HALF YEAR FINANCIAL REPORT 2017

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INTERIM MANAGEMENT REPORT

Economic environment

The muted recovery of the economy in the second half of 2016 continued in 2017. In the second quarter of 2017, the real gross domestic product (GDP) of the euro area increased by 2.1% compared to the second quarter of the previous year[1]. During the same period, the GDP of the USA increased by 2.6%[2]. For 2017, the European Commission expects the growth rate in the euro area to slow down slightly to 1.7%, after 1.8% in the previous year (forecast for Austria: 1.7%). In the USA, GDP in 2017 as a whole is expected to grow at a rate of 2.2%, as compared to 1.6% in 2016.[3]

The rate of inflation in the euro area has been constantly above the one-percent mark since December 2016. In June 2017, inflation reached 1.3% in the euro area and 2% in Austria[4]. For 2017 as a whole, the European Commission predicts a rate of inflation of 1.6% for the euro area, as compared to 0.2% in 2016. Thus, inflation is coming closer to the 2% target of the European Central Bank (ECB). In the USA, an inflation rate of 1.6% was reported for June 2017[5].

The positive trend in unemployment seen in 2016 continued: In the US labour market, the rate of unemployment dropped from 4.7% at the end of 2016 to 4.4% in June 2017, the lowest level since May 2007[6]. Unemployment in the euro area decreased from 9.6% at the end of 2016 to 9.3% in May 2017, reaching the lowest level since March 2009[7]. Unemployment in Austria dropped from 5.7% in December 2016 to 5.4% in May 2017.

In response to the positive data on employment and inflation, the Federal Reserve System (Fed) and the European Central Bank (ECB) sent out cautious signals of a step-by-step normalisation of their money supply policies.

The Fed increased its key lending rate four times within a period of 18 months – most recently in June 2017 to a range of 1% to 1.25%. Additionally, the Fed indicated its intention to gradually reduce its asset purchasing activities[8], which would result in a reduction of its total assets. Within the framework of its Quantitative Easing Program (QE), the Fed has purchased government bonds and mortgage loans in a total amount of USD 4.5 trillion to date. Since the end of 2014, the Fed has not topped up its bond portfolio, but has replaced maturing instruments with new bonds. In future, the Fed plans to reduce its asset portfolio by no longer replacing all maturing bonds and thereby to reduce its total assets over the coming years.

In June 2017, ECB President Mario Draghi issued a statement underlining the consolidation of the economic recovery of the euro area. The ECB's key lending rate has been at a record low of 0% annually since March 2016 (deposit rate: -0.4%). The Asset Purchase Programme (APP), launched by the ECB in March 2015 in order to stimulate economic activity and to bring inflation closer to the annual target of 2%, was prolonged in December 2016 until the end of 2017, but with reduced monthly volumes of EUR 60 billion from April 2017 onwards (EUR 80 billion in the period from March 2016 to March 2017). Possible changes to the

[1] Eurostat
[2] US Department of Commerce
[3] European Commission forecast, May 2017
[4] Eurostat
[5] US Bureau of Labor Statistics
[6] US Bureau of Labor Statistics
[7] Eurostat
[8] Minutes of the meeting of the Federal Open Market Committee of 2 May 2017

ECB’s Asset Purchase Programme are to be discussed at the meeting of the ECB Governing Council in September 2017.

The Bank of England is phasing out its last QE round, which was launched after the Brexit vote in June 2016. Moreover, the Bank of Canada and the Reserve Bank of Australia have also signalled interest rate hikes.

In contrast to these developments, China and Japan have not yet signalled a normalisation of their money supply policies. Japan’s key lending rate has been at 0% annually since February 2016, with the Bank of Japan continuing its programme of government bond purchases unchanged. In China, the key lending rate has been at a record low of 4.35% since October 2015.

Purpose of the company

KA Finanz AG (KF) was established on 28 November 2009 through the demerger of the former Kommunalkredit[9] and is the legal successor of the latter. As provided for in the restructuring plan approved by the European Commission on 31 March 2011, KF is responsible for the structured wind-down of the non-strategic portfolio. Effective 18 September 2010, Kommunalkredit International Bank (Cyprus) was merged with KF, the part of Kommunalkredit Old remaining as of 26 September 2015 after the demerger for new incorporation.

KF’s business purpose is to pursue focussed de-risking, while minimising the input of public resources and utilising any potential for the recovery of asset values, with the highest possible own contributions by the bank being made in accordance with EU state aid rules (burden sharing).

