rating classes, sectors, size classes and risk-exposed volumes. Possible concentrations of risks can be recognised at an early stage that way. Together with the other systems used, this report forms the basis for decision-making

processes in the lending business and enables the credit portfolio to be evaluated and managed. In addition, the counterparty risk is quantified for present values using a simulation technique that also takes into account concentrations of risk. Those results are used in the risk acceptability calculation. The risk premiums that are calculated on the basis of internal rating and availability of collateral serve the setting of risk-adjusted conditions.

To a limited extent derivative hedging instruments are used within the savings banks organisation, for the purpose of risk diversification: hitherto, the Sparkasse participated in altogether eleven credit basket transactions.

At the moment, there is no evidence of any exceptional risk exposure in our credit portfolio on account of its structure and diversification. Within the framework of the annual analyses, risk concentrations in the sectors “financial institutions” and “real estate and housing” and “financial and insurance services” are identified. Those sectors are taken into account within the framework of regular reporting and simulation calculations for stress tests.

The contingent reserve limit for counterparty risks in the business year 2016 has been reduced from 12.9 million EUR to 5.0 million EUR (in the prior year from 14.2 million EUR to 3.0 million EUR) and has been utilised at 0 % as compared to the reduced limit. Against the background of the findings from the creditworthiness assessment systems and of the limit utilization, we see the development of our risk classification structure in the lending business as very favourable.

Commercial transactions

In order to limit counterparty risk in trading, there are limits for every counterparty (as issuer and as transaction counterparty). Additionally, there are group limits for various types of exposures. The risks are limited by carefully selecting our counterparties, after thoroughly testing their creditworthiness. Fundamentally, we only accept counterparties with investment grade ratings. Limit utilisation is monitored by the Controlling and Risk Management Department.

On balance-sheet date, the total volume of trading transactions stood at EUR 2,314.6 million. Essential items are the bonds and promissory notes (EUR 1,336.2 million) and the special and public funds (EUR 579 million). It is broken down as follows, in terms of ratings:

External rating (Standard and Poor's, Fitch)	2016 %	2015 %
AAA to A-	79.6	86.0
BBB	18.2	11.8
BB+ to C	0	0
D	0	0
Not rated	2.2	2.2

97.8 % of the securities held by the Sparkasse are of investment grade area.

To calculate the counterparty risk, use the default probabilities as reference that underlie the current rating classifications, with a reduction of the rating grade of the respective trading partners by one level being assumed.

The effects on results for the period from identified risk concentrations in the financial institutions sector and from defaults of trading partners are simulated within the framework of the stress tests. In value-oriented observation, a stress test is carried out on the basis of assumed negative economic development. Monte-Carlo simulation is used for this.

During entire fiscal 2016, counterparty risk from trading activities remained within the limits that were set within the framework of risk capacity. In view of the concerned volumes, sovereign risk is considered to be low.

Equity investments

The risk of financial loss on account of impairments in the participations portfolio is designated as participation risk. Apart from the risk of potential loss of value, there is the risk of the investment returning low or no interest income. There could also be the risk of being liable under the profit transfer agreement with the subsidiary company **ProFinanz**.

The participations of the Sparkasse in parties within the savings banks association are essentially strategic participations. They are specifically meant to strengthen the financial savings banks association and the expanding of sales channels for the products of the members of the association. The participations in the association are meant to support the business purpose of the Sparkasse in the long term. In part, the participation are also held indirectly through the Savings Bank Association Saar.

Including shares in related companies, the total volume of the participations portfolio is EUR 46.5 million (book value) and is thereby 0.4 % higher than the value for the previous year.

The Sparkasse has laid down targets and framework conditions in the business and risk strategy. The participation risk are included at appropriate levels in the risk capacity concept of the Sparkasse. The participations are controlled by the Business Administration Department. The participation risk is determined through the standard rating mechanism of the Sparkasse, with complementary reference to the classification of external rating agencies (S&P). The participation risks are also presented through stress scenarios. The control and monitoring systems ensure that the Sparkasse is adequately informed about the situation in individual participations.

Reporting

We meet the necessity of suitable and real-time reporting on counterparty risks and present every quarter a risk report on counterparty risk to the Board of Directors and the Supervisory Board. Together with the other systems that we use, this report provides the basis for our decision-making processes in the lending business and enables us to be evaluate and manage the credit portfolio. It contains the following presentation and possibly required comments

- the structuring of the portfolio according to classification for size, risk, collateral security, country risks and sectors, with particular attention to risk concentration,
- Large loans and other commitments of essential importance,
- significant exceeding of limits and the reasons for it having happened,
- the development of new business,
- the development of contingent reserves,
- significant credit decisions, if they deviate from our risk strategy or that have been approved by the Board of Directors within the framework of its competency to decide on individual cases, but where the decision was not unanimous,
- the level of the participation risk,
- actual information on significant participations,
- choices for action by the decision-makers.

3.1.3 Market price risks

The Sparkasse does not engage in proprietary trading and does not maintain proprietary trading book positions. Market price risks are defined as potential losses of income as a result of changes in the market prices of securities and foreign exchange, fluctuations in interest rates and prices as well as any resultant changes in the market value of derivatives.

Market rate risks from trading transactions of the trading and investment books

The Controlling and Risk Management Department does every day retrieve current market rates and possible changes in market rates for the purpose of marking trading transactions to market, so that the values of the transactions may be compared to the limits that have been derived from the risk capacity concept. Possible negative changes in market rates for trading transactions are measured by means of scenario analyses and a value-at-risk method. An escalation procedure is triggered at a specific limit stress.

Value-at-risk for trading transactions is determined on the basis or historical simulation with a duration of ten days, a confidence level of 95 % and a historical observation period of 500 days. The quality of the risk model is verified through regular back-testing and the parameters are adjusted, when necessary.

