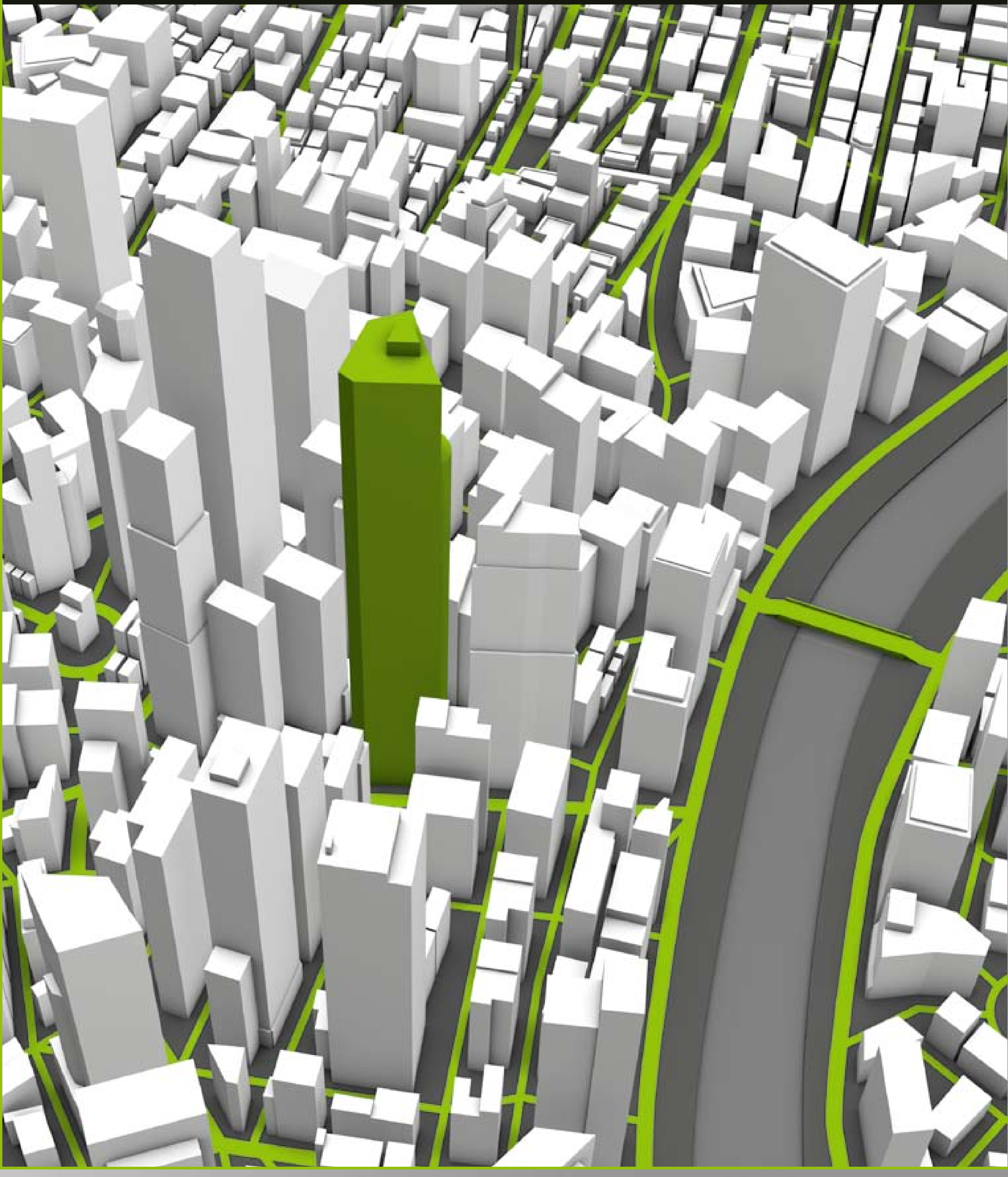
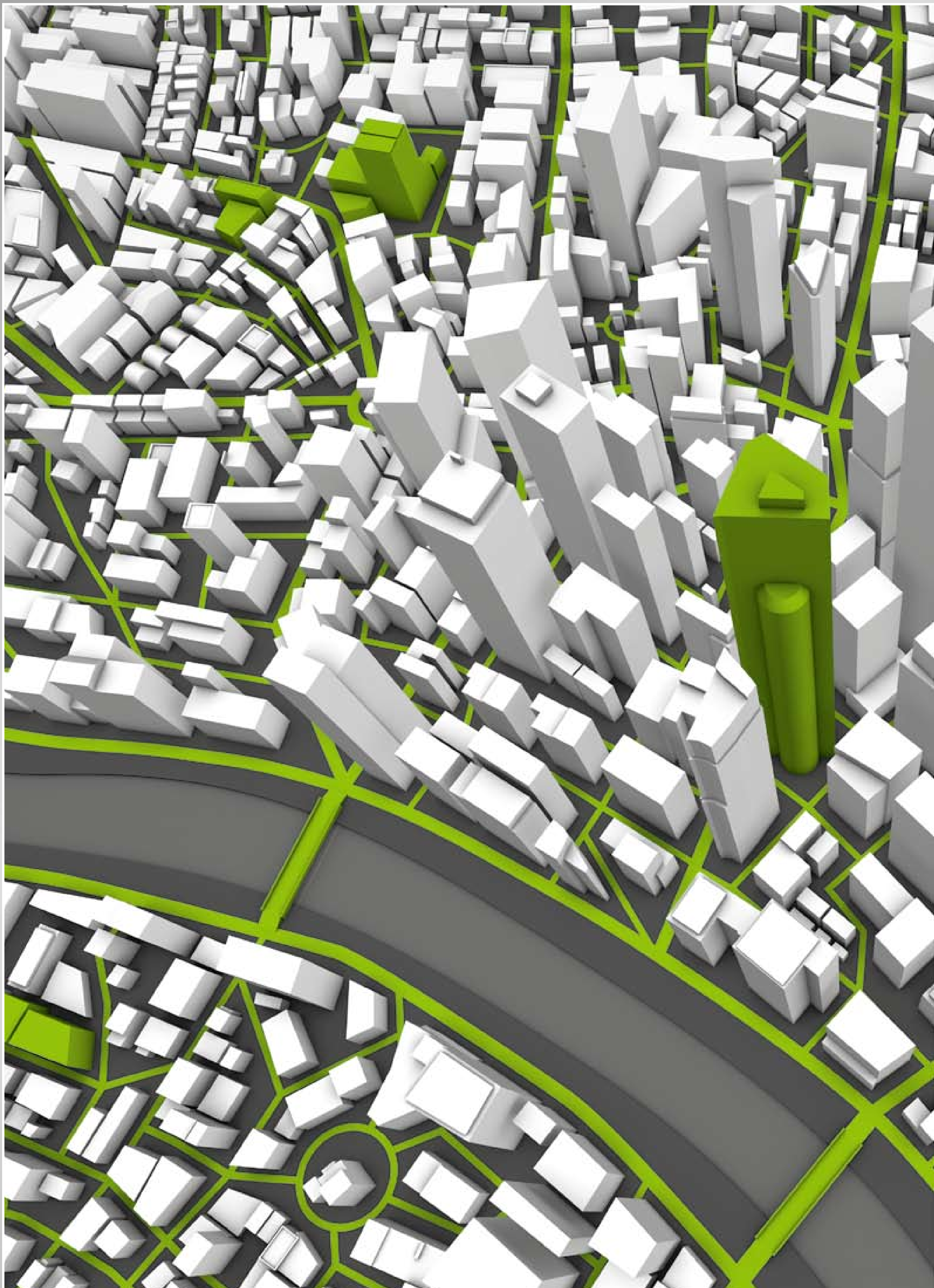
Annual Report
2009

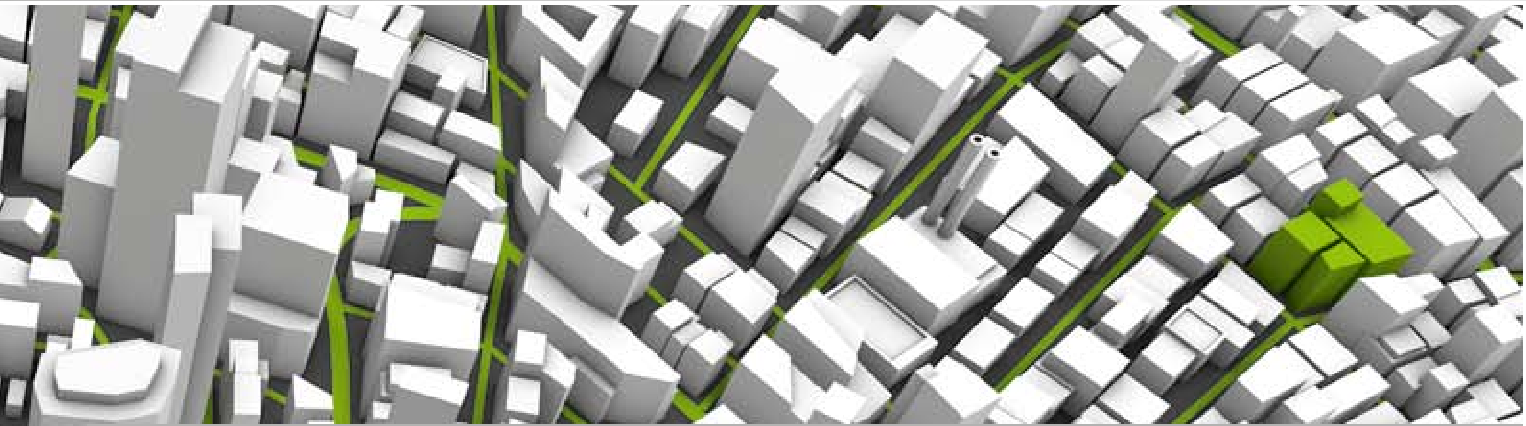
PUBLIC SECTOR FINANCE
REAL ESTATE FINANCE

pbb

DEUTSCHE
PFANDBRIEFBANK







Public Sector Finance

Public sector finance focuses on central, regional and local authorities at sub-sovereign level with only limited direct access to the capital market.

The regional focus is on European countries with good ratings in which lending operations can be funded by way of Pfandbrief issues – at present, the Bank is focusing on Germany, France, Italy and Spain.

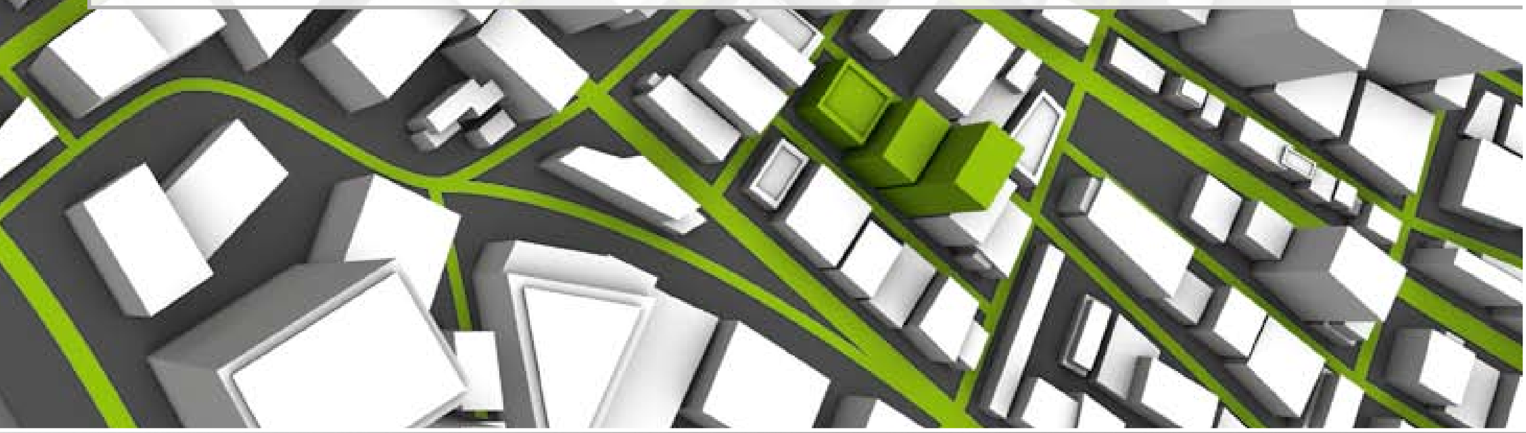
pbb Deutsche Pfandbriefbank mainly targets primary customer business. On the secondary market, the Bank will only conduct operations if this is necessary for rounding off or improving the portfolio structure. In addition to traditional or customised financing solutions, pbb Deutsche Pfandbriefbank also offers its customers derivative products for hedging risk as well as advisory services.

Real Estate Finance

In real estate financing, pbb Deutsche Pfandbriefbank mainly targets professional real estate investors such as real estate companies, institutional investors and real estate funds; in Germany, the Bank also targets SME customers and customers with a regional focus.

The Bank focuses its new business on markets eligible for Pfandbrief funding. The focus is on Germany and the European core markets, and in particular Great Britain and France, as well as Scandinavia, the Benelux countries, Poland and the Czech Republic.

The financed properties mainly comprise office buildings, retail and logistics properties as well as residential properties. pbb Deutsche Pfandbriefbank concentrates on exposures of less than € 100 million. The Bank also extends higher loans as part of syndicate loans or via syndication.



Ratings

Ratings of Deutsche Pfandbriefbank AG and its covered bonds

as of 16 March 2010		Standard & Poor's	Moody's	Fitch Ratings
Deutsche Pfandbriefbank AG	Long-term	BBB	A3	A–
	Short-term	A–2	P–1	F1+
	Outlook	Credit Watch Positive	Negative	Stable
Public Sector Pfandbrief		AAA[1]	Aaa	AAA
Mortgage Pfandbrief		AAA[1]	Aa3	AA+[1]

[1] Credit watch for possible downgrade

Due to rounding, numbers presented throughout this document may not add up precisely to the totals provided and percentages may not precisely reflect the absolute figures.

pbb Deutsche Pfandbriefbank is a specialist bank for real estate and public sector finance. The key refinancing instrument which is used is the German Pfandbrief, and the Bank is one of the largest players in this segment.

The geographical focus is Germany and other selected European countries.

The Bank will step up its presence on the credit and refinancing markets – it will thus make a contribution to credit supply, and is a reliable partner for its customers.

pbb Deutsche Pfandbriefbank was created in mid-2009 out of the merger between Hypo Real Estate Bank and DEPFA Deutsche Pfandbriefbank. It is part of the HRE Group which has been wholly-owned by the Federal Republic of Germany since October 2009.

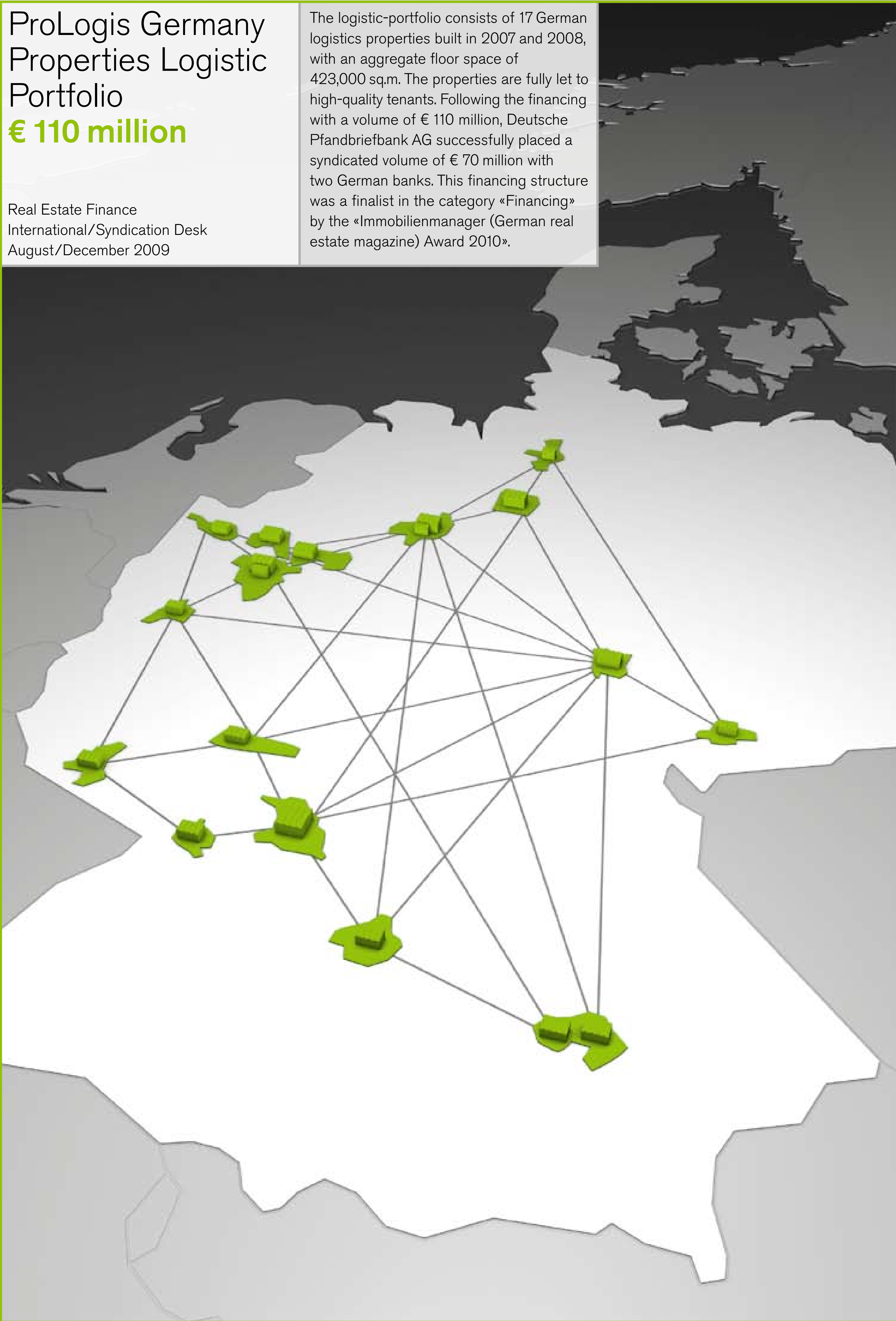
Content

ProLogis Germany Properties Logistic Portfolio

€ 110 million

Real Estate Finance
International/Syndication Desk
August/December 2009

The logistic-portfolio consists of 17 German logistics properties built in 2007 and 2008, with an aggregate floor space of 423,000 sq.m. The properties are fully let to high-quality tenants. Following the financing with a volume of € 110 million, Deutsche Pfandbriefbank AG successfully placed a syndicated volume of € 70 million with two German banks. This financing structure was a finalist in the category «Financing» by the «Immobilienmanager (German real estate magazine) Award 2010».



Preface of the CEO

Preface of the CEO

Deutsche Pfandbriefbank AG, a specialist bank for real estate and public sector Finance, was founded in June 2009. It resulted from the merger of two banks in the HRE Group (HRE) which in turn had arisen partially out of various banks in the past. Accordingly, Deutsche Pfandbriefbank AG is a young institution with a long history – and this is the basis which we are using for establishing a new business model. We have been operating under the new brand pbb Deutsche Pfandbriefbank since October 2009 – and have thus also been indicating a new start.

Our new business activities concentrate on markets eligible for Pfandbrief refinancing. Our real estate financing activities focus on Germany and other selected European countries. These are mainly the United Kingdom and France, as well as the Benelux countries, Scandinavia, Poland and the Czech Republic. Our products and services are targeted primarily at professional real estate investors – such as real estate companies, institutional investors and real estate funds. In Germany, we also focus on SME and regionally-oriented customers. We provide finance particularly for office buildings, retail or logistics properties as well as real estate for residential use.

Apart from real estate financing, public sector finance is the second mainstay of the Deutsche Pfandbriefbank Group. These operations focus on the activities in the field of primary customer business, i.e. direct lending to the public sector. The regional focus is on European countries with good ratings in which lending operations can be refinanced by way of Pfandbriefe. At present, these countries are mainly Germany and France and, to a lesser extent, Spain and Italy. Our main target customers in this respect are sub-sovereign authorities which do not have direct access to the capital market. In addition to traditional or customised financing solutions, Deutsche Pfandbriefbank AG offers its customers in the public sector finance sector derivative products for hedging risk as well as advisory services particularly for supporting PPP (Public Private Partnership) projects.

Public sector financing is the Company's second mainstay.

Despite the difficult market conditions, we have taken on new business in real estate and public sector finance in Germany and other European countries in the year under review. New real estate financing business has amounted to approx. € 3.3 billion, and the volume of new public sector finance loans totalled around € 0.7 billion. We extend expiring loan commitments and selectively take on new business on the basis of our stricter risk management principles. Deutsche Pfandbriefbank AG has also returned to the market for real estate financing syndications. Accordingly, in the fourth quarter of 2009, we arranged one of the largest syndications since the outbreak of the financial crisis.

Our new business in the area of real estate financing amounted to € 3.3 billion; and to € 0.7 billion in public sector financing.

As is the case on the credit markets, Deutsche Pfandbriefbank AG has also started to operate again on the refinancing markets: In mid-September 2009, we issued our first Jumbo Pfandbrief following an absence from the market of more than one year. This involved a five year Jumbo mortgage Pfandbrief with a volume of € 1.5 billion. In mid-October, this was followed by a public Jumbo Pfandbrief with a volume of € 1 billion and a ten-year duration. Both issues were oversubscribed and drew the attention of German and international investors. Overall, including private placements and uncovered refinancing, we raised more than € 7.5 billion debt on the market in 2009 not relying on liquidity guarantees.

Both Jumbo Pfandbrief bonds isssued in 2009 were oversubscribed.

This annual report considers the Deutsche Pfandbriefbank Group, i.e. Deutsche Pfandbriefbank AG and also the foreign subsidiaries which operate in real estate financing as well as pbb Services GmbH. The latter company was renamed in February 2010 when its name was changed from Hypo Real Estate Systems GmbH, which Hypo Real Estate Holding AG (HRE Holding) sold to Deutsche Pfandbriefbank AG at the end of June 2009.

The Deutsche Pfandbriefbank Group closed the financial year 2009 with pre-tax profit of € –1,525 million, compared with a combined pre-tax profit of € –2,376 million in 2008. For the combined figures, it was assumed that the merger between Hypo Real Estate Bank AG and DEPFA Deutsche Pfandbriefbank AG which took place in 2009 and also the sale of Hypo Real Estate Systems GmbH were effective as of 1 January 2008.

The improved performance was attributable to much higher operating revenues, which however were opposed by much higher provisions for losses on loans and advances. In the year under review, operating revenues amounted to € 653 million, compared with € –744 million in the previous year. This was attributable to net trading income and net income from financial investments which, as a result of stabilising capital and financial markets, were much less negative (namely € –44 million and € –43 million respectively) than in the previous year, when net trading income amounted to € –726 million and net income from financial investments amounted to € –1,235. Provisions for losses on loans and advances increased to € 1,891 million from € 1,236 million in 2008 as a result of the deterioration in the situation on the real estate markets.

The business year 2009 was better than the previous year. The full year result improved to € –1,525 million.

We intend to press on ahead with establishing Deutsche Pfandbriefbank AG on the credit and refinancing markets this year. We issued a further public Jumbo Pfandbrief in January 2010, and we intend to continue our issuing activities – depending of course on the capital market climate. Numerous new deals are lined up in real estate as well as public sector finance – the pipeline is well filled.

The Bank forms part of the HRE, which is wholly-owned by the Federal Republic of Germany via the Financial Market Stabilisation Fund. Our aim must be to ensure that Deutsche Pfandbriefbank AG is capable of being reprivatised. One milestone along this way will be to transfer parts of our business to a deconsolidated environment. The establishment of such a deconsolidated environment is subject to the approval of the Financial Market Stabilisation Fund, and the transfer is expected to take place in the second half of 2010 after the approval of all necessary institutions and bodies has been obtained. This move will enable us to further strengthen Deutsche Pfandbriefbank AG as the core bank, by allowing us to release non-strategic or non-performing assets and to considerably reduce the balance sheet. In addition, the transfer of assets will reduce the additional capital requirements of Deutsche Pfandbriefbank.

Via the Financial Market Stabilisation Fund, the Federal Republic of Germany is sole owner of Deutsche Pfandbriefbank AG.
Our aim is to make reprivatisation possible.

The establishment of a deconsolidated environment, to which also assets of HRE are to be transferred, as well as the support provided to the Group by the Federal Republic of Germany in the form of guarantees and capital aid, are being reviewed in the course of EU state aid proceedings. Experience with similar cases indicates that covenants will also be imposed on Deutsche Pfandbriefbank AG, for instance a considerable reduction in the balance sheet total and the definition of a timescale for reprivatising the company. However, the government in its capacity as the leader of negotiations and the company are still convinced that the European Commission will approve the overall aid package.

The support from the Federal Republic of Germany is being reviewed within the framework of the EU state aid proceedings.

The Deutsche Pfandbriefbank Group and the entire sector are facing further challenges in 2010. The crisis on the commercial real estate market will continue for some time to come, and rising public sector borrowing means that exposures to sovereign debtors will also be exposed to increasing levels of risk with a negative impact on public sector finance. Despite this difficult climate, we see opportunities offering the products and services of the Deutsche Pfandbriefbank Group.

Kind regards

Dr. Axel Wieandt
Chairman of the Management Board

The Management Board
of Deutsche Pfanbriefbank AG

From left to right:
Frank Krings,
Alexander Freiherr von Uslar-Gleichen,
Dr. Axel Wieandt (Chairman),
Manuela Better,
Dr. Kai Wilhelm Franzmeyer,
Dr. Bernhard Scholz

ADIF
Spanish high-speed Railway Network
€ 200 million

Public Sector Financing
Public Sector Finance
December 2009

State owned ADIF manages the national railway infrastructure and is responsible for the development of the high-speed network. The facility will be used to finance investments in the development of Spain's high-speed railway network.

Financial Review

Financial Review
Business and Conditions

Macro-economic Conditions

The year 2009 was characterised by the continuing financial crisis. Following the insolvency of Lehman Brothers in mid-September 2008, the entire global economy was hit by a huge economic downturn in the following latter half 2008/2009. Although this downturn affected virtually all economies, not all economies were equally affected. For instance, Poland was the only country in the European Union to report slight growth in 2009. Within the OECD member states, only Australia and South Korea succeeded in reporting such an achievement. The financial and economic crisis particularly affected countries which were reliant on international capital to a significant degree. On the other hand, countries such as China and India reported only moderate declines in growth, namely to 8.2% and 5.5% respectively.

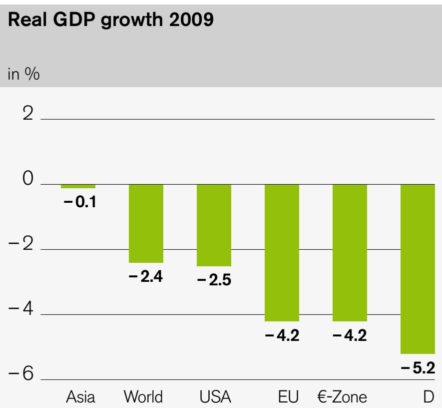
The declines in the real economy exceeded the expectations of all experts. Politicians responded to the severe economic problems with extensive packages of measures. In addition to traditional instruments of monetary and fiscal policy, the main measures which were taken focussed on providing support to the banking sector. The provision of loans, guarantees and capital as well as new laws prevented further system-relevant banks from becoming insolvent.

Monetary policy was initially manifested in the fact that Central Bank rates fell to all-time lows. In the USA, the federal funds target rate was fixed at 0.25% in December 2008, and the European Central Bank has maintained the rate for the primary refinancing facility at 1% since mid-May 2009. Numerous further measures which contributed to so-called quantitative easing were also taken. The most important measure of the European Central Bank in this respect was the unlimited provision of Central Bank funds by means of the primary refinancing facility with a term of one year (all limited only by the availability of collateral). The previously usual term was seven days.

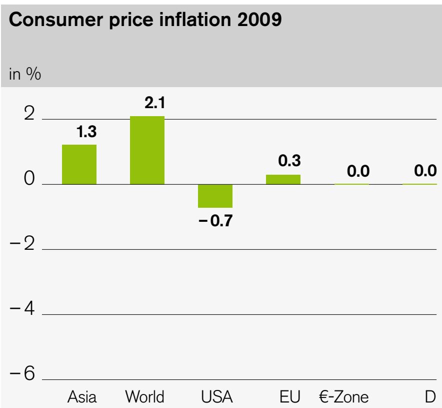
Fiscal policy was also considerably expanded in virtually all countries. In the Euro-zone, the average budget deficit was 6.4%. Together with the economic downturn, national debt increased on average by more than 10.0% within one year. This was applicable for instance for Spain, Ireland and Greece, whose budget deficits in 2009 ran into double digits, namely 11.2%, 12.5% and 12.7% of gross domestic product (GDP) respectively. This means that these countries have far exceeded the limit of 3% fixed in the Treaty of Maastricht. In consequence, this is the first time in the history of the currency union that rate spreads have widened considerably for bonds issued by the different states in the Euro-zone. Experts consider that this reflects considerable scepticism of investors, who are now again taking a more differentiated view of country risks in the Euro-zone. There is also a corresponding difference between the various ratings.

The economic downturn associated with the financial crisis ensured that inflation did not occur, despite the measures which were taken. Indeed, the rate of inflation throughout the world declined. In addition, the price of oil also fell appreciably in the year under review compared with the highs seen in mid-2008; on the other hand, these factors also did not result in deflation.

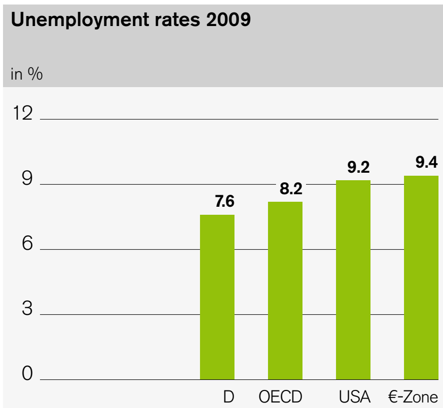
Higher unemployment is a further effect of the economic crisis triggered off by the financial crisis. The development in this respect has by no means been uniform. Accordingly, the unemployment rate in the USA virtually doubled between 2008 and 2009, whereas the number of persons unemployed in Germany declined slightly in the same period. One of the reasons for this situation was the use of short-time working.



Source: EIU, obtained from Datastream on 15.12.2009



Source: EIU, obtained from Datastream on 15.12.2009



Source: OECD, Economic Outlook No. 86, 11/2009

Sector-specific Conditions

Overall situation of the banking sector

The year 2009 proved to be very mixed for the banking sector. The expansion of the financial crisis started in the autumn of 2008 and the related liquidity shortages meant that banks throughout the world required capital support in the form of loans, guarantees or state aid in order to avoid liquidity and capital shortages. Nevertheless, 140 banks in the USA had to be closed in 2009. According to calculations of the Bank of England, state support for the financial system accounted for 73% of the gross domestic product in the USA, 74% of GDP in Great Britain and 18% of GDP in the Euro-zone.

However, towards the end of 2009, some US and British banks were able to repay some or all of this state aid, mostly on the basis of higher profits generated with investment banking operations. On the other hand, traditional commercial or credit banks without major activities in the field of investment banking reported much worse results, due to the considerable risk provisioning requirement.

At the beginning of the crisis, considerable volumes of loans which fell due were prolonged in order to avoid immediate defaults. However, the decline in the value of collateral means that this option is virtually no longer available. The difficult macro-economic situation and also the problematical capital situation and the more stringent risk valuation requirements have also had a considerably negative impact on new business in lending.

In order to restore confidence in the banks and also in lending, governments throughout the world have developed a wide range of models. In the summer of 2009, politicians in Germany issued laws which permit the founding of so-called deconsolidated environments. This enables banks to transfer high-risk securities and loans from their balance sheets and thus to avoid any further deterioration in their equity ratios. On the other hand, in Great Britain, loans are subject to the state asset backing system. The US-government has now provided collateral for securitised real estate loans and has eased the rules applicable in the event of late payment.

Commercial Real Estate Finance

(Sources: DTZ Zadelhoff, Jones Lang Lasalle, Atis Real)

The markets for commercial real estate were also affected to an increasing extent by the crisis, and some of these marketes suffered huge losses in the year under review. Compared with the highs in July 2007, the markets in the USA, Great Britain, Spain and Ireland have reported declines of up to 50% in property values.

The difficult economic situation has resulted in continuously rising vacancy rates and declining rents. Office rents in prime locations of Madrid or Paris have fallen by up to 20% compared with the end of 2008. In London and New York, these declines have been up to 18% and up to 45% respectively. Germany has been hit relatively lightly, with an average decline of 6%. The vacancy rate for the whole of Europe is around 11%; the corresponding figures for Germany and the USA are 10% and 16% respectively. This development represents a challenge particularly for highly geared investments as falling rents and rising vacancy rates would result in a lower earning rate, and such financing arrangements would accordingly be affected by shortfalls in terms of cover.

Initially, some banks prolonged loans which became due in the hope that the property values and LTVs would recover and reach a refinanceable level. It is true that the banks were able to force through higher margins and charges; however, many investors did not have a solution for unrealised losses – particularly for properties in subprime locations. The deteriorated credit portfolio quality at many institutions also meant that loans which were due to be prolonged were no longer extended as a result of lower property values, or they were prematurely called into question because it was no longer possible for the original covenants to be met. This resulted in further defaults. According to Pricewaterhouse Coopers, 38% of all insolvency applications in Spain were submitted by companies from the construction and real estate sector, and the corresponding figure for Great Britain was 24%. The real estate sector overall was thus the sector which was affected by most insolvencies.

The world-wide investment volume in the year under review was also considerably lower than the corresponding previous year figures, and amounted to €70.0 billion. Whereas the first quarter was very weak at €0.9 billion, investments rose again as the year progressed. The fourth quarter of 2009 reported a volume of €25.7 billion; this was the highest figure in terms of turnover since the peak of the financial crisis in September 2008. Whereas investors were relatively cautious in the first half of the year and focussed primarily on their domestic markets, they became more confident in the second half of the year and started to invest again across borders. The strongest growth was reported by the markets in Central and Eastern Europe, although these have traditionally been classed as more risky compared with the Western European markets.

Public sector finance

The financial crisis has also affected the borrowing activities of public sector authorities. Countries such as Italy and France for instance had to take action in order to provide financial support to regional authorities. However, a considerable percentage of the liquidity available on the markets is now again being channelled into the financing of states and public sector authorities.

In our core markets of France, Germany, Italy and Spain, the availability of liquidity for financing states and regional authorities has been supported by at least one of the following factors:

> Risk-averse tendering of regional and commercial banks, which therefore increase lending to the public sector instead of to the private economy.
> Rising volume of customer deposits at major commercial banks, which is reinvested in secure lending business.
> Easing of the lending guidelines applicable for bonds and loans at the ECB in order to permit more favourable refinancing.
> Support of the European market for covered bonds, such as the German Pfandbrief, provided by the ECB with the intention of acquiring bonds with a value of up to € 60 billion (by 8th December 2009, the ECB had acquired bonds with a value of € 28.3 billion).

Although some market players withdrew from public sector financing in the course of the reporting year, some regional banks successfully developed their domestic markets and thus ensured more intense competition particularly in the second half of the year. When demand declined for financing for central, regional and local authorities as a result of temporary measures (e.g. accelerated VAT repayment in France), pressure increased on margins.

Accordingly, the regional and local authorities in the core areas regained access to financing with comparatively lower risk premiums. One major difference between the markets is to be seen in the terms. Whereas terms of up to ten years are offered in Spain, the term for state borrowers in France and Germany is 20-30 years.

Although access to funding has become easier for states and central, regional and local authorities, the rating agencies have downgraded some EU countries. Portugal for instance was downgraded to A+ , the rating of Great Britain and Spain was left unchanged at AAA, but with a negative forecast in each case , and Greece was recently downgraded to BBB+. This development is also reflected in selected credit default swaps (CDS) and the risk premiums applicable for 10-year government bonds.

Refinancing markets

The refinancing markets have continuously stabilised in the course of 2009. Increasing numbers of successful capital market issues were seen in the second half of the year. The market for covered bonds has developed a positive performance. In addition to the so-called benchmark covered bond transactions with a volume of more then € 1 billion, comparatively high volumes of private placings were also seen. The covered bond purchasing programme of the ECB also contributed to the stabilisation. Other markets have to a certain extent followed the positive development in spreads on the market for covered bonds. For instance, the markets for unsecured bank issues have also stabilised further. However, the level of risk premiums is generally still higher than was the case before the financial crisis. The money market has not yet completely recovered. The turnover volumes outside the open market transactions of the ECB are much lower than was the case before the financial market crisis.

Major legal conditions

The law concerning the continuation of financial market stabilisation issued by the Federal Germany Government in July 2009 enables credit institutions to transfer risk assets and non-strategic areas of operation into a deconsolidated environment. The so-called deconsolidated environment model enables non-performing assets to be removed from the balance sheets of banks.

The new version of the «Minimum Requirements for the Risk Management of Credit and Financial Services Institutions» (MaRisk) is also significant for the sector. The regulatory requirements applicable for stress testing, liquidity risk as well as risk concentration are particularly relevant in this respect. The MaRisk now also imposes more stringent requirements in relation to group-wide risk management. They explicitly require a strategy to be developed for the entire Group, i.e. risk-bearing capacity must be guaranteed for the entire Group.

The law concerning the modernisation of accounting law (BilMoG) which came into force in May 2009 contains the accounting rules for the annual financial statements and consolidated financial statements under commercial law as well as numerous regulations concerning corporate governance. Most of the accounting regulations are the subject of mandatory adoption in the year 2010; all corporate governance regulations are applicable for the year 2009.

Company-specific Conditions

Organisational and legal structure of Deutsche Pfandbriefbank AG

Deutsche Pfandbriefbank AG is a subsidiary of HRE Holding. In the year under review, HRE consisted in particular of the HRE Holding parent and the operating bank subsidiaries Hypo Real Estate Bank AG and DEPFA Deutsche Pfandbriefbank AG, as well as DEPFA Bank plc. DEPFA Deutsche Pfandbriefbank AG was merged with Hypo Real Estate Bank AG on 29 June 2009, and was renamed Deutsche Pfandbriefbank AG. Since 19 May 2009, HRE Holding has also been the ultimate parent of the HRE Group for regulatory purposes (Section 16a (3) Clause 3 KWG). In the structure, the areas of responsibility are broken down into three operating segments which are to a large extent independent of the legal classification based on subsidiaries; these are accordingly also applicable for Deutsche Pfandbriefbank AG.

Strategy

Corporate strategy In the financial year 2009, the Deutsche Pfandbriefbank Group consisted of two reporting segments: Commercial Real Estate and Public Sector. There is also the Corporate Center segment. Contributions to earnings made by the non-strategic portfolios such as the CDO portfolio and an internal HRE guarantee as well as expenses of essential Group functions are some of the items shown in the Corporate Center. In addition, the Corporate Center also includes the costs of the liquidity support and certain administrative expenses of back-office operations.

Deutsche Pfandbriefbank AG is the strategic core bank of HRE. The segment structure is being revised as part of the strategic refocusing process. In the financial year 2010, HRE will change over its reporting system to three operating segments: strategic business in Commercial Real Estate Finance (previously: Commercial Real Estate) will in future be pooled in the Real Estate Finance segment, and strategic Public Sector Finance business (previously: Public Sector) will be pooled in the Public Sector Finance segment. Non-strategic business will be included in the «Value Portfolio» segment and is to be reduced in a value-preserving manner. A «Consolidation & Others» line will also be introduced; in addition to accounting consolidation items, this will comprise individual items which cannot be allocated to the strategic segments or the Value Portfolio.

New business will be taken on only at Deutsche Pfandbriefbank AG, and only in Real Estate Finance and Public Sector Finance. In the two future target segments Real Estate Finance and Public Sector Finance, key factors of success in the new business strategy will be the numerous long-standing customer relations and the large customer base which formed the basis for new business in 2009. The new business strategies of these two segments are as follows:

Real Estate Finance new business strategy Real Estate Finance focusses on real estate financing with a conservative refinancing strategy for professional investors. It focusses on financing existing properties. Development Finance is operated only on a selective and non-speculative basis. The regional focus is on markets eligible for Pfandbrief refinancing, and in particular Germany, England and France as well as other selected European regions in which Deutsche Pfandbriefbank AG had already been operating in the past. LTVs of up to 80% are taken on. The target size for financing arrangements is around € 70 million and very selectively up to € 100 million; a minimum size of € 10 million is applicable for German SMI clients and € 20 million for professional real estate financing customers in the rest of Europe. Strategic partnerships have been concluded with other institutions with the aim of permitting higher LTVs by means of syndications and syndicate financing for customers without increasing the risk for the bank.

Public Sector Finance new business strategy New business is to focus on the primary markets, i.e. direct financing for public sector entities and with a conservative refinancing strategy. The aim is to concentrate on markets eligible for Pfandbrief refinancing with excellent country ratings. For the financial year 2009, the focus was on Germany, France, Italy and Spain. The target group for this business consists of profitable customer segments with a commensurate risk level: regions, municipalities and local authorities as well as state-guaranteed public bodies and guaranteed public private partnerships. Direct business with sovereign states is conducted only to a limited extent, because most of these use direct access to the capital markets and such arrangements permit only minor cross-selling opportunities with low or even negative margins. The aim is to provide mainly simple and customised financing solutions which are essentially classified under the category of loans and receivables with maturities of up to twelve years. A further aim is to significantly improve profitability in the Public Sector Finance segment by way of actively offering customer derivatives for risk reduction purposes but not for speculative purposes.

Strategy for reducing credit and security portfolios in a value-preserving manner Following liaison with the SoFFin, HRE Holding has submitted an application to the Financial Market Stabilisation Fund (FMSA) to establish a deconsolidated environment for reducing assets in a value-preserving manner. HRE intends to transfer operations which are no longer strategically necessary for the refocusing of the Company as well as further items on the balance sheet to this deconsolidated environment. The transfer is expected to take place in the second half of 2010 after approval is obtained from all necessary institutions and bodies, and is expected to comprise assets of up to € 210 billion. Loans which are no longer consistent with the strategic focus of the core bank can thus be continued in a value-preserving manner, also in the interests of the customers. In addition, this transfer is also expected to reduce the further capital requirements of Deutsche Pfandbriefbank AG and ensure that this Company can be structured in such a way that it can be reprivatised more quickly. The FMSA is responsible for determining whether, and if so to what extent, the application for establishing the deconsolidated environment will be approved.

Management concept The management concept of Deutsche Pfandbriefbank Group corresponds to the management concept of HRE and aims to ensure the continued existence of the Group as a going concern and to enhance the enterprise value in the long term. The focus will continue to be on assuring the liquidity and solvency and also on improving the risk early warning system. The overriding aim of liquidity management is to ensure that all payment obligations which fall due can be fulfilled at all times. As was the case last year, this objective at present can only be attained with the aid of extensive support. Solvency, in other words adequate capital backing, is managed on the basis of the regulatory parameters core capital ratio and equity ratio at the Group level and at the level of individual institutions. The ratios which are prescribed by law can also be achieved only with the aid of the support. HRE also manages these ratios on the basis of scenario analyses, which for instance take account of rating migrations or changes in exchange rates. The risk early warning system was revised after the crisis of HRE; it is explained in detail in the Risk Report.

At the same time, strict cost discipline is necessary for ensuring the continued existence of the Company as a going concern. This is monitored on the basis of absolute costs and also on the basis of the cost-income ratio. The cost-income ratio is the ratio between general administrative expenses and the operating revenues, consisting of net interest income and similar income, net commission income, net trading income, net income from financial investments, net income from hedge relationships and the balance of other operating income/expenses. The aim is to improve the cost-income ratio primarily by reducing general administrative expenses following the restructuring; a secondary aim is to improve the cost-income ratio by increasing new business. In addition, HRE aims to further reduce its balance sheet total by reducing non-strategic portfolios in a value-preserving manner.

The enterprise value is deemed to have been enhanced if the return on equity of a management unit exceeds its capital costs on a sustainable basis. In order to determine return on equity, net income according to IFRS is related to average equity (excluding AfS reserve and cash flow hedge reserve). The costs of capital constitute the theoretical costs of equity, and define the marginal cost rate for existing and future risk taking. The profitability of new business and the existing portfolio is investigated within the context of economic risk by way of comparing return on equity with the capital costs.

Major events

Most of the major events which are relevant for Deutsche Pfandbriefbank AG have to be viewed in the context of the HRE Group.

Measures designed to assure liquidity In the financial year 2009, HRE continued to utilise liquidity aid provided by a syndicate from the financial industry and the SoFFin. The liquidity support amounted to a total of € 95.0 billion as of 31 December 2009. The development is set out in the following table.

On 4 November 2009, the SoFFin initially extended the entire guaranteed line of € 52 billion for HRE until 30 June 2010. This extension was necessary because the guarantees expired as of 18 November 2009. Deutsche Pfandbriefbank AG, which belongs to the HRE Group, can continue to utilise the SoFFin guaranteed line in order to back bonds which are to be issued. The conditions are unchanged: Accordingly, Deutsche Pfandbriefbank AG paid to the SoFFin a pro-rata commitment commission of 0.1% calculated in relation to that part of the guaranteed line which was not drawn down. A commission of 0.5% p.a. is charged for utilisation of the guaranteed line.

The SoFFin, HRE and a syndicate from the German financial industry agreed a new structure for the liquidity facility which has been in place since November 2004 for HRE with an original volume of € 50 billion. Principal repayments of € 7 billion meant that the new liquidity facility declined to € 43 billion in the course of 2009. Of this figure, the syndicate from the German finance and insurance industry provided around € 23 billion. The new facility was paid out on 23 December 2009 respectively on 30 December 2009. Deutsche Pfandbriefbank AG issued € 20 billion of securities which, as had previously been the case, were partially refinanced via Central Banks and also partially via the market. The facility was fully backed by means of SoFFin guarantees dated until 22 December 2010. The federal guarantees for € 35 billion have been redeemed. The security portfolio for an original figure of € 60 billion will be largely released by 31 March 2010. The federal guarantee as well as the security portfolio acted as collateral for the original facility of € 50 billion. The pledged shares in Deutsche Pfandbriefbank AG and DEPFA Bank plc as well as the pledged shares in subsidiaries of DEPFA Bank plc have not been released.

This restructuring has resulted in lower costs for HRE for the provision of liquidity. Interest is charged on the securities taken up by the syndicate at a rate of EURIBOR + 0.10% p.a. The SoFFin guarantees cost a commitment commission of 0.10 basis points p.a. or 0.50% p.a. if utilised.

Liquidity support measures for HRE

Type of support	Date of granting	Date of maturity, taking account of prolongations	**Original nominal amount** in € billion	**Nominal amount as of 31.12.2009**
Issue of state guaranteed, ECB-eligible bearer bonds (= repayment of the liquidity credit line of Deutsche Bundesbank of 13.11.2008 to 26.3.2009)	26.3.2009	30.12.2009	20.0	–
Issue of state guaranteed ECB-eligible bearer bonds	13.11.2008	23.12.2009	15.0	–
Issue of covered bonds	13.11.2008	23.12.2009	15.0	–
Issue of SoFFin guaranteed bearer bonds (Repayment of a guaranteed line provided by the SoFFin first time at 19.4.2009)	18.11.2009	30.6.2010	52.0	52.0
Issue of SoFFin guaranteed bearer bonds (repayment of the state guaranteed and covered bonds from 26.3.2009 to 23.12.2009)	23.12.2009	22.12.2010[1]	23.0	23.0
Issue of SoFFin guaranteed ECB-eligible bearer bonds (repayment of the state guaranteed ECB-eligible bearer bonds of 26.3.2009 to 30.12.2009)	30.12.2009	22.12.2010	20.0	20.0
Total liquidity support				**95.0**

[1] Pursuant to Section 5 (1) of the terms of the bond, partial repayments of € 1.5 billion in each case are to be made as of 23.3./23.6./23.9.2010.