Measures leading to the constitution of KA Finanz AG as a “wind-down unit” pursuant to the Austrian Bank Recovery and Resolution Act

On 8 June 2017, the Supervisory Board of KA Finanz AG (KF) approved the conclusion of a framework agreement with ABBAG (*Abbaumanagementgesellschaft des Bundes*), a company wholly owned by the Republic of Austria and responsible for the management of wind-down entities, on the future refinancing of KF by ABBAG. The framework agreement with ABBAG was concluded on 9 June 2017. It provides for refinancing facilities in a total volume of EUR 8.2 billion. These facilities are to fully replace the current refinancing of KF. Existing obligations under bonds and private placements issued by KF will continue to be satisfied and redeemed at their full nominal value upon maturity.

After the approval granted by the Supervisory Board of KF, the General Shareholders‘ Meeting of KF resolved – subject to the required approval by the Financial Market Authority (*Finanzmarktaufsicht* – FMA) – to operate the bank in future as a “wind-down unit” pursuant to § 162 of the Austrian Bank Recovery and Resolution Act. To this end, KF filed the corresponding application with FMA, requesting approval for KF to be operated as a “wind-

[9] In these financial statements the following names are used for the entities involved:
- Kommunalkredit Austria AG, prior to the 2009 demerger (until 28/11/2009): former Kommunalkredit
- Kommunalkredit Austria AG, from 2009 demerger until 2015 demerger for new incorporation (until 26/09/2015): Kommunalkredit Old
- Kommunalkredit Austria AG, after the 2015 demerger for new incorporation (from 26/09/2015): Kommunalkredit
- KA Finanz AG: KF

down unit" pursuant to the Austrian Bank Recovery and Resolution Act. Upon approval of the application by FMA, KF's banking license will expire.

Development of business in the first half of 2017

In the first half of 2017, KA Finanz AG (KF) wound down risk positions in a total amount of EUR 624.9 million, including EUR 56.0 million through active runoff measures and another EUR 568.8 million through scheduled and early redemptions.

The securities portfolio was reduced by EUR 87.7 million, EUR 48.0 million of which through asset sales and EUR 39.7 million through redemptions. Within the securities portfolio, optimisation measures were taken (e.g. runoff of the last remaining exposure to Estonia) and public-sector exposures were further reduced (e.g. sovereign exposure to Poland, exposure to US States).

The loan portfolio was reduced by EUR 296.5 million, EUR 8.0 million of which through the sale of a loan granted to a Dutch borrower and EUR 288.5 million through redemptions. The majority of the latter were scheduled redemptions (above all partial and complete redemptions of loans to Austrian and foreign territorial authorities and public-sector entities). Early redemptions accounted for a volume of EUR 32.8 million.

In the CDS portfolio, another major portion of Austrian CDS in a volume of EUR 240.6 million matured. The remaining CDS sell exposure to the Republic of Austria in a volume of EUR 152.4 million is due to mature in September and December 2017, which will bring KF's non-hedged CDS exposure down to zero by the end of 2017.

The following table shows the reduction of risk positions since the beginning of the restructuring process in November 2008:

Table: Reduction of risk positions since November 2008, in EUR million

Run-down of risk positions since November 2008 in EUR million	Total 2008 to 2015	2016	01 to 06/2017	Total 2008 to 06/2017
Securities – sold	6,548.5	161.4	48.0	**6,757.9**
Loans – sold	856.9	0.0	8.0	**864.9**
CDS – sold	10,799.4	0.0	0.0	**10,799.4**
Total sold	18,204.8	161.4	56.0	**18,422.2**
Securities – redeemed	3,344.4	197.3	39.7	**3,581.4**
Loans – redeemed	2,478.4	343.1	288.5	**3,109.9**
CDS – matured	786.8	188.3	240.6	**1,215.7**
Total redeemed	6,609.6	728.7	568.8	**7,907.1**
Total sold / redeemed	**24,814.4**	**890.1**	**624.9**	**26,329.3**

Altogether, KF has succeeded in winding down risk positions in a total amount of EUR 26.3 billion since the beginning of the restructuring process in November 2008, the better part thereof, i.e. EUR 18.4 billion, through active runoff of securities, CDS and loan positions.

Portfolio / Risk structure

As at 30 June 2017, the total exposure of KA Finanz AG (KF) amounted to EUR 8.7 billion (31/12/2016: EUR 9.6 billion), comprising EUR 4.4 billion in loans (31/12/2016:

EUR 4.7 billion) and EUR 3.4 billion in securities (31/12/2016: EUR 3.6 billion), corresponding to 50.3% (31/12/2016: 48.9 %) and, respectively, 38.9% (31/12/2016: 37.9%) of the total portfolio. The CDS and guarantee exposure, amounting to EUR 0.3 billion and representing 3.1% of the portfolio (31/12/2016: EUR 0.5 billion or 5.6%), primarily includes risk positions from the CDS sell exposure of EUR 152.4 million to the Republic of Austria and guarantees in the amount of EUR 113.6 million.