The following overview shows market rate risks on the basis of value-at-risk, compared to the previous year:

Market rate risks	31/12/2016	31/12/2015
in millions of Euros		
Rate risks from interest-bearing positions	2.9	3.8
Foreign exchange rate risks	0	0
Share price risks	0.2	0.4
Other price risks	7.1	4.7

During the observed fiscal year, value-at-risk was between EUR 8.4 million and EUR 10.6 million.

In 2016, market rate risks remained at all times within the value-oriented limits system as specified by the Board of Directors. At year-end 2016, the risk limit for trading transactions had been utilised for EUR 30 million (previous year EUR 30 million) or 30.7 %.

Limit utilisation of the risk budget for trading transactions in periodic view fluctuated in 2016 between 17 % and 80 %. At year end, limit utilisation was 64 %.

The quarterly executed stress tests did not produce any events that could be classified as threatening continued existence. The early-warning and escalation procedures make it possible to mitigate possible risks at an early stage.

Exchange rate risks are of only minor importance for Sparkasse Saarbrücken. Open positions are generally closed through matching transactions and / or derivatives (e.g. forward foreign exchange transactions).

The following data and / or records are presented by Risk Management to the Board of Directors on a weekly basis in the risk report on trading transactions, as risk information.

- Market price risks in the investment book
- Risk and results development of the individual portfolios of trading transactions
- Significant limit excesses

Rate change risk for the institution as a whole

Sparkasse Saarbrücken knowingly accepts interest rate risk with the aim of deriving additional income from maturity differentials. The interest rate risk is controlled value-orientedly and regularly monitored in respect to compliance with the periodic and value-oriented targets of the business and risk strategy.

The basis for managing interest rate risk is the overall cash flow that encompasses all interest-bearing transactions. On- and off-balance-sheet products and positions that react to changes in market rates are accordingly taken into account. As a rule, the contractual agreements and the fixed rates of the positions resp. products are taken into the equation. For floating rate products that have neither fixed interest rates nor fixed capital amounts (open-ended deposits), fictitious maturities according to the moving averages model are used as basis. Effects from the use of implicit options, that present the estimated exercising behaviour, are taken into account through a correctional cash flow.

Determining rate change risk in the periodic view for the entire institution is done with the help of simulations calculations on the basis of various scenarios. For developing the volumes, a scenario that is based on expected business development is used. The effect of possible interest rate development on the interest margin are simulated by means of various interest rate scenarios. Apart from an assumed constant development of interest rates, the development of the interest margin under a interest rate scenario and a risk scenario that is expected by the Sparkasse is investigated. The results of the calculations are reported to the Board of Directors on a quarterly basis. Therefore, in the face of impending impairment of the earnings position it may be possible to implement mitigating measures in good time.

The interest rate expectation scenario shows that in coming years narrowing of the interest margin must be expected. However, for all years that have been observed, the interest margin is sufficient for continuing to show possible results for the year.

The value-oriented quantification of the rate change risk is done by means of the value-at-risk risk measure. A confidence level of 95 %, a duration of three months and an observation period from 1988 till 2015 are used as basis. A benchmark that is identified as being efficient is used as reference value. The following overview shows the rate change risks (value-oriented) on the basis of value-at-risk, compared to the previous year.

	VaR Minimum 2016	VaR Maximum 2016	VaR 31/12/2016	VaR 31/12/2015
in millions of Euros				
Interest rate change risks	25.3	36.2	31.1	39.8

Occasionally, lower risk positions than the intended deviation from the benchmark are used and approved by the Board of Directors.

The stress tests that are quarterly carried out for extraordinary market developments did not reveal any threats to the continuity of the Sparkasse under any scenarios. Basis for the stress tests are extreme changes to interest rates that have occurred in the past and hypothetical changes in yield curves.

Within the framework of the overall management of the Bank, derivative financial instruments in the form of interest rate swaps (nominal amount EUR 1,570 million) and bond futures are used alongside on-balance-sheet instruments for the purpose of fine-tuning and hedging rate change risks. Revaluing the interest rate swaps is being dispensed with, because they serve the overall management of the interest rate change risk and are included in the lossless evaluation.

The following data and / or records are presented by the Controlling and Risk Management Department to the Board of Directors on a weekly, resp. quarterly basis:

- Changing in the basic assumptions or parameters
- Scenario calculations for the earnings position
- Development of the interest margin risk
- Development of the present value interest rate change risks
- Development of the interest rate risk coefficients
- Limit excesses
- Stress test results


3.1.4 Liquidity risks

Liquidity risk in the narrower sense of the word is understood to be risk of not being able to meet one's financial obligations at the time that they are due (maturities on their due dates and call and notice demands). The risk of not being able to enter the market at all or only on unfavourable terms in the event of insufficient market liquidity (market liquidity risk) is also included under liquidity risk. Refinancing risk is the danger that required subsequent financing and / or additional refinancing means cannot be acquired or only at higher cost. Liquidity risk is managed within the framework of risk management and risk control.

The liquidity risk is averted by ensuring that sufficient liquidity is available and that assets and liabilities are structured responsibly. The liquidity status and the various liquidity overviews are used as basis for planning and managing the liquidity of the Sparkasse. The actual liquidity status is measured every day by the Cash Management and Trading Department and is used for managing the liquidity on a day-to-day basis. Short-term and medium-term liquidity is monitored and managed with the aid of several calculation tools. Long-term liquidity is monitored with the aid of maturity analyses, the liquidity status and the survival period by using the FI application SDis-OSPlus.

In the planning (hypothetical and historical stress scenarios) unplanned developments, such as premature notice, is taken into consideration. The Sparkasse has no investments in markets with poor liquidity. It is continuously being verified to which extent the Sparkasse will be able to satisfy its own liquidity requirements. Courses of action for situations with impending low liquidity and for an emergency plan for a situation of actual illiquidity have been defined in the "Emergency plan for managing liquidity risk".

For measuring and limiting the liquidity reserve, the Sparkasse follows the requirements of Article 11, KWG (Kreditwesengesetz [Banking Act]), in conjunction with the Liquidity Ordinance, the Capital Requirements Regulation (CRR) and the MaRisk. Refinancing risk is quantified on the basis of an assumed reduction in customer deposits that must be refinanced at higher cost in the capital market. Treasury Division reports regularly to the Board of Directors on the liquidity situation.