Recapitalisation In the financial year 2009, the SoFFin recapitalised HRE initially with a total of around € 6 billion; HRE Holding received proceeds of € 3 billion by way of two capital increases in March and in June 2009. In November 2009, the Group received a further € 3 billion. With the decision of 13 November 2009, the EU Commission declared that the further recapitalisation tranche for HRE was provisionally (i.e. until the final decision is taken with regard to the restructuring plan) consistent with the aid regulations of the EC treaty.

The recent capital increase by the SoFFin was carried out at the level of HRE Holding and Deutsche Pfandbriefbank AG: The SoFFin has paid € 700 million into the reserve of HRE Holding. At Deutsche Pfandbriefbank AG, a figure of € 1.3 billion was paid into the reserves; € 1 billion was provided in the form of a silent contribution. In addition, in a written statement of intent provided to HRE, the SoFFin again confirmed on 6 November 2009 that it will provide adequate capital to ensure at least the continued existence of HRE Holding and its main subsidiaries as going concerns as well as the necessary viable business model, particularly that of Deutsche Pfandbriefbank AG. The support which HRE overall receives from central government depends on the result of a final review as to whether a deconsolidated environment will be established for non-strategic or non-performing assets of HRE. These as well as all further measures are conditional on meeting the aid law requirements of the EU Commission.

Proceedings at the European Commission With the decision of 2 October 2008, the European Commission approved measures designed to cover the liquidity requirement of HRE. In this decision, the Federal Republic of Germany was obliged to submit a restructuring plan for HRE by no later than 1 April 2009. HRE has prepared such a restructuring plan and submitted it on time to the European Commission via the Federal Ministry for Economics. This restructuring plan is currently being reviewed by the European Commission. With the decision of 7 May 2009, the European Commission initiated the so-called «formal review proceedings». With its decision of 13 November 2009, the European Commission extended the formal review procedure to include further measures which had in the meantime been granted in favour of HRE and also with regard to planned measures. In complex proceedings regarding Aid Law, the initiation and extension of the formal audit proceedings are the normal procedure; they are conducted by the European Commission without prejudice, and do not anticipate any decision with regard to content. The Management Board of HRE Holding currently does not expect to receive a definitive decision before the second quarter of 2010.

Location closures or consolidations The process of reducing or consolidating the number of locations is making good progress as planned. Since January 2009, nine locations throughout the world have been closed; these are expected to be followed by further closures by the end of the year 2010. In addition, at locations with several office buildings (London, Madrid, Paris and New York), the offices have been pooled.

The process of relocating the previous Munich locations to the location in Unterschleißheim was completed in the second half of August in 2009. Most of the employees who previously had been working at five locations distributed throughout Munich are now working at the new location. Only the IT subsidiary pbb Services GmbH as well as a temporary IT project have retained their two locations in Munich. The Unterschleissheim location provides offices for around 650 employees. The legal registered offices of the Company will continue to be Munich after the relocation process has been completed.

New brand pbb Deutsche Pfandbriefbank Since 2 October 2009, Deutsche Pfandbriefbank AG has been operating under the new brand «pbb Deutsche Pfandbriefbank» as well as with a new logo and new corporate design on the market. The new brand was used for the first time at the international real estate exhibition Expo Real between 5 and 7 October 2009 in Munich. With this new brand, the external presentation of the Bank has also completed the merger between DEPFA Deutsche Pfandbriefbank AG and Hypo Real Estate Bank AG to form Deutsche Pfandbriefbank AG.

Deutsche Pfandbriefbank AG has transferred operation and management of its IT infrastructure With effect from 1 November 2009, Deutsche Pfandbriefbank AG and its affiliated Group companies outsourced operation of its entire world-wide IT infrastructure to Fujitsu Services GmbH. This measure covers the operation of the data centres, the servers, the networks and other services.

Deutsche Pfandbriefbank AG is selling receivables from the Lehman Brothers insolvency and CDO portfolio In September 2009, Deutsche Pfandbriefbank AG successfully completed an auction for receivables resulting from the insolvency process of Lehman Brothers. During the auction, it sold virtually all of its receivables due from Lehman Brothers Holding and affiliated companies with a volume of around € 66.7 million. Deutsche Pfandbriefbank AG has realised a book profit as a result of the sale. In addition, in the fourth quarter of 2009, Deutsche Pfandbriefbank AG sold a portfolio of CDO and MBS securities with a volume of € 1.3 billion. This has resulted in particular in a reduction of the investment in US CDOs.

Capital market issues Deutsche Pfandbriefbank AG successfully issued a jumbo mortgage Pfandbrief with a volume of € 1.5 billion on 8 September 2009, and also issued a public jumbo Pfandbrief with a volume of € 1 billion on 14 October 2009. These were the first public issues of the institution for more than one year. Both issues were very positively received on the market and were oversubscribed. For the jumbo mortgage Pfandbrief, Deutsche Pfandbriefbank AG paid a premium of 50 basis points above the current reference price in the swap market; for the public jumbo Pfandbrief, it paid a premium of 55 basis points above the current reference price on the swap market. At the beginning of 2010, Deutsche Pfandbriefbank AG successfully issued a further public jumbo Pfandbrief with a volume of € 1 billion on 11 January 2010. The current Pfandbrief has been issued with a coupon of 3.375 % per annum, and has a term of seven years. Deutsche Pfandbriefbank AG paid a premium of 38 basis points above the current reference price on the swap market. With an issue price (re-offer price) of 99.254 %, this is equivalent to a yield of 3.497 % for the Pfandbrief. In addition, unsecured issues of € 1.6 billion were carried out in the year 2009. The issue volume of short-term deposits and commercial papers amounted to € 1.8 billion.

Personnel

Changes in the Management Board There have been the following personnel changes in the Management Board of DEPFA Deutsche Pfandbriefbank AG between 1 January 2009 and 29 June 2009. The Management Board mandates of Dr. Matthias Achilles and Dr. Marcel Morschbach ceased with the merger between DEPFA Deutsche Pfandbriefbank AG and Hypo Real Estate Bank AG.

There have been the following personnel changes in the Management Board at Hypo Real Estate Bank AG, which was renamed Deutsche Pfandbriefbank AG on 29 June 2009. On 15 January 2009, Charles Balch and Frank Hellwig stepped down from the Management Board, and Reinhold Güntner stepped down from the Management Board on 31 January 2009. Dr. Robert Grassinger terminated his mandate on the Management Board of Hypo Real Estate Bank AG as of 31 March 2009. The Supervisory Board appointed Manuela Better to the Management Board of Hypo Real Estate Bank AG with effect from 1 February 2009. She has assumed the function of Chief Risk Officer (CRO).

The Supervisory Board of Deutsche Pfandbriefbank AG appointed Alexander Freiherr von Uslar-Gleichen to the Management Board as of 1 October 2009. He has assumed the function of Chief Financial Officer (CFO). Dr. Bernhard Scholz was appointed as a member of the Management Board by the Supervisory Board of Deutsche Pfandbriefbank as of 1 January 2010. He is responsible for the area Real Estate Finance.

Ratings of Deutschen Pfandbriefbank AG

In the financial year 2009 and until 12 March 2010, the three mandated rating agencies, with regard to bank and covered bond ratings performed the following major rating changes:

In January 2009, ahead of the announced merger with the public sector cover pool of Hypo Real Estate Bank AG, Fitch Ratings set the rating of public sector Pfandbriefe of DEPFA Deutsche Pfandbriefbank to «Watch Negative». At the beginning of February 2009, Moody's completed its review of the ratings, and downgraded the long-term rating of the banks by only 1 notch from A2 to A3 in anticipation of state support. The other ratings were confirmed, and the outlook for all ratings is negative. In a further rating action, Moody's confirmed its ratings for the Pfandbriefe of Hypo Real Estate Bank AG and DEPFA Deutsche Pfandbriefbank AG and thus terminated the review for downgrade. At the beginning of April 2009, Standard & Poor's placed the bank ratings to «Credit Watch Positive» due to the expected state support. Following the Extraordinary General Meeting of HRE Holding on 2 June 2009, Fitch upgraded the short-term rating from F1 to F1+. The merger of DEPFA Deutsche Pfandbriefbank AG into Hypo Real Estate Bank AG (now trading as Deutsche Pfandbriefbank AG) which took place as of 29 June 2009 did not have an impact on the ratings. At the end of November 2009, Fitch Ratings completed its continuous review of the public sector Pfandbriefe of Deutsche Pfandbriefbank AG and confirmed the AAA rating.

Ratings of Deutsche Pfandbriefbank AG and its covered bonds

as of 31 December 2009		Standard & Poor's	Moody's	Fitch Ratings
Deutsche Pfandbriefbank AG	Long-term	BBB	A3	A–
	Short-term	A–2	P–1	F1+
	Outlook	Credit Watch Positive	Negative	Stable
Public Sector Pfandbrief		AAA[1]	Aaa	AAA
Mortgage Pfandbrief		AAA[1]	Aa3	AA+[1]

[1] Credit watch for possible downgrade

Method of operation of the Supervisory Board

The Supervisory Board of Deutsche Pfandbriefbank AG, formerly Hypo Real Estate Bank AG, consisted of the following persons between 1 January 2009 and 13 August 2009: Dr. Michael Endres (Chairman), Bernd Knobloch, Dr. h.c. Edgar Meister (until 18 May 2009), Hans-Jörg Vetter, Manfred Zaß (since 19 May 2009), Ursula Bestler (employees' representative) and Georg Kordick (employees' representative). Because the period of office of Dr. Endres, Mr. Knobloch, Mr. Vetter and Mr. Zaß on the Supervisory Board of HRE Holding expired at the end of the Annual General Meeting of HRE Holding on 13 August 2009, the above persons laid down their mandates on the Supervisory Board of Deutsche Pfandbriefbank AG at the end of 13 August 2009.

An Extraordinary General Meeting of Deutsche Pfandbriefbank AG on 13 August 2009 elected the following persons onto the Supervisory Board with effect from 14 August 2009: Dr. Bernd Thiemann, Dagmar Kollmann, Dr. Günther Bräunig and Dr. Hedda von Wedel. In the Extraordinary Supervisory Board Meeting on 14 August 2009, Dr. Bernd Thiemann was elected as the Chairman of the Supervisory Board and Dagmar Kollmann was elected as his Deputy.

Between 14 August 2009 and 31 December 2009, the Supervisory Board of Deutsche Pfandbriefbank AG consisted of the following persons: Dr. Bernd Thiemann (Chairman), Dagmar Kollmann (Deputy Chairman), Dr. Günther Bräunig, Dr. Hedda von Wedel, Ursula Bestler (employees' representative) and Georg Kordick (employees' representative).

In the meeting of 26 January 2009, the Supervisory Board appointed Manuela Better as a member of the Management Board with effect from 1 February 2009. In its meeting of 15 May 2009, the Supervisory Board appointed Alexander Freiherr von Uslar-Gleichen as a member of the Management Board with effect from 1 October 2009. Pursuant to the resolution of the Supervisory Board of 11 November 2009, Dr. Bernhard Scholz was appointed as a member of the Management Board with effect from 1 January 2010.

The Supervisory Board of Deutsche Pfandbriefbank AG did not have any committees between 1 January 2009 and 31 December 2009.

In 2009, the Supervisory Board of Deutsche Pfandbriefbank AG held ten meetings and adopted five circular resolutions outside meetings. No member of the Supervisory Board missed more than half of the meetings.

The rules of procedure of the Supervisory Board of Deutsche Pfandbriefbank AG were not changed in 2009.

The Supervisory Board and Management Board extensively discussed the measures regarding the liquidity and capital support for the Bank and the restrucuring of the Bank. The Supervisory Board was regularly and promptly informed by the Management Board with regard to the economic and financial development of Deutsche Pfandbriefbank AG, the business policy and planning, the strategy, the risk position, risk management, the liquidity strategy, all reportable exposures as well as other major events. The chairman of the Management Board was in constant contact with the chairman of the Supervisory Board with regard to major developments.

Regular discussions took place with regard to the development in lending business and lending policy as a whole, risk development, risk management, the focus of business policy as well as developments and trends on the markets in lending and funding business. The measures for overcoming the crisis which poses a threat to the very existence of the Bank were extensively discussed.

The Supervisory Board also considered the results of internal audits, annual and multi-year planning as well as the management and control mechanisms in lending, securities and derivatives business. Discussions took place with regard to the report on Compliance (including the Data Protection and Money Laundering Act), «Basle II» implementation, the verification of the necessary independence of the auditor, placing the audit engagement with the auditor and the fee agreement with the auditor.

The Supervisory Board would like to thank the Management Board and all employees of Deutsche Pfandbriefbank AG for their activities in the year under review.

Deutsche Pfandbriefbank AG as an employer in 2009

With the implementation of the strategic realignment and restrucuring of HRE which was adopted in the year 2008, the year 2009 experienced an extensive restructuring process in HRE, which also resulted in a streamlined organisation structure at Deutsche Pfandbriefbank AG and consequently led to considerable job cuts as well as closures of locations. At the same time, despite increasing competition on the market, new and highly qualified employees were recruited to strengthen strategically important staff and operating functions as part of the process of assuring the future competitiveness of the Bank.

The necessary negotiations regarding reconciliation of interests have been conducted as the basis for carrying out the restructuring measures in Germany. In addition, Management and the central Works Council in Germany have signed a framework agreement which specifies the measures following the restructuring process and which describes the rules of implementation for the restructuring process. The social plans which are also applicable for the entire duration of the restructuring process have also been agreed with the corresponding Works Council bodies.

In total, the number of employees of the Bank declined from 971 at the end of 2008 to 930 at the end of 2009. So far, the job cuts have been largely carried out in a socially compatible manner and with the agreement of the affected employees. Restructuring-related and compulsory redundancies have so far been avoided in Germany.

With the merger between Depfa Deutsche Pfandbriefbank AG and Hypo Real Estate Bank AG, which was entered in the commercial register at the end of June 2009, the employment agreements of the employees were continued in unchanged form at the new employer. In addition, the employment agreements of most HRE Holding employees were transferred to Deutsche Pfandbriefbank AG in 2009 by way of a Group transfer process. Partial secondments of employees of Deutsche Pfandbriefbank AG assured the functions which are necessary for the Holding as the ultimate parent company of the Group.

With effect from 1 November 2009, the Deutsche Pfandbriefbank Group outsourced operation of the Group's world-wide IT infrastructure to Fujitsu Services GmbH. This measure covers the operation of the data centres, the servers and the networks. The outsourcing arrangement also included «end user computing», i.e. support for the workplace PCs and their application as well as general support. Overall, 48 internal employees who previously had been employed in the IT infrastructure of the Group were taken over by Fujitsu Services GmbH at their existing locations as of 1 November.

The adjusted fluctuation in Deutsche Pfandbriefbank AG in 2009 was 14.69%. Fluctuation due to employment agreement being terminated by the employee or the Bank and due to the expiry of temporary agreements, excluding persons leaving the Company as a result of death, retirement, early retirement, a cancellation agreement or Group transfer.

Employees' compensation report

Variable compensation 2009 Because of the still difficult situation on the financial markets, the fact that the results of the Group are still negative and also because the support is still necessary, the Management Board does not plan to prepare a budget for 2009 for discretionary variable compensation in the relevant local legal framework, nor does it plan to make any payment in this respect. As was the case in 2008, this is applicable for all Group companies and locations.

However, the Management Board is currently liaising with major interest groups in order to determine that a voluntary one-off payment is to be made instead of variable compensation. With regard to the planned substitute solution, the Management Board has emphasised the need to assure operational stability and avoid operational risks, and focussed thereby on management and motivation of key staff in the critical phase of restructuring.

The purpose, legal background, extent and contents of this payment differ from the discretionary variable compensation in the past. With regard to such a substitute solution, the payment can therefore only be made to employees who in return have waived their entitlement to any payment of discretionary variable compensation for the year 2009 in a legally effective manner.

With regard to the form of this «strategic solution 2009», the planned compensation payment is to be based on standard and regionally differentiated compensation modules which are linked to the employee's basic salary, with due consideration being given to a contribution and performance weighting. For the contribution and performance weighting, the contributions and performance of the employee with regard to the stabilisation, restructuring and repositioning of the Group are to be taken into account on an overall basis. Some of the payment is to be postponed for certain employees.

The Supervisory Board and the owner have been notified and involved with regard to the «strategic solution 2009». The co-determination rights of the employees' representives in Germany have been safeguarded.

Remuneration Committee The Management Board set up a Remuneration Committee on 22 January 2010 as a result of the BaFin circular 22/2009 «Regulatory requirements applicable for the remuneration systems of institutions» which was published on 21 December 2009. The Remuneration Committee consists of representatives from Personnel, the Sales units as well as the Value Portfolio, Risk Controlling and Management, Compliance/Corporate Governance, Finance as well as – as a member without voting rights within the framework of his duties – a representative of Internal Audit. In order to emphasise the special role of the Remuneration Committee, Frank Krings, in his capacity as Chief Operating Officer and in his role as Personnel Director, has been nominated as the chairman of the Remuneration Committee.

The major tasks of the Remuneration Committee have so far been:
> Intense involvement with and appraisal of the «strategic solution 2009» in the context of the legal/regulatory requirements, as well as
> The development of a proposal for the applicability of the special requirements set out in Section 4 of the BaFin circular (positive self-assessment) as well as
> In conjunction with the interpretation of Section 4 of the BaFin circular, the development of a proposal for defining the risk-related functions («risk taker») for which the special requirements of Section 4 of the BaFin circular are applicable.

Only the Managing Directors of Deutsche Pfandbriefbank AG have been proposed as risk-related positions (risk taker) for the year 2009. The Management Board of Deutsche Pfandbriefbank AG has approved the proposal of the Remuneration Committee and has adopted the corresponding resolutions in this respect. This decision recognises that the overriding objective of the Group for the year 2009 was to reduce risks as well as to restructure and reposition the Group. In addition, in the year 2009, the Management Board was responsible for all major decisions in connection with key risk positions.

Introduction of a new compensation system starting in 2010 In line with the regulatory requirements (long-term nature, sustainability, transparency and adequacy) and also in view of the interests of the public «stakeholder», it is necessary for a new compensation system to be introduced starting in 2010. For this purpose, major preparatory work was carried out in 2009, in particular a thorough classification and allocation of employee functions and a comprehensive regionally differentiated salary study. Key structure elements of the new compensation system have been developed, and the Supervisory Board was notified extensively of the status of the work. There are plans for further liaison with the various interest groups to be completed in the first half of 2010.

Sustainability

Corporate culture The promotion of an open corporate culture is a key element of the corporate culture. In addition to the economic focus, non-financial factors are also taken into consideration. For instance, the general credit principles of Deutsche Pfandbriefbank Group define ethical principles for extending loans which are consistent with the code of conduct which is applicable for all members of staff.

In addition, the corporate culture also aims to promote and maintain an environment in which life is worth living. Care is taken to ensure that manufacturers and suppliers meet the defined environmental protection requirements and that they are correspondingly certified. Internally, this requirement is satisfied in various ways, e.g. by way of procedures which use reduced volumes of paper or by way of using modern energy-saving equipment.

Social commitment Deutsche Pfandbriefbank Group continued to meet its social responsibility in the year 2009 mainly by way of its two foundations: the Hypo Real Estate Foundation, Munich as well as the Foundation for Art and Science of the former Hypo Real Estate Bank International AG, Stuttgart. Since they were originally established in 1968 and 1987 respectively by the predecessor institutions of Deutsche Pfandbriefbank AG, the foundations have had independent capital which is not linked in any way to the Bank. This capital is used exclusively for fulfilling the aims of the foundation. In this way, despite the special financial situation of Deutsche Pfandbriefbank Group in the year under review, Deutsche Pfandbriefbank Group was still able to meet its social responsibility with regard to promoting art, culture and science. The two foundations do not have any of their own personnel. The foundation work is provided free-of-charge to the foundations in the form of ongoing personnel support of Deutsche Pfandbriefbank AG.

The **Hypo Real Estate Foundation** supports concerts and exhibitions. On the other hand, with its architecture prize which enjoys nation-wide recognition, it takes the initiative itself for improving the architectural culture of commercial properties in Germany. Beyond the architecture prize, the foundation also awards grants in the fields of music and art.

The **Foundation for Art and Science** of the former Hypo Real Estate Bank International AG supports intellectual and artistic work particularly in the fields of literature, painting, sculpture, music, the theatre, architecture/design, regional and cultural studies as well as customs and traditions – focussing on Baden-Württemberg. It also awards a foundation prize in these areas every one to two years.

Development in Earnings

Deutsche Pfandbriefbank Group

The Deutsche Pfandbriefbank Group combines the German and international commercial real estate financing business of the Hypo Real Estate Group (HRE) and the activities of the former DEPFA Deutsche Pfandbriefbank AG. The ultimate parent company of the Group is Deutsche Pfandbriefbank AG, whose shares are completely held by Hypo Real Estate Holding AG (HRE Holding).

The merger between the former DEPFA Deutsche Pfandbriefbank AG and Hypo Real Estate Bank AG was agreed and concluded by the Annual General Meeting in the second quarter of 2009 and was registered in the commercial register on 10 and 29 June 2009 by the local courts (Amtsgerichte) Frankfurt and Munich. The new entity now trades under the name of Deutsche Pfandbriefbank AG. The registered office of the company is located in Munich. The merger took place by way of absorption by an existing company by transferring the assets and liabilities of DEPFA Deutsche Pfandbriefbank AG in accordance with sections 2,60 et seq. UmwG. Because Hypo Real Estate Bank AG as well as the former DEPFA Deutsche Pfandbriefbank AG were subsidiaries of HRE Holding, the transaction is a business combination involving companies subject to joint control. The assets and liabilities transferred within the framework of the merger were valued with the consolidated carrying amounts of the subsidiary as of 30 June 2009 (so-called predecessor accounting).

In addition, HRE Holding sold its subsidiary pbb Services GmbH (formerly Hypo Real Estate Systems GmbH) to Deutsche Pfandbriefbank AG on 30 June 2009. This is also a business combination involving companies subject to joint control. The assets and liabilities transferred within the framework of the merger were valued with the consolidated carrying amounts of the subsidiary as of 30 June 2009 (so-called predecessor accounting).

The former DEPFA Deutsche Pfandbriefbank AG and Hypo Real Estate Systems GmbH are not included in the prior year comparison information 2008 in accordance with IAS 1.36. The income statement of the year 2009 includes both companies since the date of the merger respectively the purchase. However, in order to present the merger and the purchase as part of a meaningful comparison which makes sense from the accounting point of view, the results of operations of the Deutsche Pfandbriefbank Group have been shown in the form of combined figures in the financial report in the income statement for 2008 and 2009. For preparing the combined income statements, it has been assumed that the merger took place as of 1 January 2008. The recognition, accounting and valuation aspects of the combined financial information have been prepared in accordance with IFRS. The recognition, accounting and valuation principles used for the comparison information are the same as those used in the audited and published consolidated financial statements of the former Hypo Real Estate Bank AG for the period ending 31 December 2008. There are no differences between these principles and the principles of the current consolidated financial statements of Deutsche Pfandbriefbank AG for the period ending 31 December 2009.

The combined figures can be reconciled with the figures shown in the income statement and in the notes to the financial statements as follows:

Key Financials 2009 in € million	**Combined 1.1.–31.12.2009**	Deutsche Pfandbriefbank Actual 1.1.–31.12.2009	DEPFA Deutsche Pfandbriefbank 1.1.–30.6.2009	pbb Services 1.1.–30.6.2009	Consolidation 1.1.–30.6.2009
Operating performance					
Operating revenues	653	561	57	35	–
Net interest income and similar income	863	785	78	–	–
Net commission income	–66	–60	–6	–	–
Net trading income	–44	–45	1	–	–
Net income from financial investments	–43	–43	–	–	–
Net income from hedge relationships	–23	–6	–17	–	–
Balance of other operating income/expenses	–34	–70	1	35	–
Provisions for losses on loans and advances	1,891	1,890	1	–	–
General administrative expenses	305	259	12	34	–
Balance of other income/expenses	18	16	–	2	–
Pre-tax profit	–1,525	–1,572	44	3	–
Key ratios in %					
Cost-income ratio	46.7	46.2	21.1	97.1	

Key Financials 2008 in € million	**Combined 1.1.–31.12.2008**	HRE Bank Actual 1.1.–31.12.2008	HRE Bank International 1.1.–30.9.2008	DEPFA Deutsche Pfandbriefbank 1.1.–31.12.2008	pbb Services 1.1.–31.12.2008	Consolidation 31.12.2008
Operating performance						
Operating revenues	–744	–1,152	351	51	51	–45
Net interest income and similar income	1,092	711	298	83	–	–
Net commission income	73	23	54	–4	–	–
Net trading income	–726	–655	–26	–45	–	–
Net income from financial investments	–1,235	–1,255	19	1	–	–
Net income from hedge relationships	–11	–22	–1	12	–	–
Balance of other operating income/expenses	63	46	7	4	51	–45
Provisions for losses on loans and advances	1,236	1,104	133	–1	–	–
General administrative expenses	254	107	120	26	46	–45
Balance of other income/expenses	–142	–134	1	–8	–1	–
Pre-tax profit	–2,376	–2,497	99	18	4	–
Key ratios in %						
Cost-income ratio	>100.0	>100.0	34.2	51.0	90.2	

In the financial year 2009, the development in earnings of Deutsche Pfandbriefbank Group was affected by its specific situation and the continued difficult situation in lending and particularly in real estate financing. In consequence, pre-tax profit amounted to € – 1,525 million and was negative as expected. This loss was attributable to considerable impairments, which mainly affected loans on real estate financings. In addition, net commission income was depressed incurred for external liquidity support, without which, however, it would not have been assured for Deutsche Pfandbriefbank Group to continue as a going concern.

The pre-tax profit of 2008 was also affected by the crisis at the Group and the situation on the difficult markets; the figure of € – 2,376 million was lower than the current figure. The main reasons were significant impairments and reductions in value to be recognised in the income statement in relation to trading assets and financial assets in the form of Collateralised Debt Obligations (CDOs) and Mortgage Backed Securities (MBS) as well as considerable provisions for losses on loans and advances.

Operating revenues Operating revenues amounted to € 653 million, and were thus € 1,397 million higher than the corresponding figure for 2008, when operating revenues were negative with € – 744 million. The increase is solely attributable to net trading income and net income from financial investments which were by far less negative, due mainly to stabilising capital and financial markets.

Net interest income of € 863 million was lower than the corresponding prior year figure of € 1,092 million. The decline is attributable to higher exceptional factors in the prior year and also to the process of reducing interest-bearing assets which was carried out consistently throughout 2009. Impairments recognised in relation to some subordinated capital instruments resulted in income of € 138 million in 2009 (prior year: € 353 million). In addition, the one-off revenues attributable to sales of receivables, premature repayment penalties as well as repurchasing and redemptions of financial liabilities also declined compared with the prior year (2009: € 40 million, 2008: € 78 million). Furthermore, net commission income was affected by the declining portfolio holding as well as the default of borrowers and the associated interest defaults. So-called «unwinding», i.e. the extrapolation of the cash value of expected future cash flows, compensates to some extent for the effect attributable to the default of borrowers. In the first half of 2009, a positive effect was achieved as a result of income from money market operations. As a result of falling interest rates on the money market, HRE was able to take advantage of lower refinancing expenses in conjunction with constant revenues on the assets side of the balance sheet. This factor was felt primarily in the first half of 2009. Since mid-2009, it has not had a significantly positive impact on the net interest income of Deutsche Pfandbriefbank Group because interest rates are now stable.

Net commission income amounted to € – 66 million compared with € 73 million in the previous year. The decline is primarily attributable to expenses of € – 154 million incurred for the guarantees in connection with the liquidity support provided by the SoFFin and the German Federal Government. In the prior year, such expenses were only incurred in the fourth quarter (€ – 12 million). The expenses for liquidity support of the current year contain a profit-related fee. In December 2009 as expected the syndicate from the financial sector abandoned the profit-related fee in the course of the restructuring of the liquidity support granted in November 2008. In contrast, the federal government in its capacity as guarantor has not yet waived the profit-related fee. Therefore a liability of € 44 million was recognized and € 5 million were related to the months of November and December 2008.

The net trading income of € – 44 million reported for 2009 was much less negative than the corresponding prior year figure (€ – 726 million). However, the development of the portfolios and assets was unequal. The valuation losses of € – 58 million in relation to the holdings of embedded derivatives in synthetic CDOs which have to be separated were significantly less negative compared to the prior year level (2008: € – 395 million). In contrast, the latent default risk inherent in customer derivatives increased. For this, Deutsche Pfandbriefbank Group creates provisioning, a so-called counterparty risk adjustment, in line with the increasing probability of default of credit receivables. These additions amounted to € – 151 million in 2009 (2008: € – 24 million). Furthermore, an income of € 175 million resulted from a HRE internal guarantee for the default of a credit insurer for CMBS (in 2008: expenses of € – 393 million). In this respect a positive factor was the lower probability of default in connection with the restructuring of a US monoline insurer.

Impairments and write-ups in relation to securities as well as results from the disposal of securities are shown under net income from financial investments amounted in 2009 to € – 43 million (2008: € – 1,235 million). The substantial losses of the prior year were mainly attributable to impairments recognised in relation to cash CDOs (2008: € – 762 million including a partial reversal of € 70 million of the model reserve created in the year 2007) and in relation to MBS (2008: € – 464 million). In contrast, in the year 2009 impairments on cash CDOs amounted to € – 77 million (including a partial reversal of € 12 million of the model reserve created in the year 2007) and impairments on MBS of € 89 million were reversed. In addition, the portfolio-based allowances in relation to LaR financial assets were increased by € – 10 million (2008: € – 24 million) and a building impaired by € – 33 million.

The net income from hedge relationships was negative at € – 23 million, and was thus lower than the corresponding prior year figure of € – 11 million. The net income from hedge relationships includes hedge inefficiencies of € – 24 million (2008: € 15 million) within the range of 80 % to 125 % permitted under IAS 39 as well as the valuation result of € 1 million (2008: € – 26 million) resulting from «designated at Fair Value through Profit or Loss» (dFVTPL) assets and related derivatives. The hedge inefficiencies resulted mainly from the volatility of short-term interest rates. This had a positive impact on net interest income in the period under review, and had a negative impact on the net income from hedge relationships.

The balance of other operating income/expenses amounted to € – 34 million (2008: € 63 million), and resulted primarily from expenses from currency translation (in particular: US $) of € – 52 million (2008: income of € 72 million). The currency translation effect is mainly due to impairments on foreign currency assets. The income results from pbb Services GmbH which does services to sister companies or the HRE Holding.

Provisions for losses on loans and advances As was the case in the prior year, considerable additions to provisions for losses on loans and advances were again necessary in 2009 as a result of the deterioration in the situation on the commercial real estate markets. Overall, provisions for losses on loans and advances amounted to € 1,891 million (2008: € 1,236 million).

The significant increase in provisions for losses on loans and advances for real estate financings was due to the further deterioration in regional economic conditions of real estate markets, particularly in North America, Southern Europe, Great Britain and, to an increasing extent, Germany. The difficult economic conditions, due to the increasing vacancy rates and illiquid markets, have resulted in declines in the value of real estate and thus, indirectly, in increasing levels of loan defaults. In particular, the lower values of real estate have had an impact on financing arrangements without any direct possibility of recourse to the ultimate debtor, which account for most of the Group's financing arrangements, as well as junior financing tranches.

Portfolio-based allowances increased by € 126 million (2008: addition of € 295 million). The expected losses of the holdings have again increased, due to the deterioration in the credit standing of some debtors and the related increase in probability of default. In accordance with IAS 39, portfolio-based allowances are created only for receivables for which there are no indications of an individual impairment. With respect to the period between the occurrence and the identification of an impairment the accounting estimates were adjusted due to the improved credit processes. Further adjustments compared to the prior year were done to reflect the economic cycle as this is reflected in the historic loss rates. Due to the changed parameters the portfolio based provisions decreased by € 264 million.

General administrative expenses General administrative expenses have increased to € 305 million, compared with € 254 million in the prior year. Although the workforce declined from 963 employees as of 31 December 2008 to 926 employees in 2009, personnel expenses increased. The increase in workforce due to the transfer of employees from HRE Holding to Deutsche Pfandbriefbank AG was partly compensated by the downsizing in the course of transferring the responsibilities for management and operation of the IT infrastructure from pbb Services GmbH to Fujitsu Services GmbH. The operating expenses were above the prior year level due to increased consulting fees and IT expenses. The higher IT expenses resulted primarily from the project New Evolution for aligning the processes and IT infrastructure. Additional consultancy costs have been incurred starting in the fourth quarter of 2009 for the project involving the outsourcing of non-strategic assets to a deconsolidated environment. The cost-income ratio, i.e. the ratio between general administrative expenses and operating revenues, amounted to 46.7 % in 2009 (2008: > 100 %).

Balance of other income/expenses A restructuring provision was created in the fourth quarter of 2008 in connection with the strategic refocusing and restructuring of HRE and the Deutsche Pfandbriefbank Group. In contrast, in 2009 restructuring provisions could be reversed with the effect that the balance of other income/expenses amounts of € 18 million (compared with € – 142 million in 2008).

Pre-tax profit/loss Pre-tax result was negative at € – 1,525 million in 2009 (2008: € – 2,376 million) as expected on the beginning of the financial year 2009.

Business segment Commercial Real Estate

The operating segment Commercial Real Estate comprises German and international business in commercial real estate financing and includes the commercial real estate financing activities of Deutsche Pfandbriefbank Group.

In the fiscal year 2009, pre-tax profit amounted to € – 1,457 million, and was lower than the corresponding previous year figure of € – 350 million. The decline is attributable primarily to lower operating revenues and higher provisions for losses on loans and advances.

Operating revenues declined to € 587 million, compared with € 876 million in the prior year. Net interest income fell to € 632 million (2008: € 756 million). The decline is attributable to the constant reduction in loans. In addition, net interest income was negatively affected by the default of borrowers and the related defaults in interest payments. This is to some extent offset over a period of time by way of «unwinding», i.e. the process of extrapolating the present value of expected future cash flows. The prior year figure also included profits of € 10 million from the disposal of borrowers' note loans. Net commission income of € 97 million was unchanged compared with the corresponding prior year figure (2008: € 95 million). Lower income from the reduced portfolio holdings was offset by commissions which were not syndicated as originally planned, and which therefore started to be recognised in the income statement. In addition, the income from taking out hedges for customers was slightly above the prior year (€ 23 million in 2009 compared with € 18 million in 2008). Net trading income of € – 151 million was attributable to the latent default risk of customer derivatives, for which a position had been created. In the prior year, the net trading income of € – 45 million was attributable to interest positioning. Net income from financial investments in the prior year (€ 58 million) was attributable to profits generated by the disposal of securities. In 2009, only a very limited amount of such disposal profits was realised. Because the changes in the value of the underlyings were mainly offset by the hedging instruments, there was no income from hedge relationships (as was the case in the prior year). The balance of other operating income/expenses amounted to € 6 million (2008: € 12 million).

In the years 2008 and 2009, there was a dramatic deterioration in the situation on the commercial real estate markets. The solvency of customers, which in many cases depends to a considerable extent on the cash flows generated by the financed properties, was very negatively affected by rising vacancy rates and the difficulty of marketing in particular new properties and refurbished properties. These problems mainly affected real estate financing for hotels, office properties and retail properties. In line with the negative development on the real estate markets in Great Britain, Spain and the USA, exposures in these regions were particularly hard hit. Material impairments recognised in relation to individual properties in Germany also had an impact as a result of their significance in relation to the overall portfolio. Provisions for losses on loans and advances amounted to € 1,866 million for the whole of 2009; of this figure, individual allowances accounted for € 1,723 million and portfolio-based allowances for € 142 million. Last year, allocations to provisions for losses on loans and advances amounted to € 1,066 million.

General administrative expenses (€ 177 million) were higher than the level of the previous year (€ 155 million). The increase is mainly due to the shift of activities from Corporate Center into the business segments. Because operating revenues declined and general administrative expenses increased, the cost-income ratio deteriorated to 30.2 % (2008: 17.7 %).

Key Financials Commercial Real Estate in € million	**Combined 1.1. – 31.12. 2009**	**Combined 1.1. – 31.12. 2008**
Operating performance		
Operating revenues	587	876
Net interest income and similar income	632	756
Net commission income	97	95
Net trading income	– 151	– 45
Net income from financial investments	3	58
Net income from hedge relationships	–	–
Balance of other operating income/expenses	6	12
Provisions for losses on loans and advances	1,866	1,066
General administrative expenses	177	155
Balance of other income/expenses	– 1	– 5
Pre-tax profit	– 1,457	– 350
Key ratios in %		
Cost-income ratio	30.2	17.7

Business segment Public Sector

The business segment Public Sector mainly comprises public sector financing activities.

Operating revenues increased to € 118 million, compared with € 63 million in the prior year. The increase resulted from a higher net interest income and an improved net trading income. Net interest income increased from € 74 million in 2008 to € 118 million in 2009. The rate cuts at the beginning of 2009 meant that it was possible to take advantage of lower refinancing costs in conjunction with constant revenues on the assets side of the balance sheet. Net commission income was burdened by the costs of the guarantees in connection with the liquidity support provided by the SoFFin and the Federal Government. It amounted to € –7 million compared with € –3 million in the year 2008. Net trading income amounted to € 22 million (2008: € –24 million) and resulted mainly from valuation profits of stand-alone derivatives. Hedge inefficiencies within the range permitted under IAS 39 resulted in negative net income from hedge relationships of € –16 million (2008: € 12 million). The cost is an inverse effect of the corresponding income seen in the fourth quarter of 2008.

Additions to provisions for losses on loans and advances amounted to € 3 million, and resulted from portfolio-based allowances (2008: € 0 million). It was not necessary for any additions to individual allowances to be recognised. As a result of the contraction of the workforce, general administrative expenses declined from € 26 million in the corresponding prior year period to € 23 million. Because operating revenues increased and general administrative expenses declined, the cost-income ratio improved to 19.5 % compared with 41.3 % last year.

Key Financials Public Sector in € million	**Combined 1.1.–31.12.2009**	**Combined 1.1.–31.12.2008**
Operating performance		
Operating revenues	118	63
Net interest income and similar income	118	74
Net commission income	–7	–3
Net trading income	22	–24
Net income from financial investments	–	1
Net income from hedge relationships	–16	12
Balance of other operating income/expenses	1	3
Provisions for losses on loans and advances	3	–
General administrative expenses	23	26
Balance of other income/expenses	3	–8
Pre-tax profit	95	29
Key ratios in %		
Cost-income ratio	19.5	41.3

Corporate Center

Contributions to earnings made by the non-strategic portfolios such as the CDO portfolio and an internal HRE guarantee as well as the costs for essential corporate functions are some of the items shown in the Corporate Center. In addition, the Corporate Center also includes the majority of costs of the liquidity support and certain administrative expenses of backoffice operations.

The changed situation of the Deutsche Pfandbriefbank Group and the problems arising from the crisis on some markets had a significant impact in the Corporate Center. In consequence, pre-tax profit was negative at € – 163 million. The prior year figure of € – 2,055 million was affected by the impairments recognised in relation to structured products.

Net interest income was € 113 million, compared with a prior year figure of € 262 million. In both years net interest income benefited from the impairments of some instruments of subordinated capital (2009: € 138 million, 2008: € 353 million). Net commission income was affected by the costs of the guarantees in connection with the liquidity support provided by the SoFFin and the Federal Government and declined from € – 19 million to € – 156 million. Net trading income of € 85 million (2008: € – 657 million) was affected by an income of € 175 million as the result of an internal HRE guarantee for the failure of a guarantee for CMBS (in 2008: expenses of € – 393 million). This income was partly affected by changes in valuation of synthetic CDOs which had to be recognised in income statement. However, these expenses were significantly lower than the prior year level (2009: € – 58 million; 2008: € – 395 million). In addition, net trading income was budened by changes in the market value of stand-alone derivatives. Net income from financial investments of € – 46 million (2008: € – 1,294 million) mainly included impairments recognised in relation to financial investments. However, the impairments recognised in relation to cash CDOs (€ – 77 million) were considerably lower than in the corresponding prior year (€ – 762 million). In addition, impairments in relation to MBS of € 89 million were reversed whereas impairments of € – 464 million were necessary in the prior year. In addition, a building was impaired by € – 33 million. Hedge inefficiencies within the range permitted under IAS 39 caused negative net income from hedge relationships of € – 7 million (2008: € – 23 million). The balance of other operating income/expenses mainly comprised negative effects attributable to currency translation, which were partly compensated by income of the pbb Services GmbH from services to sister companies or HRE Holding.

Provisions for losses on loans and advances amounted to € 22 million compared with € 170 million in the prior year. General administrative expenses of € 105 million were higher than the corresponding prior year figure (€ 73 million) due to consultancy fees. The balance of other income/expenses was affected by reversals of restructuring provisions whereas in the prior year additions to restructuring provisions had been necessary.

Key Financials Corporate Center in € million	**Combined 1.1. – 31.12. 2009**	**Combined 1.1. – 31.12. 2008**
Operating performance		
Operating revenues	– 52	– 1,683
Net interest income and similar income	113	262
Net commission income	– 156	– 19
Net trading income	85	– 657
Net income from financial investments	– 46	– 1,294
Net income from hedge relationships	– 7	– 23
Balance of other operating income/expenses	– 41	48
Provisions for losses on loans and advances	22	170
General administrative expenses	105	73
Balance of other income/expenses	16	– 129
Pre-tax profit	– 163	– 2,055
Key ratios in %		
Cost-income ratio	>100.0	>100.0

Development in Assets

Assets in € million	31.12.2009	Combined 31.12.2008	HRE Bank 31.12.2008	DEPFA Deutsche Pfandbriefbank 31.12.2008	pbb Services 31.12.2008	Consolidation 31.12.2008
Cash reserve	618	702	546	156	–	–
Trading assets	1,435	1,646	131	1,515	–	–
Loans and advances to other banks	78,151	81,392	72,126	11,879	10	– 2,623
Loans and advances to customers	91,221	103,310	69,938	33,377	–	– 5
Allowances for losses on loans and advances	– 3,326	– 1,841	– 1,841	–	–	–
Financial investments	30,914	39,387	28,934	10,453	–	–
Property, plant and equipment	10	18	12	4	2	–
Intangible assets	28	30	23	–	7	–
Other assets	11,801	12,656	10,204	2,449	6	– 3
Income tax assets	4,365	4,519	4,423	95	1	–
Current tax assets	131	114	82	32	–	–
Deferred tax assets	4,234	4,405	4,341	63	1	–
Total assets	**215,217**	**241,819**	**184,496**	**59,928**	**26**	**– 2,631**

The former DEPFA Deutsche Pfandbriefbank AG and pbb Services GmbH are not included in the prior year comparison information 2008 in accordance with IAS 1.36. The total assets of Deutsche Pfandbriefbank Group have increased strongly as a result of the merger between DEPFA Deutsche Pfandbriefbank AG and Hypo Real Estate Bank AG and also as a result of the purchase of pbb Services. In order to present net assets position in a comparison which is meaningful and which also makes economic sense, the balance sheet of the Deutsche Pfandbriefbank Group is compared with the balance sheet of the previous year in a combined presentation.

The total assets of the Deutsche Pfandbriefbank Group declined to € 215,2 billion as of 31 December 2009, compared with € 241.8 billion as of 31 December 2008. The decline is attributable to two factors. Firstly, portfolios declined because repayments exceeded new business and the drawings of old commitments. This was reflected mainly in the positions loans and advances to customers and financial investments. In loans and advances to customers, the main decline was reported for the volume of municipal loans. In financial assets, holdings of debt securities and bonds declined. In addition, balance sheet holdings also declined as a result of exchange rate factors and the impact of the lower level of interest rates on the market values of the derivatives. Holdings were also reduced as a result of a deliberate strategy of streamlining non-strategic assets. Particular mention has to be made in this respect of the sale of CDOs and MBS (nominal value of € 1.3 billion in total), Total assets also declined as a result of the impairments recognised in relation to receivables and securities and as a result of the deconsolidiation of special purpose entities after the sale of the held tranches.

Development in the Financial Position

Equity and liabilities in € million	**31.12.2009**	Combined 31.12.2008	HRE Bank 31.12.2008	DEPFA Deutsche Pfandbriefbank 31.12.2008	pbb Services 31.12.2008	Consolidation 31.12.2008
Liabilities to other banks	67,625	60,191	56,464	5,448	5	–1,726
Liabilities to customers	12,378	14,384	13,985	399	–	–
Liabilities evidenced by certificates	109,193	140,189	95,461	45,630	–	–902
Trading liabilities	1,872	2,202	1,033	1,169	–	–
Provisions	153	247	168	75	4	–
Other liabilities	13,635	15,014	11,118	3,887	9	–
Income tax liabilities	3,733	3,761	3,576	185	–	–
Current tax assets	85	89	31	58	–	–
Deferred tax assets	3,648	3,672	3,545	127	–	–
Subordinated capital	3,895	4,419	2,237	2,182	–	–
Liabilities	**212,484**	**240,407**	**184,042**	**58,975**	**18**	**–2,628**
Equity attributable to equity holders	**2,733**	**1,412**	**454**	**953**	**8**	**–3**
Subscribed capital	380	380	380	108	3	–111
Silent participation	999	–	–	–	–	–
Additional paid-in capital	5,037	3,739	2,988	416	–	335
Retained earnings	–1,310	1,043	688	582	–	–227
Revaluation reserve	–858	–1,388	–1,239	–149	–	–
AfS reserve	–328	–424	–275	–149	–	–
Cash flow hedge reserve	–530	–964	–964	–	–	–
Consolidated loss/profit 1.1.–31.12.	–1,515	–2,362	–2,363	–4	5	–
Minority Interest in equity	**–**	**–**	**–**	**–**	**–**	**–**
Equity	**2,733**	**1,412**	**454**	**953**	**8**	**–3**
Total equity and liabilities	**215,217**	**241,819**	**184,496**	**59,928**	**26**	**–2,631**

In order to present financial position in a comparison which is meaningful and which also makes economic sense, the balance sheet of the Deutsche Pfandbriefbank Group is compared with the balance sheet of the previous year in a combined presentation.

Equity (excluding revaluation reserve) amounted to € 3.6 billion as of 31 December 2009, compared with € 2.8 billion as of 31 December 2008. Including the revaluation reserve, equity accordingly amounted to € 2.7 billion as of 31 December 2009 (31 December 2008: € –1.4 billion).

Following the recapitalisation of the Deutsche Pfandbriefbank Group by the SoFFin, equity increased by € 2.3 billion in 2009. The increase is split into two components: In November 2009, SoFFin paid a silent participation of € 1.0 billion to the Deutsche Pfandbriefbank AG. This silent participation is reported in a separate line under equity. In addition, in November 2009, SoFFin paid a figure of € 1.3 billion into the reserve of Deutsche Pfandbriefbank AG. These payments are shown under additional paid-in capital.

In line with the regulations of IAS 32, the expenses of € 3 million which are attributable directly to the capital increases are shown directly in equity.