The following table shows the development of exposures since the end of 2008:

Table: Development of exposures since November 2008, in EUR million

Development of exposures since November 2008 in EUR million	28/11/2008 / 31/12/2009	31/12/2014 BEFORE merger Kommunalkredit Old	31/12/2015 AFTER merger Kommunalkredit Old	31/12/2016	30/06/2017
Total exposure (end of year/month)	**30,000 / 27,299**	**5,701.0**	**10,638.0**	**9,550.0**	**8,670.0**
of which securities / loans	*15,200 / 13,630*	*4,696.0*	*8,994.0*	*8,286.0*	*7,735.3*
of which CDS and guarantees	*12,200 / 10,737*	*399.0*	*646.0*	*535.0*	*266.0*
of which other (money market / derivatives	*2,600 / 2,932*	*606.0*	*998.0*	*729.0*	*668.4*
Total assets pursuant to Austrian Company Code	- / 17,657	7,285.4	14,391.1	11,949.6	11,193.4
Hidden burden [1)]	-	-902.6	-1,188.1	-1,152.7	-1,002.5

[1)] from securities, loans and CDS exposures as well as hedging derivatives

Hidden burdens, i.e. the difference between book values and market values, decreased from their 2016 year-end level of EUR 1,152.7 million to EUR 1,002.5 million. Hidden burdens primarily result from the increase of credit spreads since the closure of transactions and the current low level of interest; consequently, the market value of the portfolio (incl. the corresponding derivative positions) dropped below the book value. Hidden burdens do not represent a permanent impairment; if the corresponding financial instruments are held to maturity, hidden burdens can be fully recovered (pull-to-par effect).

The majority of KF’s debtors are Austrian and foreign territorial authorities (sovereigns, municipalities, local authorities), public-sector entities (PSEs) and quasi-municipal enterprises. As at 30 June 2017, the ten biggest exposures to the public sector (from sovereign risks, territorial authorities and government-guaranteed positions) amounted to EUR 5.2 billion, i.e. 60.3% of the total portfolio (31/12/2016: EUR 5.8 billion or 60.3%), of which EUR 4.0 billion or 46.6% (31/12/2016: EUR 4.3 billion or 45.4%) is accounted for by the euro area (incl. Austria) and EUR 2.9 billion or 33.0% by the Republic of Austria and Austrian territorial authorities. The latter amount includes EUR 1.3 billion in subsidised housing loans originated by Austrian provinces and bought by the former Kommunalkredit (before the 2009 demerger). These small loans are secured by mortgages and guaranteed by the provinces concerned (double-default approach).

Overall, KF has a portfolio of very high asset quality that is concentrated in the upper rating classes; as at 30 June 2017, EUR 7.9 billion or 91.3% (31/12/2016: 92.0%) of the total portfolio was rated investment grade (BBB- or higher), and EUR 4.3 billion or 49.6% was rated AAA/AA (31/12/2016: 51.0%). The average rating has remained unchanged at A (rating scale according to Standard & Poor’s / Fitch); the non-performing-loan (NPL) ratio (definition of default according to Basel III) stood at 0.2% as at 30 June 2017.

Table: Breakdown of exposures by rating, in TEUR and %

Rating range	30/06/2017		31/12/2016	
	in TEUR	in % of exposure	in TEUR	in % of exposure
AAA / AA	4,298,270.7	49.6%	4,870,090.0	51.0%
A	2,267,897.0	26.2%	2,377,290.0	24.9%
BBB	1,349,933.4	15.6%	1,535,156.0	16.1%
Investment grade – total	**7,916,101.1**	**91.3%**	**8,782,536.0**	**92.0%**
Non-investment grade	753,591.4	8.7%	767,720.0	8.0%

Besides specific loan loss provisions in the amount of EUR 17.3 million and a receivable in the amount of EUR 4.0 million guaranteed by the Republic of Austria, provisions of EUR 122.5 million pursuant to § 57 (3) of the Austrian Banking Act (“fund for general banking risks”) were booked as at 30 June 2017; additional portfolio loan loss provisions stood at EUR 1.2 million. Altogether, KF’s risk provisions constituted a risk buffer of EUR 145.1 million as at 30 June 2017.

Capital measures taken by the Republic of Austria since nationalisation

Since 2014, KA Finanz AG (KF) has not required any capital support from the Republic of Austria. The net amount of all capital support measures taken by the Republic of Austria between November 2008 and the reporting date of 30 June 2017 decreased by EUR 16.6 million to EUR 2,075.3 million. The reduction is due to guarantee fees in the amount of EUR 16.4 million paid in the first half of 2017 and the fact that the outstanding surety of the Republic of Austria was reduced through redemption by EUR 0.2 million to EUR 4.0 million without guarantee call.