As shown in the liquidity indicators in the section on the financial position, the Sparkasse enjoys a strong overall liquidity position. Determinant is our stock of highly liquid securities, the ability to borrow short-term money at the Deutsche Bundesbank and from numerous trading partners within and outside the  Financial Group. Additional, credit balances are maintained at the Deutsche Bundesbank within the framework of the minimum reserve requirements.

The good liquidity situation during the year under review is reflected in the better than required supervisory indicators (Liquidity Ordinance, LCR, Survival Period) and the high level of available refinancing credit limits.

The stress tests that are carried out for extraordinary market developments show that the Sparkasse also has sufficient liquidity under the assumption of historical and hypothetical stress scenarios. Starting from normal case simulations, the following assumptions are applied.

Historical scenario

"The banking industry suffers from serious loss of confidence throughout the world, which was shown in its worst form during the financial crisis of April 2008. The banks no longer lent fixed deposits. Financial balancing is now only happening in a limited way within banking groups, such as the Sparkassen - Financial Group. Securities trading is now only possible in sovereign bonds. Therefore, in our stress scenario we assume that only sovereign bonds are available as means of payments and that only the savings banks sector will lend to us. The ECB continues to be active as manager of the financial system."

Hypothetical scenario

"The five largest non-bank depositors are withdrawing their deposits. Moreover, our limits at trading partners are reduced by 30 % and none of the securities portfolio can be liquidated. It assumed massive failure of the money and capital markets. Transactions with the ECB remain possible, because to central bank must attempt to maintain the functionality of the financial system."

Additionally, the Sparkasse calculates survival periods that indicate the period that outflows of cash and cash items are covered by inflows of cash and cash items. According to that, a surplus of cash and cash items will be available during at least 36 months (as at 31/12/2016), even under severe refinancing circumstances.

The Board of Directors is provided with information on a quarterly basis through an overall risk report with the following scope:

- Liquidity utilisation under normal circumstances (inflows and outflows of cash and cash items)
- Results of the scenario analyses and stress tests (short-term liquidity planning, liquidity coverage figures and survival period)

If utilisation of unencumbered cash and cash items exceeds a specified threshold, the Board of Directors will be informed on an ad hoc basis and will from then onward receive a report on a daily basis.

3.1.5 Operational risks

The Sparkasse defines operational risks the danger of as losses that occur as a result of the inadequacy or failure of internal procedures, staff, internal infrastructure or external factors. The Board of Directors is responsible for adequately dealing with operational risks, which is in this regard charged with the task of laying down, regularly verifying and securing the framework conditions for dealing with operational risks.

At the Sparkasse, operational risks are identified and documented on an annual basis, based on ex ante observations. Events of damage that have occurred are then captured in a database. The rules and/or processes that are installed for managing operational risks particularly include the internal control system, written rules governing the organisational structure and essential processes, the use of qualified staff as well as ongoing further development of methods and enhancements of the technical processes. Operational risks in the IT field or due to organisational or processing errors are minimised by agreements with an external computer centre, precautions for emergency situations, growing automation and on-going supervision carried out by qualified staff, and are covered in part by insurance. Legal risks are averted by means of careful examination of contracts and the use of standard form contracts.

Moreover, the Sparkasse makes use of the instruments "Risk map" and "Damage case database" that have been developed by the DSGV in the project "Operational risks". Apart from identifying operational risks, the "Risk map" is used for analysing potential losses that could be of relevance to risk (ex ante observation). In the "Damage case database", actual damage with a value of EUR 1,000 and higher that has occurred through operational risks is captured (ex post observation).

The scope of operational risks is considered to be manageable.

In the case of extraordinary events, stress tests are carried out on the basis of the damage that has occurred. It will not threaten continuity.

Risk information is provided annually by risk control to the Board of Directors, internal audit, the risk control manager and the compliance manager by means of the reports “Operational risks”, “Damage case database” and “Risk map”, with the following scope:

- Summary of occurred damage cases,
- Determined risks,
- Measures that have been taken

Additionally, in important cases, there is quarterly and ad hoc reporting (nature, extent and cause). Additional, early warning indicators have been defined, so that counter-measures can be taken at an early stage.

3.1.6 Summary risk assessment

Our bank has established an adequate risk management, monitoring and control system in accordance with Article 25a, Banking Act, that is appropriate in the light of the nature and scope of its business activities. The risk management and monitoring system enables risks to be identified at an early stage, information forwarded to the responsible decision-makers and risks averted. Risks are determined as periodic views until the next balance-sheet date and from the middle of the year onward also for the following year. The risk resistance during the business year was at no time at risk. On balance-sheet date, utilisation of the value-oriented risk coverage potential stood at 18.21 %. The risk capacity calculation that has been carried out in the periodic view from the middle of the year onward for the following year does not show any impairments either. The stress tests that are carried out have the objective of deriving measures and recommendations for action at an early stage, when extraordinary market circumstances prevail. Calculations for quantifying the expected capital requirement of the basis of the increasing capital adequacy requirements under Basel III show that the demanded minimum capital ratios could be met. The total capital ratio as of 31/12/2016 was 12.76 %, and the hard capital ratio 11.32 %. No risk concentrations are apparent that could threaten continuity.

As mentioned in Paragraph 1.1, Sparkasse Saarbrücken and Stadtparkasse Völklingen amalgamated as per 01/01/2017. In view of the business volume to be taken over and the similarity in the business and risk structures, there is no significant impact on the risk position of the merged institute. Given its existing risk management system, the Sparkasse sees itself to be well positioned to handle existing business and to master the challenges of the future.

3.2 Opportunities report

The Sparkasse analyses continuously trends and changes in the market place. In that regard, the staff in the market and complaints handling play a central role. They continuously receive market information in respect of required products and possible trends, in direct exchanges with our customers and partners. The information is summarised in appropriate form and assessed. The objective is the enhancement of existing products and processes and the developing of sales opportunities for our strategic business fields.