The revaluation reserve amounted to € –0.9 billion (31 December 2008: € –1.4 billion). The AfS reserve improved to € –0.3 billion as of 31 December 2009, compared with € –0.4 billion as of 31 December 2008. This positive development is attributable to improvements in credit spreads. In addition, the AfS reserve was also less negative as a result of the impairments and amortisation of securities which were reclassified in the course of the fiscal year 2008 in accordance with the IAS 39 amendment «Reclassification of Financial Assets» which was adopted by the IASB in October 2008 and endorsed by the EU. The cash flow hedge reserve amounted to

€ –0.5 billion, compared with € – 1.0 billion at the end of last year. The change was mainly attributable to maturities of derivatives and the lower level of interest rates in the course of the year.

Total group liabilities amounted to € 212.5 billion as of 31 December 2009, compared with € 240.4 billion as of 31 December 2008. The liabilities declined compared with the end of 2008 mainly because the Deutsche Pfandbriefbank Group succeeded only to a very limited extent in placing refinancing arrangements on the market.

The Deutsche Pfandbriefbank Group took advantage of support provided by the SoFFin. These supports, mainly paid out by the German Bundesbank, are shown mainly under the items liabilities to other banks and securitisised liabilities. Moreover, liquidity support amounting to € 61.9 billion (31 December 2008 € 59.4 billion) were passed down to the the sister company DEPFA Bank plc. The subordinated capital declined as a result of maturities. In addition, as a result of the merger of the former DEPFA Deutsche Pfandbriefbank AG and Hypo Real Estate Bank AG, the instruments of participation certificates outstanding of the former DEPFA Deutsche Pfandbriefbank AG became subordinate liabilities because the holders of the instruments were granted co-equal rights. These rights encompass modifications in relation to distribution and loss participation. The instruments were reclassified on the basis of these modifications as this reflects better the economic content of the contracts.

The contingent liabilities could be reduced to € 0.7 billion as of 31 December 2009 (31 December 2008: € 1.9 billion), mainly due to the cancellation of performance guarantees. The other commitments declined to € 2.7 billion compared with € 5.3 billion at the end of last year. The loans which were not paid out or which were not completely paid out are reflected in the irrevocable loan commitments, and amounted to € 2.6 billion as of 31 December 2009 compared with € 5.2 billion as of 31 December 2008. The decline in irrevocable loan commitments is attributable to the higher drawing rate and the reduced commitments of real estate and public sector financing.

Regulatory indicators according to German Solvency Regulation

The Deutsche Pfandbriefbank AG is, in accordance with the «Waiver-Rule» of section 2a KWG, not obliged to calculate on a group-level the own funds ratio and the core capital ratio.

Summary

The income statement for 2009 very much reflected the specific and extremely difficult situation of Deutsche Pfandbriefbank Group as well as the crisis on the real estate markets. It was necessary for significant impairments to be recognised primarily in relation to commercial real estate financings, and also in relation to securities. In addition, results of operations were depressed by the expenses of the support measures which were provided. Overall, pre-tax result was negative at € – 1,525 million.

Events after 31 December 2009

On 21 January 2010, HRE Holding following liaison with SoFFin submitted an application to the German Financial Markets Stabilisation Agency (FMSA) for the establishment of a deconsolidated environment aimed at reducing assets in a value preserving manner. It is intended to transfer balance sheet items of Deutsche Pfandbriefbank Group no longer strategically required for the realignment of the company as the strategy core bank of HRE to this deconsolidated environment. The transfer is scheduled to take place during the second half of 2010, once all necessary approvals have been obtained from the responsible corporate bodies and institutions. There is no legal right to the establishment of the deconsolidiated environment. FMSA has the discretionary authority to establish it.

Deutsche Pfandbriefbank AG issued a public sector jumbo pfandbrief amounting to € 1 billion on 11 January 2010. The seven year pfandbrief has a 3.375 percent coupon.

Apart from the above, no other noteable events have taken place after 31 December 2009.

Risk Report

The situation on the capital markets increasingly stabilised in individual markets in the course of 2009 (with the exception of spreads for government bonds in some south european countries). In many rating groups and maturities, the credit spreads were considerably lower than the levels seen at the end of 2008.

On the real estate markets, the rate of the downward trend in prices for commercial real estate has slowed down, and there are indications of the situation stabilising in certain areas. However, prices are still down compared with previous year levels. There is however still further room for reversals due to the high, partly still increasing vacancy rates of the commercial real estate market.

In the course of 2009, the refinancing situation of Hypo Real Estate Group (HRE) stabilised as a result of the liquidity and capital support measures which are extensively detailed in the chapter entitled «Major events» in the management report. The second half of 2009 was the first time since the beginning of the crisis that Deutsche Pfandbriefbank Group was able to place the initial private placings and benchmark transactions on the market.

However, the Deutsche Pfandbriefbank Group is again reliant on the liquidity facilities being extended in the year 2010. There are plans for market placings of Pfandbriefe and unsecured transactions; however these will only be able to reduce the liquidity support to a very limited extent.

The Deutsche Pfandbriefbank Group is integrated in the enterprise-wide risk management system of HRE. Reported portfolio holdings and risk ratios as of 31 December 2009 are also presented combined for 31 December 2008 for the Deutsche Pfandbriefbank Group – where such figures can be determined retrospectively.

Organisation and principles of risk and capital management

In line with the waiver ruling which was applicable for the former Hypo Real Estate Bank AG and which is also applied for the Deutsche Pfandbriefbank Group, HRE has installed a group-wide risk management and risk controlling system. For the entire first half of 2009, the former DEPFA Deutsche Pfandbriefbank AG additionally had its own risk management and controlling system which was consistent with the group-wide system and which is described in detail in the Risk Report of the annual report 2008 of DEPFA Deutsche Pfandbriefbank AG.

All tasks in accordance with Section 25a KWG with regard to uniform risk identification, measurement and limitation as well as risk management are specified centrally by HRE. Operational implementation is the responsibility of the respective subsidiary institutions and thus also of Deutsche Pfandbriefbank AG which is responsible for the Deutsche Pfandbriefbank Group and which was included in the risk management and risk controlling system of HRE in the first half of 2009 via the predecessor institutions.

Organisation and committees

The principles, methods and processes of the risk management system of HRE are specified centrally by risk management and controlling of HRE Holding and are applied in the Deutsche Pfandbriefbank Group. Apart from to the Credit Committee, which is responsible for credit decisions in the Deutsche Pfandbriefbank Group, the committees detailed in the following have been set up at the HRE Group level with the involvement of the respective decision-makers of the Deutsche Pfandbriefbank Group.

The Management Board of HRE Holding is responsible for the group-wide risk management system, and is responsible for taking decisions relating to all strategies and the main issues of risk management and organisation of the Group. The risk management system is a system which covers all business activities of the Group, and comprises the plausible and systematic identification, analysis, valuation, management, documentation and communication of all major risks and related monitoring on the basis of a defined risk strategy which is revised annually. The members of the Management Board of the Deutsche Pfandbriefbank AG, who also exercise their respective functions in the HRE Holding Management Board, bear overall responsibility for all strategic and operational decisions of the Deutsche Pfandbriefbank Group on the basis of the specifications of HRE. Key components in this respect are set out in the following. Key components are:

- Defining, updating and communicating business and risk strategies as the basis of business activities and risk acceptance for Deutsche Pfandbriefbank Group
- Defining and improving organisation structures in particular for risk management, which ensures that all major risks of Deutsche Pfandbriefbank Group are managed and monitored
- Adopting credit competence guidelines as a decision-making framework along the credit processes of Deutsche Pfandbriefbank Group
- Taking decisions regarding (portfolio) management measures outside the competences which have been transferred

The Management Board of the Deutsche Pfandbriefbank AG informs the Supervisory Board of the Deutsche Pfandbriefbank AG changes in group-wide business and risk strategies, the risk profile and the specific business and risk strategies of the Deutsche Pfandbriefbank Group.

Organisation of risk management of HRE Holding

as of 31 December 2009

Risk Management and Liquidity Strategy Committee of the Supervisory Board of HRE Holding AG

Management Board of HRE Holding
Sign off and special conditions of the proposal of the Risk Committee

Risk Committee (RC)
Proposal for approval to the Management Board
Coordination and cooperation with the Asset and Liability Committee

Asset and Liability Committee (ALCO)
Coordination and cooperation
with the Risk Committee

Credit Committee
subsidiaries

Watchlist Committee

Risk Provisioning Committee

Management Board of subsidiaries

The Risk Management and Liquidity Strategy Committee (RLA) of the Supervisory Board of HRE Holding which is responsible for the overall Group of HRE deals primarily with management of the risk situation as well as the monitoring, establishment and further development of an efficient risk management system as well as liquidity management and assurance of HRE in which the Deutsche Pfandbriefbank Group is integrated. Since the beginning of 2009, major and high-risk exposures of HRE and thus also of the Deutsche Pfandbriefbank Group as well as all increases to existing individual allowances and t he creation of new individual allowances in excess of € 5 million are notified to the Risk Management and Liquidity Strategy Committee of HRE on a weekly basis.

The **Risk Committee (RC)** (RC) of HRE consists of the Chief Risk Officer (CRO; chairman), the Chief Financial Officer (CFO), the Chief Operating Officer (COO), the Chief Credit Officers (CCOs) of the operating segments as well as the Heads of Risk Management & Control and Global Workout. In general, the committee meets on a monthly basis and adopts group-wide effective guidelines/policies (policies and guidelines have to be approved by the Management Board), methods for risk measurement, the related parameters as well as methods of monitoring all risk types. It submits decision-making proposals to the Management Board of HRE Holding and the Management Board of Deutsche Pfandbriefbank AG with regard to risk strategies and limits for all risk types.

The RC monitors the development of economic capital, the risk cover funds, the credit portfolio and the compliance with limits of HRE and Deutsche Pfandbriefbank Group respectively. It takes decisions with regard to suitable measures of credit risk management.

Adaption and implementation of the decisions which are taken are the responsibility of the organisation structure of the CROs and CCOs of Deutsche Pfandbriefbank Group or Treasury and Liquidity Management of HRE.

The **Asset and Liability Committee (ALCO)** of HRE is chaired by the member of the Management Board responsible for Treasury and Public Finance, and comprises the CRO, the CFO, the Head of Treasury as well as the heads of Asset Liability Management, Finance and Risk Management & Control. It meets on a monthly basis. Its tasks comprise liquidity management, management of the balance sheet structure of HRE and Deutsche Pfandbriefbank Group as well as market risk management and management of the regulatory capital ratios. This committee is also responsible for preparing decision-making proposals for liquidity and refinancing strategies. After discussions in the Risk Committee, these proposals are as well as proposals for acquisitions and disinvestments submitted for decision in the Management Board of HRE Holding.

The **Credit Committee** of Deutsche Pfandbriefbank Group comprises the CRO (chairman), the CCOs of the operating segments and the Senior Credit Executive. The front office representatives have the right to attend and vote within the framework of front office/back office responsibility. In general, the committee meets at least once every week, and is responsible for credit decisions in line with the schedule of powers for new business, prolongations and material changes in the credit relationship. It also votes on all credit decisions which come under the responsibility of the Management Board of Deutsche Pfandbriefbank AG or which have to be approved by the Supervisory Board. The Credit Committee of the Deutsche Pfandbriefbank Group ensures that the credit decisions are co nsistent with the prevailing business and risk strategy.

The **Watchlist Committee** of HRE meets on a monthly basis; it is chaired by one of the CCOs of the operating segments, and comprises the Senior Credit Executive, the head of Global Workout, optionally the CRO, as well as the relevant heads of Credit Risk Management. All exposures of Deutsche Pfandbriefbank Group identified by the early warning system are discussed and further individual measures are adopted by this body of HRE which meets every month; these measures are subsequently implemented by the relevant departments. This committee is also responsible for taking any decisions for forwarding an exposure to Global Workout of HRE, which is responsible for taking the necessary restructuring and workout steps. All necessary credit decisions are taken by the persons with appropriate responsibility in line with the allocation of credit powers or in the Credit Committee of Deutsche Pfandbriefbank Group.

If impairment triggers have been activated concerning an exposure of Deutsche Pfandbriefbank Group, the result after an impairment test is presented to the Risk Provisioning Committee of HRE, and any necessary resolution is adopted. The committee meets on a regular basis, and comprises the CRO (chairman), the CFO, the heads of the regional workout segments as well as the CCOs of the operating segments. Within the overall schedule of powers, it is responsible for taking decisions with regard to the creation and reversal of risk provisioning as well as any necessary acquisitions through foreclosures. Any decisions which exceed the allocated powers are taken, upon the recommendation of the committee, by the Management Board of Deutsche Pfandbriefbank AG which also generally has a right of veto in relation to decisions of the committee for area of responsibility.

Group Chief Risk Officer (CRO) In addition to the committees mentioned above, the following organisation entities of the Group Chief Risk Officer (CRO), who also exercises the function of CRO of the Deutsche Pfandbriefbank Group, form an integral part of the risk management system in which the Deutsche Pfandbriefbank Group is integrated:

The organisation of the CRO function comprises the following back office entities at the HRE group level:

> The **Risk Management & Control** entity of HRE which also monitors market, credit, operational and liquidity risks of the Deutsche Pfandbriefbank Group and which is also responsible for the group-wide standardised risk measurement methods, risk reports and credit processes

> The entities of the **Credit Officer Real Estate** of the Deutsche Pfandbriefbank Group and the **Credit Officer Public Sector, Financial Institutions & Value Portfolio** (also comprises the Public Sector business and the business in the Corporate Center of the Deutsche Pfandbriefbank Group), which are each responsible for portfolio management as well as analysing the selective new business

> The **Global Workout** of HRE, which is responsible for the restructuring and workout of all critical exposures (including those of the Deutsche Pfandbriefbank Group), was considerably expanded in 2009 and will be even further expanded in 2010

> The **Credit Quality Control** entity of HRE, which is currently being set up and which will also be responsible mainly for quality controls regarding the credit processes and risk analyses (including those applicable for the Deutsche Pfandbriefbank Group), as well as

> The **Property Analysis & Valuation Germany/Property Analysis Europe,** entity, which is responsible for the analysis and uniform valuation of the secured properties of the Deutsche Pfandbriefbank Group in accordance with market value and lending value methods.

In addition to the Group CRO function, the risk management system of the Deutsche Pfandbriefbank Group are complemented by Group Compliance of HRE as well as Group Internal Audit which constantly monitors the MaRisk compliance of the risk management system (including that of the Deutsche Pfandbriefbank Group) by means of regular audits of processes and systems. In addition, risk management is supported by Group Legal of HRE.

Organisation of Chief Risk Officer der HRE Holding

as of 31 December 2009

Group CRO

Risk Management & Control	Credit Officer Real Estate	Credit Officer Public Sector, Financial Institutions & Value Portfolio	Global Workout	Credit Quality Control	Property Analysis & Valuation Germany/ Property Analysis Europe

Risk strategy and policies

On the assumption of adequate recapitalisation, the risk strategy of HRE is based on the risk-bearing capacity analysis and on the risk strategy. It comprises the definition of the risk propensity of HRE on the basis of the economic capital, with due consideration being given to risk cushions and an intended A-rating.

In the third quarter of 2009, the risk strategy of HRE was amended on the basis of the updated business strategy. The risk strategy was adopted in October 2009 in the HRE Holding Management Board and was presented to the Risk Management and Liquidity Committee of the Supervisory Board of HRE Holding to be noted at the beginning of November. It is applicable throughout the Group, and the parts relevant for the Deutsche Pfandbriefbank Group were adopted separately by the Management Board of the Deutsche Pfandbriefbank AG.

The risk strategy of the Group Deutsche Pfandbriefbank reflects the strategic refocussing of the the Group Deutsche Pfandbriefbank as a specialist real estate and state financier in Germany and Europe with Pfandbrief-oriented refinancing; it is integrated in the business planning process of HRE and the Group Deutsche Pfandbriefbank and is updated every year.

The adopted, conservative risk strategy of the Group Deutsche Pfandbriefbank sets out how quality of financing can be improved e.g. by way of assets which are almost exclusively eligible for Pfandbrief refinancing, conservative refinancing of new business (largely by way of Pfandbrief issues). The strategy concretise the long term goal of HRE to become the competence centre for financing combined with servicing of the public sector and professional real estate finance operations in Germany and Europe.

The strategy is reflected in the following core points:
> Focussing of new business on the primary market for Pfandbrief-eligible issues in Public Sector operations and Pfandbrief-eligible loans in Real Estate Finance operations
> Provision of financing structures of low complexity in the primary market
> Risk-oriented portfolio management of new and existing business of the Group Deutsche Pfandbriefbank supported by syndication and securitisation activities on HRE group level
> The non-strategic existing portfolio will be reduced without a major impact on results.
> Conservative refinancing of operations primarily by way of Pfandbrief issues.

The risk strategy of the Deutsche Pfandbriefbank Group, which forms part of the risk strategy of HRE, comprises strategy for the intended new business as well as for the strategic and non-strategic existing business for the new operating segments Public Sector and Real Estate Finance. Risk sub-strategies for the main risk types of the Deutsche Pfandbriefbank Group are explained in greater detail in the relevant chapters.

A key factor of success for implementing the strategy of the Deutsche Pfandbriefbank Group is the audit, which was applied for on 21 January 2010 by HRE and which is currently being carried out, for transfering parts of the Public Sector portfolio together with non-performing loans or loans which are no longer consistent with overall strategy from Real Estate Finance as well as other non-performing assets (e.g. CDO, CMBS) to a new public sector institution to be established with partial legal capacity. This institution, which is known as an institution in the institution (Anstalt in der Anstalt – AidA), is an independent legal entity under the FMSA, whereby the establishment of this institution is subject to the discretion of the FMSA. HRE is currently holding talks with the SoFFin and the FMSA in this respect.

At HRE, the risk strategy is specified for operational purposes by way of risk policies (for the individual operating segments) which are valid throughout the Group, i.e. also for the Deutsche Pfandbriefbank Group, for all major risk types (credit, market, liquidity and operational risk) which describe risk measurement, monitoring, risk management, the limiting process as well as the escalation process in the event of a limit being exceeded. The policies are regularly reviewed and updated where necessary.

Risk reporting

In the financial year 2009, the entire risk reporting system of HRE and Deutsche Pfandbriefbank Group was thoroughly revised, and the quality was considerably improved – also within the context of the additional requirements in accordance with MaRisk 2010. The regular reports addressed to the Management Board of HRE Holding and the Management Board of Deutsche Pfandbriefbank AG include the following:
> Daily the liquidity risk report for the liquidity position and preview
> Weekly the summary of the markets, the market risk development as well as relevant management information
> Monthly the short Group risk report concerning major parameters relevant for management purposes.
> Quarterly the Group risk and credit risk report

The CRO of the Deutsche Pfandbriefbank Group and the member of the Management Board of HRE Holding responsible for Treasury and Public Sector also receive market risk reports on a daily basis.

These reports provide the Management Board of the Deutsche Pfandbriefbank AG with a comprehensive overview as well as detailed information concerning the risk situation for each risk type and company. In addition, special reports are prepared on an ad hoc basis or at the request of the Management Board or Supervisory Board; these special reports consider specific and acute risk aspects, for instance in relation to critical markets, products or counterparties.

In the individual committees described above, the members of the Management Board receive further detailed reports concerning the risk position with specific management information and recommendations.

The Supervisory Board of the Deutsche Pfandbriefbank AG or the Risk Management and Liquidity Strategy Committee of the Supervisory Board of HRE Holding are informed about the portfolio structure, the risk situation and specific risk-relevant issues at regular intervals, at least quarterly and at short notice, if necessary.

They receive the following on a regular basis:
> Monthly: the short Group risk report for major parameters which are relevant for management purposes as well as
> Quarterly: the Group risk and credit risk report.

Since the beginning of 2009, the Risk and Liquidity Strategy Committee of the Supervisory Board of HRE Holding has been notified of all major exposures of the Deutsche Pfandbriefbank Group as well as all major individual allowances.

Risk quantification, risk management

At the portfolio level of the Deutsche Pfandbriefbank Group, the value at risk (VaR) approach is used for quantifying risk also for determining the economic capital for the main risk types apart from the liquidity risk. The individual calculation methods are described extensively in the chapters for the individual risk types.

Further risk types which are considered to be major as part of the regular internal risk assessment, such as strategic risks, reputation risks, regulatory risks as well as pension risks, are not measured quantitatively; instead, they are managed and limited by way of regular detailed reports, clear specifications, e.g. the HRE group-wide effective regulations concerning compliance and corporate governance.

At the portfolio level and at the level of individual transactions, risk in the Deutsche Pfandbriefbank Group is managed by:
1. Monitoring the risk-bearing capacity of the Deutsche Pfandbriefbank Group on the basis of the comparison of economic capital and the risk cover funds, with due consideration also being given to newly developed stress tests
2. Monitoring the risk-weighted assets (RWA) of the Deutsche Pfandbriefbank Group by way of new stress tests implemented in 2009. The purpose of these tests is to ensure that the total capital ratio does not fall below 8.5%.
3. Operational risk management via
   > The use of Basle-II-compliant risk parameters in lending business of the Deutsche Pfandbriefbank Group. The Basle-II-compliant management approach shows the average expected loss at the borrower level, and is therefore a major component in risk early recognition and ongoing profitability monitoring. The parameters are reviewed and recalibrated annually.
   > An improved limit system for counterparty and issuer risks on HRE group level on the basis of a standard application with a uniform risk measuring method throughout the Group which has been tried-and-tested in the market, which was developed in 2009 and which is to be introduced throughout the Group, i.e. also in the Deutsche Pfandbriefbank Group, in the first quarter of 2010.
   > Intense monitoring and management of individual counterparties, also with the support of an early warning system which was improved in 2009
   > Monitoring the risk of losses by way of appropriate impairment triggers in accordance with IAS 39

Risk management of the Deutsche Pfandbriefbank Group will be further improved in the course of 2010 by integrating the economic capital in the business planning process.

Economic capital and monitoring the risk-bearing capacity

Deutsche Pfandbriefbank Group has established an internal risk-bearing capacity analysis which is based on the Internal Capital Adequacy Process, ICAAP), in order to ensure that risk position of the group is consistent with the information in its report concerning its willingness to take on risk. The audit of internal capital adequacy is based on the concept of economic capital. The provision of economic capital of the Deutsche Pfandbriefbank Group is specifically designed to meet the demand and requirements of business of the Deutsche Pfandbriefbank Group and to comply with the pillar-2 criteria under Basle II for banks and the corresponding specific integration in the German MaRisk which prescribe adequate internal capitalisation.

Economic capital is defined as «the quantity of capital required by a bank in order to cover the largest potential total loss with a defined probability over a time horizon of one year». The measure of loss probability used by HRE is the probability of loss associated with its intended long-term credit rating (A). The figure calculated on the basis of the estimate of the rating agency Standard & Poor's for the long-term probability of default of primary unsecured obligations with an A rating is currently 0.05% (unchanged since the end of 2008). The confidence level used as the basis for calculating the economic capital is thus 99.95%.

The economic capital is calculated by aggregating the economic capital for credit risk, market risk, operational risk and other risks, taking account of customary correlation assumptions. The calculation of economic capital is based in most cases on a Value-at-Risk approach. The VaR quantifies the loss which will not be exceeded within a given time period of for instance one year and with a certain probability. VaR models are based on historical data and assume that the future developments will follow a similar pattern. The limitations of a VaR model can be summarized as follows:

- The defined time period reflects the holding period of a risk position. Thus it is assumed that the respective position can be closed down or hedged within this time frame.
- The defined probability, the confidence level e.g. 99,95% leaves a statistical probability of 0.05% that the loss might exceed within the defined time period the calculated VaR
- The consideration of historical data might not include all possible scenarios, especially extraordinary cases, which might happen in the future
- VaR is dependent on both the risk position and the volatility of market price.

The VaR is nonetheless an important factor to calculate economic capital and for business management in the market risk section. The quality of the VaR-models is continuously monitored by back-testing in light of actual developments and improved, if necessary.

The individual VaR-calculation methods are described in greater detail in the corresponding chapters. As is normal for the sector, economic capital is not calculated for the liquidity risk; however, the liquidity risk is taken into consideration in stress scenarios.

In order to evaluate the capital backing of the Deutsche Pfandbriefbank Group, the amount of economic capital is compared with the financial resources available to the Bank within one year. The definition of the available risk cover funds for one year comprises customary components such as essentially the shareholders' equity in accordance with IFRS, components similar to shareholders' equity (subordinate capital and hybrid capital) as well as the planned result for the next twelve months. These components are suitable for alleviating the impact of potential losses and for maintaining a corresponding risk buffer. The totality of these capital components (risk cover funds) must always be greater than a potential loss which might occur (economic capital).

On the basis of the ICAAP, the main risk measured in terms of the economic capital (excluding explicit recognition of liquidity risk) is the credit risk, which accounts for more than 70% of economic capital followed by market risk, operational and business risk.

The results of the economic capital and the stress tests are regularly presented to the Management Board and the Risk Committee, where they are discussed and any management measures are defined.

For the year 2010, there are plans for a significant adjustment of the ICAAP method to the changed business strategy of the HRE Group. A corresponding project was commenced in the fourth quarter of 2009 with external support, and will probably be implemented by the first quarter of 2010. The strategic refocussing will be explicitly taken into consideration in the model with a much stronger focus on assets held to maturity, the new ownership structure, the changed funding profile as well as the plans to spin off the deconsolidated environment.

Parts of the planned adjustment have already been implemented, with regard to the calculation of the credit risk VaR as of year end 2009.

Major projects in risk management of the Deutsche Pfandbriefbank Group

As a result of the complete integration of risk management of the Deutsche Pfandbriefbank Group in risk management of HRE, the Bank also benefits from the following IT-related further developments at the group level:

Limit System The year 2009 saw the development of a Group-wide limit system which takes account of all borrowers and products of all consolidated legal entities of HRE, i.e. also the Deutsche Pfandbriefbank Group. The final implementation of the system in the risk management process of HRE and of Deutsche Pfandbriefbank Group will be completed in the first quarter of 2010. Further fine tuning and configurations are expected to follow.

Market Data System With the implementation of a Group-wide market data system, a quality-assured consistent market data supply system was introduced in 2009 throughout the Group in order to ensure uniform measurement of all risk positions.

Management Information System MIS In 2009, the Group-wide reporting platform «MIS/Risk Cockpit» was further expanded and standardised, thus providing prompt and transparent data supplies for reporting the key credit risk parameters, also for Deutsche Pfandbriefbank Group. This uniform platform will noticeably improve the data quality and consistency of the individual reports. The year 2010 will see continuous fine tuning as well as a further configuration stage with additional information and a higher degree of automation for preparing the reports.

Standardisation of market risk As part of the first phase of Group-wide standardisation of market risk management, in which the Deutsche Pfandbriefbank Group is integrated, work in 2009 focussed on the uniform measurement of loans and liabilities. Further project phases are planned in the following releases within the context of the program New Evolution – TOPP 2011.

If the mentioned projects are affected by a major delay or they fail, this might result in inappropriate management signals to the Deutsche Pfandbriefbank Group.

Internal control and risk management system relating to the accounting process

Concept The internal control and risk management system relating to the accounting process comprises the principles, procedures and measures designed to assure the effectiveness and efficiency of accounting and also for ensuring compliance with the relevant legal regulations. The aim of the risk management system in relation to the accounting process is to identify and evaluate risks which might not be consistent with the aim of ensuring that the financial statements comply with the relevant regulations; it also aims to limit identified risks and analyse the impact of these risks on the financial statements and the way in which these risks are presented. The internal control system relating to the accounting system is an integral component of the risk management system; its aim is to implement controls and provide adequate assurance that financial statements comply with the appropriate regulations despite the risks which have been identified.

Structure organisation of the internal control and risk management system relation to the Group accounting processe

as of 31 December 2009

Supervisory Board of HRE Holding					Audit Committee
Management Board of HRE Holding[1]					
Chief Executive Officer	Chief Operating Officer	Group Treasurer	Chief Financial Officer	Chief Risk Officer	
Internal Audit			Group Finance Department	Group Tax Department	Group Planning & Controlling
			Group Finance Committee and participation in further committees, e.g. Risk Committee or Asset and Liability Committee		

[1] on 1 January 2010 added by Chief Real Estate Finance

However, an internal control and risk management system relating to the accounting process cannot provide absolute certainty with regard to meeting the relevant objectives. As is the case with all decisions involving discretion, such decisions for setting up appropriate systems may also be affected by faults, errors, changes in variables or deliberate violations and criminal actions. These problems mean that it is not possible to identify or prevent misstatements in the financial statements with absolute certainty.

At Deutsche Pfandbriefbank Group internal control and risk management system relating to the accounting process is reflected in the structure and procedure organisation. In terms of structure organisation, the internal control and risk management system relating to the accounting process mainly comprises the Management Board, the Supervisory Board in its capacity as the controlling body responsible for monitoring the Management Board, the Audit Committee which is set up by the Supervisory Board, the entities which report to the Chief Financial Officer (CFO), the Group Finance Committee and Internal Audit.

In its capacity as the legal representative, the Management Board of Deutsche Pfandbriefbank AG is required to prepare consolidated financial statements and a Group management report in accordance with Section 290 HGB (German Commercial Code). In conjunction with the obligation to introduce a group-wide internal control and risk management system, the Management Board of the Deutsche Pfandbriefbank AG is also responsible for the form, i.e. the concept, implementation, maintenance and monitoring of an adequate and effective internal control and risk management system relating to the accounting process. The central Management Board takes its decisions relating to all strategies in response to the proposal of the Chief Financial Officer (CFO).

The Supervisory Board is responsible for monitoring the Management Board. For this purpose, the Supervisory Board may specify that management measures require the approval of the Supervisory Board. In addition, the Supervisory Board also has audit obligations and reporting obligations. The Supervisory Board of Deutsche Pfandbriefbank AG has set up an Audit Committee in order to support its activity. In accordance with Section 100 (5) AktG (German Stock Corporation Act), at least one member of the Supervisory Board and of the Audit Committee must be an expert in terms of accounting and auditing.

Internal Audit supports the Management Board in its control function by way of independent audits.

The CFO heads the three entities Finance, Tax as well as Planning and Controlling. In the area of responsibility of the CFO, the consolidated financial statements are prepared in accordance with IFRS and the accounting-relevant capital market information is provided. The companies of the Deutsche Pfandbriefbank Group prepare their financial statements in accordance with the relevant local legal requirements. For Group accounting purposes, the financial statements are harmonised and reflect uniform accounting and valuation methods in accordance with IFRS. Each incorporated company then reports the balance sheet, income statement and the corresponding disclosures in the notes to a central department in Group Accounting via the consolidation software. In Group Accounting, the data of the foreign currency companies are converted into Euros by means of the consolidation software. In addition, the data are also checked for plausibility, analysed and consolidated.

At HRE Group level, the Management Board has set up a Group Finance Committee (GFK) which makes recommendations to the Management Board. These include responsibility for defining and monitoring the guidelines and procedures for accounting and reporting for all entities of the Deutsche Pfandbriefbank Group and the consolidated financial statements as well as for all segments of the Deutsche Pfandbriefbank Group. In order to ensure efficient communication with other entities, the CFO or the heads of the CFO entities are also participants in other committees, such as the Risk Committee with its sub-committees or the Asset and Liability Committee.

In terms of procedure organisation, the internal control and risk management system relating to the accounting process is based on processes and software which are intended to be as standardised as possible. Guidelines and a code of conduct exist for core activities and processes. The principle of dual control is also mandatory for major transactions. Data and EDP systems are protected against unauthorised access. In addition, certain relevant information is made available only to employees who require such information for their work. Where necessary, results are agreed across all entities and companies.

Implementation For preparing the consolidated financial statements and the Group management report, Deutsche Pfandbriefbank Group has implemented the concept of the internal control and risk management system relating to the accounting process in various measures for identifying, evaluating and limiting the risks. The structure organisation measures relate to the committees and the CFO entities. To a large extent, the same people serve on the committees of the main companies of HRE Group, thus permitting uniform management. For instance, the members of the Management Board of HRE Holding are also the members of the Management Board of Deutsche Pfandbriefbank AG.

There is a clear segregation of functions within the area of responsibility of the CFO; this is for instance reflected in separate departments for processing IFRS accounting policies and preparing financial statements. In addition, the processes of preparing the consolidated financial statements and the separate financial statements are structured in individual groups. The GFK and further committees as well as department discussions form links between the various functions. In addition, executive, accounting and administrative activities, such as the payment and recording of the payment, are clearly segregated or are subject to the principle of dual control. In addition, the entities included in the consolidated financial statements report the data to a central department within the Group, thus ensuring that further processing is carried out in a uniform process.

Within the procedure organisation, there are automated or system-based and manual or non-system-based measures for managing the risks and for internal controls. Among the system-based measures, standard software for recording, reconciling, checking and reporting the data is used as far as possible in order to avoid errors. This is also applicable for consolidation, which is carried out with software which is widespread on the market. The consolidation software provides technical support for reconciling the intra-group relations in a clearly regulated process in order to ensure that these intra-group relations are completely and correctly eliminated. The data of the incorporated entities are reported in a uniform standardised position plan. Automated plausibility checks are for instance used for reporting the data of the subsidiaries for consolidation purposes. System support is provided for checking the balances carried forward. As protection against loss, the data of the consolidation software are backed up daily, and the back up data is sourced on tape. In general, the software of the Deutsche Pfandbriefbank Group is protected against unauthorised access by means of clearly regulated administration and approval of authorisations.

In addition to the system-based measures, Deutsche Pfandbriefbank Group has also implemented manual or non-system-based measures. Accordingly, a standardised process is used for assuring that the reported data are correct and complete. For this purpose, variance analyses are carried out, including variance analyses in the form of budget-actual comparisons. In addition, the consolidated balance sheet and income statements are prepared on a monthly basis. Extrapolations and planning statements are also prepared. A better understanding is achieved as a result of the frequent and continuous process of analysing figures. Accounting principles which have to be applied throughout the Group are defined and communicated in various ways, including the form of a manual. These accounting principles comprise the analysis and interpretation of the new and existing IFRS standards and interpretations in order to permit uniform accounting and measurement throughout the Group. Generally accepted measurement methods are used. The methods which are used as well as the underlying parameters are regularly revised and adjusted where necessary. Deadlines are also defined, so that timely action can be taken in the event of deadline problems.

In order to improve the quality of control, various entities are involved in certain processes and are obliged to take part in the harmonisation process. For instance, the purpose of the division-wide new-product process and the revision of existing products with a right of veto by the Finance entity is to ensure that the accounting presentation of the products is uniform and systematic. A further example of divison-wide harmonisation is the process for preparing the annual reports and interim reports. All entities which are involved have to confirm these reports before the financial statements are prepared by the Management Board (so-called subcertification process), thus providing a further control stage for the products to be disclosed. Ahead of this process, all affected divisions agree the contents of the annual reports and interim reports in editorial meetings.

In the risk management system in relation to the accounting process, Deutsche Pfandbriefbank Group takes measures designed to avert fraudulent actions and deliberate violations to the detriment of Deutsche Pfandbriefbank Group. Theft, embezzlement or misappropriation, are examples of fraudulent actions to the detriment of Deutsche Pfandbriefbank Group. In relation to the accounting process, deliberate misstatement is also defined as a fraudulent action. Deutsche Pfandbriefbank Group identifies and evaluates the risks, and puts measures in place to avert such fraudulent actions and deliberate violations. A newly developed system-based concept also provides training in compliance regulations to employees.

Maintenance Where necessary, Deutsche Pfandbriefbank Group revises and improves its internal control and risk management system relating to the accounting process continuously in the course of the meetings of the Management Board, the GFK and division-internally in order to ensure that risks are identified, evaluated and limited in a manner which is as correct and comprehensive as possible. In consequence, the internal control and risk management system relating to the accounting process is also adjusted to new circumstances such as changes in the structure and business model of the Group or new legal requirements.

The risk of fraudulent actions and deliberate violations is regularly analysed in order to enable appropriate action to be taken. Due consideration is given to various aspects in this respect, including unusual events and changes in the situation of the Deutsche Pfandbriefbank Group and individual employees.

Deutsche Pfandbriefbank Group has to comply with legal requirements. If there are any changes in legal requirements, e.g. in the form of new or amended IFRS standards, the changes have to be implemented. The necessary adjustments to the processes and IT systems are implemented department-wide and with clear functional allocation, where appropriate in separate projects. As part of the implementation process, the risk management system in relation to the accounting process is also adjusted and brought into line with the changed regulations, for instance for revising the process of hedge accounting.

As part of the restructuring process at Deutsche Pfandbriefbank Group, companies have been liquidated and merged, branches closed and the workforce reduced. Deutsche Pfandbriefbank Group limits the risk in relation to the process of preparing the consolidated financial statements by means of clear functional allocations, the centralisation of project management for restructuring and close cooperation between the various entities.

The IT system landscape of the Deutsche Pfandbriefbank Group is of a heterogeneous nature primarily as a result of numerous intra-group mergers of companies. Accordingly, the systems and processes will be harmonised as far as possible in the course of the project New Evolution during the next few years.

Monitoring Internal Audit is responsible for assessing the adequacy of transactions and is also responsible for identifying inefficiencies, irregularities or manipulation. In accordance with the rules of Minimum Requirements for Risk Management (MaRisk), Internal Audit also assesses the effectiveness and adequacy of risk management and the internal control system in a risk-oriented manner, and identifies any weaknesses in the processes of identifying, evaluating and reducing the risks. This also includes an audit of the IT systems of the Deutsche Pfandbriefbank Group as well as the processes and controls in the CFO functions of the reporting entities and Group Accounting. Plans of specific measures with specific deadlines are prepared and followed up in order to process the errors which are identified. Internal Audit reports directly to the CEO and is not integrated in the work procedure, nor is it responsible for the results of the process to be audited. In order to enable it to carry out its duties, Internal Audit has a complete and unrestricted right to receive information regarding the activities, processes as well as the IT systems.

In accordance with Section 111 (2) AktG (German Stock Corporation Act), the Supervisory Board is able to inspect and audit the accounts and the Company's assets in its capacity as the control and advisory body of the Management Board. In addition, the Management Board also reports regularly to the Supervisory Board. The internal control and risk management system relating to the accounting process is the subject of the Supervisory Board meetings. The Supervisory Board engages the auditor for auditing the annual financial statements and consolidated financial statements in accordance with Section 290 HGB (German Commercial Code). The Supervisory Board approves the consolidated financial statements which has been prepared by the Management Board and certified by the independent auditor, and also approves the Group management report. The Supervisory Board has set up an Audit Committee to relieve the Supervisory Board of its responsibility for the task of extensively and promptly auditing the consolidated financial statements, the Group management report as well as the proposal for the appropriation of the cumulative profit; essentially, the Audit Committee operates only on a preparatory basis.

The Audit Committee is responsible primarily for monitoring the accounting process, the effectiveness of the internal control system, the risk management system and the internal audit system as well as the external audit of the financial statements, and in particular the independence of the external auditor and the services additionally provided by the external auditor.

The external auditor attends the meetings of the Supervisory Board and of the Audit Committee, and reports on the main results of its audit, in particular major weaknesses of the internal control and risk management system relating to the accounting process. The external auditor also reports without delay on all findings and events which are essential for the duties of the Supervisory Board and which are identified in the course of the audit. The Supervisory Board discusses the main aspects of the audit with the external auditor in advance.

Major Risk Types

Deutsche Pfandbriefbank Group distinguishes the following major risk types for its business activities
> Credit risk
> Market risk
> Liquidity risk
> Operational risk

The following are also major risk types of the Deutsche Pfandbriefbank Group which are taken into consideration for calculating the economic capital
> Business risk
> Risks attributable to the Bank's own equity participation and real estate holdings

Economic capital is calculated for all risk types, apart from liquidity risk. However, liquidity risk scenarios are also taken into account in the course of stress tests in connection with the review of risk-bearing capacity at the HRE Group level.

The following are major risk types of the Deutsche Pfandbriefbank Group which are not quantified but which are limited by means of suitable reports, guidelines or policies
> Strategic risks
> Reputational risks
> Regulatory risks
> Pension risks.

Credit risk

Definition

Credit risk is defined as the risk of the loss of value of a receivable or the partial or complete default of a receivable due to the default or downgrading of the rating of a business partner. The credit risk also comprises the counterparty, issuer and country risk, which are defined as follows:
> Counterparty risks are defined as potential losses of value of unfulfilled transactions, and in particular derivatives, attributable to the default of the counterparty. The following sub-categories are distinguished in this respect:
>> Settlement risk, which is defined as the risk that, when a trade is settled, the counterparty fails to deliver the necessary consideration.
>> Replacement risk is defined as the risk that, in the event of a counterparty default, the contract has to be replaced on less favourable terms
> Issuer risk is the risk of the complete or partial loss of receivables from security investments due to the default of the issuer.
> Country risks are broken down into transfer and conversion risks as well as default risks. Transfer and conversion risks may arise as a result of state intervention which limits or prevents the ability to obtain foreign currency or the cross-border capital transfer of a solvent debtor. Counterparty risks may arise as a result of the default or downgraded rating of a country in its capacity as a debtor.

Credit risk strategy and principles

As part of the restructuring process, HRE has broken down the overall credit portfolio of the group into a strategic portfolio and a value portfolio. The new portfolio structure will probably be implemented in credit risk reporting in the first quarter of 2010. The adopted risk strategy of the Deutsche Pfandbriefbank Group already reflects the new structure
> The strategic portfolio comprises major parts of the real estate portfolio as well as the Public Sector portfolio of the Deutsche Pfandbriefbank Group.
>> New business in real estate business of the Deutsche Pfandbriefbank Group focusses on Pfandbrief-eligible financing of commercial real estate with sustainable cash flow in Europe, with the main emphasis on Germany, France and the United Kingdom. The main target customers of these operations are professional investors, institutional clients, real estate funds and selective developers. The intended range of products comprises less complex loan structures, selectively extended to include derivative hedging products.
>> In the Public Sector of Deutsche Pfandbriefbank Group, new business will focus on low-risk Pfandbrief-eligible financing of sovereigns and sub-sovereigns in Western Europe, particularly in Germany, France, Spain and Italy, as well as state-guaranteed public private partnerships (PPPs). New business is to be refinanced largely via Pfandbrief issues with matching maturities.
> The value portfolio, which also comprises parts of the real estate portfolio of the Deutsche Pfandbriefbank Group, mainly comprises business which is not Pfandbrief-eligible and business which, in terms of volume and risk profile, is not consistent with the overall strategy. There are no plans for business activities to be expanded in this respect; instead, the focus is on streamlining the portfolio whilst maintaining value and imposing minimum strain on capital, for instance by
>> Sales
>> Reduction by adjusting conditions

Discussions are being held with regard to spinning off parts of the strategic portfolio and parts of the value portfolio into an institution in the institution, described in greater detail in the chapter «Major events».

Organisation of credit risk management

The organisation of the CRO of HRE, as back-office entities for credit risk management of the Deutsche Pfandbriefbank Group, covers all areas which are listed in the previous part under the chapter «Chief Risk Officer» and which are described in the major tasks. At Deutsche Pfandbriefbank Group in line with the requirements of MaRisk, the back-office entities which are mentioned are organisationally independent of the sales entities right through to the Management Board.

Credit risk reports

At HRE in the financial year 2009, reporting on credit risks was thoroughly revised – also taking account of the additional requirements in accordance with MaRisk.

> In the quarterly credit risk report, details concerning the portfolio and risk parameters are extensively reported at the group level and also at the level of the Deutsche Pfandbriefbank Group; they are discussed in the Management Board of the Deutsche Pfandbriefbank AG and are notified to the Risk Management and Liquidity Strategy Committee of the Supervisory Board of the HRE Holding. Major parameters, contents and analysis which are relevant for management purposes, such as the development of the EaD, the EL and the credit VaR, are integrated in the monthly Group risk report, which is also discussed in the Management Board.
> For decisions relating to new business and adjustments of conditions, major parameters, contents and analyses are presented to the Credit Committee of the Deutsche Pfandbriefbank Group and discussed.
> In the active business of the Deutsche Pfandbriefbank Group, further regular reports support operational management with regard to the management and timely recognition of risks at the sub-portfolio level.
> Unusual developments which might result in a major deterioration in the risk position of an individual exposure of the Deutsche Pfandbriefbank Group are reported to a wider group.

Credit risk quantification via economic capital

Credit portfolio model Deutsche Pfandbriefbank Group uses a credit portfolio model for determining the credit risk VaR. The credit risk of a borrower changes, or the borrower is considered to have defaulted, when certain limits are exceeded. These limits are determined on the basis of the rating of the borrower, a migration mix or the default vector and the volatility of a rating index via an internal loan portfolio model based on the fundamental principles of Credit Metrics. The creditworthiness is modelled by means of a stochastic process, which comprises systematic and specific components and which takes account of the internal rating of the borrowers. The correlations are modelled over the systematic components of the rating index and a ten-year history of relevant time series. The migration matrix for modelling rating changes is determined by S&P and reflects a history of more than 30 years. Beyond the fundamental concept of Credit Metrics, the potential loss of value for the Available for Sale positions is taken into account by considering the maximum historic spread increases. Credit spread changes in the IFRS category Fair-Value-through-P&L are recognised in the market risk model.

The economic capital for credit risks is calculated using the credit portfolio model, and is around € 2.2 billion for a risk level of 99.95% and a time horizon of one year, without taking account of diversification effects with regard to other risk types. A comparison with previous year figures is only meaningful to a limited extent because the figures for the two predecessor institutions were determined separately at the end of 2008, i.e. without taking account of diversification effects between the two banks.

Stress tests In addition to the integrated stress tests for risk-bearing capacity of the Deutsche Pfandbriefbank Group which were newly developed in 2009 and which also cover scenarios of credit risk (see chapter on economic capital and assessment of risk-bearing capacity in the first part of the report), stress tests check the impact of the following on the credit risk VaR as well as the available risk cover funds of the Deutsche Pfandbriefbank Group:

> A rating downgrade of all borrowers by one rating notch in each case
> Assumption of the failure of the ten largest borrowers from the Real Estate Finance segment.

In addition to the stress tests for economic capital, the year 2009 saw the development of so-called RWA reverse stress tests, which consider the extent to which a certain risk parameter (e.g. rating, LGD, currency) can change before the minimum capital ratio (currently 8.5%) is no longer met. Tolerance change levels have been defined for all tested risk parameters; these levels must not be violated for the Deutsche Pfandbriefbank Group if the test is to be successfully completed.

Credit risk quantification according to Basle II: Advanced-IRBA

Deutsche Pfandbriefbank Group has – apart from the former DEPFA Deutsche Pfandbriefbank AG – already received regulatory approval to apply the so-called Advanced Internal Rating based Approach (Advanced-IRBA) for determining the regulatory capital backing. At the end of June 2009, HRE submitted the formal application – including all necessary documents – to the bank regulator for introducing the Advanced-IRBA at former DEPFA Deutsche Pfandbriefbank AG. The regulatory audit will start in the second quarter of 2010.

Credit risk management and monitoring

Credit risk management At the HRE portfolio level, the intended portfolio structure is defined in the risk strategy by means of structure components. The limits are also based on the available risk cover funds, and include for instance for the Deutsche Pfandbriefbank Group:

> Limiting of country risks
> Definition of strategic risk and yield parameters (e.g. internal equity yield rate, target customers and regions, financing duration etc.)

The following reports and measures are key elements for monitoring compliance with the defined limits and the intended risk and return parameters at the portfolio level and also at the level of individual transactions of the Deutsche Pfandbriefbank Group:

> Determining the credit risk VaR at the portfolio level of the Deutsche Pfandbriefbank Group by way of a credit risk portfolio model; analysis of concentration risks and various stress tests
> Central group-wide monitoring of risk concentrations by way of special regular and ad hoc evaluations, such as regional, product-specific evaluations
> Continuous analysis of the portfolio and the relevant markets by the local Credit Risk Management units of the Deutsche Pfandbriefbank Group
> Regular, at least annual evaluation of the collateral of the Deutsche Pfandbriefbank Group
> Special reports for exposures which are potentially at risk.