Capitalisation support received by KF since the beginning of the restructuring process in November 2008 can be broken down as follows:

Table: Overview of capital measures taken by the Republic of Austria as at 30 June 2017, in EUR million

Overview of capital measures taken by the Republic of Austria in EUR million	31/12/2015	31/12/2016	30/06/2017
Capitalisation agreement of 17/11/2009 with debtor warrant	1,140.1	1,140.1	1,140.1
Shareholder contributions / Government surety	1,139.0	1,138.9	1,138.7
Capital increase 2011	389.0	389.0	389.0
Total gross	**2,668.1**	**2,668.0**	**2,667.8**
Guarantee fees paid by KF 2008 – 06/2017	-706.7	-747.6	-764.0
Return cash flows from guarantee fees 2008 – 12/2011	210.0	210.0	210.0
Guarantee fees paid by KF under debtor warrant structure 2009 – 07/2013	-38.5	-38.5	-38.5
Total net	**2,133.0**	**2,091.9**	**2,075.3**

The Republic of Austria, having recapitalised KF as provided for in the capitalisation agreement of 17 November 2009, is entitled to receive future annual surpluses (senior to profit participation rights and equity instruments) and/or future liquidation proceeds (senior to equity instruments, but junior of all other liabilities) in the amount of EUR 1,382.7 million (as at 30/06/2017) under its value recovery right.

Liquidity guarantees of the Republic of Austria

As at 30 June 2017, the liquidity guarantees of the Republic of Austria granted under the Financial Markets Stability Act (*Finanzmarktstabilitätsgesetz – FinStaG*) amounted to EUR 4.5 billion (31/12/2016: EUR 4.5 billion), including an EUR 3.5 billion framework guarantee for the commercial paper programme and an EUR 1.0 billion government-guaranteed bond maturing in 2020.

Table: Development of liquidity guarantees, in EUR million

Liquidity guarantees in EUR million	31/12/2011	31/12/2012	31/12/2013	31/12/2014	31/12/2015	31/12/2016	30/06/2017
Guarantees under the Interbank Market Support Act [1)]	4,547.2	2,297.2	1,246.2	0.0	0.0	0.0	0.0
Guarantees under the Financial Markets Stability Act	2,500.0	3,000.0	3,000.0	3,000.0	4,500.0	4,500.0	4,500.0
Total	**7,047.2**	**5,297.2**	**4,246.2**	**3,000.0**	**4,500.0**	**4,500.0**	**4,500.0**

[1)] based on exchange rates at time of issue

The guarantees in place do not qualify as equity and, therefore, do not count as capital measures. Through the conclusion of the framework agreement with ABBAG, which provides for refinancing facilities, the current refinancing of KF is to be replaced (see "Measures leading to the constitution of KA Finanz AG as a "wind-down" unit pursuant to the Bank Recovery and Resolution Act" and KF's ad-hoc disclosure dated 8 June 2017 at https://www.kafinanz.at/investor-relations/adhoc-pressemeldungen). As regards the liquidity guarantees of the Republic of Austria described above, it has been agreed that KF will no longer issue any securities under the government-guaranteed commercial paper programme, which will thus expire, as scheduled, at the end of January 2018. In the period leading up to that date, the programme framework of the commercial paper programme as well as the guarantee framework are to be reduced step by step, presumably from July 2017 onward, in accordance with the maturity profile of the securities in circulation.

Guarantee fees

In the first half of 2017, KA Finanz AG (KF) paid guarantee fees of EUR 16.4 million, including EUR 9.3 million for the government-guaranteed commercial paper (CP) programme, EUR 6.9 million for the EUR 1.0 billion government-guaranteed bond, and EUR 0.2 million for the surety of the Republic of Austria standing at EUR 4.0 million as at 30 June 2017. By 30 June 2017, guarantee fees paid by KF since its takeover by the Republic of Austria added up to a gross total of EUR 764.0 million. After deduction of the restructuring contributions in the amount of EUR 210.0 million made by the Republic of Austria up to the end of 2011, net guarantee fees paid come to a total of EUR 554.0 million, broken down as follows:

Table: Guarantee fees, in EUR million

Guarantee fees in EUR million	Total 2008 to 2016	01 to 06/2017	Total 2008 to 06/2017
Sureties (incl. original asset-side surety and debtor warrant surety)	355.0	0.2	355.2
Issue guarantees	267.4	6.9	274.3
Commercial paper guarantee	99.2	9.3	108.5
Fees for clearing bank line [1)]	15.1	0.0	15.1
ELA guarantee	10.8	0.0	10.8
Total KF	**747.6**	**16.4**	**764.0**
Restructuring contributions of the Republic of Austria	210.0	0.0	210.0
Total net KF	**537.6**	**16.4**	**554.0**

[1)] no longer utilised after 28/02/2011

Rating

KF has been rated A-/A-2 (short-term/long-term) by Standard & Poor's (S&P); KF's Fitch rating is A+/F1+. The rating outlook is positive by S&P and stable by Fitch.