Divisions and departments are involved in the strategy process with responsibility for planning. The Senior Control Committee is responsible for overall coordination. The reporting to the Board of Directors on the opportunities that are derived from the strategy builds upon the results of the strategic planning. Our staff are informed about the potential opportunities within the framework of communicating the business strategy. The Senior Control Committee monitors achievement of targets through a quarterly reporting process on the basis of should / actual comparisons.

Strategic opportunities

When demand from abroad will be increasing again, we see opportunities for the economy in our catchment area to pick up again, especially in the automotive industry.

In the regional banking market, adjustment measures of some competing banks – prompted by pressure from costs and regulatory requirements – are leading to withdrawal from business fields that are important to the Sparkasse. This offers the opportunity of gaining new customers.

Because of the continuous strengthening of our capital base in past years, we see ourselves as well prepared for the quantitatively and qualitatively increasing capital requirements.


The rising volatility on the bourses give opportunities for higher transaction volumes with customers and for attracting more deposits. Of significant influence is the volatility on the bourses resp. of individual securities, for high volatility often leads to higher trading volumes, while stable market indices tend to dampen customer interest as there will be fewer opportunities for profitable trading. Furthermore, a positive market environment makes investments more attractive, increases funds received by our customers and keeps the value of our proprietary portfolios growing at a steady rate.

A precondition for increasing our market share, in private customer business as well as corporate business, is the targeted expansion of marketing our products and services. One objective will be increasing customer satisfaction, in order to tie them more close to the Sparkasse, and reaching out in a targeted fashion to new customers, because continuous growth of the customer base with consciously accepting risks is a fundamental condition for enhancing the success of our business. Apart from the expected, improved contributions to the results from off-balance-sheet securities business, especially expansion of association and mediation business is seen as a possibility for broadening our earnings basis.

We expect to see opportunities emanating from our investments in future-oriented information technologies. Looking ahead over the next few years, we consider our key tasks to be the enhancing of our existing management tools in order to implement integrated bank management, the risk-adjusted pricing of transactions and measures to heighten the security and user-friendliness of the internet experience for our customers. In order to further intensify customer loyalty and to promote cooperation as partners within the Sparkasse Financial Group, suitable technical solutions will be required that permit the linking of business processes throughout the business organisation and that will give us full view of the customers, so that in future we may be able to offer, together with our partners, "One-stop financial shopping". Through-processing without having to change media will provide lean, total processing.

The end-to-end integration of media distribution channels such as online banking and the internet on the one hand, and over-the-counter branch-based selling on the other, will help us to serve our customers in line with their requirements and offer them what they are specifically seeking.

In private customer business it is our mission to become the No. 1 in the region in terms of market share and quality for service and consultation as well as for products and processes. We ensure area-comprehensive supply with financial products and thus want to be financial partners for all people in the region. At the retail banking level, we are increasingly making use of digital processes. Consultants should become customer relationship managers, who may also engage specialists in case of complicated products.

In corporate customer business it is one of our aims to achieve good market penetration in corporate successions in the future. This is concretely on offer through  Pilot and the SaarLorLux corporate fair. We are active throughout Germany in the project "ICON – innovative content for corporate succession". In order to secure the market of the future "Crowd investing", our new affiliate company "Deutsche Crowdinvest GmbH" will be established in the spring of 2017 and will be used to mediate in credits and capital investments through the internet. With offers such as the BusinessLine, we want to continue to intensify contact with corporate and business customers and thus deal with their needs even more intensely.

The Bank already has a broad range of acknowledged financial products covering a large part of the regional market. We especially wish to exploit opportunities by expanding some business fields with additional products and services, in future. Our product strategy is aimed at achieving a meaningful presence in all economically viable market segments. Furthermore, through deeper intensification of sharing the work load with our partners in the savings banks association, we see the possibility of meeting strong competition and continued high pressure on profitability head on.

3.3 Outlook

The prognoses present our assessments of the most likely future developments on the basis of the information that was available to us at the time of drawing up the management report. The target values that are expected from us are compared in Section 2 with the values of the year under review. As forecasts invariably involve uncertainty or may be rendered void by changes in the underlying assumptions, it should be noted that actual events may differ from those values projected at this stage if the underlying assumptions fail to eventuate. The profitability of the banking sector is persistently under pressure because of increasing regulatory requirements (Basle III, European banking levy, deposit insurance, etc.). The period of low interest rates that has now lasted for several years, makes it increasingly difficult for financial institutions to achieve the necessary earnings.

Framework conditions for the German economy

Price development in Germany may well be similar to the development in the Eurozone as a whole. Structurally, price increases over the next few years could be higher in Germany than the average of the Eurozone. Meanwhile, capacity utilisation in Germany has been exceeding normal levels somewhat. Moreover, in this country the labour market is much broader. The constellation could lead to upward pressure on wages at a faster pace than in those countries, where unemployment is still higher and where competitiveness must first be restored.

The chief economists of the Sparkassen Financial Group are assuming for 2017 continued slightly increasing gainful employment in Germany and continued slowly falling unemployment levels. For 2017, they expect a rise in real GDP of around 1.3 %. That value fits in with other pertinent current prognoses that lie within a similar framework.

According to the prognosis of the chief economists, the growth should once again be supported exclusively by domestic economic activity. The correction in the foreign trade surplus will be sustained. In this scenario, exports could actually increase in real terms by around 1.9 %, regardless of the risks to the world economy. But, at 3.0 %, growth in imports is estimated at a higher level.

In terms of domestic demand, the contribution of consumption to growth might be a little weaker than in the previous year, because special factors that applied in 2016 do meanwhile no longer apply and/or might actually now reverse. For example, the purchasing power of private households no longer benefits from further falls in their energy bills. Nonetheless, private consumption is expected to increase by around 1.4%, in real terms. Consumption by the authorities will no longer be driven so much by the arrival of refugees, but will nevertheless again rise, at 2.4 %, by more than GDP.