The credit competence guideline also defines the decision-making powers of the individual credit risk managers of the Deutsche Pfandbriefbank Group for prolongations in existing business, depending on the counterparty group and expected loss class. In the period under review, new business is signed exclusively at the Management Board level of the Deutsche Pfandbriefbank AG.

Credit risk management and monitoring At the level of individual transactions of the Deutsche Pfandbriefbank Group, the HRE group-wide effective credit process guidelines define the necessary steps of assessing risk for new business and prolongations as well as the procedures for transferring exposures to the watchlist or workout.

Core processes of credit risk management and monitoring as well as the relevant areas of the CRO function which are involved are described in the following:

In response to an enquiry of sales of the Deutsche Pfandbriefbank Group, the credit risk management entities (Credit Officer Real Estate and Credit Officer PS, FI & Value Portfolio) carry out the initial risk analysis for new business and annual risk analysis for existing business. Basle II-compliant PD and LGD rating tools, which are developed by Credit Risk for Risk Management and Control (RMC) of HRE and annually validated and calibrated, are used for valuation purposes and for preparing the credit decision in new and prolongation business. Property Analysis & Valuation Germany/Property Analysis Europe provides support for analysing and valuing the collateral of the Deutsche Pfandbriefbank Group. The application is checked by the relevant credit risk management entity.

The Legal department of HRE, where appropriate together with external lawyers/lawyer's offices, are responsible for the contract and collateral organisation.

Defined early warning indicators are regularly analysed by Credit Risk Management (CRM). In the event of any irregularities, a credit reassessment (e.g. rating, collateral) is carried out for the corresponding cases of the Deutsche Pfandbriefbank Group, and appropriate measures are initiated. The cases are also included in a monthly monitoring cycle and presented in the Watchlist Committee of HRE.

When indicated, in conjunction with the Global Workout entity (currently only CRE exposures; CRM is responsible for all other exposures), the impairment triggers (please also refer to the chapter concerning the watchlist and non-performing loans) are analysed and impairment calculations are carried out for the Deutsche Pfandbriefbank Group. The Risk Provisioning Committee (please also refer to the overview concerning organisation and committees) takes decisions with regard to the prepared impairment calculations for the Deutsche Pfandbriefbank Group.

Global Workout of HRE (only CRE) or CRM draw up a restructuring plan or a workout plan for critical and impaired exposures of the Deutsche Pfandbriefbank Group. The decision regarding restructuring or workout takes account of scenario analyses of the potential developments of the borrower, the collateral or the relevant market. These are presented and approved in the Risk Provisioning Committee of HRE.

Critical exposures (watchlist) as well as restructuring and workout cases (non-performing loans) of the Deutsche Pfandbriefbank Group are reported monthly in the Group risk report of HRE, in the Risk Committee of HRE and, upon request, in special analyses to the Management Board and Supervisory Board.

Hedging and minimising risk by collateral

At Deutsche Pfandbriefbank Group, property collateral in the field of Commercial Real Estate is particularly important. In addition, other financial securities and guarantees are also accepted as collateral (e.g. credit insurances, guarantees, fixed-income securities, etc.), particularly in the Public Sector field.

The value of the collateral is reviewed as part of the regular (annual) rating assessment of borrowers of the Deutsche Pfandbriefbank Group performed by the credit officers; external or internal appraisals are also used in the case of collateral in the form of property.

Credit portfolio

The entire credit portfolio of the Deutsche Pfandbriefbank Group was calculated using a standard method in line with the Basle II-compliant EaD for the first time as of 31 December 2009. In order to enable a better comparison to be made with previous year figures, the «exposure» as well as the «EaD» are reported for the total exposure amount and also for the Public Sector business. The comments relating to the risk development are based on the previous logic – i.e. EaD for Commercial Real Estate Finance and exposure as well as all other operating segments.

The term «exposure» comprises the current utilisation, committed credit lines, derivatives (current market value plus regulatory add-on) and guarantees less hedging instruments used for the credit risk.

The Basle II compliant term «exposure at default» (EaD) recognizes the current utilisation as well as pro-rata credit interest in relation to which a borrower may default before an exposure is defined as having defaulted (max. default of 90 days), as well as those credit commitments which a borrower will still be able to utilise in future despite a major deterioration in creditworthiness. In the case of derivatives, the EaD – as is the case with exposure – is defined as the sum of the current market value and the regulatory add-on, which constitutes a cushion for future potential increases of the market value.

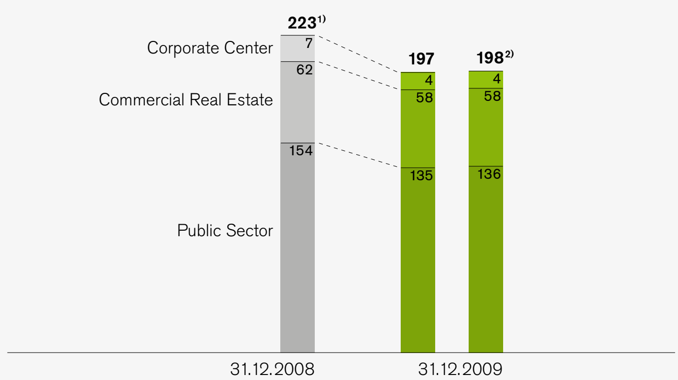
The exposure of the credit portfolio of the Deutsche Pfandbriefbank Group was around € 197 billion as of 31 December 2009, and has declined by around € 26 billion compared with the corresponding figure as of December 2008 (€ 223 billion). Most of this decline is attributable to the decline in receivables due from Germany (€ –15 billion; of this figure, € 11 billion is attributable to Public Sector operations) and also with regard to the affiliated institution DEPFA Bank plc. (approx. € 3 billion).

Overview of the total exposure of the Deutsche Pfandbriefbank Group: € 197 billion (EaD: € 198 billion) The credit portfolio is mainly broken down into the following operating segments
> Public Sector (PS) and
> Commercial Real Estate (CRE).

The Public Sector segment has an exposure of € 135 billion (unchanged at 69 %; 31 December 2008: € 154 billion) and comprises receivables due from the affiliated institution DEPFA Bank plc (€ 65 billion) from the forwarding of liquidity support; the exposure at default of the Commercial Real Estate segment is virtually unchanged at € 58 billion (29 %; 31 December 2008: 28 %).

In addition to the operating segments, the Corporate Center comprises non-strategic positions totalling € 4 billion. The positions essentially comprise structured products in the banking book.

Total exposure: Exposure/EaD according to operating segments as well as Corporate Center
in € billion



[1)] Combined presentation for the Deutsche Pfandbriefbank Group
[2)] EaD

Risk ratios The expected loss (EL), which is calculated on the basis of the annual probability of default (PD), the loss given default (LGD) and the EaD, amounted to € 873 million as of 31 December 2009 using the parameters prescribed by Basle II for the Deutsche Pfandbriefbank Group. The expected loss for a period of one year is a key management parameter for the portfolio, and is calculated for the entire exposure excluding transactions with other institutions within HRE and non-performing loans for which an impairment has already been recognised.

Distribution of the expected loss in € million	31.12.2009
Public Sector	15.2
Commercial Real Estate	834.2
Corporate Center[1]	22.8
Total	**872.6**

[1] The expected loss in the Corporate Center does not include the synthetic CDOs or the already impaired Cash CDOs.

Using the parameters defined under Basle II, the expected loss (EL) for the Commercial Real Estate portfolio was € 834 million as of 31 December 2009. It has accordingly deteriorated appreciably compared with December 2008. This reflects the negative development on the real estate markets which is described in the following and which has resulted in the subsequently described increase in the watchlist loans and non-performing loans and thus the increased expected loss. In addition, the risk parameters were recalibrated in the third quarter, resulting in an € 95 million increase in the expected loss.

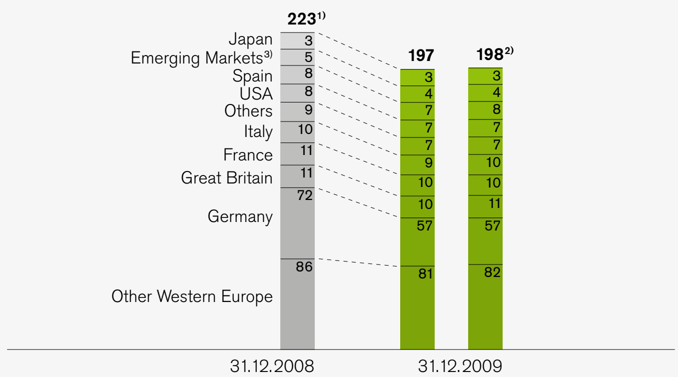
The unexpected loss of the exposure, the credit risk value-at-risk, is calculated for the Deutsche Pfandbriefbank Group as part of the risk-bearing capacity analysis of HRE using a credit risk portfolio model (for the functionality of such a model, please refer to the chapter «Credit risk portfolio model») for a period of one year and a confidence level of 99.95 %.

The economic credit risk capital was stated as € 2.2 billion as of 31 December 2009 for the Deutsche Pfandbriefbank Group (31 December 2008: € 2.8 billion), without taking account of diversification effects.

Country risk 89 % of the exposure is concentrated in Western Europe. Germany constitutes the main risk in this respect (€ 57 billion; 29 %). The UK, US and Spain currently account for € 26 billion (13 %) of the exposure of the Deutsche Pfandbriefbank Group – whereby the trend is slightly declining. The category «Rest of Western Europe» comprises Ireland (€ 58 billion exposure; 31 December 2008: € 61 billion), whereby an exposure of € 57 billion is attributable to receivables due from the affiliated institution DEPFA Bank plc. The next most significant exposures in this category are Austria (unchanged at € 8 billion) and Greece (€ 3.7 billion; 31 December 2008: € 4.5 billion). The exposure for «Emerging Markets» (according to the IMF definition) is € 5 billion (2 %). Poland (€ 2.1 billion; 31 December 2008: € 2.4 billion) and Hungary (unchanged at € 1.1 billion) are the most significant countries in this respect, and together account for 76 % (31 December 2008: 78 %) of the entire «Emerging Markets».

Total exposure: Exposure/EaD of country risk according to regions

in € billion



[1] Combined presentation for the Deutsche Pfandbriefbank Group
[2] EaD
[3] Emerging markets according to the IMF definition

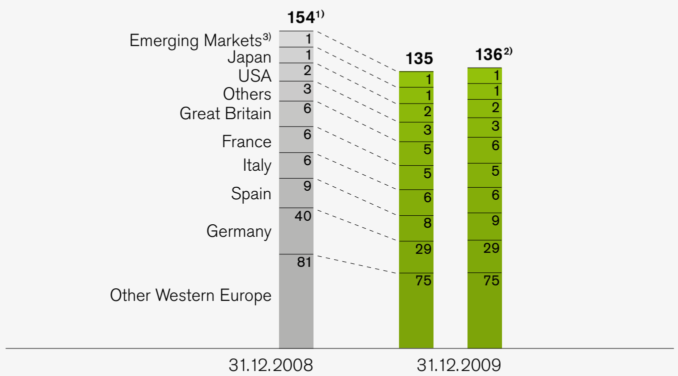
Public Sector: € 135 billion exposure (EaD: € 136 billion) Portfolio development and structure The exposure of the Public Sector segment amounted to € 135 billion as of 31 December 2009 (31 December 2008: € 154 billion). A considerable percentage of this figure (more than € 57 billion) is still attributable to receivables due from the affiliated institution DEPFA Bank plc.

The portfolio is regionally diversified over 35 countries. With exposure of € 128 billion (31 December 2008: € 141 billion) or 95 %, the main exposure is in Europe; Germany accounts for € 29 billion of this figure. This figure has declined by € 11 billion (around 27 %) compared with 31 December 2008. «Emerging Markets» (according to the IMF definition in the «World Economic Outlook April 2009») account for 0.9 % or € 1.2 billion.

The main countries in the category «Emerging Markets» are Poland (€ 0.7 billion) (31 December 2008: € 0.9 billion) and Hungary (unchanged at € 0.4 billion). The category «Rest of Western Europe» comprises Ireland (€ 58 billion; 31 December 2008: € 61 billion), mainly receivables due from DEPFA Bank plc, Austria (€ 7.4 billion; 31 December 2008: € 8.0 billion) as well as Greece (€ 3.7 billion; 31 December 2008: € 4.5 billion) and Portugal (€ 2.6 billion; 31 December 2008: € 2.9 billion).

PS & IF: Exposure/EaD according to regions

in € billion



[1] Combined presentation for the Deutsche Pfandbriefbank Group
[2] EaD
[3] Emerging markets according to the IMF definition

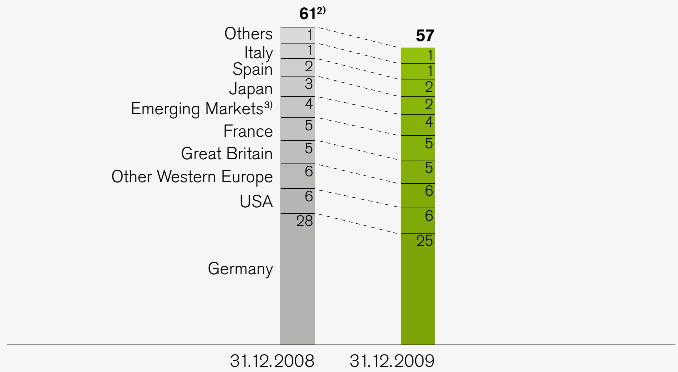
Commercial Real Estate: € 58 billion exposure at default **Portfolio development and structure** Compared with 31 December 2008, the EaD (Exposure at Default) of the Commercial Real Estate portfolio of the Deutsche Pfandbriefbank Group declined gradually by a total of € 4 billion during financial 2009. The customer derivatives included in this figure amounted to € 1.6 billion as of 31 December 2009, compared with € 1.2 billion at the end of 2008.

The commitments amount to € 56 billion, and are thus 12% lower than the corresponding previous year figure (€ 64 billion). Receivables amount to € 55 billion (previous year: € 58 billion); the credit lines which have not yet been paid out amounted to around € 1 billion, and have declined appreciably compared with the end of 2008 (around € 6 billion). This development is also due to the very low amount of new business, which comprises essentially prolongations with existing customers.

The regional structure of the Commercial Real Estate portfolio is stable compared with the end of 2008, and is spread over 35 countries with the main emphasis in Germany (44%) and the other Western European countries (33%); the USA accounts for 10%.

Commercial Real Estate: EaD according to regions[1]

in € billion



[1] Split without € 1.6 billion EaD (December 2008: € 1.2 billion) customer derivatives
[2] Combined presentation for the Deutsche Pfandbriefbank Group
[3] Emerging markets according to the IMF definition

The distribution of the portfolio according to property types also remained mainly stable compared with the end of 2008. Residential properties (mainly portfolio transactions) account for approx. 21% (31 December 2008: one fourth) of the overall portfolio. Commercial properties consist primarily of office buildings and retail properties.

The portfolio is still dominated by investment financing (84%; 31 December 2008: 87%); higher risk construction financing still accounts for 12% of EaD. Investment financing comprises the financing of real estate for which the cash flow is generated by means of rental.

The negative development of the real estate markets in the USA and in Spain continued in 2009; on the other hand, in Great Britain, there have been initial signs of stabilisation since the third quarter. These so-called hot-spot markets are analysed regularly and in a particularly thorough manner; the sub-portfolios are intensively monitored and are being further reduced. Due to the continuing difficult situation on the real estate markets, particularly in the above-mentioned countries, there has been a further increase in the high-risk loans (please refer to the chapter: «Watchlist and non-performing loans»). Because the secondary market for credit risks is characterised by extremely low liquidity and because of the nature of the long-term loan agreements, the risk management possibilities are limited only to the adjustment of terms of loans which fall due, new business and, to a minor extent, to credit lines which have not yet been drawn down.

Key risk aspects The negative market developments in the year under review especially affected the real estate markets in Great Britain (which has been showing initial signs of consolidation since the third quarter of 2009), Spain and also in the USA. Because these negative trends had been anticipated at an early stage, the corresponding financing portfolios had been significantly reduced since the end of 2006: Great Britain by 45% to € 5.2 billion commitments as of the reporting date (€ 5.2 billion EaD), Spain by 36% to € 1.8 billion commitments (€ 1.9 billion EaD) and financing for so-called condominiums in the USA by 57% to € 1.2 billion (€ 1.0 billion EaD). Despite these efforts, the remaining portfolios in the above-mentioned countries still feature significant risk concentrations in certain areas. Accordingly, major parts have been classified as high-risk, and have been placed on the watchlist or have already been classified as non-performing loans (Great Britain 31%, Spain 53%, USA 58%). Corresponding impairments have already been recognised in relation to numerous exposures (please refer to the chapter «Watchlist loans and non-performing loans»).

On the German commercial real estate markets, area sales and yields are still under pressure due to the continuing risk aversion of investors, particularly in the case of properties in less than prime locations. Since the third quarter of 2009, there have been increasing signs of recovery for quality real estate in excellent locations and with tenants with a high credit rating.

Development financing is a further key risk aspect particularly in times of falling real estate demand. The business volume in this segment amounted to € 6.7 billion EaD as of the reporting date, and was operated mainly in the USA (mainly with the above-mentioned condominiums) and in Germany (in this case primarily with commercial real estate). The development portfolios also contain an above-average volume of exposures which are classified as high-risk and which in certain cases have already been impaired.

In relation to the type of financed properties, hotels in particular (commitments of € 2.8 billion as of 31 December 2009) have been affected by the economic crisis; particularly in the USA, there has been a considerable decline in the number of overnight stays in connection with business travel and also holiday travel. The resultant collapse in the cash flows of the financing arrangements together with the decline in the value of the financed real estate has meant that numerous hotel loans have been classified as critical.

Corporate Center: € 4 billion exposure (EaD: € 4 billion) Corporate Center comprises non-strategic positions with a total of € 3.6 billion exposure (December 2008: € 7 billion). The portfolio is broken down as follows:

- € 0.3 billion positions which were taken out by the former DEPFA Pfandbriefbank AG as part of positioning in interest rate risk. The main positions are borrowers note loans of German federal states as well as medium term notes (MTN) of financial institutions and public sector counterparties with an average rating of AA
- € 1.5 billion exposure of a mainly macro-hedged asset/liability management portfolio which can be traced back to the time ahead of the DEPFA/Aareal split
- € 1.3 billion exposure of structured products in the banking book and in consolidated special purpose vehicles (please also refer to the following chapter «Portfolio development and structure of the structured products»)
- € 0.5 billion (December 2008: € 0.4 billion) real estate portfolio which is fully secured with bank guarantees and which can be traced back to the time before the DEPFA/Aareal split.

Portfolio development and structure of the structured products The holdings of structured securities, which Deutsche Pfandbriefbank Group breaks down into real estate linked investments such as Commercial Mortgage Backed Securities (CMBS), Residential Mortgage Backed Securities (RMBS) and credit linked investments, e.g. Collateralised Debt Obligations (CDO) (in the narrower sense of the term) and Collateralised Loan Obligations (CLO), have declined considerably compared with the end of 2008, by a nominal amount of € 1.9 billion to the current figure of € 3.2 billion, mainly as a result of sales of € 1.3 billion in the fourth quarter of 2009.

The CMBS and RMBS securities are valued on the basis of a recognised discounted cash flow model. By way of contrast with the valuation of relatively simple CDO structures, a separate valuation model is mainly used for complex structures and illiquid underlying securities. In this internal valuation model, the US and EU CDOs are valued with the aid of expected losses with a bottom-up distribution. The valuation of this portfolio is essentially determined by the development of the underlying securities, which consist primarily of ABS, MBS or CDO tranches.

The current intrinsic fair value of these securities which evidence credit risks amounted to € 1.62 billion as of 31 December 2009 (€ 1.30 billion MBS, € 0.32 billion CDO).

Total Volume of structured securities in € billion		31.12.2009 Nominal value	31.12.2009 Internal fair value	31.12.2009 Amortised cost of purchase	31.12.2008 Nominal value	31.12.2008 Internal fair value	31.12.2008 Amortised cost of purchase
Real Estate Linked Investments							
CMBS	**Total**	**1.62**	**0.76**	**1.34**	**1.97**	**1.19**	**1.55**
	Europe	1.40	0.62	1.18	1.51	0.88	1.18
	USA	0.22	0.14	0.16	0.46	0.31	0.37
RMBS	Europe	0.71	0.54	0.63	0.78	0.55	0.70
Credit Linked Investments							
CDO	**Total**	**0.91**	**0.16**	**0.17**	**2.32**	**0.56**	**0.65**
	USA	0.34	0.15	0.16	0.88	0.38	0.47
	Europe	0.57	0.01	0.01	1.44	0.18	0.18
ABS (other)		–	–	–	0.01	0.01	0.01

In the year under review a loss of € –44 million (previous year: € –1,903 million) in the profit and loss account was attributable to structured securities.

Special-Purpose Vehicle of Deutsche Pfandbriefbank Group

Special-purpose vehicles are generally used for ring-fencing assets from operating companies in a manner in which they are protected from insolvency and also to enable these assets, which are frequently used as collateral, to be disposed of more readily if necessary. Within the framework of its business activities, Deutsche Pfandbriefbank Group uses special purpose vehicles for different purposes, but the explicit focus lays on the reduction of risk.

Special-purpose vehicles which have been established or sponsored by Deutsche Pfandbriefbank Group or with which contractual relations exist may have to be consolidated. In line with the IFRS, special-purpose vehicles are consolidated if they are substantially controlled by Deutsche Pfandbriefbank Group although they are not controlled in the formal legal sense of the term (IAS 27 in conjunction with SIC 12). This is the case particularly if most opportunities and risks of the special-purpose vehicle are attributable to the Deutsche Pfandbriefbank Group. The question as to whether consolidation in accordance with IFRS is applicable is considered when the special-purpose vehicle is established and also when there is a change in the financial circumstances of the special-purpose vehicle, or when there are any changes in the business relations between the Group and the special-purpose vehicle.

The following statements reflect in more detail the different purposes traced by Deutsche Pfandbriefbank Group in relation to its special-purpose vehicles.

Refinancing of the Group Special purpose vehicles in this context are used for supporting the refinancing of the Group and thus for reducing the liquidity risk. A variety of forms is used. In addition to traditional refinancing vehicles which collect funds on the capital market and extend them to Deutsche Pfandbriefbank Group in the form of loans, special purpose vehicles can also be used for securitising certain assets in such a way that they can be used in security lending operations.

Outplacement of credit risks The outplacement of own credit risks is also a very important purpose for the use of special purpose vehicles. Most of these outplacement arrangements were carried out in or before 2007, so that these are only recognised in accordance with Basle I and in general are not recognised in accordance with the Solvency Ordinance (SolvV) or Basle II. Deutsche Pfandbriefbank Group generally transfers the risks synthetically to the special purpose vehicle which in turn transmits them to third parties. The risk is normally transmitted in two stages. For the so-called first loss (primary risks – junior tranche with highest risk of loss) and the subordinate risks, second losses in the broader sense of the term, the special purpose vehicle issues credit linked notes (CLN), whereas finance guarantees or credit default swaps (CDS) are acquired from third parties for the remaining subordinated risks (senior tranches). The proceeds generated by the CLN are invested in prime securities, which in turn are used as collateral for Deutsche Pfandbriefbank Group. The special purpose vehicles are consolidated if only a very small percentage of the CLNs of the special purpose vehicles are placed on the market.

Capital-backed investments In the past, investments were made in capital-backed securitisations in order to optimise the regulatory capital requirements. The special purpose vehicles issued capital-backed bonds which in turn were acquired completely by Deutsche Pfandbriefbank Group. In the case of capital-backed bonds, repayment of the invested nominal amount is guaranteed at maturity. These companies are fully consolidated.

Special-purpose vehicles within the framework of investments in ABS structures As a result of previous investments of Deutsche Pfandbriefbank Group in ABS structures, it is necessary for the corresponding special purpose vehicle to be consolidated at some selected investments. These are mainly investments in first loss tranches which have been completely written off, so that they do not pose any risk to Deutsche Pfandbriefbank Group in this respect. There is also an investment in a special purpose vehicle based on a pool of AAA-rated US Commercial Mortgage Backed Securities (CMBS).

Assets of consolidated special purpose vehicles The following table summarizes the special purpose vehicles which have been included in the annual financial statement of Deutsche Pfandbriefbank Group as of 31 December 2009 or as of 31 December 2008 in accordance with IFRS. The underlying assets of the consolidation are all classified as loans and receivables (LaR).

Consolidated special-purpose entities by categories Nominal value of special purpose vehicles in € million	31.12.2009	31.12.2008
Refinancing of the Group	136	136
Outplacement of credit risks	431	548
Capital-backed investments	633	1,473
Investments in ABS structures	948	3,039
Total	**2,148**	**5,196**

The consolidation of the special purpose vehicles has resulted in particular in a balance sheet extension of approx. € 0.9 billion (31 December 2008: € 3.0 billion) from securitisation special purpose vehicles within the framework of investments in ABS structures in which the Deutsche Pfandbriefbank Group holds first loss tranches which have already been fully written down. From the point of view of risk, this means that the volume exposed to risk has declined by € 0.6 billion (31 December 2008: € 2.5 billion).

Watchlist and non-performing loans: € 12,4 billion

Early warning system The early warning system of HRE guarantees that loans and borrowers of Deutsche Pfandbriefbank Group, which might be affected by a deterioration in rating or the value of collateral are identified promptly and closely monitored or transferred to the watchlist.

In 2009, the existing early warning criteria as well as allowance criteria were gradually further developed. In particular, they were specified in further detail and segment-specific criteria were defined.

Non-performing loans are classified under the categories «restructuring loans» and «Workout». The distinction criteria between «workout» and «restructuring loans» were revised in the third quarter of 2009.

> «Restructuring loans» comprise cases for which an individual allowance has been recognised (but not any enforcement) as well as cases which have defaulted in accordance with Basle II (e.g. payment in arrears > 90 days).

> «Workout loans» now include only loans which are subject to foreclosure and for which an impairment has to be recognised. Only in the Commercial Real Estate segment has this resulted in a considerable shift in the classification of non-performing loans which are now classified as restructuring loans, whereas they had previously been classified as workout loans. In addition, the watchlist now includes loans for which payments are now past due by 60 days instead of the previous figure of 30 days. This has not resulted in any change in the previously reported figures.

Particularly in the event of payment problems and payment arrears of more than 90 days, such cases are forwarded to non-performing loan processing. Non-performing loan processing is also responsible for carrying out an impairment test in line with the relevant accounting regulations of the Group.

As soon as it has been decided that a watchlist loan is to be forwarded to non-performing loan processing, a relevant responsible officer in non-performing loan processing is nominated within one week. Within a further week, the transferring department must review the up-to-date nature of the relevant documents and update them where appropriate (e.g. collateral, ratings, valuation). In addition, a check is performed to determine whether a current internal prolongation exists; otherwise, this has to be created. The transfer of the loan is documented in writing, and is signed by both parties.

The following table sets out only engagements of the business segment commercial real estate (CRE) of Deutsche Pfandbriefbank Group.

Watch list and non-performing loans in € million	31.12.2009	new definition 31.12.2008	31.12.2008
Workout loans	918	495	3,723
Restructuring loans	8,023	3,723	495
Non-performing loans	8,941	4,218	4,218
Watch list loans	3,449	785	785
Total	**12,390**	**5,003**	**5,003**

The increase of € 7.4 billion in the non-performing loans and watchlist loans to € 12.4 billion essentially reflects a considerable deterioration in the real estate markets and the overall economic climate. The main increase in the year under review is attributable to the USA (€ +2.8 billion); followed by Europe (€ +2.3 billion; of which Great Britain: € +0.8 billion) as well as Germany (€ +1.7 billion).

Impairments and provisions

Individual allowances and portfolio-based allowances All loans of Deutsche Pfandbriefbank Group are regularly tested to determine whether they are impaired. In a first step it is analysed whether there is an objective indication for an impairment. After that the extent of impairment is calculated as the difference of the current book value and the present value of all expected future cash flows. Objective indications of an impairment are described in detail in the «notes» of the consolidated financial statement.

The specific criteria which trigger off the creation of an impairment, the so-called «impairment triggers», were revised and fine tuned in 2009.

The following factors in particular are taken into consideration for determining the extent of the impairment, taking account of the group-wide credit exposure:

> The amount and timing of the expected interest rate payment and redemption payment
> The recoverable amount of the security and the probability of successful recovery
> The probable amount of costs for collecting outstanding amounts
> If available, the market price of the asset.

Portfolio-based allowances are calculated using risk parameters which are compliant with Basle-II, such as probability of default (PD) and loss given default (LGD). The resultant expected loss in relation to a time horizon of one year is scaled using an IFRS-compliant conversion factor to the period which on average is required for identifying the impairment event. With regard to the period between the point at which an impairment occurs and the point at which it is identified, the estimate parameters have been adapted to the improved credit processes.

The impairments of all credit risks are approved in the Risk Provisioning Committee in which the CROs of all subsidiary institutions, i.e. also of Deutsche Pfandbriefbank Group, are represented.

If differences are identified between long-term average values for the parameters PD and LGD on the one hand and the current figures on the other as a result of the market environment in some portfolios of the operating segments, these are taken into consideration accordingly.

Risk provisioning of Deutsche Pfandbriefbank Group An overview of the development in provisions for losses on loans and advances and provisions is set out in the notes as well as in the financial- and risk report.

The increase in the individual allowances reported in the notes from € 1.402 billion as of 31 December 2008 to € 2.780 billion as of 31 December 2009, reflects reflects the continuing difficult situation on the real estate markets as well as the significant slow-down of the global economy.

The portfolio-based allowances amount to € 541.8 million as of 31 December 2009 (12/2008: € 419.3 million). Of the figure stated for the increase, € 122.5 million were attributable to the recalibration of the PD and LGD methods in the third quarter of 2009; these are used as the basis for calculating the portfolio-based allowances. In addition, an increase in the non-performing loans for which an impairment has not yet been recognised has resulted in a significant increase in the portfolio-based allowances. With regards to the assumed time frame between the evidence and identification of an impairment the parameters have been adjusted to the improved credit processes. An effect in the opposite direction had the adjustment of the parameters to the economic cycle, increasingly impacting the historical loss ratios. The adjusted parameters reduced the portfolio-based allowances by € 264 million.

Provisions for contingent liabilities and other obligations in credit business

The provisions for contingent liabilities and other obligations mainly comprise provisions for guarantee risks, letters of credit and irrevocable loan commitments in lending business. At € 11 million as of 31 December 2009, they were unchanged compared with the previous year.

Market Risk

Definition

Market risk is defined as the risk of a loss of value resulting from the fluctuation of the market prices of financial instruments. Transactions of the Deutsche Pfandbriefbank Group are mainly exposed to the following risk types:
> Credit-spread risk
> General interest rate risk
> Foreign currency risk

Market risk strategy

Deutsche Pfandbriefbank Group follows the following fundamental principles in relation to market risks:
> Transactions should cover customer requirement; own transactions must be limited
> Transactions may be conducted only in financial instruments which are measured independently via a model or for which market prices are observable; they must have successfully passed through the new product process
> All positions are subject to daily P&L- and risk monitoring by Risk Management & Control

Organisation of market risk management

In line with the requirements of MaRisk, the positions are monitored by Risk Management & Control which is separate from trading in the structure organisation right through to the level of management.

Market risk reports

Risk Management & Control prepares extensive market risk reports every day for various recipients:
> The daily market risk report is addressed to the Management Board of Deutsche Pfandbriefbank AG. It shows market risk value at risks (VaR), limit utilisations and economic performance figures.
> Daily sensitivity reports comprise analyses for the main risk factors at various levels of detail. They are made available to risk management as well as to the Management Board of Deutsche Pfandbriefbank AG.

Measurement and limiting of market risk

Functional measurement and limiting Risk Management & Control uses a variance-covariance approach to calculate the market risk VaR at the overall and sub-portfolio level on a daily basis. All trading and bank book positions are taken into consideration for this purpose.
> The correlations and volatilities which are used are based on historical time series of the previous 250 trading days, which are included in the calculation on an equally weighted basis.
> For the daily operational risk management, the VaR relates to a holding period of ten days and a one-sided 99% confidence interval.
> When the individual market risk components, such as the interest, FX and credit spread VaR, are aggregated to form a total VaR, which constitutes the basis for the limits, it is assumed that the market risk categories are not correlated. This assumption is regularly and explicitly checked and validated for significant portfolios of the HRE Group.

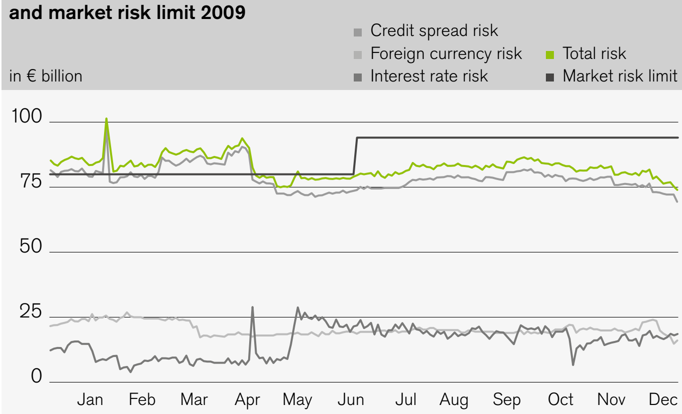
The presented figures relate to Hypo Real Estate Bank AG until 29 June 2009. Since the merger of DEPFA Deutsche Pfandbriefbank AG with Hypo Real Estate Bank AG and following the change of name to the Deutsche Pfandbriefbank Group on 30 June 2009, figures are shown for the new institution Deutsche Pfandbriefbank Group.

Up to the time of the merger, the market risk VaR was roughly equivalent to the limit of € 80 million. After the merger, the limit increased to € 95 million. This is equivalent to the sum of the sub-limits of the merged banks. Since that time, the market risk VaR has been considerably below the limit.

As of 31 December 2009 market risk VaR (10-day holding period; 99% confidence level) amounted to € 74.2 million (31 December 2008: € 84.8 million).

The following diagram illustrates the development of the market risk VaR as well as the VaR for the individual risk types compared with the market risk limit during the year.

Market risk VaR (10-day, 99%) of individual risk types and market risk limit 2009



The VaR assessment is complemented by further instruments such as sensitivity analyses as well as stresstesting.

Sensitivity analyses Sensitivity analyses quantify the impact of a change in individual market parameters on the value of the positions of HRE. For instance, the credit spread sensitivity provides an indication of the change in economic present value which results from an isolated change of one basis point in the credit spreads which are relevant for measurement purposes.

Stresstesting Whereas the VaR measurement simulates the market risk under «normal» market conditions, and is not to be understood as a standard for a potential maximum loss, stress scenarios show the market risk under extreme conditions. At Deutsche Pfandbriefbank Group, uniform hypothetical stress scenarios are calculated on a monthly basis for all key risk drivers (credit spreads, interest rates, foreign currency rates). Historical stress scenarios are also simulated. For example, a parallel shift of the interest rate curve of 200 basis points would affect all positions of Deutsche Pfandbriefbank Group and result in a change of approx. € 158.6 million in the market value. The corresponding figure for the end of 2008 was € 278.7 million. The Management Board and the corresponding committees are regularly informed of the results of the scenario analyses.

Control, management and monitoring of market risk

The Deutsche Pfandbriefbank Group uses a three-pillar approach for managing and monitoring the market risk:

- Management of the position in Treasury/Public Finance,
- Risk measurement and monitoring in compliance with limits by Risk Management & Control as well as
- Escalation processes across all decision-making committees right through to the management board.

The market risk for all position is monitored via a combination of value-at-risk (VaR) limits as well as the monitoring of sensitivities by Risk Management & Control.

Outlook

With the planned establishment of a deconsolidated environment, risk-relevant positions of Deutsche Pfandbriefbank Group will be spun off. This will most likely lead to a reduction of the VaR.

Development of the relevant market risk types

General interest rate risk The total general interest rate risk of Deutsche Pfandbriefbank Group amounted to approx. € 18.4 million as of 31 December 2009 (compared with € 11.5 million as of 31 December 2008). On average, the interest rate risk of approx. € 15.1 million for 2009 (max. € 29.3 million; min. € 3.5 million) was still at a low level (average VaR for 2008 € 8.5 million; max. € 23.9 million; min. € 2.8 million).

Credit spread risk The credit spread risk reflects the potential change in the present value of positions as a result of changes in the corresponding credit spreads. Risk measuring systems for determining credit spread risks exist for all relevant positions of Deutsche Pfandbriefbank Group. Most of the credit spread risk is attributable to assets eligible as cover for Pfandbriefe. The VaR-limit is applicable only to the credit spread risks of the AfS and FVtPL holdings, and is not applicable for the LaR positions. However, sensitivities are calculated and limited for all holdings, i.e. also for LaR positions.

Due to the business model of the Group, the security holdings in the cover funds account for by far the majority of HRE's positions which are sensitive to credit spread changes. Accordingly, the credit spread sensitivity of the overall portfolio (including the security holdings classified as LaR) amounted to € 40.3 million at the end of December 2009 (end of 2008: € 16.1 million) The significant increase of credit spread sensitivity is caused by the fact that the amount at the end of 2009, other than the one of end 2008 contained positions of the former DEPFA Deutsche Pfandbriefbank AG.

Foreign currency risk and other market risks The foreign currency risk which is calculated as a present value amounted to € 15.2 million as of 31 December 2009; the corresponding figure at the end of 2008 was € 20.2 million. The general strategy is to hedge foreign currency risks as far as possible.

The Group is not exposed to equity price, commodity and inflation risks, or any such risks are essentially hedged. Financial derivatives are used mainly for hedging purposes.

Liquidity Risk

Definition

Liquidity risk is defined as the risk of not being able to meet the extent and deadlines of existing or future payment obligations in full or on time. This would for instance be the case if – as indeed has happened at HRE – there were no longer sufficient external refinancing sources. Because the continued existence of HRE and hence as well of the Deutsche Pfandbriefbank Group as a going concern very much depends on the guarantees provided by the SoFFin, the liquidity risk is currently one of the most significant risks. Therewith the Deutsche Pfandbriefbank Group is included into the group wide liquidity management.

Liquidity risk strategy

The liquidity risk strategy is a key component of the risk strategy of HRE thus as well the Deutsche Pfandbriefbank Group, and is broken down into various modules. This ensures that as well the short – as the long term refinancing of Deutsche Pfandbriefbank Group is monitored and controlled by means of a limit system. The limits are defined as part of the annual business planning process.

Organisation of liquidity risk management

Risk Management & Control of HRE identifies, measures, reports and monitors the liquidity risk of Deutsche Pfandbriefbank Group. Risk management is the responsibility of the Treasury entity of the HRE Group which is independent of Risk Management & Control. The processes and methods which are used are regularly reviewed by the Risk Committee of HRE and Asset Liability Committee of HRE.

Liquidity risk report

HRE has group wide introduced an improved consolidated reporting and planning process in October 2008, and further developed this process in 2009. The liquidity management reports are prepared daily on a group-wide basis and reported to the entire Management Board as well as to the Bundesbank, Bafin and SoFFin. The reports contain the daily liquidity situation as well as projections on the basis of contractual cash flows and assumptions made in relation to future events which will influence the probable liquidity development.

Measuring and limiting liquidity risk

A system for measuring and limiting short-term and structual variances within the cash flows has been installed in order to manage the liquidity risks. In addition to contractual cash flows optional cash flows are also considered. The latter are back-tested on a regular basis.

The liquidity position which consists of contractual and optional cash flows is measured by considering different scenarios. On a daily basis different liquidity positions are calculated: A position based on the assumption of a constant market and funding environment (base case) and a further liquidity position assuming a liquidity squeeze (risk stress scenario) similar to the situation HRE was confronted with at year end 2008.

For the short tem liquidity risk different liquidity scenarios with each a limit of one month have been defined.

The limit system consists of three key aspects:
> Headroom limit for the liquidity reserve of the HRE Group
> Limit for the liquidity stress profile of HRE Group
> Limitsystem for Deutsche Pfandbriefbank Group

Within the limit system of Deutsche Pfandbriefbank Group for the next month for the risk stress scenario a buffer of at least € 2.0 billion has been set for the next five trading days and a positiv saldo over null for the rest of the month. On Group level the limit amounts to € 4.5 billion for the next five trading days.

In 2010 it is planned to limit the medium and long term liquidity risk.

In addition to reporting, HRE uses additional regular stress tests and scenario analyses for quality assurance of the measurement results and for investigating the effect of additional stress events on the liquidity position.

Scenario analyses are performed to simulate the potential impact of crises attributable to macroeconomic, monetary policy and political causes on the liquidity situation of HRE.

The scenarios are reported to the Management Board of HRE Holding and Deutsche Pfandbriefbank AG and external bodies, e.g. the Bundesbank and the SoFFin and are jointly analysed.

Liquidity risk monitoring and management

Monitoring of the liquidity risks is assured by the daily reporting of the liquidity situation of HRE and a defined escalation process. In 2009 a liquidity contingency plan has been approved in this context, which sets the frame for the management of liquidity squeezes.

Liquidity risk management is based on various interconnected components which in turn are based on a «liquidity risk tolerance» defined by the Management Board. This ensures that the individual companies of HRE thus as well the Deutsche Pfandbriefbank Group have adequate liquidity reserves.

Hedging and reduction of liquidity risk

A risk tolerance system is used to limit the liquidity risk on HRE group level. Risk tolerance is integrated in the liquidity management process by means of triggers (limit system) in order to ensure a «survival period» of Deutsche Pfandbriefbank Group in stress conditions.

The limits applicable for risk tolerance are determined in the scope of the stress scenarios and are frequently adjusted.

Development of the risk position of HRE

The development in the liquidity situation in the fourth quarter has shown a slightly positive trend. This was due primarily to the provision of shareholder's equity by the SoFFin (€ 3 billion).

At the same time, an increasing problem was the more stringent requirements imposed by the rating agencies with regard to the surplus cover in the cover funds.

The external liquidity support was restructured as of 23 December 2009. The liquidity aid/commitments provided via BLUE (recently € 43 billion) were replaced by securities of the same amount which were backed with SoFFin guarantees. Of this figure, € 23 billion is refinanced via a syndicate of banks, and € 20 billion is refinanced via the capital market/central banks.

As of 31 December 2009 guarantees of the SoFFin of € 95 billion existed. Thereof (after deduction of haircuts) approx. € 14 billion of liquidity facilities remained undrawn.

Despite the fact that HRE and thus as well the Deutsche Pfandbriefbank Group have returned to the public financing markets, they will continue to be extremely reliant on external support measures. The liquidity needs of the Deutsche Pfandbriefbank Group will furthermore be dependant on market fluctuations, especially fluctuations of interest-, currency- and credit spreads. The current support measures are extensively described in the chapter «Major events» in this financial review. The support measures are due to expire on 30 June 2010 and on 22 December 2010. Even if Deutsche Pfandbriefbank Group continues to be able to establish itself on the capital markets and even if the capital markets continue to recover in the course of 2010, HRE and Deutsche Pfandbriefbank Group will still be reliant on the support measures being extended.

As a result of the support measures described in the above-mentioned chapter, the liquidity ratio of Deutsche Pfandbriefbank Group in accordance with the liquidity ordinance amounted to 2.12 as of 31 December 2009; it was thus higher than the statutory minimum of 1.0.

Breakdown of remaining terms on the balance sheet of Deutsche Pfandbriefbank Group according to IFRS

in € billion (as of 31 December 2009)	Assets	Liabilities
Total	**215**	**215**
up to 3 months	76	67
3 months to 1 year	17	48
1 to 5 years	48	38
> 5 years	60	40
Other assets[1]/liabilities[2]	14	22

[1] Trading assets, deferred tax assets, impairments, other assets
[2] Shareholders' equity, liabilities held for trading, provisions, deferred tax liabilities, other liabilities

For refinancing of Deutsche Pfandbriefbank Group, covered and uncovered issues are available. Pfandbriefe and other covered bonds are a key component of the refinancing sources. As a result of their high quality and stable maturity profile, the existing covered bonds have been affected to a comparatively minor extent by market turmoil. This is applicable particularly for the German Pfandbriefe; this is the instrument which the Group will use for refinancing new business and the residual portfolio after the spin-off. The positive market environment was supported in the fourth quarter of 2009 by the covered bond purchase programme of the ECB. In the third and fourth quarters of 2009, Deutsche Pfandbriefbank Group was able to place two Jumbo Pfandbriefe of € 1 billion and € 1.5 billion respectively on the market. These so-called benchmark transactions were complemented by private placings. The strategy of restructuring the business model of Deutsche Pfandbriefbank Group on the basis of new business eligible for cover funds takes account of this development. However, the premiums which Deutsche Pfandbriefbank Group has to pay compared with other issuers are relatively high. If this situation does not return to normal over a period of time, this might have an impact on the profitability of new business.

Deutsche Pfandbriefbank Group was also able to reestablish themselves on the market in the field of secured repo transactions, and were thus able to refinance a part of the security portfolio subject to normal market conditions.

The field of unsecured refinancing was also able to contribute to Deutsche Pfandbriefbank Group's refinancing of HRE via money market transactions and longer-dated issues. However, the volumes are not able to significantly reduce the extent of external liquidity support. Also the secured refinancing via the Central Banks is still indispensable for the refinancing of HRE.

Covered refinancing via ECB/Bundesbank in € billion (as of 31 December 2009)	External liquidity support[1]	Own securities
Up to 1 months	12.5	5.2
Up to 3 months	–	–
Up to 6 months	–	–
Up to 12 months	1.0	3.5
Total	**13.5**	**8.7**

[1] SoFFin-guarantees

Outlook

The extent of the liquidity requirement for Deutsche Pfandbriefbank Group up to the end of 2010 depends on numerous factors. Most short-term refinancing instruments dating back to the time before the crisis have expired and have been replaced by the liquidity support of the SoFFin and the banking syndicate. Scenarios have to be defined for numerous volatile factors in order to present the expected future development:
> The future development of the discounts for repo refinancing on the market and with the central banks
> Possible additional collateral demands as a result of changing market parameters (such as interest rates and foreign currency rates)
> The development in collateral demands for hedges
> Changed requirements of the rating agencies regarding the necessary surplus cover in the cover funds

For assuring the liquidity requirement of Deutsche Pfandbriefbank Group, unrestricted access to ECB is necessary. So is the continuation of the facilities, currently running at € 95.0 billion, provided by the SoFFin essential for the refinancing of the Group in 2010 and in subsequent years. HRE as well as Deutsche Pfandbriefbank Group will continue to be reliant on external liquidity support being provided.

Operational Risk

Operational risks are still associated with most aspects of Deutsche Pfandbriefbank Group's business, and comprise numerous widely differing risks; particularly in times of internal and/or external problems, which have been affecting the entire financial sector and in particular Deutsche Pfandbriefbank Group in the year under review, these will have to be monitored particularly intensively.

Definition

Deutsche Pfandbriefbank Group defines operational risk as «the risk of losses caused by processes which are not satisfactory or which have not even been implemented, human error, technology failure or external events». The definition includes legal risks, but excludes strategic and reputation risks.

Strategy for operational risks

The main aims of Deutsche Pfandbriefbank Group are the early recognition, recording, valuation as well as monitoring, prevention and limiting of operational risks as well as an early and meaningful report to the management. Deutsche Pfandbriefbank Group is attempting to minimise the losses attributable to operational risks. The provision of adequate information is the basis for decisions regarding the limitation of risk.