KF's covered bond rating is AA-, awarded by S&P for the first time on 4 March 2016.

The ratings of the government-guaranteed commercial paper programme remain unchanged at A-1+ by S&P and F1+ by Fitch.

Legal proceedings

No changes to KF's legal risks, including those resulting from pending proceedings, occurred in the interim reporting period that would require a modification of the assessment expressed in the annual financial statements as at 31 December 2016. On the basis of information obtained from their legal counsel, the Boards of the company maintain their opinion that the objections and claims raised in the proceedings are unfounded.

All the necessary steps are being taken to contest the objections and claims raised in the proceedings.

Balance sheet structure and income position

Assets

As compared to the 2016 year-end value, the total assets of KA Finanz AG (KF) decreased by EUR 0.8 billion or 6.3% to EUR 11.2 billion as at 30 June 2017 (31/12/2016: EUR 11.9 billion). This reduction is primarily due to active portfolio runoff measures and to redemptions.

Loans and advances to customers of EUR 6.3 billion (31/12/2016: EUR 6.8 billion) represent the biggest asset item on the balance sheet. Moreover, KF's total assets also include public-sector debt instruments and bonds in the amount of EUR 2.1 billion (31/12/2016: EUR 2.2 billion) and loans and advances to banks in the amount of EUR 2.2 billion (31/12/2016: EUR 2.3 billion). Contingent liabilities of EUR 0.3 billion (31/12/2016: EUR 0.5 billion), reported as off-balance-sheet items, comprise the remaining CDS exposure (exposure to the Republic of Austria) of EUR 0.2 billion as well as guarantees in the amount of EUR 0.1 billion. The reduction by EUR 0.2 million, compared to the value reported as at 31 December 2016, results from the contractual time to maturity of CDS.

Risk-weighted assets and equity

As at 30 June 2017, KF reported regulatory own funds of EUR 501.5 million (31/12/2016: EUR 545.0 million), including common equity tier 1 of EUR 415.0 million (31/12/2016: EUR 453.0 million). Based on risk-weighted assets of EUR 2.4 billion as at 30 June 2017 (31/12/2016: EUR 2.6 billion), this results in a total capital ratio of 21.3% (31/12/2016: 20.7%) and a common equity tier 1 ratio of 17.6% (31/12/2016: 17.2%).

The values reported reflect KF's own funds as determined in accordance with the provisions of CRR on the basis of the separate financial statements of KF according to the Austrian Company Code/Austrian Banking Act (Austrian GAAP). KF uses the standardised approach for the calculation of its risk-weighted assets and its operational risk.

Funding structure / Liquidity

As at 30 June 2017, KF's funding volume (excluding own funds) totalled EUR 10.1 billion (31/12/2016: EUR 10.9 billion). Of this total, an amount of EUR 6.1 billion (31/12/2016: EUR 8.0 billion) was accounted for by short-term debt, in particular commercial paper issues, ECB tender, money-market deposits and repo funding. The long-term funding volume amounts to EUR 4.0 billion (31/12/2016: EUR 2.9 billion), primarily including covered bonds and the EUR 1.0 billion government-guaranteed bond issued by KF in August 2015. Moreover, in the course of the implementation of refinancing facilities as provided for by the framework agreement concluded with ABBAG (*Abbaumanagementgesellschaft des Bundes*) on 9 June 2017, new refinancing of EUR 1.4 billion was agreed upon with ABBAG as at 30 June 2017.

Income statement

For the first half of 2017, KF reported an after-tax result for the period of EUR -38.0 million (HY1 2016: EUR -15.7 million after the release of EUR 26.0 million from the statutory provision pursuant to § 57(1) of the Austrian Banking Act). The negative result is due, in particular, to guarantee fees of EUR -16.4 million (HY1 2016: EUR -20.4 million) paid by KF to the Republic of Austria for liquidity guarantees and a government surety, contributions to the Bank Resolution Fund of EUR -7.7 million (EUR -3.7 million), and other administrative expenses of EUR -12.2 million (HY1 2016: EUR -7.7 million).