Construction investments may still be mainly in the field of building residential properties. In terms of investments in equipment, the chief economists estimate on average 1.6 %, with risks and opportunities. Within a framework of stable development and growing optimism and still very low interest rates, a stronger development would also be imaginable. On the other hand, new political shocks or protectionist threats being turned into reality, would first and foremost have negative consequences for investment activities.

Within the planning framework for 2017, the Sparkasse does not foresee major changes in the financial market indicators. The interest rates are expected to remain at a historically low level, though may rise a little “in the longer periods.”

The Sparkasse faces the challenge of responding to dynamic, competitive conditions. This includes the continued intensification of competition amongst financial institutions as well as growing demands from our customers, consumer protection and banking supervision. Since the crisis in the financial markets in 2008, statutory requirements have not stopped rising. Complaints with the requirements of the Basle Committee for banking supervision with its increasing tying up of technical and personnel resources also further restrict our freedom of action.

Expected development of the Sparkasse

Against the background of the presented prognoses that are specific for the sector, we expect falls in net interest income for fiscal 2017 and 2018, which may currently be compensated by a rise in fee income. In terms of total footings, we expect to see growth that will not only be the result of the amalgamation with Stadtparkasse Völklingen as per 01/01/2017, but will also be based on growth of volumes in customer business.

We expect to see moderate growth in commercial lending business, spurred for the most part by companies seeking to finance their new and replacement capital expenditure. On the basis of the employment and income situations, we also see favourable preconditions for moderate increases in consumption and corresponding willingness to incur debts. The financing of building, acquisition and renovation of residential properties will continue to have its important place in our lending business. In spite of increasing efforts to achieve consolidation, the public purse will continue to be an important group of customers for the lending business of the Sparkasse.

The volume of deposits from customers was during the first months characterised by inflows of public funds, although deposits from private individuals and companies remained relatively stable respectively fell slightly. For 2017 as a whole, we expect to see constant to volumes.

The implemented and already announced measures of the ECB indicate a sideways movement on the money and capital markets, in terms of interest rates. This continues to keep pressure on the interest margin. We expect consistent income from the fund investments and reducing expenses from the collateral transactions of the money book. All in all, the expected interest surplus is expected to reduce.

Resulting from the expansive money policy of the ECB and – connected to this – the low market interests, we see further increase potential for the share indices in 2018.

For reasons of caution, we expect, as last year, only little earnings from association participations and have left them out of the equation for the purpose of prognosticating earnings. It cannot be excluded that further write-offs resp. setting aside of reserves may be necessary in connection with our association participations.

For 2017, we expect a rising fee income of about EUR 29 million. We expect that not only margins, but also prices for services will come under pressure for some time to come. Apart from the expected, slightly increasing contributions to the results from off-balance-sheet securities business, especially expansion of association and mediation business is seen as a possibility for broadening our earnings basis. We expect similar results for fees in 2018.

By implementing systematic cost management, the Sparkasse will attempt to keep the forecast increase in operating expenditure in check. As staffing costs will tend to rise on account of future wage and salary settlements, those costs are to be kept within reasonable limits through strict staff management. We are planning to spend on information technologies and products offering potential for the future, as a basis for expanding our market share. Through its connection with the Finanz-Automatik that is active throughout the federal republic, the Sparkasse is well placed for meeting those challenges. Expenditure in connection with data processing will rise during the coming years, particularly due to continually increasing supervisory-law requirements.

In our budget accounts for 2017, we are looking initially at the anticipated revaluation results as shown in the simulation run through our credit risk model. We expect the danger of high, negative revaluation results for securities to be low, because we do not expect interest rates to rise significantly in the near term.

Compliance with the statutory specifications is ensured for 2017, also under the increased requirements to quality and quantity in terms of capital adequacy under Basle III.

A comparison between individual expense and income items according to the assignment criteria of the operating comparison as of 31/12/2016 regarding the corresponding forecast values for the key date of 31/03/2016 and a forecast for the year of 2017 (as of 31/03/2017) is reflected in the following table:

	31/12/2016 €million	Prognosis 2016 as at 31/03/2016 €million	Deviation €million	Prognosis 2017 as at 31/03/2017 €million
Interest surplus	129.1	126.8	+2.3	125.2
Net commission income	27.3	27.0	+0.3	29.3
Proper expenses	106.2	108.4	-2.2	114.4
Result before provisioning	51.8	46.9	+4.9	41.7
Net provisioning result	-9.5	-19.6	+10.1	-13.4
Result after provisioning	20.4	27.3	-6.9	20.8