Organisation of operational risk management

In the field of Risk Management & Control, the Operational Risk & MaRisk department is responsible for uniform Group-wide processes, instruments and methods for recording, valuing, monitoring and reporting operational risks in HRE. This includes Deutsche Pfandbriefbank Group. The primary focus is on the early recognition, reduction and management of risks, and the secondary focus is on the measurement, monitoring and reaction to risks.

Risk reports, monitoring and management of operational risks

Operational risks are monitored by means of a network of controls, procedures, reports and responsibilities. Within the Deutsche Pfandbriefbank Group, each individual unit takes on responsibility for its own operational risks, and provides appropriate resources and processes for limiting such risks.

Deutsche Pfandbriefbank Group uses the following HRE-group-wide processes and methods for management, assessment, monitoring and reporting of operational risks:

> Regular evaluation of risk-relevant parameters (key risk indications, KRI), which are suitable for early recognition of control problems and unfavourable developments
> Performance of risk self assessments for evaluating the possible impact of potential risk sources in processes, as well as the existing controls for limiting the risk
> Collecting loss data from operational risks for identifying process, control and system weaknesses in order to enable countermeasures for reducing risk to be taken at an early stage
> Co-ordination of the new product process of the Deutsche Pfandbriefbank Group for measuring and monitoring risks which may be associated with new products or business activities
> Focussed analysis of predefined risk areas in conjunction with the specialist units for providing appropriate measures for backing risk

The collected information is used in order to determine the operational risk profile of Deutsche Pfandbriefbank Group and the measures to be derived from this profile.

The Operational Risk & MaRisk department evaluates the data which are collected; it recommends measures and works together with the specialist units to identify possibilities of preventing and managing operational risks. The head of the specialist unit is responsible for monitoring and managing operational risks for the Deutsche Pfandbriefbank Group.

In order to support the specialist units specifically in critical processes or procedures, Operational Risk & MaRisk carries out individual analyses on behalf of the Management Board, and prepares a catalogue of special measures.

Further this unit is responsible for the co-ordination to guarantee compliance with the minimum requirements applicable for risk management (MaRisk) in Deutsche Pfandbriefbank Group.

Risk reports Regular reports are prepared for the Chief Risk Officer (CRO) of Deutsche Pfandbriefbank Group and the Risk Committee of HRE. The quarterly report for the Management Board of Deutsche Pfandbriefbank AG, with details concerning the operational claims and losses, is used for assessing and evaluating the operational risk profile. In addition, a quarterly key risk indicator report indicates potential risk sources to the Management Board. The results of the regular risk self assessments in the specialist units are also reported to the Management Board after the assessment process has been completed. After the completion of a special risk analysis which has been ordered, the relevant member of the Management Board receives a final report.

Risk measurement In order to determine the minimum capital requirement in accordance with Basle II or in accordance with the EU Capital Adequacy Guideline (CRD), the HRE uses the standard approach. The standard approach is also used for allocating the economic capital.

The capital backing of HRE for operational risks in line with the standard approach under Basle II is € 104 million as of 31 December 2009 (€ 212 million as of 31 December 2008).

Major operational risks of Deutsche Pfandbriefbank Group

The main operational risks are essentially attributable to the ongoing process of restructuring of the HRE as well as the Deutsche Pfandbriefbank Group.

Major operational risks are attributable to the high number of manual records as well as the high number of different processing and monitoring systems. The systems are being consolidated at present. Until the consolidation process has been completed, there will be an increased level of susceptibility to faults with regard to the manual processes and controls which are carried out for ensuring data consistency.

There is also a significant reliance on know-how for implementing restructuring processes on the one hand and for operating daily business on the other. The loss of know-how represents an increased level of risk in the current situation of Deutsche Pfandbriefbank Group. The significant changes which have now been implemented in the Group also require experienced personnel in order to establish and assure a stable control process.

In the course of the financial year 2009 Deutsche Pfandbriefbank Group suffered no losses from operational risk.

Process and control improvements have been implemented in order to remedy the underlying causes of the losses which have occurred.

Deutsche Pfandbriefbank Group is involved in numerous court proceedings and out-of-court proceedings, resulting in legal risks for the Group particularly in conjunction with the proceedings which are described in the notes of this consolidated financial statement.

Results of the Risk-bearing Capacity Analysis

Excluding the diversification effects between the individual risk types, the economic capital of the Deutsche Pfandbriefbank Group amounted to around € 3.0 billion. If these effects are taken into consideration, the economic capital declines to around € 2.6 billion. A comparison with the previous year figures is meaningful only to a limited extent because the figures shown here as of 31 December 2008 result from a global addition of the risk capital amounts per risk type of the two predecessor institutions without explicitly taking account of the diversification effects between the two banks.

Economic capital according to risk types Excluding diversification effects in € million	**31.12.2009**	**31.12.2008**[1]	Changes in %
Credit risk (default and migration risk as well as credit spread risk in Available for sale)	2,170	2,521	–14
Market risk (credit spread risk in the trading book and fair value through P&L)	–	–	–
Market risk (interest and currency risk)	178	360	–51
Operational risk	290	237	22
Business risk	261	211	24
Risk of the Bank's own real estate holdings	80	77	4
Risk of investment holdings	2	40[2]	–95
Total before diversification effect	**2,981**	**3,446**	–13
Total after diversification effect	**2,631**	**3,096**	–15

[1] The figures reported as of 31 December 2008 consist of the risk values of DEPFA Deutsche Pfandbriefbank AG together with those of Hypo Real Estate Bank AG.
[2] The figure of € 104 million reported for 31 December 2008 included companies which are consolidated.

Method used for the individual risk types

The economic capital of each risk type is calculated using a quantitative approach, and is aggregated to the overall bank risk, with due consideration being given to specific correlations. In line with the common market standard, the risk types are scaled to a period of one year and a risk level derived from the target rating (in this case: 99.95%).

The calculation and allocation of economic capital are subject to various assumptions and expectations. The methods used in the credit portfolio model have been further developed in the period under review in order to ensure that the calculation of economic capital is kept consistent with the current business strategy, ownership structure and the changed funding profile. This adjustment is an initial implementation stage in the direction of the above-mentioned revision of the model. Further details are set out in the section concerning the credit portfolio model in the chapter «Credit risk».

The definition and method of calculating the economic capital for the risk types credit risk, market risk and operational risk have been detailed in the relevant previous chapters.

Business risk The economic capital is individually scaled on the basis of the scaling of the operational costs for each operating segment. The operating costs are used as an approximation for the fixed costs which would have to be covered in the event of a collapse in earnings. Similar to the situation applicable for operational risk, implied costs from the cost-income ratio of 35% are used as the calculation basis. The most conservative value from various externally calculated comparable operating segments are used for the scaling factors.

Business risk comprises several underlying risk categories, which mainly consist of strategic risk and the risk of fluctuations in costs/income, and thus to a certain extent also comprises liquidity risk.

Equity participation holdings and the Bank's own real estate holdings Together, these account for approx. 3% of the economic capital of Deutsche Pfandbriefbank Group.

Both risk types are derived via the volatility of the MSCI real estate index for a 15-year history. The Bank's own real estate holdings of Deutsche Pfandbriefbank Group is roughly unchanged compared with the previous year level. The equity participation portfolio has declined to almost zero as a result of sales in 2009.

Liquidity risk In the current situation of the Group, the approach of using specific capital as a cushion in times of substantial liquidity crises is not unproblematical. Sources of capital such as shareholders' equity and subordinate capital may become illiquid as a result of systematic or specific factors. Capital is not able to replace the function of credit lines or high-quality assets. The distinction between capital and liquidity in times of a liquidity crisis shows that liquidity risks have to be managed; however, liquidity risks do not have to be managed by way of providing economic capital. The purpose of calculating the economic capital is to ensure that providers of debt will be repaid their claim with a certain probability in the event of a default.

However, liquidity risks are recognised by way of additional meaningful stress tests which were introduced at HRE in 2009.

Stress tests

Models are based on assumptions and the data which have been entered. Stress tests in relation to the economic capital are used in order to obtain a better understanding of the sensitivity of results in relation to these factors. Deutsche Pfandbriefbank Group carries out stress tests as an instrument for appropriate regulatory and economic capital management for eleven categories, each in relation to an isolated risk type:
- Downgrading of the main counterparties
- Stress tests of the real estate credit portfolio
- Stress tests of the creditworthiness of all counterparties
- Operational risk
- Business risk
- Equity participation risks
- Risks of the Bank's own real estate portfolio
- Stress tests of refinancing and liquidity
- Interest rate changes
- Foreign currency changes
- Widening of credit spreads

In addition, stress test scenarios covering all risk types were introduced on the basis of historical results in the third quarter of 2009 on HRE level as a result of the financial market crisis. The investigation covers both scenarios which actually occurred during the recent financial crisis or which appear to be realistic. Detailed scenario-descriptions and their results are presented in the Risk Report of the consolidated financial statement 2009 of HRE.

Macro-economic Conditions

In general, a moderate economic recovery is expected for the year 2010; this means that the economy will probably return to positive growth rates. However, this positive expectation has to be viewed in perspective in two respects: firstly, and particularly for Europe, growth in 2010 will again be considerably lower than the rates seen before the crisis. Secondly, many countries will fail significantly to return to the levels of economic output seen before the crisis.

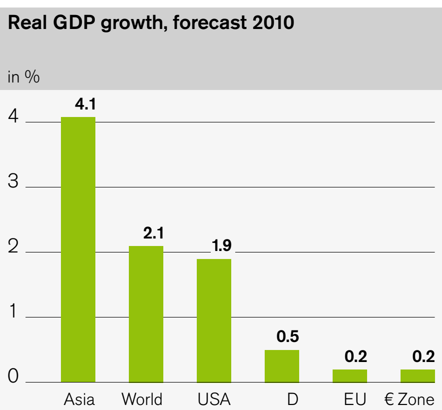
However, the ranges of expectations for 2010 are still relatively wide at present. Whereas the internationally comparable forecasts used in the following diagram are predicting growth of only 0.5 % for Germany, the current forecasts of other institutions for 2010 are currently running at around 1.5 %, and in certain cases slightly higher than this level. This forecast uncertainty is also a reflection of different scenarios relating to how the economy will react to the extensive range of state measures designed to support the economy. Nevertheless, most forecasts are predicting a considerable recovery for the USA and Asia, whereas the euro zone will probably achieve only very moderate growth.

The fact that the risk situation for the financial sector still cannot be clearly assessed poses a certain risk for the upswing. It is true that many banks in the USA have now returned the state aid which was originally granted; however, the balance sheets still include particularly high-risk positions such as credit risks and high-risk securities. In addition, a wave of bankruptcies which is still threatened might result in impairments particularly in some economies of Eastern Europe which have been particularly severely affected by the crisis. In this context, banks have become much more cautious with regard to extending new loans. However, if banks also adopt an excessively cautious lending policy with regard to healthy companies, this might also act as a brake on the upswing.

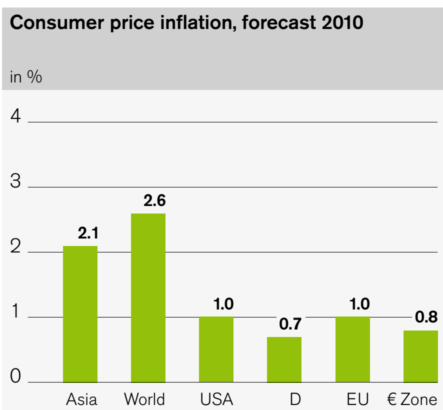
The rates of inflation will continue to be very moderate for the year 2010. Whereas in the USA prices will probably rise by 1 %, inflation in the euro zone as a whole, and also in Germany, will probably be somewhat lower than this level. This is due to the fact that production capacities are still very much under-utilised. In such an economic climate, price increases are not expected, even if some commentators are pointing to potential inflationary pressure as a result of the generous monetary policy of the year 2009. However, with regard to these fears, it has to be borne in mind that the liquidity in the banking system has increased dramatically as a result of quantitative easing; However, there has not been a dramatic increase in the money supply in the private sector outside the banking system which is crucial for inflationary pressure. It appears to be probable that the quantitative easing measures will be reversed in the near future, whereas there are still no specific indications of a hike in leading interest rates.

The current crisis has also resulted in problems in Public Sector Finance in countries in the euro zone, some of which are providing cause for concern. The limits of what is possible with fiscal policy have certainly been reached in 2009, if not exceeded in certain cases, particularly in Greece, Portugal, Ireland and Spain, so that no further impetus is likely from this quarter for the year 2010. The risk premium which the financial markets are now demanding in these countries is imposing an additional restriction on the amount of scope available for fiscal policy.

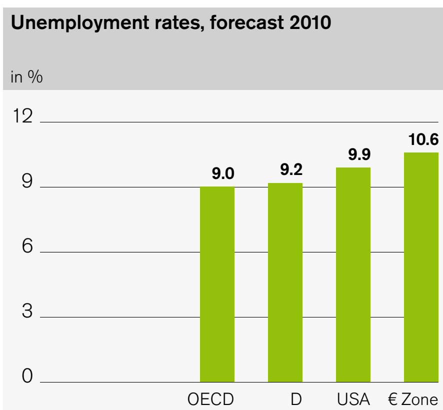
Because of the relatively mild increase in real economic activity, the unemployment rate is expected to increase appreciably in all major economies in 2010. Particularly for the European economies, the unemployment rate typically follows the development in the real economy with a delay of around one year. Specifically in Germany, a wave of redundancies is likely when the short-term working in manufacturing comes to an end. The OECD is predicting that the unemployment rate in Germany will rise by around 1.5 percentage points to 9.2 %, whereas a minor increase to 9.9 % is forecast in the USA.



Source: EIU, obtained from Datastream on 15.12.2009



Source: EIU, obtained from Datastream on 15.12.2009



Source: OECD, Economic Outlook No. 86, 11/2009

Sector-specific Conditions

Overall situation of the banking sector

The banking sector is again having to face major challenges in the year 2010. This is due to the still fragile state of the real estate markets, the only moderately expanding economy, the increasing number of insolvencies and rising unemployment as well as the considerable volatility of capital markets. A further factor is the critical national debt of countries such as Greece, Portugal, Ireland, Italy and Spain. It is also likely that banks will again have to recognise further impairments in the year 2010, and will also have to press on ahead with transferring assets at risk to restructuring units. More stringent accounting rules as well as special taxes are also likely to have an impact on returns on equity at the banks in the year 2010. The financial sector will also have to face new requirements resulting from regulatory changes which are set to come into force in 2010.

New regulatory requirements and changes in the bank regulatory climate The year 2009 has already seen the introduction of far-reaching innovations with the aim of further harmonising international bank regulation. As part of this process, work has started on revising the Bank and Capital Adequacy Directive. This directive is expected to be implemented in the individual EU states by October 2010, and is expected to come into force by the end of the year.

The main changes are as follows:
> Extension of the obligation to create borrower units for calculating large loans
> Interbank receivables charged in full against large loan limits
> Greater transparency for the individual debtors in the reference asset for investment shares, securitisation positions and other structured products
> Stricter rules for recognising hybrid capital instruments as shareholders' equity
> Tightening the requirements for securitisations

In addition, in response to the financial crisis, various institutions have drawn up numerous proposals for improving bank regulation. However, these proposals have not yet been definitively discussed. Experts expect that these proposals will have considerable implications for the banking sector. As recently as December 2009, the Basel Committee on Banking Supervision published a draft for revising the Basle II framework. The following are examples of major issues in this respect:
> Strengthening the quality, consistency and transparency of core capital
> Increasing the capital requirements for risks of derivatives, repos and financing activities for securitisations
> Establishment of an anti-cyclical capital cushion
> Introduction and limiting of a so-called modified accounting equity ratio
> Tightening of the disclosure requirements
> Strengthening of liquidity backing
> New rule governing the compensation of bank employees

Real Estate Finance

In the year 2010, the high vacancy rates and rent defaults, falling rents and lower property values as a result of the still difficult economic situation will continue to pose a strain on the credit portfolios of the banks and make it much more difficult for existing loans to be prolonged.

A sustained recovery of the real estate market would solve the problem. In Great Britain, growth of 3.2 % for prime commercial real estate has been reported since the summer. However, any further increase in property prices would be sustainable only in that region and also only if employment figures rise and rents increase.

The market is therefore looking for further solutions. In addition to government aid and deconsolidated environments, the banks are sounding out alternative exit strategies. These range from joint ventures right through to the setting-up of funds and real estate funds which are intended to kick-start the market again.

It is expected that more investors will gradually return to the markets and that investment volumes will gradually rise. Increasing competition might result in lower margins and a gradual increase in LTVs. The prospects for 2010 are indicating that the market will gradually return to normal, whereby there will only be a complete recovery when investors and lenders consider properties in sub-prime locations again.

Public finance

As is the case on other markets, the forecast for 2010 very much depends on the extent of economic recovery. Such a recovery will have an impact on the behaviour of some players on the market, and in particular commercial banks with a broad base. When the capital markets are in a better state, the available liquidity and capital can be shifted to other areas which are more profitable but which are exposed to greater risk, and the attention for the Public Finance sector could decline. On the other hand, many banks in Europe are still restructuring their balance sheets, and the losses which in certain cases run into several billions might continue to have an impact on the business strategies to the benefit of lower risk credit markets. However, the high levels of state debt in countries such as Greece, Portugal, Iceland, Ireland and Spain will probably have a negative impact on the public sector finance market and might also have a negative effect on the risk premiums of the other members of Monetary Union.

In the year 2010, demand for public sector finance in Europe will increase. Although, according to the EU Commission, the economies of the 16 euro countries will probably expand in the years 2010 and 2011, the low level of growth in conjunction with rising unemployment will not be sufficient to compensate for budget deficits. In 2010, budget deficits throughout Europe will rise up to 6.9 % of gross domestic product. European governments will also continue to support economic recovery for mechanical reasons (rising costs and declining income as a result of the crisis) and also for political reasons.

Accordingly, we expect that our core markets will see continuing demand for medium-term and long-term public sector finance, state-guaranteed public-private partnerships and ECA transactions with public guarantees in our European core markets.

Refinancing markets

The refinancing markets have stabilised further in recent months. The future development depends on the overall market and individual factors in the individual markets. Selective markets will probably continue to product a stable development – particularly if the state support programs have an effect. The more stable markets will probably also include the Pfandbrief market, not least as a result of the purchasing programme of the ECB. It is very difficult to predict whether the risk premiums in the market for uncovered bank issues will be able to stabilise further or even be reduced. Moreover, it is not likely that there will be a very rapid increase in the volumes on the money market. Overall, it is possible that there might be further volatilities on individual sub-markets or the overall market.

Company-specific Conditions

The forecasts for the future development of Deutsche Pfandbriefbank Group are estimates which have been made on the basis of information available at present. If the assumptions underlying these forecasts fail to materialise, or if risks (such as those addressed in the Risk Report) occur to an extent which has not been calculated, the actual results may differ considerably from the results which are currently expected.

The existence of companies in Deutsche Pfandbriefbank Group continued to be threatened in the whole business year 2009.

Deutsche Pfandbriefbank Group continues to assume unchanged that it is a going concern and will continue in operation under the following described conditions (external factors/internal factors). Based on present information, the Management Board considers it currently as predominantly probable that these conditions are in existence or will occur.

External factors

> Deutsche Pfandbriefbank Group will receive further essential liquidity support from SoFFin in respect of terms and total volume. Moreover, Deutsche Pfandbriefbank Group will receive necessary capital support from SoFFin to strengthen its capital base. These supports will be granted under reasonable conditions. No legal reservations, especially EU legal actions, will be successfully enforced.

> The capital markets environment will begin to stabilise from 2010 to 2012, particularly if there is no further serious deterioration of the financial market crisis from unforeseeable consequences, for instance triggered by external shocks such as the collapse of major states or major banks, and the crisis of the real estate markets does not result in defaults of loans and securities to an extent which would pose a threat to the existence of the Group.

> The interbank market and other short-term unsecured refinancing markets as well as the long-term secured and unsecured refinancing markets will start to recover from 2010. The ratings of Deutsche Pfandbriefbank AG will stabilise or slightly increase. The support can be covered by own funding in the following years.

Internal factors

> Deutsche Pfandbriefbank Group further succeeds in regaining the confidence of customers and successfully writes new business subject to adequate volumes and adequate margins.

> There are no significant delays or obstructions of the implementation of the restructuring of Deutsche Pfandbriefbank Group that aims to improve efficiency, profitability and streamlining of business processes.

> Work-out or restructuring of non-performing loans throughout Deutsche Pfandbriefbank Group can be implemented as currently scheduled.

> HRE has been given the possibility of reducing assets in a value preserving manner and of transferring balance sheet items by way of establishing a deconsolidated environment.
> Deutsche Pfandbriefbank Group is able to hire and keep staff in key positions despite specific restrictions, for example, on compensation.

On 28 March 2009, the German Finanzmarktstabilisierungsfonds confirmed in written form to HRE Holding and to Deutsche Pfandbriefbank AG (formerly Hypo Real Estate Bank AG) that it intends to stabilise the HRE Holding by way of adequate recapitalisation and Deutsche Pfandbriefbank AG by further sufficient extensions of guarantees. The German Finanzmarktstabilisierungsfonds renewed its statement of intent on 6 November 2009. In particular, the German Finanzmarktstabilisierungsfonds has confirmed that it will provide adequate capital to ensure at least the continued existence of HRE Holding and its main subsidiaries as going concerns as well as the necessary viable business model, particularly that of Deutsche Pfandbriefbank AG. The support which HRE overall receives from federal government depends on the result of a final review as to whether a deconsolidated environment will be established for non-strategic or non-performing assets of HRE. In addition, the German Finanzmarktstabilisierungsfonds will provide further guarantees to assure the liquidity of the Group. These and possible further measures are conditional on meeting the aid law requirements of the EU Commission.

As a step in the recapitalisation process, Deutsche Pfandbriefbank Group received a capital contribution of a total of € 2.3 billion from the SoFFin in November 2009. This tranche consists of a silent participation of € 1.0 billion to Deutsche Pfandbriefbank AG and a contribution of € 1.3 billion to the reserve of Deutsche Pfandbriefbank AG.

The HRE Holding and the Deutsche Pfandbriefbank AG have provided a commitment to the German Finanzmarktstabilisierungsfonds that they will take the steps necessary for implementing the recapitalisation process.

Risks threatening the existence

The future existence of the Deutsche Pfandbriefbank AG as a going concern is dependent on the assumption that sufficient equity will be provided to the Deutsche Pfandbriefbank AG to avoid a situation of sustained over-indebtedness. External liquidity support is necessary to avert insolvency due to illiquidity of the significant subsidiaries of Deutsche Pfandbriefbank AG or the Deutsche Pfandbriefbank AG itself. These liquidity supports must be available until the Deutsche Pfandbriefbank AG is capable to raise sufficient liquidity on the money and capital market by themselves, and until the agreed restructuring arrangements are implemented and the equity capital increase is performed as scheduled.

To ensure the future existence of the Deutschen Pfandbriefbank AG and its significant subsidiaries as a going concern it is thus particularly necessary that

> the German Finanzmarktstabilisierungsfonds provides sufficient support in form of equity capital
> the German Finanzmarktstabilisierungsfonds and the Deutsche Bundesbank maintain their liquidity support and, if necessary, provide further liquidity assistance
> refinancing with sustainable conditions on the money and capital market occurs
> the restructuring arrangements will be implemented as scheduled
> the appropriate authorities do not take regulatory actions and
> no legal reservations (especially EU legal actions) will be successfully enforced

Development in earnings Deutsche Pfandbriefbank Group has reported a negative pre-tax profit for the business year 2009. Deutsche Pfandbriefbank Group expects that earnings will continue to be negatively affected in future to a significant extent, resulting in an ongoing loss-making situation. Deutsche Pfandbriefbank Group is not assuming that it will be able to return to profitability before the year 2012. The extent of the expected loss-making situation will in particular be influenced by the occurrence or non-occurrence of the following risks, or the extent to which the following risks might materialise.

> The restructuring of the liquidity support measures made available by a syndicate from the German financial sector and the Deutsche Bundesbank with the involvement of the German Federal Government will lower the refinancing costs of the Deutsche Pfandbriefbank Group. Nevertheless, the refinancing rates for the new and existing SoFFin funds are higher than the refinancing rates before the liquidity support was drawn down in September 2008. This means that net interest income and net commission income will continue to be very much affected.
> The net interest income in 2009 was boosted by high income in the money market. A similarly positive market interest rate situation is not expected to occur in the year 2010, a similarly high net interest income from this factor is not expected to be seen in the course of the next few years.
> The extent that the existing portfolio will decline as a result of streamlining and disposals as well as the possible transfer of assets and liabilities to a deconsolidated environment, with a resultant negative impact on net interest income. In addition, the negative market values might result in the case of disposals would depress net interest income or net income from financial investments.
> Apart from the funding through the financial market HRE also uses funding possibilities made available by the central banks. It cannot be assumed that these funding possibilities will change. It cannot be forecasted if and to which costs alternative funding possibilities will be available in time. If alternative funding is necessary, higher costs would probably arise and would therefore be disadvantageous for the profitability of the Group.

- Further widening of credit spreads and a deterioration of the securities pool may result in additional costs arising from the remaining collateralised debt obligations which have to be recognised in the income statement under net income from financial investments and net trading income. In addition, default risks and other deteriorations of market conditions may result in lower fair values of trading assets, which would have to be recognised immediately in the income statement. It may also be necessary to recognise impairments on holdings which have been reclassified from «Held-for-trading» and «Available for Sale» into «Loans and receivables» in accordance with IAS 39.
- The situation on the US and some European real estate markets will continue to be tense. The situation of some public sector customers has also deteriorated. As a result of this and also in view of the fact that the overall macro-economic situation is deteriorated, provisions for losses on loans and advances will probably be at an increased level in 2010 and 2011.
- If contracting parties get into financial difficulties as a consequence of the crises on capital and financial markets or even have to announce insolvency, impairments on securities and loans could be unavoidable.
- The restructuring of the Deutsche Pfandbriefbank Group and the harmonisation of the IT infrastructure and processes will result in further costs which will mainly have an impact on general administrative expenses and which might at least partially compensate for the savings achieved from the process of streamlining the workforce.
- The planned establishment of a deconsolidated environment with a subsequent transfer of assets will result in additional consultancy services costs and other administrative expenses.
- Litigation which is currently pending and which might become pending in future might have a considerably negative impact on the results of Deutsche Pfandbriefbank Group or might even threaten the existence of Deutsche Pfandbriefbank Group as a going concern. This litigation is described extensively in the Notes.
- As a result of the rating downgrades, several ISDA master agreements as well as Guaranteed Investment Contracts have been terminated or could be terminated in the future; this may result in costs due to premature contract termination and has resulted in additional costs to repurchase hedges. Further rating downgrades would result in further terminations of ISDA master agreements
- The bank also might incur additional costs as a result of the limited choice of counterparties due to their current long-term ratings.
- The support measures received by Deutsche Pfandbriefbank Group are being reviewed by the EU Commission in state aid proceedings. The eventual decision of the EU Commission might have a negative impact on development in earnings of Deutsche Pfandbriefbank Group and may possibly endanger the going concern of Deutsche Pfandbriefbank Group.
- Deutsche Pfandbriefbank Group is exposed to operational risks as a result of its restructuring, such as the reliance on key positions, technology risks due to the large number of entry systems, increased staff fluctuation levels and risks in connection with change management activities. These risks might result in major losses.

Development in assets The development in assets of Deutsche Pfandbriefbank Group is particularly influenced through the occurrence or non-occurrence of the following risks, or the extent to which the following risks might materialise.

- If the credit spreads of states e.g. Greece, Portugal, Ireland, Italy and Spain and other banks widen further respectively widen again, the values of the securities issued by them will decline. Deutsche Pfandbriefbank Group has reclassified most of the available-for-sale securities into the measurement category «loans and receivables» in accordance with the Amendments to IAS 39 «Reclassification of Financial Assets» which was published in October 2008. However, for the remainder of the available-for-sale securities, widening of credit spreads would have a further negative impact on the AfS reserve.
- The portfolio will probably decline as a result of streamlining or disposals, and the possible transfer of assets and liabilities to a deconsolidated environment; this is in line with the process of focussing on functioning Group areas of activity.
- The difficult situation and the subsequent action taken to stabilise the HRE and the Deutsche Pfandbriefbank Group have resulted in debates on the political scene, in the media and in the public. Overall, the image of the HRE and the Deutsche Pfandbriefbank Group has suffered. Despite the fact that success has already been achieved as a result of the Bank re-entering markets, it is possible that there may be negative consequences for future business and customer relations.

Development in the financial position The development in the financial position of Deutsche Pfandbriefbank Group is particularly influenced through the occurrence or non-occurrence of the following risks, or the extent to which the following risks might materialise:

- The support measures received are being reviewed by the EU Commission in the ongoing state aid proceedings. In its final decision, the European Commission will very probably impose some major covenants on HRE, including a major reduction in the balance sheet total and the commitment of a time line for reprivatising Deutsche Pfandbriefbank AG. However, if the European Commission concludes that the state aid is not consistent, or is not completely consistent, with the EC Treaty, it is possible that it might oblige Germany to suspend or restructure this aid by a certain deadline, or it may order the aid to be repaid. This might result in insolvency for some or all companies of HRE, and might thus endanger the continued operation of Deutsche Pfandbriefbank Group as a going concern.

- The refinancing of Deutsche Pfandbriefbank Group in the course of the next few years will continue to be reliant on the support measures provided by the SoFFin. The repayment of the support measures will depend on various factors, including the access of Deutsche Pfandbriefbank Group to the refinancing markets and its rating.
- The Deutsche Pfandbriefbank Group has issued irrevocable loan commitments and liquidity facilities. Drawings may result in additional outflows of liquidity. In addition, further rating downgrades would result in further terminations due to ISDA frameword agreements and this may lead to outflows of liquidity.
- The Deutsche Pfandbriefbank AG is, in accordance with the «Waiver-Rule» of section 2a KWG, not obliged to calculate on a group-level the own funds ratio and the core capital ratio. The capital backing of HRE as the ultimate parent company has improved as a result of the support provided by SoFFin, and the regulatory minimum ratios have been met. In the years 2010 and 2011, IFRS equity and the regulatory core capital may decline again as a result of the factors detailed above. In addition, a revision of the regulatory regulations could lead to stricter demands in respect to the capital backing. Based on the assumed support measures by the German Finanzmarktstabilisierungsfonds, it is expected that the going concern of the HRE and Deutsche Pfandbriefbank AG will not be put into question.

The new business model may be an opportunity for the Deutsche Pfandbriefbank Group. In the field of commercial real estate financing, many competitors will probably go out of the market or will be seriously weakened. The granting of loans is becoming more restrictive in general. In consequence, margins on the real estate financing market may rise. Globalisation of financial flows and investors of large-volume projects will appreciate a specialist commercial real estate financier such as Deutsche Pfandbriefbank Group as a result of its special market and product knowledge, whose expertise is recognised on the market and who has succeeded in signing new business in 2009. Numerous competitors in the field of public sector finance are also affected by the financial market crisis. The experience of the Deutsche Pfandbriefbank Group in Pfandbrief business may be an advantage. In this context, the Deutsche Pfandbrief Group will continue to search for market opportunities in 2010 and 2011 and conclude new business with attractive margins. In line with overall strategy, the focus will be on Pfandbrief-eligible follow-up funding and newly acquired business in the real estate and public sector segments.

On 21 January 2010, and following liaison with SoFFin, HRE Holding submitted an application to the German Financial Market Stabilisation Authority (FMSA) for establishing a deconsolidated environment aimed at reducing assets in a value preserving manner. Deutsche Pfandbriefbank AG is the strategic core bank of HRE what will give further opportunities to Deutsche Pfandbriefbank Group. There is no right to the establishment of the deconsolidiated environment. Instead, the FMSA has the discretionary authority to establish it.

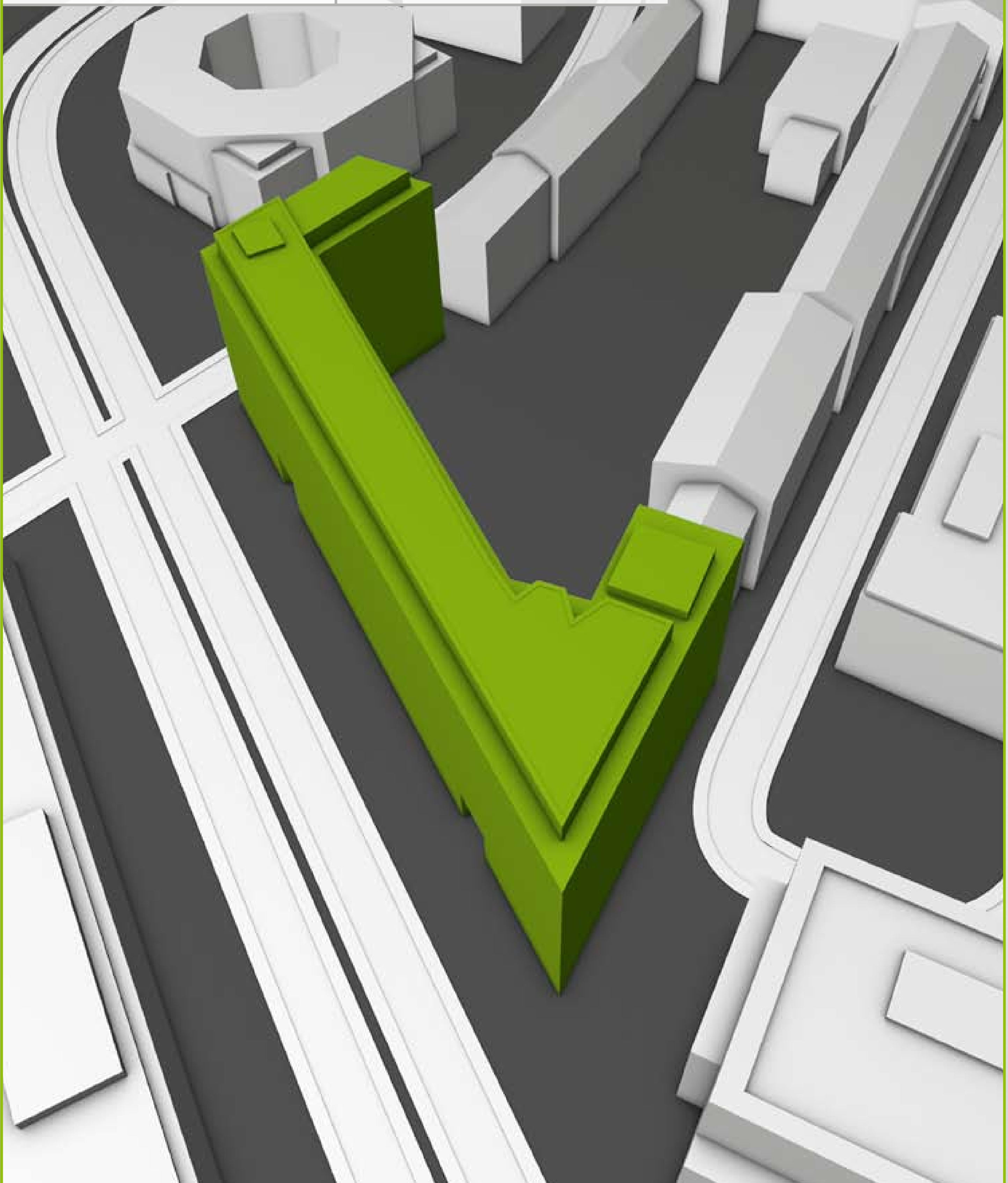
The results for 2010 and 2011 will probably be considerably affected by further impairments in relation to receivables and securities and the costs of the liquidity support measures. In addition, the expenses arising in the course of the establishment of a deconsolidated environment with a subsequent transfer of assets will depress general administrative expenses and net income. Deutsche Pfandbriefbank Group is not assuming that it will be able to return to profitability before the year 2012.

UBS Global Property Fund & Shaftesbury AM Altstadt Palais

€ 40 million

Investment Financing
Real Estate Finance, France
July 2009

Altstadt Palais is a prime new office building, completed in September 2008. It was acquired by UBS Wealth Management – Global Property Fund Ltd in October 2008 with Shaftesbury AM acting as asset manager. It is located on Karl-Scharnagl-Ring, a prime location close to the historical city centre of Munich. It comprises 11,049 sq.m. of office space, is fitted to international standards, and is fully let to tenants with strong covenants.



Consolidated Financial Statements

Consolidated Financial Statements
Income Statement

Income/expenses in € million	Note | Page	2009	2008	Δ in € million	Δ in %
Operating revenues		561	−1,152	1,713	>100.0
Net interest income and similar income	31 | 97	785	711	74	10.4
Interest income and similar income		5,256	4,418	838	19.0
Interest expenses and similar expenses		4,471	3,707	764	20.6
Net commission income	32 | 97	−60	23	−83	<−100.0
Commission income		109	72	37	51.4
Commission expenses		169	49	120	>100.0
Net trading income	33 | 97	−45	−655	610	93.1
Net income from financial investments	34 | 98	−43	−1,255	1,212	96.6
Net income from hedge relationships	35 | 98	−6	−22	16	72.7
Balance of other operating income/expenses	36 | 98	−70	46	−116	<−100.0
Provision for losses on loans and advances	37 | 98	1,890	1,104	786	71.2
General administrative expenses	38 | 99	259	107	152	>100.0
Balance of other income/expenses	39 | 99	16	−134	150	>100.0
Pre-tax profit/loss		**−1,572**	**−2,497**	925	37.0
Taxes on income	40 | 99	−2	−80	78	97.5
Net income/loss		**−1,570**	**−2,417**	847	35.0
attributable to: Equity holders (consolidated profit/loss from the parent company)		−1,570	−2,417	847	35.0

Statement of Comprehensive Income

Statement of Comprehensive Income			**2009**			**2008**
in € million	before tax	tax	net-of-tax	before tax	tax	net-of-tax
Net income/loss	– 1,572	– 2	– 1,570	– 2,497	– 80	– 2,417
AfS reserve	126	34	92	– 220	– 47	– 173
Cash flow hedge reserve	597	163	434	199	144	55
Exchange differences	9	–	9	– 43	–	– 43
Total	**– 840**	**195**	**– 1,035**	**– 2,561**	**17**	**– 2,578**
attributable to: Equity holders (consolidated profit/loss from the parent company)	– 840	195	– 1,035	– 2,561	17	– 2,578

Disclosure of components of comprehensive income in € million	**2009**	**2008**
Net income/loss	– 1,570	– 2,417
AfS reserve	92	– 173
Gains arising during the year	92	– 173
Reclassification adjustments for gains/losses included in profit or loss	–	–
Cash flow hedge reserve	434	55
Gains/losses arising during the year	434	55
Exchange differences	9	– 43
Total	**– 1,035**	**– 2,578**

Balance Sheet

Assets in € million	Note | Page	31.12.2009	31.12.2008	Δ in € million	Δ in %	31.12.2007
Cash reserve	7 | 87, 42 | 101	618	546	72	13.2	971
Trading assets	8 | 87, 43 | 101	1,435	131	1,304	>100.0	40
Loans and advances to other banks	9 | 87, 44 | 101	78,151	72,126	6,025	8.4	13,722
Loans and advances to customers	9 | 87, 45 | 102	91,221	69,938	21,283	30.4	38,169
Allowances for losses on loans and advances	10 | 88, 47 | 103	–3,326	–1,841	–1,485	–80.7	–799
Financial investments	11 | 88, 48 | 104	30,914	28,934	1,980	6.8	21,167
Property, plant and equipment	12 | 88, 49 | 107	10	12	–2	–16.7	30
Intangible assets	13 | 89, 50 | 108	28	23	5	21.7	23
Other assets	14 | 89, 51 | 108	11,801	10,204	1,597	15.7	2,351
Income tax assets	23 | 91, 52 | 108	4,365	4,423	–58	–1.3	2,212
Current tax assets		131	82	49	59.8	57
Deferred tax assets		4,234	4,341	–107	–2.5	2,155
Total assets		**215,217**	**184,496**	30,721	16.7	**77,886**

Equity and liabilities in € million	Note | Page	31.12.2009	31.12.2008	Δ in € million	Δ in %	31.12.2007
Liabilities to other banks	15 | 89, 56 | 110	67,625	56,464	11,161	19.8	15,332
Liabilities to customers	15 | 89, 57 | 110	12,378	13,985	–1,607	–11.5	10,267
Liabilities evidenced by certificates	58 | 110	109,193	95,461	13,732	14.4	44,862
Trading liabilities	16 | 89, 59 | 111	1,872	1,033	839	81.2	226
Provisions	17 | 89, 60 | 111	153	168	–15	–8.9	22
Other liabilities	18 | 90, 61 | 114	13,635	11,118	2,517	22.6	4,062
Income tax liabilities	23 | 91, 62 | 114	3,733	3,576	157	4.4	1,312
Current tax liabilities		85	31	54	>100.0	19
Deferred tax liabilities		3,648	3,545	103	2.9	1,293
Subordinated capital	19 | 90, 63 | 114	3,895	2,237	1,658	74.1	905
Liabilities		**212,484**	**184,042**	28,442	15.5	**76,988**
Equity attributable to equity holders		2,733	454	2,279	>100.0	898
Subscribed capital	64 | 116	380	380	–	–	133
Silent participation	20 | 90, 64 | 116	999	–	999	>100.0	–
Additional paid-in capital		5,037	2,988	2,049	68.6	1,442
Retained earnings	64 | 116	–1,310	688	–1,998	<–100.0	252
Revaluation reserve		–858	–1,239	381	30.8	–1,121
AfS reserve		–328	–275	–53	–19.3	–102
Cash flow hedge reserve		–530	–964	434	45.0	–1,019
Consolidated profit/loss 1.1.–31.12.		–1,515	–2,363	848	35.9	192
Minority interest in equity		–	–	–	–	–
Equity		**2,733**	**454**	2,279	>100.0	**898**
Total equity and liabilities		**215,217**	**184,496**	30,721	16.7	**77,886**

Statement of Changes in Equity

Statement of Changes in Equity	Equity attributable to equity holders							Minority interest in equity	**Equity**
					Revaluation reserve				
in € million	Subscribed capital	Silent participation	Additional paid-in capital	Retained earnings including unappropriated net income	AfS reserve	Cash flow hedge reserve	Consolidated profit/loss		
Equity at 1.1.2008	**133**	**–**	**1,442**	**252**	**–102**	**–1,019**	**192**	**–**	**898**
Capital increase	107	–	109	–216	–	–	–	–	–
Treasury shares	–	–	–	–	–	–	–	–	–
Distribution	–	–	–	–	–	–	–	–	–
Total comprehensive income for the year	–	–	–	–43	–48	547	–2,363	–	–1,907
Transfer to retained earnings	–	–	–	78	–	–	–78	–	–
Changes in the group of consolidated companies	140	–	1,437	617	–125	–492	–114	–	1,463
Equity at 31.12.2008	**380**	**–**	**2,988**	**688**	**–275**	**–964**	**–2,363**	**–**	**454**
Equity at 1.1.2009	**380**	**–**	**2,988**	**688**	**–275**	**–964**	**–2,363**	**–**	**454**
Capital increase	–	–	1,300	–	–	–	–	–	1,300
Transaction costs of capital measures	–	–1	–2	–	–	–	–	–	–3
Treasury shares	–	–	–	–	–	–	–	–	–
Distribution	–	–	–	–	–	–	–	–	–
Total comprehensive income for the year	–	–	–	9	92	434	–1,570	–	–1,035
Transfer to retained earnings	–	–	–	–2,363	–	–	2,363	–	–
Proceeds from silent participation	–	1,000	–	–	–	–	–	–	1,000
Changes in the group of consolidated companies	–	–	751	356	–145	–	55	–	1,017
Equity at 31.12.2009	**380**	**999**	**5,037**	**–1,310**	**–328**	**–530**	**–1,515**	**–**	**2,733**

Cash Flow Statement

Cash Flow Statement in € million	2009	2008
Net income/loss	**–1,570**	**–2,417**
Write-downs, provisions for losses on, and write-ups of, loans and advances and additions to provisions for losses on guarantees and indemnities	1,880	1,108
Write-downs and depreciation less write-ups on long-term assets	169	1,312
Change in other non-cash positions	62	737
Result from the sale of investments, property, plant and equipment	4	–54
Other adjustments	–785	–791
Subtotal	**–240**	**–105**
Change in assets and liabilities from operating activities after correction for non-cash components		
Increase in assets/decrease in liabilities (–)		
Decrease in assets/increase in liabilities (+)		
Trading portfolio	575	80
Loans and advances to other banks	1,340	–55,283
Loans and advances to customers	8,888	4,009
Other assets from operating activities	15	–46
Liabilities to other banks	7,287	28,360
Liabilities to customers	–1,886	–1,233
Liabilities evidenced by certificates	–25,517	20,706
Other liabilities from operating activities	–710	–215
Interest income received	6,667	3,855
Dividend income received	–	3
Interest expense paid	–6,665	–2,412
Taxes on income paid	–30	–18
Cash flow from operating activities	**–10,276**	**–2,299**
Proceeds from the sale of non-current assets	8,521	6,030
Payments for the acquisition of non-current assets	–309	–4,020
Proceeds from the sale of investments	–	3
Payments for the acquisition of investments	–3	–
Cash flow from investing activities	**8,209**	**2,013**
Proceeds from capital increases	2,297	–
Subordinated capital, net	–165	–144
Cash flow from financing activities	**2,132**	**–144**
Cash and cash equivalents at the end of the previous period	**546**	**971**
+/– Cash flow from operating activities	–10,276	–2,299
+/– Cash flow from investing activities	8,209	2,013
+/– Cash flow from financing activities	2,132	–144
+/– Effects of exchange rate changes and non-cash valuation changes	7	5
Cash and cash equivalents at the end of the period	**618**	**546**

Notes

1 General information

The Deutsche Pfandbriefbank Group combines the strategic assets and new business of Hypo Real Estate Group (HRE) in its real estate finance and public finance segment. Deutsche Pfandbriefbank AG is incorporated in the commercial register of the Amtsgericht (local court) Munich (HRB 41054) and is a 100% subsidiary of Hypo Real Estate Holding AG (HRE Holding). With the incorporation in the commercial register by the Amtsgericht Munich as of 29 June 2009, the merger of the former DEPFA Deutsche Pfandbriefbank AG with the former Hypo Real Estate Bank AG is from the economical view retrospectively effective as of 1 January 2009. The new entity will trade under the name of «Deutsche Pfandbriefbank AG», and will have its registered office in Munich.

Accounting Policies

2 Principles

Deutsche Pfandbriefbank AG has prepared its financial statements for the period ended 31 December 2009 in line with EC ordinance No. 1606/2002 of the European Parliament and Council of 19 July 2002 in accordance with International Financial Reporting Standards (IFRS). These financial statements are based on the IFRS rules, which have been adopted in European Law by the EU commission as part of the endorsement process; it is also based on the regulations of commercial law which are applicable in accordance with section 315a (1) HGB (German Commercial Code). With the exception of specific regulations relating to fair value hedge accounting for a portfolio hedge of interest risks in IAS 39 all mandatory IFRS rules have been completely endorsed by the EU. The Deutsche Pfandbriefbank Group does not apply this type of hedge accounting. Therefore, the financial statements are accordingly consistent with the entire IFRS and also with the IFRS as applicable in the EU.

The IFRS are standards and interpretations adopted by the International Accounting Standards Board (IASB). These are the International Financial Reporting Standards (IFRS), the International Accounting Standards (IAS) and the interpretations of the International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC).