The main income components were as follows:

- *Net interest result*
  The net interest result was negative at EUR -2.8 million (HY1 2016: EUR -3.2 million). The negative result is primarily due to the reduction of the commercial paper programmes and the temporary replacement of these funds by more expensive bridge financing to cover the period until the transition to the aforementioned new refinancing regime. The resulting higher interest expense is offset by the simultaneous reduction in guarantee fees paid to the Republic of Austria as a consequence of the reduction of the government-guaranteed commercial paper programme.

- *Net fee and commission result – Guarantee fees paid to the Republic of Austria*
  The net fee and commission result for the first half of 2017 came to EUR -16.2 million (HY1 2016: EUR -20.1 million); it was primarily accounted for by guarantee fees of EUR -16.4 million (HY1 2016: EUR -20.4 million) paid to the Republic of Austria for sureties, issue guarantees and the government-guaranteed commercial paper programme. The reduction compared to the previous period reflects the lower utilisation of the guaranteed commercial paper programme following the aforementioned change in KF's refinancing structure.

- *General administrative expenses (excluding contributions to the national bank resolution fund)*
  KF's general administrative expenses in the first half of 2017 amounted to EUR -12.7 million (HY1 2016: EUR -8.5 million), with EUR -12.2 million (HY1 2016: EUR -7.7 million) accounted for by other administrative expenses and EUR -0.5 million (HY1 2016: EUR -0.8 million) by personnel expenses. Besides compensation paid by KF for operational services rendered by Kommunalkredit Austria AG under the service level agreement (SLA) in the amount of EUR -6.5 million (HY1 2016: EUR -5.5 million), other administrative expenses also include expenses incurred in connection with the planned constitution of KF as a "wind-down unit" pursuant to the Bank Recovery and Resolution Act.

- *Contributions to the Single Resolution Fund*
  The annual contribution to the Single Resolution Fund (Bank Resolution Fund), prescribed by the Financial Market Authority (FMA) for 2017 and payable pursuant to the Bank Recovery and Resolution Act, amounts to EUR -7.7 million (HY1 2016: EUR -3.7 million); in accordance with Austrian GAAP, the expense is recognised under general administrative expenses.

- *Net valuation and realisation result / Appropriation to provisions pursuant to § 57 of the Austrian Banking Act*
  The net result from valuations and realisations amounted to EUR 1.4 million in the first half of the year (HY1 2016: EUR 19.9 million). It is primarily accounted for by the costs of portfolio runoff measures in the amount of EUR -4.1 million (HY1 2016: EUR -6.1 million), booked against positive valuations of securities classified as current assets in the amount of EUR 5.5 million (HY1 2016: EUR 0.0 million). The reduction compared to the previous year's value primarily results from the release of EUR 26.0 million from the provision pursuant to § 57 (1) of the Austrian Banking Act in the previous year.

Events after the balance sheet date

No significant events occurred after the balance sheet date.

Outlook

A decision by the Financial Market Authority (FMA) on the application submitted on 9 June 2017, requesting approval for KA Finanz AG (KF) to be operated in future as a "wind-down unit" pursuant to § 162 of the Bank Recovery and Resolution Act, is expected for the third quarter of 2017. Upon approval of the application, KF's banking license will expire. When operated as a wind-down unit, KF would be able to create an efficient, low-cost structure in a changing regulatory environment. Credit institutions in the European Union are confronted with increasingly stringent regulatory conditions and own funds requirements, which are designed to be met by active commercial banks, but are difficult and expensive to comply with for wind-down units, such as KF.

The transformation of KF into a wind-down unit would also shorten the wind-down horizon for KF's portfolio. Originally, complete wind-down by 2040 was agreed upon with the European Commission. As a wind-down unit, KF would aim to reach this target within a period of about ten years. While winding down its portfolio, KF will make every effort to take advantage of market opportunities and utilise any potential for the recovery of asset values.

Vienna, 18 August 2017

The Executive Board of
KA Finanz AG

Helmut Urban
Chairman of the Executive Board

Bernhard Achberger
Member of the Executive Board

INTERIM FINANCIAL STATEMENTS

Balance Sheet of KA Finanz AG pursuant to the Austrian Banking Act

Assets in TEUR	30/06/2017	31/12/2016
Cash and balances with central banks	343,363.3	417,723.2
Public-sector debt instruments eligible as collateral for central bank funding	457,813.0	453,492.7
Loans and advances to banks	2,183,169.2	2,307,268.5
Loans and advances to customers	6,305,491.3	6,780,769.7
Bonds and other fixed-income securities	1,601,609.6	1,731,937.9
Participations	0.1	0.1
Property, plant and equipment	70.8	70.8
Other assets	251,595.8	203,270.6
Accruals / deferrals	50,307.1	55,026.4
Total assets	**11,193,420.1**	**11,949,559.8**