Overall statement

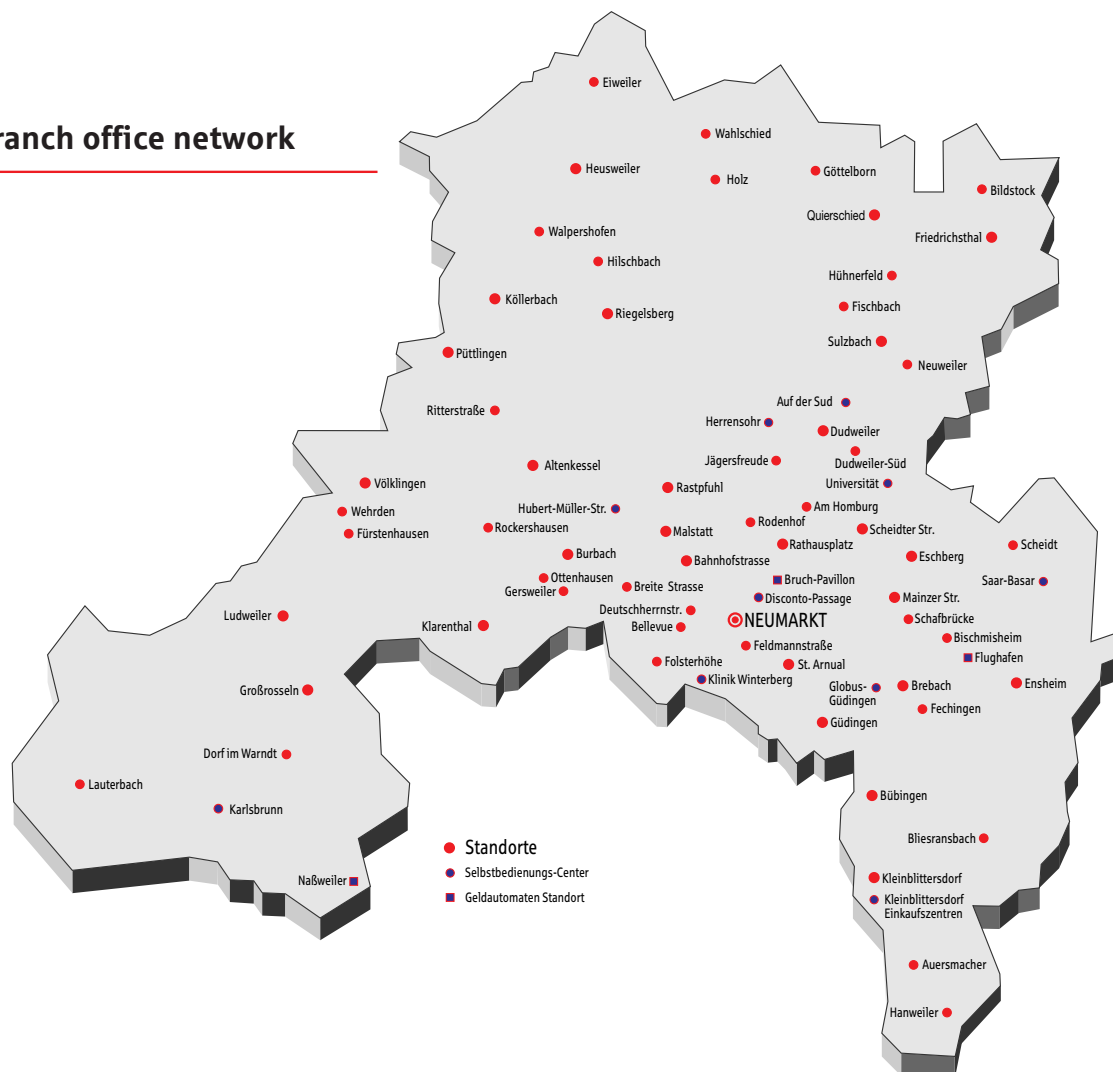
As far as we can forecast at this stage, we expect a slightly improving economic performance, with also for the following year a steady development of the business. It can be assumed that the operating result will reduce due to the reducing interest surplus caused by lower margins, in particular in the deposit-taking business. The cause for this is the continued low interest level. From our good market position, however, we expect that we will be able to profit of a positive economic development and achieve a satisfactory annual result for the business year of 2017. Thus, the necessary development of equity can be continued.

On the basis of our anticipatory financial projections, we assume that we will remain solvent at all times during the forecast period of 2017 and 2018. Deviating negative developments in terms of risk are covered by the existing risk capacity.

Saarbrücken, May 2017

Sparkasse Saarbrücken
– The Board of Directors –

B Branch office network



The Board of Directors

Hans-Werner Sander
Chairman

Uwe Kuntz
Deputy Chairman

Uwe Johmann
Board Member

Frank Saar
Board Member

Commercial register

Saarbrücken, A 8590

Sparkasse Saarbrücken is a member of Sparkassenverband Saar (Saarland Savings Banks Association) and as such is affiliated with Deutscher Sparkassen und Giroverband e.V., Berlin/Bonn. The shareholder is Sparkassenzweckverband Saarbrücken, of which the Saarbrücken Regional Association and the City of Saarbrücken are members.

The Supervisory Board of Sparkasse Saarbrücken

Chairperson of the Board of Administrators

Peter Gillo
Regional Union Director
until 30/04/2016

Charlotte Britz
Mayor
from 01/05/2016

Further members:

Dr. Gerhard Bauer, Peter Bauer, Roland Bentz, Karin Bernhard, Pia-Maria Blankenburg, Berthold David, Winfried Jung, Günther Karcher, Timo Lehberger, Thomas Linnemann-Emden, Klaus Meiser, Norbert Moy, Volker Schmidt, Frank Schuler, Jörg Schwindling, Peter Strobel, Karlheinz Wiesen, Rainer Ziebold

Deputy Chairman of the Board of Administrators

Charlotte Britz
Mayor
until 30/04/2016

Peter Gillo
Regional Union Director
from 01/05/2016

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C A-class correspondent banks

France	Banque Fédérative du Crédit Mutuel	Paris	CMCI	FR	PA
Japan	Sumitomo Mitsui Banking Corporation	Tokyo	SMBC	JP	JT
Switzerland	Bank CIC (Schweiz AG)	Basle	CIAL	CH	BB
United States	The Bank of New York Mellon	New York	IRVT	US	3N
Germany	Commerzbank AG	Frankfurt am Main	COBA	DE	FF
Germany	Landesbank Baden-Württemberg	Stuttgart	SOLA	DE	ST
Germany	Landesbank Hessen-Thüringen	Frankfurt am Main.....	HELA	DE	FF
Germany	Landesbank Saar.....	Saarbrücken	SALA	DE	55