If they are not inconsistent with the IFRS, the German Accounting Standards (Deutsche Rechnungslegungs Standards – DRS) published by the Deutsche Rechnungslegungs Standards Committee (DRSC) have been taken into account.

The Management Board of Deutsche Pfandbriefbank AG has prepared the group financial statements on 16 March 2010 under the going-concern assumption. In preparing the consolidated group financial statements, the Management Board is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the HRE Holding and its significant subsidiaries, under which the Deutsche Pfandbriefbank Group belongs to, ability to continue as a going concern. The future existence of the Deutsche Pfandbriefbank AG as a going concern is dependent on the assumption that sufficient equity will be provided to the Deutsche Pfandbriefbank AG to avoid situation of sustained over-indebtedness and, respectively that sufficient equity will be provided to the HRE Holding being the superordinated institute of the group of companies to fulfil regulatory capital requirements. External liquidity support is necessary to avert insolvency due to illiquidity of the Deutsche Pfandbriefbank AG and its significant subsidiaries. These liquidity supports must be available until the Deutsche Pfandbriefbank AG is capable to raise sufficient liquidity on the money and capital markets by itself and until the agreed restructuring arrangements are implemented and the equity capital increase is performed as scheduled.

To ensure the future existence of the Deutsche Pfandbriefbank AG and its significant subsidiaries as a Going Concern it is thus particularly necessary that

> The German Finanzmarktstabilisierungsfonds provides sufficient support in form of equity capital to both the Deutsche Pfandbriefbank AG and the HRE Holding,
> The German Finanzmarktstabilisierungsfonds and the Deutsche Bundesbank maintain their liquidity support and, if necessary, provide further liquidity assistance,
> Refinancing with sustainable conditions on the money and capital markets occurs,
> The restructuring arrangements will be implemented as scheduled
> The appropriate authorities do not take regulatory actions, and
> No legal reservations (especially EU legal actions) will be successfully enforced.

On 28 March 2009, the German Finanzmarktstabilisierungsfonds confirmed to HRE Holding and the Deutsche Pfandbriefbank AG (formerly Hypo Real Estate Bank AG) that it intends to stabilise the HRE Holding in a sustainable manner by way of adequate recapitalisation and the Deutsche Pfandbriefbank AG by further sufficient extensions of guarantees. The German Finanzmarktstabilisierungsfonds renewed its statement of intent on 6 November 2009.

In particular, the SoFFin has confirmed that it will provide adequate capital to ensure at least the continued existence of HRE Holding and its main subsidiaries as going concerns as well as the necessary viable business model, particularly that of Deutsche Pfandbriefbank AG. The support which HRE overall receives from central government depends on the result of a final review as to whether a deconsolidated environment will be established for non-strategic or non-performing assets of HRE. In addition, the SoFFin will provide further guarantees to assure the liquidity of the Group. These and possible further measures are conditional on meeting the aid law requirements of the EU Commission.

As a first step in the direction of recapitalising HRE, the German Finanzmarktstabilisierungsfonds has acquired 20 million HRE Holding shares on 28 March 2009 for a legal minimum price of € 3.00 per share, whereby shareholders' subscription rights were excluded. As the second step of recapitalisation of HRE, the shareholders adopted a resolution regarding a capital increase of around € 2.96 billion in return for a cash contribution at the Extraordinary General Meeting held on 2 June 2009. The round 986.5 million shares were issued at the nominal value and legal minimum price of € 3.00 specified in the articles of incorporation. Only the German Finanzmarktstabilisierungsfonds was permitted to take up the new shares out of the capital increase, and the statutory shareholders' subscription rights were excluded. After the registration of the capital increase on 8 June 2009, the German Finanzmarktstabilisierungsfonds hold 90% of the Company's share capital. On 5 October 2009, a resolution for transferring the shares of the minority shareholders to SoFFin was adopted at an Extraordinary General Meeting. The Amtsgericht (local court) Munich entered the transfer resolution into the commercial register on 13 October 2009 so that SoFFin became the only shareholder of HRE Holding. As a third step in the recapitalisation process, HRE received a further capital contribution of a total of € 3.0 billion from the SoFFin in November 2009. This tranche consists of a silent participation of € 1.0 billion to Deutsche Pfandbriefbank AG, a contribution of € 1.3 billion to the reserve of Deutsche Pfandbriefbank AG and a contribution of € 0.7 billion to the reserve of HRE Holding.

The HRE Holding and the Deutsche Pfandbriefbank AG have provided a commitment to the German Finanzmarktstabilisierungsfonds that they will take the steps necessary for implementing the recapitalisation.

IFRS and interpretations applied for the first time as well as changes of standards and interpretations In the financial year 2009 the following new or revised standards and interpretations were applied initially:
> IFRS 1 and IAS 27 (Cost of an Investment in a Subsidiary, Jointly-controlled Entity or Associate)
> IFRS 2 (Share-based Payment: Vesting Conditions and Cancellations)
> IFRS 7 (Financial Instruments: Disclosures – Improving Disclosures about Financial Instruments)
> IFRS 8 (Operating Segments)
> IAS 1 (Presentation of Financial Statements: A revised Presentation, revised 2007)
> IAS 23 (Borrowing Costs, revised 2007)
> IAS 32 and IAS 1 (Puttable Financial Instruments and Obligations Arising on Liquidation)
> IFRIC 9 und IAS 39 (Embedded Derivatives, amendment 2009)
> IFRIC 13 (Customer Loyalty Programmes)
> IFRIC 15 (Agreements for the Construction of Real Estate)
> IFRIC 16 (Hedges of a Net Investment in a Foreign Operation)
> IFRIC 18 (Transfer of Assets from Customers)

Only the new or revised standards IAS1 (Presentation of Financial Statements: A revised Presentation, revised 2007), IAS 24 (Related Party Disclosures), IFRS 7 (Financial Instruments: Disclosures – Improving Disclosures about Financial Instruments) and IFRS 8 (Operating Segments) had a material effect on the recognition, measurement or disclosure of Deutsche Pfandbriefbank Group. The new or revised standards had no effect on recognition and measurement.

As per the revision of IAS 1 the income and expense components of the period are disclosed in two statements, the income statement and a reconciliation from the net income or net loss to the comprehensive income including a disclosure of the components of other comprehensive income (statement of comprehensive income). The balance sheet is disclosed voluntarily with two comparative periods. Apart from the transactions with owners in their capacity as owners the statement of changes in equity contains the comprehensive income in one position.

In March 2009, the IASB issued amendments to IFRS 7 that require enhanced disclosures about fair value measurements and liquidity risk. As a result of this change, all assets and liabilities of Deutsche Pfandbriefbank Group which are measured at fair value have to be grouped within the fair value hierarchy. The three-level hierarchy is based on the observability of the parameters which are used for fair value measurement. In addition, an analysis of the remaining contractual maturities for derivative and non-derivative financial liabilities has to be disclosed for the presentation of the liquidity risk. The amended IFRS 7 has resulted in more extensive disclosures in the notes, but does not have any impact on the recognition and measurement of financial instruments.

The standard IFRS 8 supersedes the former standard IAS 14. IFRS 8 deals with the disclosure of operating segments of a company. Currently, the Management Board manages three segments which fulfil the requirements of IFRS 8 for operating segments. Therefore, there were no changes from the revised segment definition of IFRS 8 relating to the segment report of Deutsche Pfandbriefbank Group. In addition, the standard contains some additional disclosures, for example the reporting about products and services.

In addition, most of the amendments to IFRS which were implemented by the IASB as part of the Annual Improvements Project 2008 were applicable for the first time in the fiscal year 2009.

These amendments did not have a material impact on the presentation of the financial statements and on the net assets, financial position and results of Deutsche Pfandbriefbank Group.

Published IFRS and interpretations that are not yet mandatory and which were not subject to early adoption The following material amended standards and interpretations which are endorsed by the EU have not been applied earlier by Deutsche Pfandbriefbank Group:
> IFRS 3 (Business Combinations, revised 2008)
> IAS 27 (Consolidated and Separate Financial Statements)
> IAS 32 (Financial Instruments: Presentation: Classification of Rights Issues)
> IAS 39 (Financial Instruments: Recognition and Measurement: Eligible Hedged Items)
> IFRIC 17 (Distributions of Non-Cash Assets to Owners)

IFRS 3 (revised) reconsiders the application of acquisition accounting for business combinations. Major changes relate to the measurement of non-controlling interests, the accounting for business combinations achieved in stages as well as the treatment of contingent consideration and acquisition related costs. The standard is initially applicable prospectively in the annual period beginning on 1 January 2010. The impact for Deutsche Pfandbriefbank Group is dependent on future business combinations.

Major changes of IAS 27 relate to the accounting for transactions which do not result in a change of control as well as to those leading to a loss of control. The standard is initially applicable prospectively in the annual period beginning on 1 January 2010. The impact for Deutsche Pfandbriefbank Group is dependent on future transactions.

The amendment to IAS 32 addresses the accounting for rights, options and warrants to acquire a fixed number of an entity's own equity instruments that are denominated in a currency other than the functional currency of the issuer. The amendment applies for annual periods beginning on or after 1 February 2010. As Deutsche Pfandbriefbank Group has not issued any such rights at the moment, the amendment will not have an impact on Deutsche Pfandbriefbank Group.

The amendment of IAS 39 clarifies how the existing principles underlying hedge accounting should be applied. Addressed are the designation of a one-sided risk in a hedged item and the designation of inflation as a hedged risk. The amendment applies prospectively in the annual period beginning on 1 January 2010. No material impacts on the hedge relationships of Deutsche Pfandbriefbank Group are expected.

The interpretation IFRIC 17 provides guidance on the appropriate accounting treatment when an entity distributes assets other than cash as dividends to its shareholders. IFRIC 17 is initially applicable in the annual period beginning on 1 January 2010. Any impact for Deutsche Pfandbriefbank Group will depend on future transactions and profit distributions.

Published IFRS and interpretations that are not yet endorsed by the EU In the business year 2009, Deutsche Pfandbriefbank Group has not applied the following new or amended standards and interpretations. These standards and interpretations are not yet endorsed by the EU:
> IAS 24 (Related Party Disclosures)
> IFRS 2 (Share-based Payment: Group Cash-settled Share-based Payment Transactions)
> IFRS 9 (Financial Instruments)
> IFRIC 14 (Prepayments of a Minimum Funding Requirement)
> IFRIC 19 (Extinguishing Financial Liabilities with Equity Instruments)

Compared with the predecessor version, the revised IAS 24 has remedied the previous inconsistencies regarding the definitions of a related entity and a related person. In addition, it will only be necessary to disclose information about significant transactions with entities which are controlled or significantly influenced by the same government. The revised IAS 24 is applicable for the first time in annual periods beginning on or after 1 January 2011. Especially the new disclosure rules regarding government-related entities will impact Deutsche Pfandbriefbank Group.

The amendment to IFRS 2 clarifies the accounting for group cash-settled share-based payment transactions. The amended IFRS 2 is initially applicable in annual periods beginning on 1 January 2010. As Deutsche Pfandbriefbank Group currently does not have any share-based payment arrangements, the amendment will not have an impact.

The IASB revises the current accounting requirements for financial instruments. The new standard IFRS 9 (Financial Instruments) shall be effective for annual periods beginning on or after 1 January 2013. In November 2009 the IASB published the first phase of the new IFRS 9 which focus on the classification and measurement of financial assets. Rules regarding the classification and measurement of financial liabilities are scheduled to be published in the first half of 2010. The second and third phase of the new standard will cover the subjects «Impairments of financial instruments» and «Hedge accounting». However, it will only be possible to make a definitive assessment of the impact of the new standard when all parts of IFRS 9 have been published.

The IASB issued an amendment to the interpretation IFRIC 14 regarding the recognition of pension plans. The amendment permits entities, under certain circumstances, to recognise prepayments as an asset. IFRIC 14 amended is applicable for the first time in annual periods beginning on or after 1 January 2011. The amendment is not expected to have any impact on Deutsche Pfandbriefbank Group.

The interpretation IFRIC 19 clarifies the accounting when an entity issues equity instruments to extinguish all or part of a financial liability. IFRIC 19 is applicable for the first time for annual periods beginning on or after 1 July 2010. Any impact for Deutsche Pfandbriefbank Group will depend on future transactions.

In addition, various standards and interpretations were amended by the IASB as part of the Annual Improvements Project 2009. Most of the amendments are effective for the annual period beginning on 1 January 2010. It is not expected that the amendments will have a material impact on the presentation of the financial statements and on the net assets, financial position and results of Deutsche Pfandbriefbank Group.

Statement of compliance for the Public Corporate Governance Code The Management Board of the Company, which is an entity that is indirectly completely owned by the Federal Republic of Germany, has adopted a resolution to apply the Public Corporate Governance Code in accordance with «Comply or Explain» and subject to the Supervisory Board adopting a resolution with the same wording. The Management Board and the Supervisory Board will publish a statement of compliance for the Public Corporate Governance Code on the web site of the company (www.hyporealestate.com) after the respective resolution is adopted by the Supervisory Board.

Consolidated financial review The consolidated financial review meets the requirements of section 315 (1) and (2) HGB (German Civil Code) and DRS 15. It comprises a report on the business and conditions, a report on the net assets, financial position and results of operations, a report of significant events after the 31 December 2009, and a forecast report as well as a risk report. The risk report contains information which, under IFRS 7, is required to be disclosed (especially in the chapters Credit Risk, Market Risk and Liquidity Risk). Events after the balance sheet date are described in the report of events after 31 December 2009 and the major events.

3 Consistency

The Deutsche Pfandbriefbank Group applies accounting policies consistently in accordance with the framework of IFRS as well as IAS 1 and IAS 8. In principal, in financial year 2009 no accounting policies for recognition, measurement and disclosure were changed.

4 Uniform consolidated accounting

The individual financial statements of the consolidated domestic and foreign companies are incorporated in the IFRS consolidated financial statements of Deutsche Pfandbriefbank AG, using uniform accounting and valuation principles.

5 Consolidation

Deutsche Pfandbriefbank AG and subsidiaries (including special purpose entities)	Fully consolidated		Not fully consolidated(due to immateriality/ not to be consolidated according to SIC-12)		
	Total	Thereof special purpose entities	Total	Thereof special purpose entities	**Total**
1.1.2009	**44**	**31**	**17**	**1**	**61**
Additions	4	1	9	8	13
Disposals	8	8	4	4	12
Merger	1	–	3	–	4
31.12.2009	**39**	**24**	**19**	**5**	**58**

Associated companies and other investments	Associated companies	Other investments	**Total**
1.1.2009	**12**	**8**	**20**
Additions	–	2	2
Disposals	–	4	4
31.12.2009	**12**	**6**	**18**

These financial statements set out a list of «shareholdings» in the chapter «Holdings». In this list, the subsidiaries are structured on the basis of whether or not they are consolidated. Other shareholdings are also listed. All fully consolidated companies have prepared their financial statements basically for the period ended 31 December 2009.

The balance sheet effects of the contractual relations between the Group companies and the subsidiaries which are not consolidated are set out in the consolidated financial statements. The pooled results of the subsidiaries, which have not been consolidated in view of their minor significance, totalling € 0 million. Net losses are almost completely included in the Group financial statement by depreciation on investments, provisions and profits transferred. The pooled total assets of the non-consolidated subsidiaries account for 0.1% of the Group total assets. The shares in the non-consolidated companies are shown as AfS financial investments.

The following newly established or existing subsidiaries have been initially included in the group of consolidated companies since control has been obtained:

Liffey Camelback LLC, Wilmington, was initially consolidated on 15 June 2009. This subsidiary of Hypo Real Estate Capital Corp., New York, took over a salvage acquisition in Arizona, USA. The book value of salvage acquisition amounted to € 9 million as of the initial consolidation date and as of 31 December 2009. The initial consolidation has not resulted in any significant impact on the income statement or balance sheet of the Group.

The subsidiaries DEPFA Erste GmbH, Frankfurt am Main, Högni Portfolio GmbH, Munich, und PBI-Beteiligungs-GmbH in Liquidation, Munich, were not consolidated due to considerations of materiality; in the forth quarter of 2008, they were merged with their parent company Deutsche Pfandbriefbank AG, Munich. This has not resulted in any significant impact on the income statement or balance sheet of the Group.

The former DEPFA Deutsche Pfandbriefbank AG was merged with Hypo Real Estate Bank AG by way of absorption in an existing company by transferring the assets and liabilities of DEPFA Deutsche Pfandbriefbank AG in accordance with sections 2, 60 et seq. UmwG. Because Hypo Real Estate Bank AG as well as the former DEPFA Deutsche Pfandbriefbank AG were subsidiaries of HRE Holding, the transaction is a business combination involving companies subject to joint control. The assets and liabilities transferred within the framework of the merger were valued with the consolidated carrying amounts of the parent company at the time of the transaction (so-called predecessor accounting). DEPFA Finance N.V., Amsterdam, which was a subsidiary of former DEPFA Deutsche Pfandbriefbank AG, became a consolidated subsidiary of Deutsche Pfandbriefbank AG by the merger.

From 30 June 2009, pbb Services GmbH (former Hypo Real Estate Systems GmbH) was sold at arms length by HRE Holding to Deutsche Pfandbriefbank AG. Because Deutsche Pfandbriefbank AG as well as the pbb Services GmbH are subsidiaries of HRE Holding, the transaction is a business combination involving companies subject to joint control.The assets and liabilities transferred within the framework of the merger were valued with the consolidated carrying amounts of the parent company at the time of the transaction (so-called predecessor accounting).

The following special purpose entities were deconsolidated in the year 2009:
> House of Europe II Funding plc, Dublin
> House of Europe III Funding plc, Dublin
> Kiel I Ltd., St. Helier, Jersey
> Kiel II Ltd., St. Helier, Jersey
> Kiel VI Ltd., St. Helier, Jersey
> Kiel VII Ltd., St. Helier, Jersey
> Kiel VIII Ltd., St. Helier, Jersey
> Kiel IX Ltd., St. Helier, Jersey

The securitisation vehicles House of Europe II Funding plc, Dublin, and House of Europe III Funding plc, Dublin, were deconsolidated in 2009 after the tranches hold were sold.

Consolidation principles At the acquisition date the costs of a business combination are allocated by recognising the acquiree's identifiable assets, liabilities and contingent liabilities that satisfy the recognition criteria according to IFRS 3.37 at their fair values at that date. Any difference between the cost of the business combination and the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities so recognised are accounted as goodwill or as an excess if acquirer's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities in accordance with IFRS 3.51–57. If the interest in net fair value of the identifiable assets, liabilities and contingent liabilities exceeds the costs of business combination the acquirer shall reassess the identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination and recognise immediately in profit or loss any excess remaining after reassessment.

Business relations within the group of consolidated companies are netted with respect to each other. Intercompany results attributable to internal transactions are eliminated.

6 Financial instruments

According to IAS 32, a financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Recognition and derecognition Deutsche Pfandbriefbank Group recognises a financial asset or a financial liability on its balance sheet when, and only when, a group company becomes party of the contractual provisions of the financial instrument.

In principle, the purchases or sales of financial instruments are accounted for at trade date. Premiums and discounts appear in the position net interest income and similar income for the accounting period in question. In accordance with the primary derecognition concept of IAS 39, a financial asset has to be derecognised when all risks and rewards have mainly been transferred. If the main risks and rewards associated with ownership of the transferred financial asset are neither transferred nor retained, and if the power of disposal continues to be exercised over the transferred asset, the company has to recognise the asset to the extent of the supposed continuing involvement. There are no transactions within Deutsche Pfandbriefbank Group which result in partial derecognition due to a continuing involvement.

In case of repurchase agreements and synthetic securitisations the assets transferred do not qualify for derecognition because derecognition criteria of IAS 39 are not fulfilled.

Categories pursuant to IAS 39 Initially, when a financial asset or financial liability is recognised, it is measured at its fair value.

For subsequent measurement according to IAS 39, all financial instruments have to be classified according to this standard, to be recognised in the balance sheet and to be measured according to its categorisation:

Held-for-trading A financial asset or a financial liability is held for trading if it is:
> Acquired or incurred principally for the purpose of selling or repurchasing it in the near term
> Part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit- taking or
> A derivative (except for a derivative that is a designated and effective hedging instrument).

Held-for-trading financial instruments are measured at fair value. Changes in fair value are recognised in profit or loss. Held-for-trading financial instruments are stated under trading assets and trading liabilities. Interest and dividend income as well as the refinancing costs for the trading instruments are shown in net trading income.

If there is a difference between transaction price and market value at trade date and the difference results from unobservable data that have a significant impact on the valuation of a financial instrument, the difference (so-called day one profit) is not recognised immediately in the income statement but is recognised over the life of the transaction. The remaining difference is treated directly in the income statement when the inputs become observable, when the transaction matures or is closed out.

Designated at fair value through profit or Loss (dFVTPL) If certain conditions are satisfied, financial assets or liabilities can be classified at their fair value through profit or loss when they are initially stated. A designation can be made if the use of the valuation category means that a recognition and valuation inconsistency is either avoided or considerably reduced, and management and performance measurement of a portfolio of financial instruments are based on the fair values or if the instrument contains a separable embedded derivative. The Deutsche Pfandbriefbank Group classifies financial assets under the dFVTPL category only for the first two cases. As of 31 December 2009, only fixed-income securities are held in the category dFVTPL. Financial liabilities and loans are not allocated to this category. The portfolio of fixed-income securities is managed on fair value basis. In addition, open interest risk positions of the portfolio are to a large extent closed by hedging derivatives. Because changes in the value of derivatives under IAS 39 in principle have to be recognised in profit or loss, the designation of fixed income securities under the category dFVTPL will avoid inconsistency in terms of valuation. As a result of the designation of fixed income securities and loans and advances, the opposite movements relating to the hedged risk in the income statement cancel each other to a large extent. The accounting treatment is accordingly consistent with risk management and the investment strategy.

dFVTPL financial instruments are measured at fair value. Changes in fair value are recognised in profit or loss. Because financial liabilities are not designated in the category dFVTPL, the Deutsche Pfandbriefbank Group does not have any effect resulting from the instruments being valued with the own current credit risk. The fixed income securities under the category dFVTPL are stated under the item of financial instruments. Interest income from the securities is shown under the position net interest income and similar income. The changes in value to be recognised in profit or loss (net gains and net losses from fair value option) are stated under the line net income from hedge relationships in the same way as the changes in value of the corresponding derivatives.

Held-to-maturity (HtM) investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that are quoted on an active market and that an entity has the positive intention and ability to hold to maturity. HtM financial investments are measured at amortised cost.

In the past, the Deutsche Pfandbriefbank Group has used the HtM category. As a result of the changed intention of the Deutsche Pfandbriefbank Group of not necessarily holding the financial investments to maturity the entire portfolio of HtM investments was reclassified as of 1 July 2007 in accordance with IAS 39.51 into the category AfS. In financial years 2009 and 2008, no financial assets were classified as HtM.

Loans and receivables (LaR) are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables include bonded notes.

Loans and receivables are recognised in the positions loans and advances to banks, loans and advances to customers and financial investments, and are measured at amortised cost. Interest income from loans and receivables are shown in net interest income and similar income. Market price related net gains and net losses attributable to prepayment penalties and selling of loans and advances to customers and of loans and advances to banks are shown under the position net interest income and similar income. Such net gains and net losses from financial investments are shown in net income from financial investments. Reductions in value due to credit standing factors are shown under provisions for losses on loans and advances respectively in net income from financial investments for financial investments.

Available-for-sale (AfS) assets are those non-derivative financial assets that are designated as available for sale and which are not categorised as loans and receivables, held-to-maturity investments or financial assets at fair value through profit or loss. Deutsche Pfandbriefbank Group only categorises securities as AfS but not loans and advances.

AfS financial assets are measured at fair value. Changes in fair value are recognised in a separate item of equity (AfS reserve) not affecting income until the asset is sold, withdrawn or otherwise disposed or if an impairment is established for the financial asset in accordance with IAS 39.58 et seq., so that the cumulative loss previously recorded under equity is now taken to the income statement. If the objective evidence for the impairment of an AfS debt instrument drops out, the impairment has to be reversed to the income statement. On the other hand, impairments for an AfS equity instrument which have been recognised in the income statement are not permitted to be reversed and taken to the income statement.

AfS financial assets are disclosed under financial investments. Interest income from AfS assets is stated under the position net interest income and similar income. Net gains and net losses generated by the disposal of AfS financial instruments as well as by changes in value as a result of impairment or write-ups to be recognised in profit or loss are shown under net income from financial investments.

Financial liabilities at amortised cost are those non-derivative financial liabilities that are not classified at fair value through profit or loss.

Financial liabilities at amortised cost are measured at amortised cost. Financial liabilities at amortised cost that are not securitised are recognised in the positions liabilities to other banks and liabilities to customers. If these financial liabilities are securitised and not subordinated, they are disclosed in liabilities evidenced by certificates. Subordinated liabilities are shown in subordinated capital. Interest expenses from financial liabilities at amortised cost are shown under the position net interest income and similar income. In addition, the position net interest income and similar income includes net gains and net losses attributable to repurchases or withdrawals from financial liabilities at amortised cost before maturity.

Derivatives are measured at fair value. Changes in fair value are recognised in the income statement if the derivatives are not recognised in cash flow hedge accounting. The valuation results from stand-alone derivatives are shown in net trading income and from hedging derivatives in net income from hedge relationships. The interest from trading derivatives is shown under net trading income. In the balance sheet stand-alone derivatives are disclosed under trading assets and trading liabilities and hedging derivatives under other assets and other liabilities.

Outside the held-for-trading and dFVTPL category, embedded derivative financial instruments to be separated within a structured product are separated from the host contract and recognised as separate derivative financial instruments. The host contract is then accounted for in accordance with the categorisation made. The change in value arising from the separated derivatives that are recognised and measured at fair value is recognised in the income statement.

Classes IFRS 7 required disclosures according to classes of financial instruments. Deutsche Pfandbriefbank Group mainly defined the IAS 39 measurement categories, irrevocable loan commitments, financial guarantees, hedging derivatives and cash reserve as classes.

Valuation methods Financial instruments which have to be measured at fair value are valued on the basis of stock market prices or other market prices, if existent. If a price is not available from an active market, observable market prices from comparable financial instruments were used. If prices from comparable financial instruments are not available, valuation models are used that base on observable market parameters. If these parameters are neither observable at the markets, the valuation of the financial assets is based on models with non-market-observable parameters. The used valuation models are market standard models. A description of these models and the products is given in the note «fair values of financial instruments».

Impairment According to IAS 39.58 a financial asset must be tested for impairment. At each balance sheet date Deutsche Pfandbriefbank Group assesses on a case-by-case basis whether there is objective evidence for impairment. The criteria used to determine if there is such objective evidence included:
> Significant financial difficulties of the borrower
> Overdue contractual payments of either principal or interest or other breaches of contract
> Becoming probable that the borrower will enter bankruptcy or other financial reorganisation
> Renegotiations due to economic problems
> When available, the market price of the asset
> For AfS equity instruments a significant and/or prolonged decline in the fair value.

Two types of impairment allowances are in place: individual allowances and portfolio-based allowances. Allowances for loans and advances are disclosed in a separate account (allowances for losses on loans and advances) rather than directly reducing the carrying amount of the assets. The expense is shown under provisions for losses on loans and advances in the income statement. Individual allowances on AfS financial investments as well as individual allowances and portfolio-based allowances on LaR financial assets are directly deducted from the carrying amount of the assets. The expense is shown under net income from financial investments in the income statement. Where subsequent measurement of financial assets is based on fair value through profit or loss, an impairment is implied in the fair value.

Deutsche Pfandbriefbank Group records an impairment on loans and advances as well as financial investments whose terms have been renegotiated if there is objective evidence for impairment.

In determining allowances on individually assessed accounts, the following factors are especially considered:
> Deutsche Pfandbriefbank Group's aggregate exposure to the customer
> The amount and timing of expected interest and redemption payments
> The realisable value of collateral and likelihood of successful repossession
> The likely deduction of any costs involved in recovering amounts outstanding
> The market price of the asset if available

Financial assets carried at amortised cost for which no evidence of impairment has been specifically identified on an individual basis are grouped according to their credit risk for the purpose of calculating portfolio-based allowances. This impairment covers losses which have been incurred but have not yet been identified on loans subject to individual assessment. The parameters used to determine portfolio-based provisions are checked regularly and adjusted if necessary. The portfolio-based allowances are determined after taking into account:

> Historical loss experience in portfolios of similar credit risk characteristics
> A judgement whether current economic conditions and credit conditions improved or deteriorated compared to the past
> The estimated period between impairment occurring and the being identified
> State of the current economic cycle.

With respect to the period between the occurrence and the identification of an impairment the accounting estimates were adjusted due to the improved credit processes. Further adjustments compared to the prior year were done to reflect the economic cycle as this is reflected in the historic loss rates. Du to the changed parameters the portfolio based provisions decreased by € 264 million.

Hedge accounting Hedging relationships between financial instruments are classified as a fair value hedge, a cash flow hedge or hedge of a net investment in a foreign operation in accordance with IAS 39. Hedging instruments are mainly interest rate derivatives, for example interest rate swaps and options. Mainly interest rate risks are hedged but also other types of risk, for instance currency risks.

Fair value hedge Under IAS 39, with a fair value hedge, a stated asset, liability, off-balance-sheet fixed obligation or a precisely designated part of such an asset, liability or obligation, is hedged against the risk of a change in fair value which is attributable to a specific risk and possibly have an effect on profit or loss for the period.

If the hedge of the fair value in the course of the reporting period satisfies the criteria of IAS 39.88, the hedge is stated in the balance sheet as follows:

> The profit or loss arising when the hedging instrument is revalued with its fair value (for a derivative hedging instrument) or the currency component of its carrying amount calculated in accordance with IAS 21 (for non-derivative hedging instruments) is recognised in profit or loss for the period.
> The carrying amount of an underlying transaction is adjusted by the profit or loss arising from the underlying transaction and attributable to the hedged risks, and is recognised in profit or loss for the period. This is applicable if the underlying transaction is otherwise stated using the costs of purchase. The profit or loss attributable to the hedged risk is recognised in profit or loss for the period if the underlying transaction is an available-for-sale (AfS) financial asset. The amortisation of the hedge adjustment is started at dedesignation of the hedge relationship.

The Deutsche Pfandbriefbank Group uses fair value hedge accounting for presenting micro-hedge relationships. Fair value hedge accounting is not used for a portfolio of interest risks. Ineffectiveness within the range permitted under IAS 39 is shown in the line net income from hedge relationships. For measuring effectiveness mainly the regression analysis is used. The dollar offset method is applied for quantifying the ineffectiveness. If the hedge relationship is terminated for reasons other than the derecognition of the hedged item, the difference between the carrying amount of the hedged item at that point and the value at which it would have been carried, had the hedge never existed (the unamortised fair value adjustment), is amortised to the income statement over the remaining term of the original hedge. If the hedged item is derecognised, e.g. due to sale or repayment, the unamortised fair value adjustment is recognised immediately in the income statement.

Cash flow hedge According to IAS 39, a cash flow hedge hedges the risk inherent with fluctuating payment streams which is attributable to a certain risk associated with the stated asset, the stated liability (for instance some or all future interest payments of a variable-interest debt), the risk associated with a future transaction (expected to occur with a high degree of probability) and might have an effect on profit or loss for the period.

Cash flow hedge accounting recognises derivatives which are used for hedging the interest rate risk as part of asset/liability management. For instance, future variable interest payments for variable interest receivables and liabilities are swapped for fixed payments primarily by means of interest rate swaps.

Deutsche Pfandbriefbank Group uses the cash flow hedge model for hedging interest risks on a portfolio basis.

Under cash flow hedge accounting, hedging instruments are stated with their fair value. The valuation result has to be broken down into an effective and an ineffective part of the hedge relationship.

The effective part of the hedging instrument is recognised in a separate item of equity without any impact on earnings (cash flow hedge reserve). The inefficient part of the hedging instrument is recognised in profit or loss in the net income from hedge relationships.

A hedging relationship is deemed to be effective if, at the beginning and throughout the entire duration of the transactions, changes in the payment streams of the underlying transactions are balanced almost completely (range of 80% to 125%) by changes in the payment streams of the hedging instruments. For the purpose of establishing whether a specific part of the hedging instrument is effective, the future variable interest payments from the receivables and liabilities to be hedged are compared quarterly for the financial statements with the variable interest payments from the interest derivatives in detailed maturity bands. The dollar offset method or statistical methods are used to measure efficiency.

In those periods in which the payment streams of the hedged underlying transactions have an impact on profit or loss for the period, the cash flow hedge reserve is released in the income statement. If a cash flow hedge for a forecast transaction is deemed to be no longer effective, or if the hedge relationship is terminated, the cumulative gain or loss on the hedging derivative previously reported in equity remains there until the committed or forecast transaction occurs or is no longer expected to occur, at which point it is transferred to the income statement.

Hedge of a net investment in a foreign operation A net investment hedge is a hedge of the foreign currency exposure on a net investment in a foreign operation. Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. The Deutsche Pfandbriefbank Group does not hedge a net investment in a foreign operation in the financial year 2009 and as of 31 December 2008.

7 Cash reserve

Cash reserve contains balances with central banks which are measured at cost.

8 Trading assets

Trading assets comprise positive market values of stand alone derivatives of the bank book. Trading assets are stated with their fair value. In the case of derivative and original financial transactions which are not listed on an exchange, internal price models based on cash value considerations and option price models are used as the basis of calculating the balance sheet value. Valuation and realised profits and losses attributable to trading assets are stated under net trading income in the income statement.

9 Loans and advances

Loans and advances to other banks and loans and advances to customers are disclosed under IAS 39 with their amortised cost of purchase if they are not categorised dFVTPL or AfS or an underlying transaction of a fair value hedge. dFVTPL financial instruments are measured at fair value. Changes in fair value are recognised in profit or loss. As of 31 December 2009, and as of 31 December 2008, Deutsche Pfandbriefbank Group did not have loans and advances which are categorised as AfS.

Allowances for losses on loans and advances are shown under a separate line item provisions for losses in the income statement. All other income and expenses from loans and advances including net gains and net losses are shown under the position net interest income and similar income.

10 Allowances for losses on loans and advances and provisions for contingent liabilities and other commitments

Allowances for loans and advances are created if there is objective evidence that it will not be possible for the entire amount which is due in accordance with the original contractual conditions to be recovered. Allowances for loans and advances are calculated mainly on the basis of expectations with regard to loan defaults, the structure and quality of the loan portfolio as well as macro-economic parameters on an individual and portfolio basis.

Individual allowances For all recognisable default risks, the extent of the allowance for losses on loans and advances is calculated as the difference between the carrying amount of the asset and the present value of the expected future cash flow. The latter is calculated on the basis of the original financial effective interest rate. Market rate changes do not have any effect in this respect. The increase in the present value of an adjusted receivable (so-called unwinding) which occurs over a period of time is shown as interest income.

Portfolio-based allowances Under IAS 39.64, loans for which there is no objective indication for the need of an allowance are grouped together to form risk-inherent portfolios. Portfolio-based allowances are set aside for these portfolios; these allowances are calculated on current events and information with regard to significant changes with detrimental consequences which have occurred in the technology, market, economic or legal environment, as well as historical default rates.

Allowances for losses on loans and advances are broken down into allowances relating to loans and advances and provisions for contingent liabilities and other commitments like irrevocable loan commitments. An allowance relating to loans and advances is shown as a negative item on the assets side of the balance sheet, whereas a provision for contingent liabilities and other commitments is shown on the liabilities side of the balance sheet. In the income statement, all effects are shown in provisions for losses on loans and advances apart from time-related increases in the present value of impaired receivables which are shown under the position net interest income and similar income.

11 Financial investments

dFVTPL, LaR and AfS securities are stated under financial investments. dFVTPL and AfS financial assets are stated with their fair value. Changes in the fair value are taken to the income statement in case of dFVTPL financial assets assets and are disclosed in net income from hedge relationships. Changes in fair value of AfS financial assets are recognised in a separate item of equity (AfS reserve) not affecting income statement until the asset is sold, withdrawn, disposed of, or if an impairment is established for the financial asset in accordance with IAS 39.58 et seq. Therefore, the cumulative profit or loss previously recorded under equity is now taken to the income statement. Individual allowances on AfS financial assets are directly deducted from the carrying amount of the assets. Portfolio-based allowances on AfS financial assets must not be created for AfS financial assets. AfS financial assets which are hedged efficiently against market price risks are recognised within the framework of fair value hedge accounting. LaR financial investments are measured at amortised cost. Individual allowances and portfolio-based allowances on LaR financial investments are directly deducted from the carrying amount of the assets. In the financial years 2009 and 2008, Deutsche Pfandbriefbank Group did not have any HtM financial assets.

12 Property, plant and equipment

Property, plant and equipment are normally shown at cost of purchase or cost of production. The carrying amounts, if the assets are subject to wear and tear, are diminished by depreciation in accordance with the expected useful life of the assets. In addition, property, plant and equipment are tested at least annually for impairment. If the value of property, plant and equipment has additionally been diminished, non-scheduled depreciation is taken to the income statement. If the reasons for the non-scheduled depreciation are no longer applicable, an amount is written back to the income statement, not exceeding the extent of the amortised cost of purchase for production. In the case of fittings in rented buildings, the contract duration taking account of extension options is used as the basis of this contract duration if it is shorter than the economic life.

Useful economic life in years	
Fixture in rental buildings	5 to 15
IT equipment (broad sense)	3 to 5
Other plant and operating equipment	3 to 25

Cost of purchase or cost of production, which is subsequently incurred, is capitalised if an additional economic benefit accrues to the Company. Measures which are designed to maintain the condition of the property, plant and equipment are recognised in the income statement of the financial year in which they arose.

13 Intangible assets

Purchased and internally generated software are the main items disclosed as intangible assets. Software is an intangible asset with a finite useful life. Purchased software is stated at amortised cost of purchase. Deutsche Pfandbriefbank Group capitalises internally generated software if it is probable that future economic benefits will flow to the Group and the expenses can be measured reliably. Expenses eligible for capitalisation include external directly attributable costs for materials and services as well as personnel expenses for employees directly associated with an internally generated software project. Software is written down in a straight-line basis over an expected useful life of three to five years. In addition, intangible assets with a finite useful life have to be tested for impairment at least annually and whenever there is an indication that the intangible asset may be impaired.

14 Other assets

Other assets mainly contain positive fair values from derivative financial instruments (hedging derivatives and derivatives hedging dFVTPL financial instruments), salvage acquisitions and the capitalised excess cover of qualified insurance for pension provisions. Salvage acquisitions are measured as inventories according to IAS 2 at the lower of cost of purchase and net realisable value.

15 Liabilities

Liabilities other than underlying transactions of an effective fair value hedge and which are not classified as dFVTPL are stated at amortised cost. Discounts and premiums are recognised on a pro rata basis. Interest-free liabilities are stated with their cash value. The Deutsche Pfandbriefbank Group has not designated any liabilities under the category dFVTPL. All income and expenses from liabilities including net gains and net losses resulting from redemption of liabilities are shown under the net interest income and similar income.

16 Trading liabilities

Refinancing positions of the trading portfolio measured at fair value are stated under trading liabilities. In addition, trading liabilities also include negative market values of trading derivatives and of stand alone derivatives of the bank book. Trading liabilities are recognised with their fair values. Valuation and realised profits and losses attributable to trading liabilities are stated under net trading income in the income statement.

17 Provisions

Under IAS 37.36 et seq., the best possible estimate is used for establishing the provisions for uncertain liabilities and contingent losses attributable to pending transactions. Long-term provisions are discounted.

Provisions for defined benefit plan pensions and similar obligations are calculated on the basis of actuarial reports in accordance with IAS 19. They are calculated using the «projected unit credit» method, and this method takes into account the cash value of the earned pension entitlements as well as the actuarial profits and losses which have not yet been redeemed. These are differences between the expected and actual factors (for instance a higher or lower number of invalidity or mortality cases than expected on the basis of the calculation principles used) or changes in the calculation parameters.

The actuarial profits and losses are dealt with using the so-called corridor method: a consideration in the income statement only has to be taken to the income statement in subsequent years if the total profits or losses which have accumulated as of the reference date for the financial statements exceed 10% of the maximum figure calculated as the cash value of the earned pension entitlements and the assets of any external benefit facility. The effect to be treated in income statement is divided by the expected average remaining working lives of the employees participating in that plan.

The interest rate used for discounting defined benefit obligations is based on the long-term interest rate applicable for first-class fixed-income corporate bonds on the reference date for the financial statements.

Deutsche Pfandbriefbank AG obtained insurance against parts of the risks arising from defined-benefit pension commitments as of 1 January 2005 by taking reinsurance classified as a «qualifying insurance policy» under IAS 19. This reinsurance is pledged to the plan beneficiaries and constitutes plan assets under IAS 19. The pension obligations have to be netted with the plan assets by taking into account the ceiling according to IAS 19.58. In the event of surplus cover, the amount stated under other assets is equivalent to the negative balance of the following:

- the present value of the vested pension claims of defined benefit obligations as of the balance sheet date
- plus any actuarial profits (less any actuarial losses) which have not yet been recognised in the income statement
- less any past service cost which has to be recognised but which has not yet been taken into consideration
- less the fair value of the plan assets on the balance sheet date.

In accordance with IAS 19, the cost of defined-benefit pension commitments included under general administrative expenses in the position «Costs for retirement pensions and benefits» has been reduced by the expected income from the plan assets.

18 Other liabilities

Besides negative fair values from derivative financial instruments (hedging derivatives and derivatives hedging dFVTPL financial instruments), accrued liabilities are one of the items stated under other liabilities. These are liabilities for products or services which have been received or supplied and have not yet been paid for, invoiced by the supplier or formally agreed. This also includes short-term liabilities to employees, for instance flexi time credits and vacation entitlements. The accrued liabilities have been stated in the amount likely to be utilised.

If the obligations listed at this point cannot be quantified more precisely on the reference date for the financial statements and if the criteria specified in IAS 37 for establishing provisions are satisfied, these items have to be stated under provisions.

19 Subordinated capital

In the event of bankruptcy or liquidation subordinated capital may only be repaid after all non-subordinated creditors have been satisfied. Subordinated capital of Deutsche Pfandbriefbank Group encompasses subordinated liabilities, participating certificates outstanding and hybrid capital instruments. For some instruments of subordinated capital the holders participate in any net loss or balance sheet loss. In addition, the interest entitlement can be ceased or reduced under specific conditions. For other instruments the interest ceases only in case of a net loss which can be caught up depending on the structuring.

Pursuant to IAS 32 the subordinated capital instruments issued by companies of Deutsche Pfandbriefbank Group were classified as financial liabilities or equity instruments in according with the substance of the contractual arrangement and the definitions of a financial liability and an equity instrument. Financial liabilities are measured at amortised cost. The amortised costs are the amount at which the financial liability is measured at initial recognition minus principal payments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and minus any expected reduction of interest and/or principal payments.

By applying the effective interest method an expected reduction of the interest entitlement and/or an expected loss participation of the subordinated capital led to a devaluation of the subordinated capital in the years 2008 and 2009. The devaluation is disclosed as an interest income in the income statement. In the following years the present value of the adjusted allowances resulting over a period of time (unwinding) will result in an expense.

20 Silent participation

The SoFFin provided the Deutsche Pfandbriefbank AG with a silent participation of € 1.0 billion in 2009. The silent participation has an indefinite life. The silent partner SoFFin shares any balance sheet deficit suffered by Deutsche Pfandbriefbank AG up to the full amount of the silent participation. The silent participation is classified as an equity instrument on initial recognition in accordance with the substance of the contractual arrangement and the definitions in IAS 32. The silent participation is measured initially at cost, with such cost being equivalent to the fair value of the consideration received.

21 Share-based compensation

As of 31 December 2009 no company of Deutsche Pfandbriefbank Group have provided a commitment for share-based compensation.

22 Currency translation

Currency translation is carried out in accordance with the regulations of IAS 21. On the reference date for the financial statements, monetary items in a foreign currency are translated into the functional currency. The reporting currency is the Euro. Non-monetary items which were stated in a foreign currency using historical cost of purchase are stated using the exchange rate applicable at the point they were purchased.

Income and expenditures attributable to currency translation at the individual companies in the Group are normally shown in the income statement under «Balance of other operating income/expenses».

In these consolidated financial statements, balance sheet items of the subsidiaries, if they do not prepare financial statements in Euros, are translated using the closing rates at reference date for the financial statements. For translating the expenses and income of these subsidiaries, the average rates are used. Differences resulting from the translation of the financial statements of the subsidiaries are treated without any impact on the income statement and are shown in movements in shareholders' equity. The group of consolidated companies does not include any companies from high-inflation countries.

23 Taxes on income

Taxes on income are accounted for and valued in accordance with IAS 12. Apart from the exceptions defined in the standard, deferred taxes are calculated for all temporary differences for the values under IFRS and the tax values as well as for the differences resulting from uniform group valuation within the group and differences from the consolidation (balance sheet method). Deferred tax assets arising from non-utilised losses carried forward, interest assets carried forward and tax credits are calculated if necessary according to IAS 12.34 et seq.

Deferred taxes are calculated using the national tax rates which are expected at the time when the differences are balanced, as the concept of deferred taxes is based on the presentation of future tax assets or tax liabilities (liability method). Changes of tax rates have been taken into account. The pay-out of the corporate income tax claim which was capitalised on 31 December 2006 has begun since 1 January 2008 over a period of ten years independently of a dividend payment. The interest-free claim had to be shown with the present value. A rate of 3.7 % p.a. has been used for discounting purposes. Changes of the capitalised corporate income tax claims due to tax assessment notes for previous periods in the year 2009 were recognised accordingly in the income statement.

24 Non-current assets held for sale

In accordance with IFRS 5, non-current assets or disposal groups held for sale have to be shown on the balance sheet date at the lower of carrying amount and fair value less costs to sell. The assets have to be shown separately in the balance sheet. As of 31 December 2009 and of 31 December 2008, Deutsche Pfandbriefbank Group did not own material non-current assets held for sale.

25 Future-related assumptions and estimation uncertainties

When the financial statements are being prepared, the Deutsche Pfandbriefbank Group makes future-related assumptions as well as estimations, resulting in a considerable risk of a major change to the stated assets and liabilities becoming necessary during the next financial year.

Going concern The consolidated financial statements of Deutsche Pfandbriefbank AG is based on the assumption of going concern. The conditions of going concern are described in the forecast report.

Standards which are not the subject of early adoption New standards that are issued or existing standards, which have been revised and not the subject of early adoption, may result in changes in the accounting treatment and valuation as well as the statement of assets and liabilities when they are applied for the first time. The standards that are not the subject of early adoption are described in detail in Note 2.

Allowances for losses on loans and advances The loan portfolio of the Deutsche Pfandbriefbank Group is reviewed at least annually in order to identify any impairment losses on loans and advances. It is necessary to assess whether the estimated future cash flows of a loan portfolio are lower than the actual contractual ones. For this purpose, it is necessary to make judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers, or national or economic conditions that correlate with defaults on assets in the portfolio. The methods and assumptions concerning the assessments of the extent and timing of the payment streams are reviewed regularly to reduce any differences between estimated and actual defaults. In addition, the determination of portfolio-based provisions is based on a loss identification period as well as the expected loss based on statistical data.

Impairment on financial investments In 2009 and 2008 no reliable market prices existed for the assessment of the majority of structured products and for other securities. These were measured on the basis of valuation models with observable market data. For this, the expected cash flows were discounted with the swaps curves allocated per kind of product, rating category and currency. The methods and assumptions concerning the assessments of the extent and timing of the payment streams are regularly checked in order to minimise the differences between estimated and actual defaults.