Liabilities in TEUR	30/06/2017	31/12/2016
Amounts owed to banks	3,372,165.2	3,699,453.5
Amounts owed to customers	3,727,584.7	1,036,977.0
Securitised liabilities	3,248,121.4	6,245,222.4
Other liabilities	186,995.5	228,684.1
Accruals / deferrals	45,896.8	50,388.4
Provisions	101,200.2	99,768.2
Fund for general banking risks	122,500.0	122,500.0
Tier 2 capital (pursuant to Part 2 Title I Chapter 4 of Regulation (EU) No 575/2013)	96,472.5	136,058.6
Subscribed capital	389,000.0	389,000.0
Capital reserve	74,819.4	74,819.4
additional paid-in capital	*65,845.8*	*65,845.8*
unappropriated reserve	*8,973.6*	*8,973.6*
Statutory reserve pursuant to § 57 (5) Austrian Banking Act	93,388.1	93,388.1
Net loss	-264,723.7	-226,700.0
of which loss carryforward	*-226,700.0*	*-198,665.6*
of which result for the period	*-38,023.7*	*-28,034.4*
Total liabilities	**11,193,420.1**	**11,949,559.8**

Income Statement of KA Finanz AG pursuant to the Austrian Banking Act

in TEUR	01/01/2017 - 30/06/2017	01/01/2016 - 30/06/2016
Interest and similar income [1)]	213,649.9	257,135.1
Interest and similar expenses	-216,483.9	-260,369.9
Net interest result	**-2,834.0**	**-3,234.8**
Net fee and commission result	-16,165.5	-20,125.7
of which guarantee fees paid to the Republic of Austria	*-16,367.7*	*-20,370.2*
Result from financial transactions	-0.4	50.7
Other operating income	70.3	982.6
Operating income	**-18,929.5**	**-22,327.3**
General administrative expenses	**-20,450.7**	**-12,148.4**
Personnel expenses	-546.3	-768.0
Other administrative expenses	-12,170.9	-7,699.4
Contributions to the Bank Resolution Fund	-7,733.5	-3,681.0
Other operating expenses	-0.8	-1,052.1
Operating expenses	**-20,451.5**	**-13,200.5**
Operating result	**-39,381.0**	**-35,527.8**
Result from valuations and realisations	1,360.7	19,883.0
of which changes in provisions pursuant to § 57 (1) Austrian Banking Act	*0.0*	*26,000.0*
of which from portfolio runoff and valuations	*1,360.7*	*-6,117.0*
Profit on ordinary activities	**-38,020.3**	**-15,644.8**
Taxes on income	-2.7	-3.3
Other taxes	-0.6	-3.3
Result for the period	**-38,023.7**	**-15,651.4**

[1)] Negative interest paid on balances with the Austrian National Bank amounted to TEUR 672.6 in the first half of 2017 (HY1 2016: TEUR 852.2).

NOTES TO THE INTERIM FINANCIAL STATEMENTS OF KA FINANZ AG

1. General principles

These interim financial statements of KA Finanz AG (KF), prepared in accordance with § 87 of the Stock Exchange Act, comprise a condensed balance sheet, a condensed income statement, explanatory notes and an interim management report. The interim financial statements presented for the period from 1 January to 30 June 2017 do not contain all the information and disclosures required for the annual financial statements and, therefore, are to be read in conjunction with the 2016 annual financial statements of KF.

2. Accounting and measurement principles

The accounting and measurement methods applied in preparing these interim financial statements are the same as those applied in the preparation of the annual financial statements of KF as at 31 December 2016.

3. Other disclosures

a. Development of earnings

Disclosures regarding the development of earnings in the first half of 2017 and the significant events during the period under review are contained in the interim management report.

b. Development of regulatory own funds

Basis for calculation in TEUR	30/06/2017	31/12/2016
Total exposure amount pursuant to Art.92 CRR	2,352,245.2	2,630,985.7
Own funds requirements		
for credit risk [1]	180,428.3	199,743.5
for operational risk [1]	0.0	0.0
for the risk of credit value adjustment [2]	7,751.4	10,735.3
Total (own funds target)	**188,179.6**	**210,478.9**
Capital conservation buffer	29,403.1	16,443.7
Own funds target	**217,582.7**	**226,922.5**

[1] The standardised approach is applied to determine the own funds requirements for credit risk and operational risk..
[2] pursuant to Art.381 CRR; market value of the credit risk of the counterparty relative to the portfolio of transactions with OTC derivatives