D Balance sheet as of 31 December 2016

		EUR	EUR	EUR	31. 12. 2015 €000	
Assets	1. Cash reserve					
	a) Cash and cash items		42,044,577.27		46,062	
	b) Balances held with Deutsche Bundesbank		19,791,226.90		28,539	
				61,835,804.17		74,601
	2. Public-sector bonds and bills of exchange approved for discounting at the Deutsche Bundesbank					
	a) Treasury bills and non-interest bearing treasury notes and similar public-sector bonds		0.00			0
	b) Bills of exchange		0.00			0
				0.00		0
	3. Loans to banks					
	a) Due daily		10,652,003.54			7,944
	b) Other loans		128,158,607.82			108,483
				138,810,611.36		116,427
	4. Loans to customers			4,663,383,969.65		4,346,541
	Of which:					
	secured by mortgages	EUR 1,563,411,950.07				(1,485,613)
	Local authority lending	EUR 1,290,015,528.51				(1,269,097)
	5. Bonds and other fixed income securities					
	a) Money market securities					
	aa) from public issuers		0.00			0
	of which: eligible as collateral at the Deutsche Bundesbank	EUR 0.00				(0)
	ab) From other issuers		0.00			0
of which: eligible as collateral at the Deutsche Bundesbank	EUR 0.00				(0)	
			0.00		0	
b) Debentures and bonds						
ba) From public issuers		507,118,785.75			507,277	
of which: eligible as collateral at the Deutsche Bundesbank	EUR 507,118,785.75				(507,277)	
bb) From other issuers		893,217,010.24			1,146,454	
of which: eligible as collateral at the Deutsche Bundesbank	EUR 797,015,888.96				(1,061,296)	
			1,400,335,795.99		1,653,730	
c) Own bonds			0.00		0	
Nominal amount	EUR 0.00				(0)	
			1,400,335,795.99		1,653,730	
6. Shares and other non-fixed-income securities			586,362,272.51		548,030	
6a) Trade account			0.00		0	
7. Equity investments			46,317,814.55		46,133	
Of which:						
in financial institutions	EUR 0.00				(0)	
in financial services companies	EUR 2,201,012.92				(2,201)	
8. Shares in affiliated companies			148,000.00		148	
Of which:						
in financial institutions	EUR 0.00				(0)	
in financial services companies	EUR 0.00				(0)	
9. Trustee assets			299,061.05		331	
Of which: Fiduciary credits	EUR 299,061.05				(331)	
10. Compensation claims from public-sector bodies including bonds from their exchange			0.00		0	
11. Intangible assets						
a) Self-created trade property rights and similar rights and values		0.00			0	
b) concessions, trade property rights and similar rights and values, as well as licences for such rights and values, acquired against payment		195,803.00			339	
c) Goodwill		0.00			0	
d) Performed down payments		0.00			0	
			195,803.00		339	
12. Tangible assets			25,280,988.24		26,318	
13. Other assets			6,387,400.09		9,212	
14. Deferred income			754,581.00		355	
15. Active deferred taxes			0.00		0	
16. Pro rata balance from off-setting assets			0.00		0	
Total assets			6,930,112,101.61		6,822,165	

Liabilities

	EUR	EUR	EUR	31. 12. 2015 €000
1. Liabilities to financial institutions				
a) Due daily		416,561,291.36		589,936
b) With agreed maturity date or notice period		1,781,197,566.33		1,350,138
			2,197,758,857.69	1,940,073
2. Liabilities to customers				
a) Savings deposits				
aa) With agreed period of notice of three months	2,131,183,187.40			2,171,430
ab) With agreed period of notice of more than three months	17,663,532.62			21,685
		2,148,846,720.02		2,193,115
b) Other liabilities				
ba) Due daily	1,727,378,304.06			1,499,782
bb) With agreed term or period of notice	258,652,371.02			659,944
		1,986,030,675.08		2,159,725
			4,134,877,395.10	4,352,840
3. Securitised liabilities				
a) Bonds issued		64,829,094.40		70,836
b) Other securitised liabilities		0.00		0
Of which:				
Money market paper	EUR 0.00			(0)
own acceptances and sole bills of exchange in circulation	EUR 0.00			(0)
			64,829,094.40	70,836
3a) Trade account			0.00	0
4. Trustee liabilities			299,061.05	331
Of which: Fiduciary credits	EUR 299,061.05			(331)
5. Other liabilities			4,806,647.04	4,237
6. Deferred income			485,535.43	738
7. Provisions				
a) Provisions for pensions and similar commitments		12,304,762.00		12,181
b) Tax reserves		97,027.00		1,243
c) Other reserves		16,286,923.38		19,088
			28,688,712.38	32,512
8. (ceased)				
9. Subordinated liabilities			33,474,094.89	33,474
10. Participatory capital			0.00	0
of which: maturing within two years	EUR 0.00			(0)
11. Fund for general banking risks			174,600,000.00	105,000
Of which: Extraordinary items as per Article 340 e, Paragraph 4, Commercial Code	EUR 0.00			(0)
12. Equity capital				
a) Subscribed capital		0.00		0
b) Capital reserves		0.00		0
c) Revenue reserves				
ca) Contingency reserve	280,416,390.97			273,588
cb) Other reserves	0.00			0
		280,416,390.97		273,588
d) Unappropriated surplus		9,876,312.66		8,536
			290,292,703.63	282,124
Total of liabilities			6,930,112,101.61	6,822,165
1. Contingent liabilities				
a) Contingent liabilities from passed-on settled bills of exchange		0.00		0
b) Liabilities from sureties and guarantee contracts		151,468,442.79		135,410
c) Liability from the provision of collateral for third-party liabilities		3,933,177.30		3,213
			155,401,620.09	138,622
2. Other obligations				
a) Commitments deriving from sales with an option to repurchase		0.00		0
b) Placement and underwriting obligations		0.00		0
c) Irrevocable loan commitments		168,835,460.64		174,901
			168,835,460.64	174,901