Fair values of original and derivative financial instruments The fair value of financial instruments that are not listed on active markets is calculated using valuation models. In the cases in which valuation models are used, a check is performed regularly to assess whether the valuation models provide a comparable standard for current market prices. For practical considerations, the valuation models can only take account of quantifiable factors (e.g. cash flows and discount rates) that also require estimates. Changes in assumptions relating to these factors might have an impact on the fair values of the financial instruments.

Embedded derivatives According to IAS 39.11, an embedded derivative has to be separated from the underlying contract and has to be valued separately if, in addition to other criteria, the economic features and risks of the embedded derivative are not closely related to the economic features and risks of the underlying agreement. The economic risks of the underlying contracts and embedded derivatives are assessed on the basis of measuring methods to evaluate the existence of an obligation to separate.

Hedge accounting Relations between underlyings and hedging instruments can be presented in hedge accounting. A relation only qualifies for hedge accounting when certain conditions specified under IAS 39.88 are satisfied. One of these conditions is that the hedge has to be very efficient with regard to achieving compensation for the risks resulting from changes in the fair value or the cash flow in relation to the hedged risk.

The establishment of the effectiveness of the risk hedge depends on risk measuring methods, the parameters which are used and assumptions relating to the probability of occurrence. These methods and parameters are continuously developed in line with the risk management objectives and strategies.

Taxes on income The Deutsche Pfandbriefbank Group is subject to a wide range of national tax regulations with regard to the calculation of taxes on income. In order to evaluate the actual tax burden, it is necessary to make estimates that are calculated with the knowledge existing as of the reporting date and closely related to the tax return prepared in the following financial year. In some countries, the current tax charges attributable to the current financial year can only be definitely finalised after the corresponding tax audit has been completed. The variances with regard to the estimated tax burden may have a positive or negative influence on the tax burden in future financial years.

With regard to the capitalisation of losses carried forward and other tax credits, the extent as well as the availability of such tax benefits are subject to estimation. Major losses carried forward are subject to national German tax law, and their availability also depends on the restrictions set out in section 8 (4) and 8c KStG as well as section 10a GewStG. Deferred tax assets arising from losses carried forward are stated as far as it is likely that taxable income will be available to off set the non-utilised tax losses carried forward.

The extent of future payments of the corporate income tax claim has been calculated using the present-value method and an interest rate of 3.7% p.a.

Segment Reporting

26 Notes to segment reporting by business segment

HRE and consequently **Deutsche Pfandbriefbank Group** are refocusing its business. On the one hand, the strategic, sustainable business areas will be elaborated, meaning that the strategic activities will be comprised at the core bank Deutsche Pfandbriefbank AG. On the other hand non-strategic portfolios will be reduced, whereas the income statement should not be depressed as far as possible. Parallel to the approved refocusing of HRE and Deutsche Pfandbriefbank Group, the existing segment structure is currently revised elementarily. Until the corporate steering will be reorganised completely, Deutsche Pfandbriefbank Group still divides its business activities into the two operating segments Commercial Real Estate and Public Sector. In addition, the Corporate Center is disclosed.

The business segment **Commercial Real Estate (CRE)** combines mainly the international and German businesses of the strategic, commercial real estate financing including customer derivatives.

The business segment **Public Sector (PS)** pools mainly the Public Sector business.

Contributions to earnings made by the non-strategic portfolios such as the CDO portfolio and an internal HRE guarantee as well as the costs for essential corporate functions are some of the items shown in the **Corporate Center.** In addition, the Corporate Center also includes the costs of the liquidity support and certain administrative expenses of backoffice operations.

The segment report of Deutsche Pfandbriefbank Group is based on the internal controlling instruments and the management information system which is prepared in accordance with IFRS. Income and expenses are allocated to appropriate cost centres, whereby portfolio structures are used as the basis for allocating income. General administrative expenses are allocated to the appropriate cost centres in the segment. The segments generated only Group external income, and did not generate any income with other segments of Deutsche Pfandbriefbank Group or the Corporate Center. Accordingly, there are no issues of consolidation between the segments or with the Corporate Center. The management information is based on the accounting and valuation methods of the consolidated financial statements prepared in accordance with IFRS. Accordingly, reconciliation with the accounting and valuation methods used in the consolidated financial statements is not necessary.

The cost-income ratio is the ratio of general administrative expenses and operating revenues, consisting of net interest income and similar income, net commission income, net trading income, net income from financial investments, the result of hedging relationships and the balance of other operating income/expenses.

27 Income statement, broken down by business segment

Income/expenses in € million		CRE	PS	Corporate Center	Deutsche Pfandbriefbank
Operating revenues	Deutsche Pfandbriefbank 2009	587	64	–90	561
	Deutsche Pfandbriefbank (combined figures) 2009	587	118	–52	653
	former HRE Bank 2008	487	5	–1,644	–1,152
	Deutsche Pfandbriefbank (combined figures) 2008	876	63	–1,683	–744
Net interest income and similar income	Deutsche Pfandbriefbank 2009	632	41	112	785
	Deutsche Pfandbriefbank (combined figures) 2009	632	118	113	863
	former HRE Bank 2008	397	5	309	711
	Deutsche Pfandbriefbank (combined figures) 2008	756	74	262	1,092
Net commission income	Deutsche Pfandbriefbank 2009	97	–1	–156	–60
	Deutsche Pfandbriefbank (combined figures) 2009	97	–7	–156	–66
	former HRE Bank 2008	46	–	–23	23
	Deutsche Pfandbriefbank (combined figures) 2008	95	–3	–19	73
Net trading income	Deutsche Pfandbriefbank 2009	–151	23	83	–45
	Deutsche Pfandbriefbank (combined figures) 2009	–151	22	85	–44
	former HRE Bank 2008	–24	–	–631	–655
	Deutsche Pfandbriefbank (combined figures) 2008	–45	–24	–657	–726
Net income from financial investments	Deutsche Pfandbriefbank 2009	3	–	–46	–43
	Deutsche Pfandbriefbank (combined figures) 2009	3	–	–46	–43
	former HRE Bank 2008	57	–	–1,312	–1,255
	Deutsche Pfandbriefbank (combined figures) 2008	58	1	–1,294	–1,235
Net income from hedge relationships	Deutsche Pfandbriefbank 2009	–	1	–7	–6
	Deutsche Pfandbriefbank (combined figures) 2009	–	–16	–7	–23
	former HRE Bank 2008	–	–	–22	–22
	Deutsche Pfandbriefbank (combined figures) 2008	–	12	–23	–11
Balance of other operating income/expenses	Deutsche Pfandbriefbank 2009	6	–	–76	–70
	Deutsche Pfandbriefbank (combined figures) 2009	6	1	–41	–34
	former HRE Bank 2008	11	–	35	46
	Deutsche Pfandbriefbank (combined figures) 2008	12	3	48	63
Provisions for losses on loans and advances	Deutsche Pfandbriefbank 2009	1,866	2	22	1,890
	Deutsche Pfandbriefbank (combined figures) 2009	1,866	3	22	1,891
	former HRE Bank 2008	903	–	201	1,104
	Deutsche Pfandbriefbank (combined figures) 2008	1,066	–	170	1,236
General administrative expenses	Deutsche Pfandbriefbank 2009	178	11	70	259
	Deutsche Pfandbriefbank (combined figures) 2009	177	23	105	305
	former HRE Bank 2008	59	–	48	107
	Deutsche Pfandbriefbank (combined figures) 2008	155	26	73	254
Balance of other income/expenses	Deutsche Pfandbriefbank 2009	–1	3	14	16
	Deutsche Pfandbriefbank (combined figures) 2009	–1	3	16	18
	former HRE Bank 2008	–5	–	–129	–134
	Deutsche Pfandbriefbank (combined figures) 2008	–5	–8	–129	–142
Pre-tax profit	Deutsche Pfandbriefbank 2009	**–1,458**	**54**	**–168**	**–1,572**
	Deutsche Pfandbriefbank (combined figures) 2009	**–1,457**	**95**	**–163**	**–1,525**
	former HRE Bank 2008	**–480**	**5**	**–2,022**	**–2,497**
	Deutsche Pfandbriefbank (combined figures) 2008	**–350**	**29**	**–2,055**	**–2,376**

Cost income-ratio

in %		CRE	PS	Corporate Center	Deutsche Pfandbriefbank
Cost income-ratio (based on operating revenues)	Deutsche Pfandbriefbank 2009	30.3	17.2	>100.0	46.2
	Deutsche Pfandbriefbank (combined figures) 2009	30.2	19.5	>100.0	46.7
	former HRE Bank 2008	12.1	–	>100.0	>100.0
	Deutsche Pfandbriefbank (combined figures) 2008	17.7	41.3	>100.0	>100.0

28 Total assets, broken down by business segment

Total assets

in € million		CRE	PS	Corporate Center	Deutsche Pfandbriefbank
Total assets	Deutsche Pfandbriefbank 2009	54,608	87,286	73,323	215,217
	Deutsche Pfandbriefbank (combined figures) 2009	54,608	87,286	73,323	215,217
	former HRE Bank 2008	58,703	36,808	88,985	184,496
	Deutsche Pfandbriefbank (combined figures) 2008	58,703	93,538	89,578	241,819

29 Key regulatory capital ratios (based on German Commercial Code [HGB]), broken down by business segment

Deutsche Pfandbriefbank AG is according the «Waiver Rule» regulated in section 2a KWG not obliged to determine the equity capital ratio and the core capital ratio on a sub-group level.

The waiver rule regulated in section 2a KWG contains that a credit institute or financial services institute incorporated in Germany and that is part of a regulated institute group or finance holding group does not have to comply with the following:

- Relating to solvency (equity capital in relation to risk-weighted assets)
- Relating to large exposure (equity capital in relation to credit to single borrower units)
- For setting up internal control measures according to section 25a KWG

if specific conditions are fulfilled.

30 Breakdown of operating revenues

Operating revenues by products

Operating revenues in € million	2009	2008
Commercial Real Estate financings	587	487
Public Sector financings	64	5
Other products	−90	−1,644
Total	**561**	**−1,152**

Operating revenues by regions The Deutsche Pfandbriefbank Group as of 31 December 2009 differentiates between the regions Germany, rest of Europe and America/Asia. The column «Corporate Center» includes consolidation transactions as well as the contributions to earnings of the non-strategic portfolios. In addition, it includes the contributions to earnings of the Corporate Center. Allocation of values to regions is based on the location of the registered offices of the Group companies or their branches.

Operating revenues by regions in € million		Germany	Rest of Europe	America/Asia	Corporate Center	Deutsche Pfandbriefbank
Operating revenues	Deutsche Pfandbriefbank 2009	470	40	51	–	561
	Deutsche Pfandbriefbank (combined figures) 2009	560	42	51	–	653
	former HRE Bank 2008	−1,259	26	81	–	−1,152
	Deutsche Pfandbriefbank (combined figures) 2008	−962	77	135	6	−744

Operating revenues by customers Deutsche Pfandbriefbank Group has not generated 10% or more of its operating revenues with a single external customer.

Notes to the Income Statement

31 Net interest income and similar income

Net interest income and similar income, broken down by categories of income/expenses in € million	**2009**	**2008**
Interest income and similar income	**5,256**	**4,418**
Lending and money-market business	3,731	3,174
Fixed-income securities and government-inscribed debt	1,038	1,004
Participating interests	–	3
Current result from swap transactions (balance of interest income and interest expenses)	475	–
Subordinated capital	12	236
Other	–	1
Interest expenses and similar expenses	**4,471**	**3,707**
Deposits	1,038	1,254
Liabilities evidenced by certificates	3,433	2,202
Current result from swap transactions (balance of interest income and interest expenses)	–	251
Total	**785**	**711**

Total interest income for financial assets that are not at fair value through profit or loss, amount to € 4.8 billion (2008: € 4.4 billion). Total interest expenses for financial liabilities that are not at fair value through profit or loss amount to € 4.5 billion (2008: € 3.5 billion).

Net interest income and similar income includes income of € 103 million (2008: € 37 million) due to the increase in the present value of the adjusted allowances resulting over a period of time and an expense of € – 24 million (2008: € 0 million) due to the increase in the present value of the adjusted liabilities over a period of time.

32 Net commission income

Net commission income in € million	**2009**	**2008**
Securities and custodial services	– 6	– 7
Lending operations and other service operations	– 54	30
thereof: Costs of the liquidity support	– 149	– 10
Total	**– 60**	**23**

Net commission income is attributable exclusively to financial assets and financial liabilities which are not designated at fair value through profit or loss. The decline in net commission income results mainly due to the expenses through the liquidity support. Commission income from trust and other fiduciary activities amount to € 0 million as was the case last year, with commission expenses at € 0 million (2008: € 0 million).

33 Net trading income

Net trading income in € million	**2009**	**2008**
From interest rate instruments and related derivatives	– 158	89
From credit risk instruments and related derivatives	113	– 744
Total	**– 45**	**– 655**

34 Net income from financial investments

Net income from financial investments in € million	2009	2008
Income from financial investments	179	143
Expenses from financial investments	222	1.398
Total	**– 43**	**– 1,255**

Net income from financial investments consists of income from the sale of securities of the measurement categories AfS and LaR together with changes in the value of such instruments that are to be recognised in the income statement. HtM investments were not held in 2009 and 2008. Based on valuation categories, net income from financial investments is broken down as follows:

Net income from financial investments by IAS 39 categories in € million	2009	2008
Available-for-sale financial investments	– 3	– 254
Loans-and-receivables financial investments	– 7	– 1,032
Negative difference from business combination	–	1
Result from investment properties	– 33	30
Total	**– 43**	**– 1,255**

35 Net income from hedge relationships

Net income from hedge relationships in € million	2009	2008
Result from fair value hedge accounting	– 7	4
Result from hedged items	17	– 16
Result from hedging instruments	– 24	20
Result from dFVTPL investments and related derivatives	2	– 25
Result from dFVTPL investments	17	12
Result from derivatives related to dFVTPL investments	– 15	– 37
Ineffectiveness from cash flow hedge accounting affecting income	– 1	– 1
Total	**– 6**	**– 22**

The item net income from hedge relationships reflected two effects. On the one hand expenses resulted from hedge inefficiencies within the range of 80 % to 125 % which is admissible under IAS 39. These expenses are mainly a reverse effect from the corresponding income in the fourth quarter 2008. On the other hand a negative valuation result was attributable to assets designated at Fair Value through Profit or Loss (dFVTPL) and related derivatives.

36 Balance of other operating income/expenses

Balance of other operating income/expenses in € million	2009	2008
Other operating income	10	76
Other operating expenses	80	30
Balance of other operating income/expenses	**– 70**	**46**

Rental income attributable to buildings in current assets (salvage acquisitions) of € 4 million (2008: € 3 million) is the biggest individual amount in other operating income. The main component in other operating expenses stems from currency translation effects totalling € – 52 million (2008: € 64 income). Depreciation and other expenses attributable to buildings in current assets (salvage acquisitions) amounted to € – 12 million (2008: € – 16 million). In addition the balance of other operating income/expenses does not contain any individual amounts of major significance.

37 Provisions for losses on loans and advances

Provisions for losses on loans and advances in € million	2009	2008
Provisions for losses on loans and advances	1,889	1,102
Additions	2,019	1,156
Releases	– 130	– 54
Provisions for contingent liabilities and other commitments	3	5
Additions	4	5
Releases	– 1	–
Recoveries from write-offs of loans and advances	– 2	– 3
Total	**1,890**	**1,104**

The development of allowances of individual allowances on loans and advances as well as portfolio-based allowances is shown in the note allowances for losses on loans and advances.

38 General administrative expenses

General administrative expenses in € million	2009	2008
Personnel expenses	112	21
Wages and salaries	92	13
Social security costs	13	8
Pension expenses and related employee benefit costs	7	–
Other general administrative expenses	131	78
Depreciation/amortisation	16	8
On software and other intangible assets excluding goodwill	11	6
On property, plant and equipment	5	2
Total	**259**	**107**

Cost income-ratio in %	2009	2008
Cost income-ratio	46.2	> 100.0

39 Balance of other income/expenses

Balance of other income/expenses in € million	2009	2008
Other income	26	4
thereof: Realeses of restructuring provisions	26	4
Other expenses	10	138
thereof: Other taxes	–	2
Impairment on goodwill	–	10
Additions to restructuring provisions	10	123
Balance of other income/expenses	**16**	**– 134**

40 Taxes on income

Breakdown in € million	2009	2008
Current taxes	41	– 29
Deferred taxes	– 43	– 51
thereof: Deferred taxes on capitalised losses carried forward	3	37
Total	**– 2**	**– 80**

Current taxes contain a current tax expense of € 41 million (2008: current tax income € 29 million). Non-recurrent effects amounted in 2008 to € 79 million as result from the revaluation of deferred taxes according to the relocation of the place of business to Unterschleißheim. The current taxes contain tax expense for prior years of € 32 million.

The differences between the expected (computed) taxes on income and the taxes on income actually shown are outlined in the following reconciliation:

Reconciliation in € million	2009	2008
Net income/loss before taxes	– 1,572	– 2,497
Applicable (legal) tax rate in %	15.83	15.83
Expected (computed) tax expense	– 249	– 395
Tax effects		
arising from foreign income	1	6
arising from tax rate differences	– 9	– 19
arising from losses	– 1	–
arising from tax-free income	– 7	– 16
arising from deductible and non-deductible items	75	8
arising from valuation adjustments and the non-application of deferred taxes	166	343
arising from the write-down of deferred taxes	2	–
arising from prior years and other aperiodical effects	27	– 8
arising from other differences	– 7	1
Accounted taxes on income	**– 2**	**– 80**
Group tax ratio in %	**0.1**	**3.2**

The tax rate applicable for the financial year, including solidarity surcharge, is 15.83 % and is comprised of the 15.0 % German corporate tax rate actual effective together with the payable solidarity surcharge of 5.5 %.

The effects attributable to foreign income comprise tax rate differences arising from foreign fiscal jurisdictions. These arose as foreign income has been taxed with different tax rates.

The effects from tax rate differences include the trade tax burden (current and deferred in accordance with IFRS) which exists in Germany additionally to German corporation tax and solidarity surcharge. The effect from the planned relocation of the place of business is included, too. The trade tax multiplier effective in the new municipality is lower and the revaluation already mirrors at the reporting date the expected lower tax burden in the future.

The item «Effects arising from tax-free income» comprises effects from tax-free income from participating interests, dividends and capital gains or losses both domestically and internationally. Regulations for the determination of taxable income were applied as valid for the particular jurisdiction.

The effects attributable to tax additions and deductions relate primarily to non-deductible expenses, which do not have to be taken into account as deferred taxes as a result of permanent differences, but which have reduced or increased the basis of taxation.

The item «Effects arising from valuation adjustments and non-application of deferred taxes» comprises major effects from not recognised deferred tax assets at loss carry-forwards.

The write-up of deferred taxes mainly resulted from in the context of deferred income.

The item «Effects from previous years on other aperiodical effects» includes both current taxes for years which have been incurred as a result of tax audits or a reassessment of the tax liability, as well as aperiodical effects and deferred taxes for prior years.

The Group tax ratio is the quotient of the stated income taxes (current and deferred taxes) and net income/loss before taxes.

The deferred tax liabilities or deferred tax assets relate to the following items:

Deferred tax liabilities/assets in € million	**2009**	**2008**
Loans and advances to other banks/customers (including loan loss allowances)	1	1
Financial investments	396	254
Other assets/liabilities	2,602	2,739
Liabilities to other banks/to customers	577	514
Others	72	37
Deferred tax liabilities	**3,648**	**3,545**
Loans and advances to other banks/customers (including provisions for losses on loans and advances)	683	627
Financial investments	121	100
Provisions	26	43
Other assets/liabilities	2,822	3,204
Losses carried forward	168	168
Liabilities evidenced by certificates	265	9
Trading liabilities	117	181
Others	32	9
Deferred tax assets	**4,234**	**4,341**

For the domestic companies, the deferred taxes are calculated using the uniform rate of corporation tax of 15 % plus the 5.5 % solidarity surcharge payable on this and the locally applicable collection rate for municipal trade tax (the current basic rate is 3.5 %). Due to the relocation to Unterschleißheim is the tax rate for the valuation of deferred taxes for Deutsche Pfandbriefbank AG 26.84 %.

On the reporting date, there are unused loss carried-forward totalling € 4,074 million (2008: € 2,830 million). Deferred tax assets have been stated on the amount of € 625 million (2008: € 632 million) because the criteria for recognition in accordance with IAS 12.34 et seq. were satisfied. The loss carried-forward can be utilised for an unlimited period of time. Additionally temporary differences of € 61 million (2008: € 7 million) were not recognised with deferred tax assets.

An amount of € 121 million (2008: € 102 million) for deferred taxes has been netted with the AfS reserve and € 194 million (2008: € 357 million) have been netted with the cash flow hedge reserve. No netting of deferred taxes with other equity capital (2008: € 2 million).

41 Net gains/net losses

The income statement contains the following income-statement-related net gains/net losses according to IFRS 7.20(a):

Net gains/net losses in € million	**2009**	**2008**
Loans and receivables	−1,853	−1,052
Available for sale	−3	−254
Held for trading	−45	−655
Designated at Fair Value through P&L	2	−25
Financial liabilities at amortised cost	144	330

Notes to the Balance Sheet (Assets)

42 Cash reserve

Cash reserve in € million	**31.12.2009**	**31.12.2008**
Cash in hand	–	–
Balances with central banks	618	546
Total	**618**	**546**

Cash in hand amounts to less than € 1 million as was the case last year.

43 Trading assets

Trading assets in € million	**31.12.2009**	**31.12.2008**
Positive fair values from derivative financial instruments	360	–
Stand-alone derivatives (bankbook)	1,075	131
Total	**1,435**	**131**

44 Loans and advances to other banks

Loans and advances to other banks, broken down by type of business in € million	**31.12.2009**	**31.12.2008**
Loans and advances	77,967	68,073
Public sector loans	9,126	5,725
Real estate loans	42	94
Other loans and advances	68,799	62,254
Investments	184	4,053
Total	**78,151**	**72,126**

Loans and advances to other banks, broken down by maturities in € million	31.12.2009	31.12.2008
Repayable on demand	4,167	18,087
With agreed maturities	73,984	54,039
Up to 3 months	63,858	48,073
From 3 months to 1 year	3,142	1,075
From 1 year to 5 years	2,502	3,474
From 5 years and over	4,482	1,417
Total	**78,151**	**72,126**

Loans and advances to customers, broken down by maturities in € million	31.12.2009	31.12.2008
Unspecified terms	1	1
With agreed maturities	91,220	69,937
Up to 3 months	6,539	7,517
From 3 months to 1 year	10,765	7,488
From 1 year to 5 years	35,814	29,694
From 5 years and over	38,102	25,238
Total	**91,221**	**69,938**

45 Loans and advances to customers

Loans and advances to customers, broken down by type of business in € million	31.12.2009	31.12.2008
Loans and advances	91,221	66,700
Public sector loans	36,277	8,091
Real estate loans	54,303	57,974
Other loans and advances	641	635
Investments	–	3,238
Total	**91,221**	**69,938**

46 Volume of lending

Volume of lending in € million	31.12.2009	31.12.2008
Loans and advances to other banks	77,967	68,073
Loans and advances to customers	91,221	66,700
Contingent liabilities	689	1,855
Total	**169,877**	**136,628**

47 Allowances for losses on loans and advances

Development in € million	Individual allowances on loans and advances	Portfolio-based allowances	**Total**
Balance at 1.1.2008	**635**	**164**	**799**
Changes affecting income	816	184	1,000
Gross additions	902	254	1,156
Releases	–54	–70	–124
Increase of the present value due to passage of time (unwinding)	–32	–	–32
Changes not affecting income	–49	91	42
Addition and disposals in the group of consolidated companies	94	95	189
Use of existing loan-loss allowances	–176	–4	–180
Effects of currency translations and other changes not affecting income	33	–	33
Balance at 31.12.2008	**1,402**	**439**	**1,841**
Balance at 1.1.2009	**1,402**	**439**	**1,841**
Changes affecting income	1,662	112	1,774
Gross additions	1,895	124	2,019
Releases	–130	–	–130
Increase of the present value due to passage of time (unwinding)	–103	–	–103
Release model reserve	–	–12	–12
Changes not affecting income	–288	–1	–289
Addition and disposals in the group of consolidated companies	–	2	2
Use of existing loan-loss allowances	–357	–3	–360
Reclassifications	3	–	3
Effects of currency translations and other changes not affecting income	66	–	66
Balance at 31.12.2009	**2,776**	**550**	**3,326**

The allowances for losses on loans and advances were exclusively created for the measurement category loans and receivables.

Breakdown in € million	**31.12.2009**	**31.12.2008**
Individual allowances for losses on loans and advances to other banks	30	85
Individual allowances for losses on loans and advances to customers	2,746	1,317
Portfolio-based allowances	550	439
Total	**3,326**	**1,841**

Loan loss ratio in € million	**31.12.2009**	**31.12.2008**
Loan losses	361	180
Use of existing loan-loss allowances	360	180
Use of allowances for losses on guarantees and indemnities	3	3
Recoveries from written-off loans and advances	–2	–3
Total volume of lending	169,877	136,628
Loan loss ratio[1] in %	**0.21**	**0.13**

[1] Loan losses/total volume of lending

Ratio of allowances to total lendings in € million	31.12.2009	31.12.2008
Total allowances	3,337	1,852
Allowances for losses on loans and advances	3,326	1,841
Allowances for contingent liabilities and other commitments	11	11
Total volume of lending	169,877	136,628
Provision rate[1] in %	**1.96**	**1.36**

[1] Total allowances/total volume of lending

48 Financial investments

Breakdown in € million	31.12.2009	31.12.2008
AfS financial investments	2,811	2,822
Shares in non-consolidated subsidiaries	2	44
Participating interests	7	8
Debt securities and other fixed-income securities	2,799	2,769
Equity securities and other variable-yield securities	3	1
dFVTPL financial investments	925	1,037
Debt securities and other fixed-income securities	925	1,037
LaR financial investments	27,178	25,075
Debt securities and other fixed-income securities	27,178	25,075
Total	**30,914**	**28,934**

The carrying amounts of the LaR financial investments were reduced by portfolio-based allowances amounting to € 33 million (31 December 2008: € 24 million).

Financial investments, broken down by maturities in € million	31.12.2009	31.12.2008
Unspecified terms	12	53
With agreed maturities	30,902	28,881
Up to 3 months	736	780
From 3 months to 1 year	2,682	2,288
From 1 year to 5 years	9,549	9,405
From 5 years and over	17,935	16,408
Total	**30,914**	**28,934**

Deutsche Pfandbriefbank Group has made use of the IASB amendments to IAS 39 and IFRS 7, published on 13 October 2008, and reclassified financial assets. The Group identified assets, eligible under the amendments, for which at the reclassification date it had a clear change of intent to hold for the foreseeable future rather than to exit or trade in the short term and which had met the definition of loans and receivables according to IAS 39 (amongst others not quoted in an active market). The reclassified portfolios are disclosed under financial investments.

Former Hypo Real Estate Bank AG and former DEPFA Deutsche Pfandbriefbank AG reclassified retrospectively as of 1 July 2008 financial investments out of the category available-for-sale of € 20.7 billion respectively € 9.5 billion (total € 30.2 billion).

At the date of reclassification the effective interest rate for the AfS assets was between 0.25 % and 34.4 %.

Since the date of reclassification, financial assets with a (reclassified) carrying amount of around € 3,8 billion became due.

In 2009 securities with a reclassified carrying amount of € 1.3 billion were sold due to the decided reduction of portfolios. Thereby a net loss of € –103 million was realised.

The reclassification of AfS assets did not cause a disclosure change of current interest income. Interest income is still shown under net income from financial investments.

The following tables summarise the carrying amounts and fair values as of 31 December 2009 as well as fair value gains and losses that would have been recognised in 2009 if the financial assets had not been reclassified.

Reclassifications 2009		into: Financial investment loans and receivables (LaR)		Effect in reporting period if no assets would have been reclassified (1.1.–31.12.2009)	
			31.12.2009		
	Date	Carrying amount in € billion	Fair value in € billion	Income statement in € million	AfS reserve (after taxes) in € million
out of:					
Financial investments available for sale (AfS)	1.7.2008	24.1	32.9	–35	381

Reclassifications 2008		into: Financial investment loans and receivables (LaR)		Effect in reporting period if no assets would have been reclassified (date of reclassification until 1.7.–31.12.2008)	
			31.12.2008		
	Date	Carrying amount in € billion	Fair value in € billion	Income statement in € million	AfS reserve (after taxes) in € million
out of:					
Financial investments available for sale (AfS)	1.7.2008	19.2	19.4	24	140

Securities listed on the stock exchange		31.12.2009		31.12.2008
in € million	listed	unlisted	listed	unlisted
Debt securities and other fixed-income securities	26,826	4,076	26,652	2,229
Equity securities and other variable-yield securities	–	3	–	1
Total	**26,826**	**4,079**	**26,652**	**2,230**

Development of financial investments in € million	2009 Participating interests	Companies valued using the equity method	Investment properties	2008 Participating interests	Companies valued using the equity method	Participating interests
Acquisition costs						
Balance at 1.1.	**16**	**–**	**–**	**–**	**–**	**28**
Changes in the group of consolidated companies	–	–	–	16	3	–
Changes from foreign currency translation	–	–	–	–	–3	–
Additions	–	–	–	–	–	–
Reclassifications	–	–	–	–	–	–
Disposals	–	–	–	–	–	–28
Transfer between consolidated group companies	–	–	–			
Balance at 31.12.	**16**	**–**	**–**	**16**	**–**	**–**
Changes in valuation not affecting income						
Balance at 1.1.	**–**	**–**	**–**	**–**	**–**	**–**
Changes in the group of consolidated companies	–	–	–	–	–	–
Changes from foreign currency translation	–	–	–	–	–	–
Changes in value	–	–	–	–	–	–
Reclassifications	–	–	–	–	–	–
Disposals	–	–	–	–	–	–
Transfer between consolidated group companies	–	–	–			
Balance at 31.12.	**–**	**–**	**–**	**–**	**–**	**–**
Cumulative change arising from accounting using the equity method		**–**			**–**	
Amortisation/depreciation and write-ups						
Balance at 1.1.	**–8**	**–**	**–**	**–**	**–**	**–2**
Changes in the group of consolidated companies	–	–	–	–5	–	–
Changes from foreign currency translation	–	–	–	–	–	–
Impairments	–1	–	–	–3	–	–
Reversals of premiums/discounts	–	–	–	–	–	–
Write-ups	–	–	–	–	–	–
Reclassifications	–	–	–	–	–	–
Disposals	–	–	–	–	–	2
Changes in fair value	–	–	–	–	–	–
Transfer between consolidated group companies	–	–	–			
Balance at 31.12.	**–9**	**–**	**–**	**–8**	**–**	**–**
Carrying amounts						
Balance at 31.12.	**7**	**–**	**–**	**8**	**–**	**–**

The Deutsche Pfandbriefbank Group cannot determine reliably a fair value for some shares in companies for which there is no market value available and which are not fully consolidated or are not accounted for using the equity method due to considerations of materiality. These companies in the legal form of limited or private are not traded in an active market. Therefore, the investments are stated at amortised cost. The carrying amount of these financial investments amounted to € 552 million as of 31 December 2009 (2008: € 646 million). In financial year 2009, financial investments, for which it is not possible for the fair value to be reliably established, were sold for € 53 million (2008: € 28 million). As in the previous year, this resulted in a profit of less than € 1 million.

After the complete take over of Quadra Realty Trust, Inc., New York in the first quarter 2008, Deutsche Pfandbriefbank Group does not have any holding in joint ventures or associated companies valued using equity method.

Breakdown of debt securities and other fixed-income securities in € million	31.12.2009	31.12.2008
Money market papers	–	–
Bonds and debt securities	30,902	28,881
By public issuers	14,409	9,437
By other issuers	16,493	19,444
Total	**30,902**	**28,881**

49 Property, plant and equipment

Breakdown in € million	31.12.2009	31.12.2008
Land and buildings used for operational purposes and buildings under construction	–	–
Plant and operating equipment	10	12
Total	**10**	**12**

Development of property, plant and equipment			2009	2008
in € million	Land and buildings used for operational purposes and buildings under construction	Plant and operating equipment	Total	Total
Acquisition/production costs				
Balance at 1.1.	**–**	**36**	**36**	**41**
Changes in the group of consolidated companies	–	15	15	24
Changes from foreign currency translation	–	–	–	–
Additions	–	3	3	8
Disposals	–	–22	–22	–37
Balance at 31.12.	**–**	**32**	**32**	**36**
Amortisation/depreciation and write-ups				
Balance at 1.1.	**–**	**24**	**24**	**11**
Changes in the group of consolidated companies	–	11	11	14
Changes from foreign currency translation	–	–	–	–
Scheduled amortisation/depreciation	–	5	5	2
Unscheduled amortisation/depreciation	–	–	–	–
Write-ups	–	–	–	–
Reclassifications	–	–	–	1
Disposals	–	–18	–18	–4
Balance at 31.12.	**–**	**22**	**22**	**24**
Carrying amounts				
Balance at 31.12.	**–**	**10**	**10**	**12**

50 Intangible assets

Breakdown in € million	31.12.2009	31.12.2008
Software acquired	23	23
Internally generated software	3	–
Advance payments	2	–
Total	**28**	**23**

Development of intangible assets in € million	Software acquired	Internally generated software	Advance payments
Acquisition/production costs			
Balance at 1.1.2009	**70**	**–**	**–**
Changes in the group of consolidated companies	10	–	–
Additions	3	3	5
Reclassifications	8	1	–3
Disposals	–5	–	–
Balance at 31.12.2009	**86**	**4**	**2**
Amortisation/depreciation and write-ups			
Balance at 1.1.2009	**47**	**–**	**–**
Changes in the group of consolidated companies	9	–	–
Scheduled amortisation/depreciation	10	1	–
Unscheduled amortisation/depreciation	–	–	–
Write-ups	–	–	–
Reclassifications	–	–	–
Disposals	–3	–	–
Balance at 31.12.2009	**63**	**1**	**–**
Carrying amounts			
Balance at 31.12.2009	**23**	**3**	**2**

51 Other assets

Other assets in € million	31.12.2009	31.12.2008
Positive fair values from derivative financial instruments	11,389	9,789
Hedging derivatives	11,389	9,789
Micro fair value hedge	2,884	175
Cash flow hedge	8,505	9,614
Salvage acquisitions	108	183
Other assets	285	157
Deferred charges and prepaid expenses	19	23
Capitalised excess cover of qualified insurance for pension provisions	–	52
Total	**11,801**	**10,204**

The salvage acquisitions initially recognised in 2009 are described in the note consolidation. The impairments on salvage acquisitions amounted to € 37 million in the financial year 2009 (2008: € 5 million) and the losses from sales to € 5 million (2008: € 0 million).

52 Income tax assets

Income tax assets in € million	31.12.2009	31.12.2008
Current tax assets	131	82
Deferred tax assets	4,234	4,341
Total	**4,365**	**4,423**

The «income tax assets» item contains both reimbursement claims from actual taxes as well as a considerable element of deferred tax claims. These are attributable to capitalised temporary tax claims in connection with tax losses carried forward as well as other temporary tax claims. A considerable proportion of deferred tax assets were credited pursuant to IAS 12.61 of AfS and cash flow hedge reserve, because the underlying assets were also posted under these items. The actual tax claims also include the capitalised claim for payment of the corporate income tax credit.

53 Subordinated assets

The following balance sheet items contain subordinated assets:

Subordinated assets in € million	31.12.2009	31.12.2008
Loans and advances to other banks	510	511
Loans and advances to customers	66	–
Financial investments	20	20
Total	**596**	**531**

54 Repurchase agreements

As a pledgor of genuine repurchase agreements, Deutsche Pfandbriefbank Group has pledged assets with a book value of € 1 billion (2008: € 4 billion). The securities are not derecognised. The considerations which have been received amount to € 0.1 billion (2008: € 0 billion) and are recognised under liabilities and thereof mainly come under liabilities to other banks. Assets in repurchase agreements are the only transferable assets the acquirer can sell or re-pledge in the absence of default according to IAS 39.37(a).

55 Securitisation

Synthetic securitisation Issuer	Transaction name	Maturity in years	Type of asset securitised	Total volume of lending in € million
Deutsche Pfandbriefbank AG	DUKE 2002	25	Commercial mortgage loans	114
Deutsche Pfandbriefbank AG	GECO 2002	52	Commercial mortgage loans	253
Deutsche Pfandbriefbank AG	Estate Germany 2007-1	56	Private/small commercial mortgage loans	1,019
Deutsche Pfandbriefbank AG	Estate UK-3	15	Commercial mortgage loans	512
Deutsche Pfandbriefbank AG	ESTATE Pan Europe 5	11	Commercial mortgage loans	1,315
Total				**3,213**

Securitisation involves the full or partial passing on to the capital market of lending risks for selected loan portfolios that have been precisely defined in advance. The prime aim of the bank's own securitisation programmes is to reduce the loan portfolio risk. In the traditional forms of securitisation, risk is transferred and the pressure on equity is reduced through the sale («true sale») of balance sheet assets. According to IFRS the securitised portfolio is not eliminated in the case of synthetic transactions. Synthetic transfer of credit risk is executed in two forms while usually it is a combination of both forms:

> Cash-funded transactions, where Deutsche Pfandbriefbank Group is entering into a credit default swap (CDS) (protection buyer) which is collateralised, and
> Unfunded transactions, where Deutsche Pfandbriefbank Group is entering into a CDS which is not collateralised.

Securitisation programmes usually provide for a small part of the risks being retained in the form of a first-loss piece or interest sub-participation on the part of the pledgor. For the programmes listed above, first-loss pieces amount to € 92 million. Thereof risks are held by interest sub-participations (€ 43 million) and purchase of own junior tranches (€ 32 million).

Due to changed regulatory regulations (Basle II) the reduction of risk-weighted assets is no longer possible for the majority of the above-mentioned securitisation programmes. Overall a reduction of risk-weighted assets according to Basle II of € 220 million was achieved with the transactions.

Notes to the Balance Sheet (Equity and Liabilities)

56 Liabilities to other banks

Liabilities to other banks by maturities in € million	**31.12.2009**	**31.12.2008**
Repayable on demand	895	1,795
With agreed maturities	66,730	54,669
Up to 3 months	57,608	41,533
From 3 months to 1 year	7,034	8,723
From 1 year to 5 years	1,158	3,496
From 5 years and over	930	917
Total	**67,625**	**56,464**

57 Liabilities to customers

Liabilities to customers by maturities in € million	**31.12.2009**	**31.12.2008**
Repayable on demand	53	575
With agreed maturities	12,325	13,410
Up to 3 months	205	1,911
From 3 months to 1 year	1,572	1,356
From 1 year to 5 years	3,809	2,986
From 5 years and over	6,739	7,157
Total	**12,378**	**13,985**

58 Liabilities evidenced by certificates

Liabilities evidenced by certificates, broken down by type of business in € million	**31.12.2009**	**31.12.2008**
Debt securities in issue	84,626	78,336
Mortgage bonds	11,569	12,488
Public sector bonds	40,254	15,971
Other debt securities	32,789	49,039
Money market securities	14	838
Registered notes in issue	24,567	17,125
Mortgage bonds	8,230	9,330
Public sector bonds	15,323	6,786
Other debt securities	1,014	1,009
Total	**109,193**	**95,461**

Liabilities evidenced by certificates, broken down by maturities in € million	31.12.2009	31.12.2008
With agreed maturities		
Up to 3 months	8,225	37,165
From 3 months to 1 year	39,141	12,046
From 1 year to 5 years	31,664	27,549
From 5 years and over	30,163	18,701
Total	**109,193**	**95,461**

59 Trading liabilities

Trading liabilities in € million	31.12.2009	31.12.2008
Negative fair values from derivative financial instruments	452	369
Other trading liabilities	2	–
Stand-alone derivatives (bankbook)	1,418	664
Total	**1,872**	**1,033**

60 Provisions

Breakdown in € million	31.12.2009	31.12.2008
Provisions for pension and similar obligations	5	–
Restructuring provisions	100	128
Provisions for contingent liabilities and other commitments	11	11
Other provisions	37	29
thereof: Long-term liabilities to employees	4	5
Total	**153**	**168**

Provisions for pensions and similar obligations include in-house employer's pension direct commitments for company pensions payable to executive bodies and employees of the Deutsche Pfandbriefbank Group.

For the vast majority of German employees of Deutsche Pfandbriefbank Group there are both existing defined benefit plans as well as defined contribution plans. In the defined contribution plans, Group companies make payments for commitments by industry-wide organisations, for instance in Germany the BVV and HVB benefit funds.

In the case of defined benefit plans, the employees receive a direct commitment from their respective company. Active employees received predominantly modern modular pension plans. Pension provisions are created for obligations arising from direct commitments. The pension plans have been principally closed.

The non-German Group entities only have defined contribution plans. For almost all international entities, a defined percentage of fixed salary is paid into externally managed pension funds for employees as a part of defined contribution pension schemes. Expenses in respect of contribution-based plans amounted to € 5 million, compared with € 2 million in the previous year.

Discount rates and valuation parameters in %	31.12.2009/ 1.1.2010	31.12.2008/ 1.1.2009
Discount rate	5.25	5.80
Expected return from plan assets	4.50	5.00
Rate of increase in pension obligations	2.00	2.25
Rate of increase in future compensation and vested rights	2.50	2.50
Rate of increase over career	0–1.50	0–1.50

As of 1 January 2005, Deutsche Pfandbriefbank AG took out reinsurance which is classified as a «qualifying insurance policy» under IAS 19 to protect itself against parts of the risks arising from the defined-benefit pension commitments. The expected return of the plan assets has been calculated by employing the long-term risk-free interest rate in accordance with the investment strategy of the plan assets.

The reinsurance is a plan asset in accordance with IAS 19. In accordance with IAS 19.54, the pension obligations have to be reduced by the extent of the plan assets. Accordingly, the funding is as follows:

Funding status in € million	31.12.2009	31.12.2008	31.12.2007	31.12.2006
Present value of partly funded pension claims vested	204	143	116	130
Fair value of plan assets	−198	−195	−156	−153
Funding status	**6**	**−52**	**−40**	**−23**
Outstanding actuarial profit (+)/loss (−)	−1	–	–	−17
Outstanding past service cost	–	–	–	–
Net of balance sheet value	**5**	**−52**	**−40**	**−40**

The 10% corridor of the higher amount originating from the present value of the pension claims vested and the fair value of plan assets was not exceeded as of 31 December 2009 and as of 31 December 2008. Movements in pension obligations are shown below:

Development of pension obligations in € million	2009	2008
Balance at 1.1.	**143**	**116**
Changes in the group of consolidated companies	63	31
Transfer of staff	1	–
Pensions claims vested	1	1
Interest expense	11	8
New arised actuarial profit (−)/loss (+)	−2	−5
Payments to beneficiaries	−13	−8
Balance at 31.12.	**204**	**143**

The experience-based adjustment of pension claims (profit [−]/loss [+]) amounts to −2% (2008: 0%; 2007: 1%) of the corresponding present value of pension claims vested as of 31 December 2009.

Pension expenses are broken down as follows:

Breakdown of pension expenses in € million	2009	2008
Present value of pension claims vested	1	1
Interest expense	11	8
Expected return from plan assets	−9	−10
Past service cost	–	–
Actuarial losses recognised as expense	–	–
Total	**3**	**−1**

Plan assets consist exclusively of reinsurance pledged to the plan beneficiaries. The plan assets accordingly do not contain any own financial instruments or any owner-operated property, plant and equipment which is used. Developments in plan assets are as follows:

Development of plan assets in € million	2009	2008
Balance at 1.1.	**195**	**156**
Changes in the group of consolidated companies	1	43
Transfer of staff	3	–
Expected return from plan assets	9	10
Outstanding actuarial profit (+)/loss (−)	−3	−6
Payments to beneficiaries	−7	−8
Balance at 31.12.	**198**	**195**

The actual return from the plan assets amounts to € 6 million (2008: € 4 million).

Development of provisions in € million	Restructuring provisions	Provisions for contingent liabilities and other commitments	Other provisions
Balance at 1.1.2009	**128**	**11**	**29**
Changes in the group of consolidated companies	9	–	13
Additions	13	4	6
Reversals	–26	–1	–3
Amounts used	–36	–3	–8
Intragroup transfers	12	–	–
Balance at 31.12.2009	**100**	**11**	**37**

On 19 December 2008 the Management Board and Supervisory Board of HRE decided upon the strategic realignment and restructuring of the Group. HRE and Deutsche Pfandbriefbank Group are adjusting their business model to sustainable changed conditions on capital markets and increasing challenges in the real estate business. The objective of the strategic realignment is to reposition HRE and Deutsche Pfandbriefbank Group as one of the leading specialist for real estate and public-sector finance in Germany and Europe, with a funding strategy focused on Pfandbrief issuance. The structural cost base shall be reduced, and the balance sheet structure and risk profile shall be enhanced. The Group plans to further simplify its corporate structure. The number of employees shall be further reduced. A restructuring provision amounting to € 120 million was created for obligations relating to the strategic realignment and restructuring in the fourth quarter 2008. In the business year 2009 € 29 million were used of this provision. This restructuring provision increased not affecting income in 2009 due to intragroup transfers (€ 9 million) and changes in the group of consolidated companies (€ 7 million). The provision will completely be utilised until the year 2013.

The provisions for contingent liabilities and other commitments mainly comprise provisions for guarantee risks, letters of credit, irrevocable loan commitments and litigation risks in the lending business.

The other provisions comprise provisions in connection with town planning agreements of € 9 million (2008: € 9 million) and provisions for long-term liabilities with regard to employees of € 4 million (2008: € 5 million).

Legal and Arbitration Proceedings Deutsche Pfandbriefbank AG is the defendant in judicial appraisal proceedings (Spruchverfahren) filed in connection with the merger of Bayerische Handelsbank AG, Nürnberger Hypothekenbank AG and Süddeutsche Bodencreditbank AG in 2001 which resulted in the formation of HVB Real Estate Bank AG.

In connection with the repurchase of Quadra Realty Trust Inc., a class action has been filed against Hypo Real Estate Capital Corporation (and other parties), a subsidiary of Deutsche Pfandbriefbank AG, in 2008. The claim was not quantified.

In May 2008, two customers filed a suit to a Rome court against the Milan branch of the Issuer for payment of a mid-eigth-figure sum in connection with the alleged failure by Hypo Real Estate Bank, Milan branch to pay out a loan.

In March 2009, a former broker of financings in France filed a lawsuit against Deutsche Pfandbriefbank AG to Stuttgart Regional Court (Landgericht) for payment of damages in an amount of at least € 20 million in connection with the suspension of the brokerage contract.

In May 2009, Glitnir Bank Luxembourg S.A. (in liquidation) filed a claim with a Swedish court against Deutsche Pfandbriefbank AG for payment of SEK 125 million (approx. € 12 million). Deutsche Pfandbriefbank AG had set-off payments due from Glitnir banki hf in Iceland against claims of Glitnir banki hf under a sub-participation agreement. Glitnir Bank Luxembourg S.A. alleges that the claims under the sub-participation agreement had been transferred to it whereas Deutsche Pfandbriefbank AG had not received a notice of assignment.