Own funds actual in TEUR	30/06/2017	31/12/2016
Common equity tier 1 after deductible items	414,983.9	453,007.6
Tier 2 capital after deductible items	86,555.9	91,976.4
Eligible own funds (tier 1 and tier 2)	**501,539.8**	**544,984.0**
Free equity	313,360.2	318,061.5
Total capital ratio	21.3%	20.7%
Common equity tier 1 ratio	17.67%	17.2%

c. Contingent liabilities

As at 30 June 2017, contingent liabilities were as follows:

in TEUR	30/06/2017	31/12/2016
Contingent liabilities		
Sureties and guarantees	275,101.0	544,513.8
of which credit default swaps	*161,329.0*	*430,066.9*
of which guarantees	*113,772.0*	*114,446.9*
Other obligations		
Loan commitments and unused lines	15,159.5	17,089.3

The remaining CDS positions include an exposure to the Republic of Austria of TEUR 152,429.0 (31/12/2016: TEUR 421,166.9) and a position of TEUR 8,900.0 (31/12/2016: TEUR 8,900.0) held to hedge an own issue.

The CDS portfolio developed as follows in the first half of 2017:

in TEUR	Nominal amounts 31/12/2016	CDS runoff 01-06/2017	FX changes	Nominal amounts 30/06/2017
Credit default swaps	430,066.9	-240,620.3	-28,117.6	161,329.0

The market values of the CDS portfolio are as follows:

in TEUR	Market values 30/06/2017	Market values 31/12/2016
Credit default swaps	-81.7	-321.7

d. Legal risks and other obligations

No relevant changes to legal risks, including those resulting from pending proceedings, occurred in the interim reporting period that would have required a modification of the assessment expressed in the annual financial statements as at 31 December 2016. Based on information received from their legal counsel, the Boards of the bank maintain their opinion that the objections and claims raised in the proceedings are unfounded.

All the necessary steps are being taken to contest the objections and claims raised.

Vienna, 18 August 2017

The Executive Board of
KA Finanz AG

Helmut Urban
Chairman of the Executive Board

Bernhard Achberger
Member of the Executive Board

DECLARATION BY THE LEGAL REPRESENTATIVES ON THE INTERIM FINANCIAL STATEMENTS

We herewith confirm to the best of our knowledge that the condensed **Interim Financial Statements** prepared in accordance with the relevant accounting standards present a true and fair view of the assets, the financial position and the income of the company and that the **Interim Management Report** presents a true and fair view of the assets, the financial position and the income of the company as regards the important events during the first six months of the business year and their impact on the condensed Interim Financial Statements, and as regards the material risks and uncertainties of the remaining six months of the business year.

Vienna, 18 August 2017

The Executive Board of
KA Finanz AG

Helmut Urban
Chairman of the Executive Board

Bernhard Achberger
Member of the Executive Board

AUDITOR’S REPORT ON THE REVIEW OF INTERIM CONDENSED FINANCIAL STATEMENTS AS OF JUNE 30, 2017

Introduction

We have reviewed the accompanying interim condensed financial statements of KA Finanz AG, Vienna, for the period from January 1, 2017 to June 30, 2017. The interim condensed financial statements comprise the balance sheet as of June 30, 2017, the income statement for the period from January 1, 2017 to June 30, 2017, and the notes.

The management is responsible for the preparation and fair presentation of this interim financial information in accordance with business and banking regulations in force in Austria.

Our responsibility is to provide a review summary on these interim condensed financial statements based on our review.

Scope of review

We conducted our review in accordance with the relevant expert opinions and standards, in particular International Standard on Review Engagements 2410 “Review of Interim Financial Information Performed by the Independent Auditor of the Entity”. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Austrian generally accepted auditing standards and International standards on auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, no matters have come to our attention that cause us to presume that the accompanying financial statements do not present a true and fair view of the Company’s financial position as of June 30, 2017 and its financial performance for the period from January 1, 2017 to June 30, 2017 in accordance with business and banking regulations in force in Austria.

Statement on the half-year group management report and on the declaration of the legal representatives as per section 87 of the Austrian Securities Exchange Act (BörseG)

We have read the half-year management report in the half-yearly report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements. Based on our review, nothing has come to our attention that causes us to believe that the management report in the half-yearly report contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

The half-yearly report comprises the required declaration of the legal representatives as per section 87 paragraph 1 number 3 BörseG.

Vienna, August 18, 2017

PwC Wirtschaftsprüfung GmbH

signed:

Dipl.-Kfm. Timo Steinmetz
Austrian Certified Public Accountant

This report is a translation of the original report in German, which is solely valid. Publication and sharing with third parties of the financial statements together with our auditor's review opinion is only allowed if the financial statements and the management report are identical with the German version. This review opinion is only applicable to the German and complete financial statements with the management report. For deviating versions, the provisions of Section 281 (2) UGB apply.

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