E Profit-and-loss account for the period from 1 January until 31 December 2016

01/01 – 31/12. 2015

1. Interest income from			
a) Lending and money market business	128,941,347.27		135,708
of which: from discounting provisions			(0)
EUR 0.00			24,734
b) Fixed-income securities and debt register claims	19,431,168.96	148,372,516.23	160,442
		28,547,770.67	37,646
2. Interest expenditure			(808)
of which: from marking up provisions	EUR 673,676.36		122,796
		119,824,745.56	
3. Current income from			
a) Shares and other non-fixed-interest securities		10,403,528.50	13,828
b) Participations		2,104,422.54	3,172
c) Shares in affiliated companies		0.00	0
		12,507,951.04	17,000
4. Income from profit pools and full or partial profit transfer agreements		1,828,688.13	1,953
5. Commission income		30,643,181.20	29,195
6. Commission expenditure		3,296,652.08	4,305
		27,346,529.12	24,890
7. Net income or net expenditure on the trade account		0.00	0
Of which: Additions to or withdrawals from the fund for general banking risks	EUR 0.00		(0)
8. Other operating income		8,120,410.64	9,655
Of which: from foreign currency conversions	EUR 64,565.54		(84)
		169,628,324.49	176,294
9. (ceased)			
10. General administrative costs			
a) Staffing costs			
aa) Wages and salaries	53,570,709.39		52,985
ab) Contributions and expenditure for old-age care and support of which: for old-age care	EUR 5,227,651.89	69,232,030.87	(5,898)
		15,661,321.48	68,970
b) Other administrative expenses		33,079,370.83	32,993
		102,311,401.70	101,963
11. Depreciation and amortisation of intangible assets and properties		4,243,223.58	4,738
12. Other operating costs		18,244,034.98	13,008
Of which: from foreign currency conversions	EUR 0.00		(0)
13. Value adjustments and write-downs on receivables and certain securities as well as allocations to provisions for lending business		0.00	24,611
14. Income from write-ups of receivables and certain securities as well as release of provisions for lending business		47,708,966.08	0
		47,708,966.08	24,611
15. Value adjustments and write-downs on participations, shares in related companies and securities treated as fixed assets		0.00	0
16. Income from write-ups on participations, shares in related companies and securities treated as fixed assets		2,163,842.20	877
		2,163,842.20	877
17. Loss-absorption expenses		664,770.38	635
18. Additions to or withdrawals from the fund for general banking risks		69,600,000.00	10,000
19. Results from ordinary business activities		24,437,702.13	22,216
20. Extraordinary income		0.00	0
Of which: Transition effects as a result of Accounting Law Modernisation Act	EUR 0.00		(0)
21. Extraordinary expenses		0.00	0
Of which: Transition effects as a result of Accounting Law Modernisation Act	EUR 0.00		(0)
22. Extraordinary net income/loss		0.00	0
23. Taxes on income and on earnings		14,397,081.50	13,519
Of which: Changes in deferred taxation as per Article 274, Commercial Code	EUR 0.00		(0)
24. Other taxes not included in Item 12		164,307.97	162
		14,561,389.47	13,680
25. Surplus for the year		9,876,312.66	8,536
26. Profit/loss carried forward from the previous year		0.00	0
		9,876,312.66	8,536
27. Withdrawals from revenue reserves			
a) From contingency reserve		0.00	0
b) From other reserves		0.00	0
		0.00	0
		9,876,312.66	8,536
28. Allocations to revenue reserves			
a) To contingency reserve		0.00	0
b) To other reserves		0.00	0
		0.00	0
29. Unappropriated surplus		9,876,312.66	8,536

F At a glance

Position	As at	As at	Changes	
	31/12/2016	31/12/2015	2016	
	EUR mil- lions	EUR mil- lions	EUR mil- lions	%
Balance sheet total	6,930.1	6,822.1	108.0	1.6
Business volume*	7,085.5	6,960.7	124.8	1.8
Deposits from customers	4,168.3	4,386.3	-218.0	-5.0
Of which:				
Savings deposits	2,148.8	2,193.1	-44.3	-2.0
Non-certificated liabilities	1,986.0	2,159.7	-173.7	-8.0
Securitised liabilities	0.0	0.0	0.0	0.0
Subordinated liabilities	33.5	33.5	0.0	0.0
Liabilities to financial institutions	2,262.6	2,011.8	250.8	12.5
Of which:				
Subordinated liabilities	0.0	0.0	0.0	0.0
Securitised liabilities	64.8	70.8	-6.0	-8.5
Other liabilities	189.7	175.5	14.2	8.1
(Including contingent liabilities and provisions)				
Equity capital	464.9	387.1	77.8	20.1
(Including fund for general banking risks)				
Volume of loans to customers	4,819.1	4,485.4	333.7	7.4
Of which:				
Loans to customers	4,663.4	4,346.5	316.9	7.3
Trustee assets	0.3	0.3	0.0	0.0
Guarantee loans	155.4	138.6	16.8	12.1
Loans to banks	138.8	116.4	22.4	19.2
Investments in securities	1,986.7	2,201.7	-215.0	-9.8
Fixed assets	71.9	72.9	-1.0	-1.4
Other assets	69.0	84.2	-15.2	-18.1
Surplus for the year	9.9	8.5	1.4	16.5

* Total footings plus contingent liabilities

Basis: Balance sheet figures as of 31 March 2017

G Appendix to the annual accounts as per Article 26a, Paragraph 1, Point 2, Banking Act as per 31 December 2016 (“Country-specific reporting”)

Sparkasse Saarbrücken has no branch offices abroad. All of the following information results from the annual accounts as per 31 December 2016 and refers only to its business activities as a regionally active savings bank in the Federal Republic of Germany. The activities of Sparkasse Saarbrücken essentially consist of receiving deposits or other repayable moneys from private individuals and business customers and granting loans for its own account.

Sparkasse Saarbrücken defines turnover as the result from the following components of the profit-and-loss account, as stipulated in the Commercial Code: Interest revenues, interest expenses, current revenues from shares, etc., revenues from profit pools, etc., commission income, commission expenses, other operational income. The

turnover for the period from 1 January to 31 December 2016 was EUR 169,628,000.

The number of wage and salary recipients in full-time equivalents was 941.60 staff at the end of the year.

The profit before taxation was EUR 24,438,000 according to the profit-and-loss account as per the Commercial Code; taxation on profits according to this amounts to EUR 14,397,000.

Sparkasse Saarbrücken did not receive any public subsidies in the business year.

Sparkasse Saarbrücken

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