The decision of the Management Board not to pay any discretionary variable compensation for the year 2008 has since resulted in the institution or threat of labour court proceedings with several employees in Germany. The question as to whether bonus claims of employees exist for the year 2008 (and if so, to what extent), is a question of the basis of the claim, the contract interpretation and the application of the law of the general terms and conditions in each individual case. So far, two first instance judgements have been issued against the Bank with regard to the bonus for the year 2008 (Labour Court Munich) and already did so in one case. The reasons for the judgement have not yet been provided. The Company intends to appeal against this judgement. It is possible that further employees might be able to enforce bonus claims for 2008.

Bonus claims for the year 2009 have also already been enforced by employees, in certain cases by way of court proceedings. The Management Board has also taken the decision that no discretionary variable compensation will be paid for the year 2009. Also with regard to these bonuses, it is possible that further employees might enforce successfully bonus claims for 2009.

61 Other liabilities

Other liabilities in € million	31.12.2009	31.12.2008
Negative fair values from derivative financial instruments	13,087	10,736
Hedging derivatives	13,020	10,687
Micro fair value hedge	3,784	694
Cash flow hedge	9,236	9,993
Derivatives hedging dFVTPL financial instruments	67	49
Other liabilities	451	267
Deferred income	97	115
Total	**13,635**	**11,118**

Other liabilities mainly include liabilities from the offsetting of results and also accruals pursuant to IAS 37. Accrued liabilities in particular include trade accounts payable in respect of invoices still outstanding, short-term liabilities to employees and other accruals in respect of commission, interest, operating expenses, etc.

62 Income tax liabilities

Income tax liabilities in € million	31.12.2009	31.12.2008
Current tax liabilities	85	31
Deferred tax liabilities	3,648	3,545
Total	**3,733**	**3,576**

Income tax liabilities include both provisions and liabilities from current taxes as well as deferred tax liabilities. A significant proportion of deferred tax liabilities were netted against AfS or cash flow hedge reserves.

63 Subordinated capital

Breakdown in € million	31.12.2009	31.12.2008
Subordinated liabilities	3,626	1,826
Participating certificates outstanding	13	125
Hybrid capital instruments	256	286
Total	**3,895**	**2,237**

With all subordinated liabilities, there can be no early repayment obligation on the part of the issuer. In the event of bankruptcy or liquidation, such liabilities may only be repaid after all non-subordinate creditors have been satisfied.

Subordinated capital, broken down by maturities in € million	31.12.2009	31.12.2008
With agreed maturities		
Up to 3 months	32	163
From 3 months to 1 year	217	81
From 1 year to 5 years	1,353	1,084
From 5 years and over	2,293	909
Total	**3,895**	**2,237**

The devaluation of some instruments of subordinated capital led to an income of € 138 million in the year 2009 (2008: € 321 million).

Participating certificates outstanding Issued participatory capital comprises the following issues:

Participating certificates outstanding Issuer	Year of issue	Type	Nominal amount in € million	Interest rate in %	Maturity
Deutsche Pfandbriefbank AG	1989	Registered participation certificate	10	8.000	2014
Deutsche Pfandbriefbank AG	1998	Bearer participation certificate	38	variable interest rate	2009
Deutsche Pfandbriefbank AG	1999	Bearer participation certificate	70	7.000	2009
Deutsche Pfandbriefbank AG	1999	Registered participation certificate	5	6.000	2009
Deutsche Pfandbriefbank AG	1999	Registered participation certificate	1	6.000	2009
Deutsche Pfandbriefbank AG	2001	Registered participation certificate	21	7.100	2011
Deutsche Pfandbriefbank AG	2001	Registered participation certificate	5	7.130	2011
Deutsche Pfandbriefbank AG	2001	Bearer participation certificate	13	6.750	2010
Deutsche Pfandbriefbank AG	2001	Bearer participation certificate	50	7.000	2011
Deutsche Pfandbriefbank AG	2002	Bearer participation certificate	50	7.000	2012

The interest entitlement is reduced to the extent that a pay-out would result in the respective issuer recording an annual net loss or balance sheet loss for the year. Holders of participating certificates outstanding principally participate in any net loss or balance sheet loss for the year recorded by an issuer through a reduction in their repayment entitlements; this is based on the ratio between the repayment entitlements and the subscribed capital as shown in the balance sheet plus retained earnings and additional paid-in capital, participatory capital as well as profits and losses carried forward.

Balance profits for subsequent years must be increased to bring repayment entitlements back up to their nominal value. The participating certificates outstanding certify subordinated creditor rights; they do not guarantee any share in liquidation proceeds.

Hybrid capital instruments Hybrid capital instruments in particular include issues in the form of preferred securities placed by specifically established special-purpose entities. These instruments differ from conventional supplementary capital in that they are subject to more stringent conditions in terms of maturity. In addition, hybrid capital instruments are not repaid until after supplementary capital (subordinated liabilities and participating certificates outstanding) in the event of bankruptcy. In contrast to traditional components of core capital, the claim to a share of profit, which depends on the existence of profit, takes the form of a fixed or variable interest payment in the case of hybrid capital instruments. Moreover, hybrid capital can be issued both with unlimited maturity and repayable in the long term.

As a result of the merger between the former DEPFA Deutsche Pfandbriefbank AG and Hypo Real Estate Bank AG, the instruments of profit participation rights of the former DEPFA Deutsche Pfandbriefbank AG have become subordinated liabilities because the holders of the instruments were granted co-equal rights. These rights encompass modifications in relation to distribution and loss participation. The instruments were reclassified on the basis of these modifications as this reflects better the economic content of the contracts.

64 Equity

Subscribed capital equals the maximum liability of the shareholder for the liabilities of the corporation to its creditors. Additional paid-in capital includes premiums from the issue of shares and the contribution of SoFFin to reserves. It is only permissible to designate amounts to retained earnings where these are created from net income in the current or previous financial years. This includes legal reserves to be created from net income and other retained earnings.

The subscribed capital amounts to € 380,376,059.67 which is divided into 134,475,308 ordinary bearer shares representing a rounded interest of € 2.83 in the share capital as of 31 December 2009 and as of the whole year 2009. HRE Holding holds 100.00% of the share capital of the bank. The SoFFin is the only shareholder of HRE Holding.

In the fourth quarter 2009 the SoFFin provided Deutsche Pfandbriefbank AG with a silent participation of € 1.0 billion. The silent participation participates in the cumulative loss calculated in accordance with the regulations of commercial law to the same extent that the silent participation is related to the total carrying amount of all liable capital shares which participate in the cumulative loss. The total loss of the silent partner in relation to the cumulative loss under commercial law is limited to its silent contribution. The cumulative loss which is attributable to the year 2008 is not used for calculating the loss participation. At the end of the year, the silent contribution was reduced by € 397 million to € 603 million in the commercial law financial statements of Deutsche Pfandbriefbank AG. Deutsche Pfandbriefbank AG has a replenishment obligation.

65 Foreign-currency assets and liabilities

Foreign-currency assets and liabilities in € million	31.12.2009	31.12.2008
Foreign-currency assets	36,722	44,694
thereof: US$	20,779	30,098
JP¥	3,536	4,184
CHF	2,670	1,269
SEK	2,123	2,061
HK$	6	47
GB£	6,310	5,443
Others	1,298	1,592
Foreign-currency liabilities (excluding equity)	36,146	44,327
thereof: US$	20,434	30,155
JP¥	3,429	3,871
CHF	2,651	1,262
SEK	1,963	2,008
HK$	–	52
GB£	6,364	5,452
Others	1,305	1,527

66 Trust business

The following tables show the volume of fiduciary business not shown in the consolidated balance sheet.

Trust assets in € million	31.12.2009	31.12.2008
Loans and advances to customers	25	24
Total	**25**	**24**

Trust liabilities in € million	31.12.2009	31.12.2008
Deposits from other banks	20	19
Amounts owed to other depositors	5	5
Total	**25**	**24**

Notes to the Cash Flow Statement

67 Notes to the items in the cash flow statement

The cash flow statement shows the cash flows of the financial year broken down into cash flows attributable to operating activities, investing activities and financing activities. Cash and cash equivalents correspond to the balance sheet item «cash reserve», and include cash in hand and credit balances at central banks.

Operating activities are defined broadly, and correspond to operating result. Cash flow from operating activities includes payments (inflows and outflows) attributable to loans and advances to other banks and customers as well as securities attributable to trading assets and other assets. Inflows and outflows attributable to liabilities to other banks and customers, liabilities evidenced by certificates and other liabilities are also included under operating activities. The interest and dividend payments resulting from operating activities are shown under cash flow from operating activities.

Cash flow from investing activities comprises payments for investment and security holdings as well as for property, plant and equipment.

Cash flow from financing activities comprises inflows from capital increases, payments into reserves and silent participations as well as inflows and outflows for subordinated capital.

In 2009, no subsidiaries were sold. pbb Services GmbH was purchased from HRE Holding.

Notes to the Financial Instruments

68 Derivative transactions

The following tables present the respective nominal amounts and fair values of OTC derivatives and derivatives traded on a stock exchange.

In order to minimise (reduce) both the economic and the regulatory credit risk arising from these instruments, master agreements (bilateral netting agreements) have been concluded. By means of such netting agreements, the positive and negative fair values of the derivatives contracts included under the master agreement can be offset against one another, and the future regulatory risk add-ons for these products can be reduced. Through this netting process, the credit risk is limited to a single net claim on the party to the contract (close-out netting).

For both regulatory reports and the internal measurement and monitoring of the credit commitments, such risk-reducing techniques are utilised only if they are considered to be enforceable under the respective legal system in the event that the business associate becomes insolvent. Legal advice was taken in order to check enforceability.

Similar to the master agreements, the Deutsche Pfandbriefbank Group concludes collateral agreements with its business associates to collateralise the net claim or liability remaining after netting (obtained or pledged collateral). As a rule, this collateral management reduces credit risk by means of prompt measurement and adjustment exposure to customers.

Volume of derivatives at 31.12.2009				Nominal amount		Fair value
	Remaining maturities					
in € million	Less than 1 year	1 to 5 years	More than 5 years	**Total**	positive	negative
Interest-based transactions						
OTC products	57,860	143,189	132,625	333,674	12,251	14,032
Forward rate agreements	1,000	–	–	1,000	–	–
Interest rate swaps	53,364	136,412	131,837	321,613	12,185	13,901
Interest rate options	3,496	6,777	778	11,051	66	129
Call options	1,610	3,426	146	5,182	53	13
Put options	1,886	3,351	632	5,869	13	116
Other interest rate contracts	–	–	10	10	–	2
Total	**57,860**	**143,189**	**132,625**	**333,674**	**12,251**	**14,032**
Foreign-currency-based transactions						
OTC products	19,644	7,453	2,398	29,495	573	520
Spot and forward currency transactions	17,133	136	–	17,269	45	326
Interest rate/currency swaps	2,511	7,317	2,398	12,226	528	194
Total	**19,644**	**7,453**	**2,398**	**29,495**	**573**	**520**
Other transactions						
OTC products	–	55	488	543	–	405
Credit derivatives	–	55	488	543	–	405
Total	**–**	**55**	**488**	**543**	**–**	**405**
Total	**77,504**	**150,697**	**135,511**	**363,712**	**12,824**	**14,957**

Use made of derivative transactions at 31.12.2009			Fair value
in € million	Nominal amount	positive	negative
Interest-based transactions			
Fair value hedge accounting	75,485	2,879	3,764
Cash flow hedge accounting	238,549	7,938	8,795
Derivatives hedging dFVTPL Fis	876	–	67
Stand-alone derivatives	18,764	1,434	1,406
Total	**333,674**	**12,251**	**14,032**
Foreign-currency-based transactions			
Fair value hedge accounting	528	5	20
Cash flow hedge accounting	26,132	567	441
Stand-alone derivatives	2,835	1	59
Total	**29,495**	**573**	**520**
Other transactions			
Stand-alone derivatives	543	–	405
Total	**543**	**–**	**405**
Total	**363,712**	**12,824**	**14,957**

Volume of derivatives at 31.12.2008	Nominal amount				Fair value	
	Remaining maturities					
in € million	Less than 1 year	1 to 5 years	More than 5 years	**Total**	positive	negative
Interest-based transactions						
OTC products	131,275	129,829	116,670	377,774	8,473	10,151
Forward rate agreements	–	–	–	–	–	–
Interest rate swaps	122,080	121,494	114,358	357,932	8,293	9,017
Interest rate options	9,195	8,335	2,312	19,842	180	1,134
Call options	3,593	2,963	728	7,284	180	–
Put options	5,602	5,372	1,584	12,558	–	1,134
Total	**131,275**	**129,829**	**116,670**	**377,774**	**8,473**	**10,151**
Foreign-currency-based transactions						
OTC products	20,432	2,063	1,514	24,009	1,447	644
Spot and forward currency transactions	15,346	92	48	15,486	538	43
Interest rate/currency swaps	5,086	1,971	1,466	8,523	909	601
Total	**20,432**	**2,063**	**1,514**	**24,009**	**1,447**	**644**
Other transactions						
OTC products	119	139	1,225	1,483	–	974
Credit derivatives	119	139	1,225	1,483	–	974
Total	**119**	**139**	**1,225**	**1,483**	**–**	**974**
Total	**151,826**	**132,031**	**119,409**	**403,266**	**9,920**	**11,769**

Use made of derivative transactions at 31.12.2008		Fair value	
in € million	Nominal amount	positive	negative
Interest-based transactions			
Fair value hedge accounting	11,526	175	694
Cash flow hedge accounting	359,958	8,168	9,349
Derivatives hedging dFVTPL Fis	1,000	–	49
Stand-alone derivatives	5,290	130	59
Total	**377,774**	**8,473**	**10,151**
Foreign-currency-based transactions			
Cash flow hedge accounting	24,009	1,447	644
Total	**24,009**	**1,447**	**644**
Other transactions			
Stand-alone derivatives	1,483	–	974
Total	**1,483**	**–**	**974**
Total	**403,266**	**9,920**	**11,769**

Counterparties in € million	31.12.2009 Fair value positive	negative	31.12.2008 Fair value positive	negative
OECD banks	11,314	14,228	8,904	10,712
OECD financial institutions	217	318	–	–
Other companies and private individuals	1,293	411	1,016	1,057
Total	**12,824**	**14,957**	**9,920**	**11,769**

Fair values appear as sum of positive and negative amounts per contract, from which no pledged collateral has been deducted and no netting agreements have been taken into consideration. By definition, no positive fair values exist for put options.

69 Cash flow hedge accounting

The cash flows of the hedged items shown in cash flow hedge accounting are expected to occur in the following periods:

Cash flow hedge: Periods of hedged items when cash flows are expected to occur in € million	31.12.2009	31.12.2008
Up to 1 month	12	67
From 1 month to 3 months	5	154
From 3 months to 1 year	117	431
From 1 year to 2 years	130	317
From 2 years to 5 years	656	833
From 5 years and over	1,838	1,643
Total	**2,758**	**3,445**

It is expected that the cash flows will affect the income statement in the period of occurrence.

The development of the cash flow hedge reserve is shown in the statement of changes in equity.

70 Undiscounted cash flows of financial liabilities

The contractual undiscounted cash flows from derivative and non-derivative financial instruments of the financial liabilities according to IFRS 7.39 are split up into the following remaining maturities:

Contractual undiscounted cash flows of the financial liabilities according to IFRS 7.39 in € billion	31.12.2009	31.12.2008
Up to 3 months	75	84
From derivative financial instruments	4	1
From non-derivative financial instruments	71	83
From 3 months to 1 year	65	25
From derivative financial instruments	10	1
From non-derivative financial instruments	55	24
From 1 year to 5 years	56	48
From derivative financial instruments	11	5
From non-derivative financial instruments	45	43
From 5 years and over	55	36
From derivative financial instruments	3	8
From non-derivative financial instruments	52	28

In conformity with the requirements, the contractual undiscounted cash flow maturities are presented in accordance with the worst-case scenario, meaning that if there are options or terminations rights involved the most unfavourable case from a liquidity perspective is assumed. This presentation does not reflect the economic management which is based on expected cash flows. The liquidity risk strategy and management of Deutsche Pfandbriefbank Group is described in the Risk Report.

71 Assets assigned or pledged as collateral for own liabilities

The following assets were assigned or pledged as collateral:

Own liabilities in € million	31.12.2009	31.12.2008
Liabilities to other banks	56,906	50,939
Liabilities evidenced by certificates	–	30,098
Total	**56,906**	**81,037**

The following assets were pledged as collateral for the above liabilities:

Assets pledged in € million	31.12.2009	31.12.2008
Loans and advances to other banks	214	–
Loans and advances to customers	5,476	31,542
Financial investments	5,842	11,708
Total	**11,532**	**43,250**

Within the framework of the liquidity support from a syndicate from the German finance sector and the Bundesbank with the participation of the German Federal Government as well as from the financial market stabilisation fund, HRE Holding as well as its major subsidiaries have transferred or assigned almost all of their freely available assets as collateral to the security trustee of the lenders. Within the scope of the restructuring of the liquidity support the collaterals will be widely released until 31 March 2010. The pledging of the shares in Deutsche Pfandbriefbank AG and DEPFA Bank plc as well as the pledging of the shares in subsidiaries of DEPFA Bank plc have not been released.

The remaining assets pledged mainly resulted from repurchase agreements. The transactions were carried out at the normal standard terms for repurchase transactions.

72 Collaterals permitted to resell or repledge

There were no collaterals that may be resold or repledged in the absence of default as of 31 December 2009 and as of 31 December 2008.

73 Fair values of financial instruments

The recognised fair values of financial instruments according to IFRS 7 correspond to the amounts at which, in the opinion of the Deutsche Pfandbriefbank Group, an asset could be exchanged on the balance sheet date between willing, competent business partners or the amount at which a liability could be settled between such business partners. The fair values were determined as of the balance sheet date based on the market information available and on valuation methods described in note «Financial instruments».

As per the amendment to IFRS 7 «Financial Instruments: Disclosures» issued in March 2009 all financial assets and liabilities of Deutsche Pfandbriefbank Group that are measured at fair value should be grouped into the fair value hierarchies. The three-level hierarchy is based on the degree to which the input for the fair value measurement is observable.

- Level 1 – quoted priced (unadjusted) in active markets for identical financial assets or financial liabilities
- Level 2 – inputs that are observable either directly or indirectly, other than quoted prices included within Level 1
- Level 3 – valuation techniques that include inputs that are not based on observable market data (unobservable inputs)

The following table shows financial assets and financial liabilities measured at fair value grouped into the fair value hierarchy:

Fair value hierarchy at 31.12.2009				
in € million	**Total**	Level 1	Level 2	Level 3
Assets				
Financial assets at fair value through P&L	5,244	871	4,346	27
Trading assets	1,435	–	1,426	9
dFVTPL financial investments	925	871	54	–
Hedging derivatives	2,884	–	2,866	18
Financial assets at fair value not affecting P&L	11,307	2,792	8,467	48
AfS financial investments[1)]	2,802	2,792	10	–
Cash flow hedge derivates	8,505	–	8,457	48
Total	**16,551**	**3,663**	**12,813**	**75**
Liabilities				
Financial liabilities at fair value through P&L	5,723	–	5,480	243
Trading liabilities	1,872	–	1,636	236
Hedging derivatives	3,784	–	3,777	7
Derivatives hedging dFVTPL financial instruments	67	–	67	–
Financial liabilities at fair value not affecting P&L	9,236	–	9,218	18
Cash flow hedge derivates	9,236	–	9,218	18
Total	**14,959**	**–**	**14,698**	**261**

1) Excluding participating interests and shares in non-consolidated subsidiaries

During the current year, due to changes in market conditions for certain financial instruments, quoted prices in active market were no longer available for these instruments. However, there was sufficient information available to measure fair values of these instruments based on observable market inputs. Hence, these financial assets with a fair value of € 63 million, were transferred from Level 1 to Level 2 of the fair value hierarchy.

There have been no transfers from Level 2 to Level 1 in the reporting period.

The following table presents the changes in Level 3 instruments for the business year ended 31 December 2009:

Changes in Level 3 financial assets	Financial assets at fair value through P&L		Financial assets at fair value not affecting P&L	
in € million	Trading assets	Hedging derivatives	Cash flow hedge derivatives	**Total**
Balance at 1.1.2009	**5**	**12**	**34**	**51**
Comprehensive income				
Income statement	4	15	–	19
AfS reserve	–	–	14	14
Purchases	–	–	–	–
Sales	–	–	–	–
Issues	–	–	–	–
Settlements	–	–9	–	–9
Transfers into Level 3	–	–	–	–
Transfers out of Level 3	–	–	–	–
Balance at 31.12.2009	**9**	**18**	**48**	**75**

Changes in Level 3 financial liabilities	Financial liabilities at fair value through P&L		Financial liabilities at fair value not affecting P&L	
in € million	Trading liabilities	Hedging derivatives	Cash flow hedge derivatives	**Total**
Balance at 1.1.2009	**–610**	**–35**	**–15**	**–660**
Comprehensive income				
Income statement	–14	28	–	14
AfS reserve	–	–	–3	–3
Purchases	–2	–	–	–2
Sales	–	–	–	–
Issues	–	–	–	–
Settlements	390	–	–	390
Transfers into Level 3	–	–	–	–
Transfers out of Level 3	–	–	–	–
Balance at 31.12.2009	**–236**	**–7**	**–18**	**–261**

In 2009, the Deutsche Pfandbriefbank Group transferred no financial instruments into or from Level 3.

Of the total gains or losses for the period recognised in income statement € 33 million relates to financial assets and financial liabilities dFVTPL held at the balance sheet date. Fair value gains or losses on financial assets dFVTPL (thereof € 4 million trading assets and € 15 million hedging derivatives) are included in «net trading income» (€ 4 million) and «net income from hedge relationships» (€ 15 million). Fair value gains or losses on financial liabilities dFVTPL (thereof € –14 million trading assets and € 28 million hedging derivatives) are included in «net trading income» (€ –14 million) and «net income from hedge relationships» (€ 28 million).

All gains or losses recognised directly in equity (€ 11 million) relate to financial investments held at the balance sheet date and are reported as changes of «cash flow hedge reserve».

Although Deutsche Pfandbriefbank Group believes that its estimates of fair value are appropriate, using reasonably possible alternative input factors significantly changes the fair value. The following table shows the fair value sensitivity of Level 3 measurements to reasonably possible alternative assumptions:

Sensitivities of Level 3 instruments in € million	Favourable changes	Unfavourable changes
Assets		
Financial assets fair value through P&L		
Hedging derivatives	5.3	–5.1
Total	**5.3**	**–5.1**
Liabilities		
Financial liabilities at fair value through P&L		
Hedging derivatives	0.3	–0.4
Total	**0.3**	**–0.4**

The above favourable and unfavourable changes are calculated independently from each other. No alternative fair values were determined for derivatives used in cash flow hedge accounting, as these derivatives hedges interest rate risks (future variable interest payments are swapped for fixed payments).

Offsetting effects due to compensating derivatives and hedge relationships attenuate both, favourable and unfavourable changes.

The methods and valuation techniques used for the purpose of measuring fair value are unchanged compared to the previous reporting period. In the following the valuation methods on the level of product classes are described in detail:

The fair values of certain financial instruments reported at nominal values are almost identical to their carrying amounts. These include for example cash reserve, receivables and liabilities without fixed interest rates or maturity respectively mature in the short-term. Differences between the carrying amount and the fair value of these financial instruments are not material.

Quoted market prices are applied for market securities and derivatives as well as for quoted debt instruments. The fair value of the original debt instruments for which no active market price is available is determined as the present value for future expected cash flows on the basis of related benchmark interest curves and credit spreads.

The fair value of interest and currency interest swap agreements and also interest rate futures are determined on the basis of discounted future expected cash flows. The market interest rates applicable for the remaining maturity of the financial instruments are used for the purpose of the calculation. The fair value of forward exchange transactions is determined on the basis of current forward rates. Options are valued using exchange rate quotations or recognised models for determining option prices. For simple European options, the current Black-Scholes models (currency and index instruments) or lognormal models (interest instruments) are used as the valuation models. In the case of more exotic instruments, the interest rates are simulated via one and multidimensional term structure models with use of the current interest rate structure as well as caps or swaption volatilities as parameters relevant for valuation purposes. One and multifactor models are used for interest-currency products.

Widely accepted standard models are used for credit derivatives, e.g. credit default swaps. Credit risk is considered when valuing credit derivatives, interest rate derivatives and currency derivatives.

Gaussian copula models which are usual in the market and appropriate adjustments thereof are used for determining fair values for structured credit products. In parallel the expected loss of the respected papers was calculated on the basis of the underlyings and the subordination. A detailed separate credit analysis was performed for the tranches being held in case of significant expected losses. Counterparty risk adjustments are taken into account for the measurement of customer derivatives.

Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost according to IAS 39.46. Deutsche Pfandbriefbank Group is able to reliably establish the fair value for all other financial instruments.

Fair values of financial instruments	31.12.2009		31.12.2008	
in € million	Carrying amounts	Fair value	Carrying amounts	Fair value
Assets	**210,814**	**208,649**	**180,038**	**178,706**
Cash reserve	618	618	546	546
Trading assets (HfT)	1,435	1,435	131	131
Loans and advances to other banks[1]	78,121	77,891	72,041	72,138
Category LaR	78,121	77,891	72,041	72,138
Loans and advances to customers[1]	87,925	87,323	68,182	67,780
Category LaR	87,925	87,323	68,182	67,780
Financial investments[2]	30,914	29,581	28,934	27,907
Category AfS	2,811	2,811	2,822	2,822
Category dFVTPL	925	925	1,037	1,037
Category LaR	27,178	25,845	25,075	24,048
Other assets	11,801	11,801	10,204	10,204
thereof: Hedging derivatives	11,389	11,389	9,789	9,789
Liabilities	**208,598**	**207,742**	**180,298**	**177,067**
Liabilities to other banks	67,625	67,654	56,464	56,091
Liabilities to customers	12,378	12,248	13,985	12,064
Liabilities evidenced by certificates	109,193	108,518	95,461	95,345
Trading liabilities (HfT)	1,872	1,872	1,033	1,033
Other liabilities	13,635	13,635	11,118	11,118
thereof: Hedging derivatives	13,020	13,020	10,687	10,687
Derivatives hedging dFVTPL financial instruments	67	67	49	49
Subordinated capital	3,895	3,815	2,237	1,416
Other items	**3,338**	**3,156**	**7,087**	**6,720**
Contingent liabilities	689	689	1,855	1,855
Irrevocable loan commitments	2,649	2,467	5,232	4,865

[1] Reduced by allowances for losses on loans and advances
[2] Excluding investment properties and companies valued using the equity method

The carrying amounts reflect the maximum on balance sheet exposure to credit risk of the assets and the maximum amount the entity could have to pay of the other items according to IFRS 7.

Asset and liabilities according to measurement categories and classes in € million	31.12.2009	31.12.2008
Assets		
Loans-and-receivables (LaR)	193,224	165,298
Held-to-maturity (HtM)	–	–
Available-for-sale (AfS)	2,811	2,822
Held-for-trading (HfT)	1,435	131
dFVTPL-assets (dFVTPL)	925	1,037
Cash reserve	618	546
Positive fair values from hedging derivatives	11,389	9,789
Liabilities		
Held-for-trading (HfT)	1,872	1,033
Financial liabilities at amortised cost	193,238	168,360
Negative fair values from hedging derivatives	13,087	10,736

74 Past due but not impaired assets

At 31 December 2009, the following amounts were noted by the Group as being past due. However, no individual impairment provision was made against these assets respectively the collaterals underlying these assets as Deutsche Pfandbriefbank Group does not consider that there is any issue regarding their recoverability. Such timing issues in receipts of payments due occur regularly (up to 3 months) in the normal course of business and do not, by themselves, impair the quality of the asset. The total investment in relation to the past due amounts have also been disclosed to put the size of the amounts in question into context.

LaR assets

LaR assets: past due but not impaired (total investments) in € million	31.12.2009	31.12.2008
Up to 3 months	761	443
From 3 months to 6 months	288	252
From 6 months to 1 year	205	53
From 1 year and over	222	80
Total	**1,476**	**828**

Carrying amounts LaR assets in € billion	31.12.2009	31.12.2008
Carrying amount of LaR assets that are neither impaired nor past due	192.1	165.1
Carrying amount of LaR assets that are past due but not impaired (total investment)	1.5	0.8
Carrying amount of individually assessed impaired LaR assets (net)	2.4	0.8
Balance of portfolio-based allowances	0.6	0.4
Total	**196.6**	**167.1**
thereof:		
Loans and advances to other banks (including investments)	78.2	72.1
Loans and advances to customers (including investments)	91.2	69.9
Financial investments (gross)	27.2	25.1

The carrying amount of assets that would otherwise be past due or impaired and whose terms have been renegotiated amounts to € 0 million (2008: € 0 million).

The fair value of collaterals for the impaired financial assets amounts to approx. € 2.0 billion (2008: € 1.2 billion). The collaterals mainly consist of lands charges.

AfS assets As of 31 December 2009 and as of 31 December 2008 Deutsche Pfandbriefbank Group has neither past due and not impaired nor impaired AfS financial investments in the portfolio.

Other Notes

75 Contingent liabilities and other commitments

Contingent liabilities and other commitments in € million	31.12.2009	31.12.2008
Contingent liabilities	**689**	**1,855**
Guarantees and indemnity agreements	689	1,855
Loan guarantees	39	47
Performance guarantees and indemnities	650	1,808
Other commitments	**2,691**	**5,289**
Irrevocable loan commitments	2,649	5,232
Book credits	558	846
Guarantees	60	64
Mortgage and public sector loans	2,031	4,322
Other commitments	42	57
Total	**3,380**	**7,144**

The former Hypo Real Estate Bank International AG, a predecessor institute of Deutsche Pfandbriefbank AG, has overtaken with the announcement as of 2 January 2008 irrevocable and unconditional guarantees to fulfil all liabilities of Hypo Public Finance Bank, Dublin. By the fact that all shares of Hypo Public Finanance Bank, Dublin were sold, the commitment was limited according the guarantee contract to all liabilities, which existed until the date of sale.

As of 3 July 2008, the former Hypo Real Estate Bank International AG guaranteed DEPFA Bank plc the loss of AAA rated CMBS with an amount up to US $ 0.9 billion. This guarantee was assigned by DEPFA Bank plc to its subsidiary Hypo Public Finance Bank. The guarantee is constituted in a contingency, which arose at year end in accordance with the sale of Hypo Public Finance Bank puc to DEPFA Bank plc.

Deutsche Pfandbriefbank AG obligated itself to Hypo Real Estate Bank International LLC I, and to Hypo Real Estate Capital Hongkong Corporation Limited, Hong Kong, to support these companies in such a way that the companies are in a position to satisfy their financial obligations.

The Deutsche Pfandbriefbank Group is a lessor within the framework of operating lease agreements. Non-terminable operating lease agreements for land and buildings as well as for operating and business equipment existed as of 31 December 2009. The minimum obligations arising from non-terminable leasing arrangements will result in costs of € 12 million in 2010, € 41 million in total in the years 2011 to 2014 and € 53 million in total for 2015 and beyond. In the previous year the non-terminable operating lease agreements were as follows: for financial year 2009: € 3 million, in financial years 2010 to 2013 € 8 million in total and for 2014 and beyond € 2 million in total.

For Deutsche Pfandbriefbank Group irrevocable loan commitments form the largest part of other commitments. Irrevocable loan commitments comprise all commitments of a creditor which can grant a loan and advance at a later date and which can cause a credit risk. These are mainly credit commitments which are not fully drawn by the customer.

76 Key regulatory capital ratios (based on German Commercial Code)

Deutsche Pfandbriefbank AG is according the «Waiver Rule» regulated in section 2a KWG not obliged to determine the equity capital ratio and the core capital ratio on a sub-group level.

HRE is obliged to assure a minimum own funds ratio of 8% according to section 3 SolvV in connection with sector 2 (2) and (3) SolvV. In the financial year 2009 the fulfilment of this minimum ratio was not met in the period from 24 April 2009 (date of the approval of the financial statements 2008) to 7 June 2009. The relevant regulators BaFin and Deutsche Bundesbank were informed about that in time as obligatory according to section 7 SolvV. Due to the steps to recapitalise HRE which were already under way the regulators did not impose a sanction for the relevant period of time. The own funds ratio has not fallen below 8% since the capital increase approved on 2 June 2009 was registered in the commercial register on 8 June 2009.

77 Group auditors' fee

Group auditors' fee in € thousand	31.12.2009	31.12.2008
Audits	3,732	2,417
Other affirmation	148	587
Tax consultancy	116	89
Other services	1,248	–
Total	**5,244**	**3,093**

78 Relationship with related parties

According to IAS 24 (Related-Party Disclosures), a party is related to an entity if, directly, or indirectly through one or more intermediaries, the party controls or is controlled by the reporting entity, has an interest in the entity that gives it significant influence over the entity or has joint control over the entity as well as associates and joint ventures.

In addition to the subsidiaries included in the consolidated financial statements, Deutsche Pfandbriefbank AG also directly or indirectly maintains relations with non-consolidated subsidiaries and other related entities in the course of exercising its normal business operations. Transactions with related parties are carried out on an arm's length basis, until the application of section 7 (d) FMStBG, by considering the specifics of section 311 ff AktG (German Stock Corporation Act).

As of 31 December 2009 Deutsche Pfandbriefbank AG had liabilities netted by loans to its parent company HRE Holding of € 0.4 billion (31 December 2008: loans netted by liabilities € 3.2 billion). Deutsche Pfandbriefbank AG had loans to its sister company DEPFA Bank plc loans netted by liabilities of € 62.7 billion (31 December 2008: € 58.8 billion), thereof € 0.7 billion subordinated liabilities netted with subordinated loans (31 December 2008: subordinated loans netted with subordinated liabilites € 0.5 billion). These loans mainly resulted from the liquidity supports passed to the sister companies. In addition, there were contingent liabilities of Deutsche Pfandbriefbank AG to sister companies which are described in the note contingent liabilities and other commitments in the consolidated financial statements.

Loans and advances to non-consolidated subsidiaries amounted to € 16 million as of 31 December 2009 (31 December 2008: € 18 million) whereas liabilities to non-consolidated subsidiaries amounted to € 4 million (31 December 2008: € 1.7 billion).

In the financial year 2009 Deutsche Pfandbriefbank Group had a net interest income of € 944 million (2008: € 482 million) and a net commission income of € 586 million (2008: € 83 million) to DEPFA Bank plc and its subsidiaries. These net incomes mainly resulted from the liquidity supports passed to the sister companies. There was a net interest income of € 43 million (2008: € 0 million) to HRE Holding.

As a result of HRE Holding and hence of Deutsche Pfandbriefbank AG being controlled by the SoFFin, a special estate of the German Federal according to § 2 section 2 FMStFG, Deutsche Pfandbriefbank AG is a state-controlled entity and a related party with other enterprises which are subject to the control, joint control or significant influence of the Federal Republic of Germany (so-called government-related entities). Business relations with public sector entities are carried out on an arm's length basis. The support measures of the SoFFin are described in detail in the management report.

Apart from the above there have been no other material relationships with related companies.

Remuneration paid to persons with key function in the Group (Senior Management)[1]			2009	2008
in € thousand	Remuneration	Severance payments	Total	Total
Total	5,648	2,441	**8,089**	**4,662**

[1] Members of the Management Board of HRE Holding, its subsidiaries as well as managing directors of pbb Services GmbH and the staffs of the second management level of the group.

Pension obligations to persons with key function in the Group (Senior Management)		
in € thousand	31.12.2009	31.12.2008
Total[1]	**67,343**	**47,933**

[1] Thereof € 60,519 thousand (2008: € 41,798 thousand) for pensioners and surviving dependants

The overall Management Board remuneration in the reporting period amounted to € 1,476 thousand (2008: € 1,562 thousand) and consisted of fixed remuneration of € 149 thousand (2008: € 1,562 thousand) and severance payments of € 1,327 (2008: € 0 thousand).

The overall remuneration paid to former members of the Management Board and their surviving dependants for the year 2009 amounted to € 3,783 thousand (2008: € 3,616 thousand).

The Supervisory Board remuneration for the reporting period amounted to € 76 thousand (2008: € 24 thousand). This figure was composed exclusively of fixed remuneration.

79 Employees

Average number of employees	2009	2008
Employees (excluding apprentices)	858	843
Apprentices	6	8
Total	**864**	**851**

80 Members of the Supervisory Board and of the Management Board

Supervisory Board

Dr. Bernd Thiemann
Kronberg, Self-employed management consultant
(Chairman of the Supervisory Board since 14 August 2009)

Dagmar Kollmann
Bad Homburg, Chairperson of the Partners Committee of Kollmann GmbH
(Deputy Chairperson of the Supervisory Board since 14 August 2009)

Ursula Bestler
Munich, Bank employee

Dr. Günther Bräunig
Frankfurt, Member of the Management Board of KfW
(Member of the Supervisory Board since 14 August 2009)

Georg Kordick
Poing, Bank employee

Dr. Hedda von Wedel
Andernach, President of the Bundesrechnungshof (retired)
(Member of the Supervisory Board since 14 August 2009)

Dr. Michael Endres
Koenigstein, Chairman of the Management Board of the Charitable Hertie Foundation, Frankfurt/Main
(Chairman of the Supervisory Board to 13 August 2009)

Bernd Knobloch
Frankfurt, Member of the Management Board of Charitable Hertie Foundation, Frankfurt/Main
(Member of the Supervisory Board to 13 August 2009)

Dr. h.c. Edgar Meister
Kronberg, Member of the Supervisory Board of Commerzbank AG, Frankfurt/Main
(Member of the Supervisory Board to 18 May 2009)

Hans-Jörg Vetter
Koenigstein, Chairman of the Management Board of Landesbank Baden-Württemberg, Stuttgart
(Member of the Supervisory Board to 13 August 2009)

Manfred Zaß
Koenigstein, Chairman of the Supervisory Board of Deutsche Euroshop AG, Hamburg
(Member of the Supervisory Board from 19 May 2009 to 13 August 2009)

Management Board

Dr. Axel Wieandt
Koenigstein
(Chairman of the Management Board)

Manuela Better
Munich
(Member of the Management Board since 1 February 2009)

Dr. Kai Wilhelm Franzmeyer
Bad Homburg

Frank Krings
Hofheim

Dr. Bernhard Scholz
Regensburg
(Member of the Management Board since 1 January 2010)

Alexander Freiherr von Uslar-Gleichen
Gruenwald
(Member of the Management Board since 1 October 2009)

Charles Balch
Cranbrook/Great Britain
(Member of the Management Board to 15 January 2009)

Dr. Robert Grassinger
Neufarn
(Member of the Management Board to 31 March 2009)

Reinhold Güntner
Kirchheim
(Member of the Management Board to 31 January 2009)

Frank Hellwig
Starnberg
(Member of the Management Board to 15 January 2009)

81 Holdings of Deutsche Pfandbriefbank AG

Holdings of Deutsche Pfandbriefbank AG as of 31.12.2009 Name and place of business	Interest in % Total Sec 16 (4) Stock Corp. Act	 of which held indirectly	Currency	Total assets in thousands	Equity in thousands	Net income/loss in thousands	Alternative financial year
Subsidiaries							
Consolidated subsidiaries							
Banks and financial institutions							
Foreign banks and financial institutions							
Hypo Real Estate Capital Hong Kong Corporation Ltd. i.L., Hong Kong	100.00	–	HK$	799,330	–54,303	–63,265	–
Hypo Real Estate Capital India Corporation Private Ltd., Mumbai	100.00	–	INR	375,857	317,320	9,500	–
Hypo Real Estate Capital Singapore Corporation Private Ltd., Singapur	100.00	–	SG$	631,150	2,021	804	–
Other consolidated subsidiaries							
DEPFA Finance N.V., Amsterdam	100.00	–	€	1,230,640	3,298	554	–
Flint Nominees Ltd., London	100.00	–	GB£	228,669	50,300	1,024[4)]	–
Hypo Property Investment (1992) Ltd., London	100.00	100.00	GB£	1	1	–	–
Hypo Property Investment Ltd., London	100.00	100.00	GB£	497	497	136[4)]	–
Hypo Property Participation Ltd. i.L., London	100.00	100.00	GB£	240	238	1	–
Hypo Property Services Ltd., London	100.00	100.00	GB£	112	112	1	–
Hypo Real Estate Capital Corp., New York	100.00	–	US$	6,019,163	459,079	32,951[4)]	–
Hypo Real Estate Capital Japan Corp., Tokyo	100.00	–	JP¥	285,794,682	29,988,776	–124,900	–
Hypo Real Estate International LLC I i.L., Wilmington	100.00	–	€	381,941	59	33	–
Hypo Real Estate International Trust I i.L., Wilmington	100.00	–	€	381,741	57	7	–
Hypo Real Estate Investment Banking Ltd. i.L., London	100.00	100.00	GB£	–	–	–96[4)]	–
Hypo Real Estate Systems GmbH, Munich	100.00	–	€	36,649	2,615	1,792[1)]	–
Hypo Real Estate Transactions S.A.S., Paris	100.00	–	€	59,940	65	33	–
IMMO Immobilien Management GmbH & Co. KG, Munich	94.00	–	€	6,385	–6,319	–4,392	–
Liffey Belmont I LLC i.L., Wilmington	100.00	100.00	US$	1,042	1,021	–	–

Holdings of Deutsche Pfandbriefbank AG as of 31.12.2009	Interest in %						
Name and place of business	Total Sec 16 (4) Stock Corp. Act	of which held indirectly	Currency	Total assets in thousands	Equity in thousands	Net income/loss in thousands	Alternative financial year
Liffey Belmont II LLC i.L., Wilmington	100.00	100.00	US$	1,378	1,350	–	–
Liffey Belmont III LLC i.L., Wilmington	100.00	100.00	US$	1,152	1,129	–	–
Liffey Camelback LLC i.L., Wilmington	100.00	100.00	US$	17,017	1,500	–	–
Liffey NSYC LLC i.L., Wilmington	100.00	100.00	US$	40,181	2,600	–	–
Quadra Realty Trust, Inc. i.L., Maryland	100.00	100.00	US$	–	–	641	–
Ragnarök Vermögensverwaltung AG & Co. KG, Munich	94.00	–	€	8,657	–1,447	–1,547 3)	–
The Greater Manchester Property Enterprise Fund Ltd. i.L., London	100.00	100.00	GB£	–	–	–133 4)	–
WH-Erste Grundstücks GmbH & Co. KG, Schoenefeld	93.98	–	€	83,387	78,803	–25,484	–
WH-Zweite Grundstücks GmbH & Co. KG, Schoenefeld	93.98	93.98	€	44,764	42,299	–25,574	–
Zamara Investments Ltd. i.L., Gibraltar	100.00	100.00	GB£	89	81	–11,506 4)	–
Non-consolidated subsidiaries							
Other non-consolidated subsidiaries							
Frappant Altona GmbH, Munich	88.40	88.40	€	11,883	26	2)	–
FSHC Guernsey Holdings Ltd., Guernsey	6.03	–	GB£	–	–	–	–
FSHC Jersey Holdings Ltd., Jersey	6.03	6.03	GB£	–	–	–	–
FUNDUS Gesellschaft für Grundbesitz und Beteiligungen mbH, Munich	94.00	–	€	3,360	904	1)	–
GfI-Gesellschaft für Immobilienentwicklung und -verwaltung mbH i.L., Stuttgart	100.00	–	€	15	11	4	1.1.–31.12.2008
Immo Immobilien Management Beteiligungsgesellschaft mbH, Munich	100.00	–	€	35	35	–1	–
IMMO Invest Real Estate GmbH, Munich	100.00	–	€	3,514	28	1)	–
IMMO Trading GmbH, Munich	100.00	–	€	1,817	525	1)	–
Meridies Grundbesitz- und Bebauungsgesellschaft mbH, Munich	94.00	–	€	724	78	1)	–
Quadra QRS, LLC i.L., Maryland	100.00	100.00	US$	–	–	–	–
WestHyp Immobilien Holding Aktiv Bau GmbH, Munich	100.00	100.00	€	33	–27	37	1.1.–31.12.2008
WestHyp Immobilien Holding GmbH, Munich	100.00	–	€	882	734	105	1.1.–31.12.2008

Holdings of Deutsche Pfandbriefbank AG as of 31.12.2009	Interest in %						
Name and place of business	Total Sec 16 (4) Stock Corp. Act	of which held indirectly	Currency	Total assets in thousands	Equity in thousands	Net income/loss in thousands	Alternative financial year
WH-Erste Grundstücks Verwaltungs GmbH, Schoenefeld	100.00	–	€	307	295	18	–
WH-Zweite Grundstücks Verwaltungs GmbH, Schoenefeld	100.00	100.00	€	19	19	–	–
Associated companies							
Associated companies valued using the equity method							
Other companies							
Aerodrom Bureau Verwaltungs GmbH, Berlin	32.00	–	€	714	–702	–10	1.1.–31.12.2007
Airport Bureau Verwaltungs GmbH, Berlin	32.00	–	€	713	–661	–41	1.1.–31.12.2007
Archplan Projekt Dianastraße GmbH, Munich	33.20	33.20	€	192	–135	–24	1.1.–31.12.2008
Burleigh Court (Barnsley) Management Limited, London	20.00	20.00	GB£	–	–	–	–
Kondor Wessels – WestHyp Immobilien Holding GmbH i.L., Berlin	33.30	33.30	€	740	–562	–55	1.1.–31.12.2008
Projektentwicklung Schönefeld Verwaltungsgesellschaft mbH, Stuttgart	50.00	–	€	29	28	–	1.1.–31.12.2008
Riedemannweg 59–60 GbR, Schoenefeld	32.00	32.00	€	11,315	–4,761	47	1.1.–31.12.2008
SANO Grundstücks-Vermietungsgesellschaft mbH & Co. Objekt Dresden KG, Duesseldorf	33.33	–	€	13,614	–4,122	–219	1.1.–31.12.2008
SOMA Grundstücks-Vermietungsgesellschaft mbH & Co. Objekt Darmstadt KG, Duesseldorf	33.33	–	€	35,659	–8,492	–705	1.1.–31.12.2008
SP Projektentwicklung Schönefeld GmbH & Co. KG, Stuttgart	50.00	–	€	16,734	15,372	–4,538	1.1.–31.12.2008
Vierte Airport Bureau Center KG Airport Bureau Verwaltungs GmbH & Co., Berlin	32.00	–	€	10,859	–2,183	335	1.1.–31.12.2008
Wisus Beteiligungs GmbH & Co. Zweite Vermietungs-KG, Munich	33.00	–	€	10,970	–3,182	164	1.1.–31.12.2008
Other investments							
Other companies							
ILLIT Grundstücks- und Verwaltungsgesellschaft mbH & Co. KG i.L., Gruenwald	5.00	–	€	67,625	–17,227	–2,531	1.1.–31.12.2008
Inula Grundstücks-Verwaltungsgesellschaft mbH & Co. KG, Gruenwald	10.00	–	€	95,646	–45,703	1,284	1.1.–31.12.2008
JER Europe Fund III, L.P., London	0.31	0.31	GB£	–	–	–[5)]	–
KOROS Grundstücks-Verwaltungs GmbH & Co. KG, Gruenwald	2.50	–	€	18,491	–8,818	463	1.1.–31.12.2008

Holdings of Deutsche Pfandbriefbank AG as of 31.12.2009	Interest in %						
Name and place of business	Total Sec 16 (4) Stock Corp. Act	of which held indirectly	Currency	Total assets in thousands	Equity in thousands	Net income/loss in thousands	Alternative financial year
S.W.I.F.T SCRL, La Hulpe	0.02	–	€	501,652	262,281	24,730	1.1.–31.12.2008
WILMA Bouwfonds Bauprojekte GmbH & Co. «An den Teichen» KG, Ratingen	5.00	–	€	117	86	32	1.1.–31.12.2007

1) Profit transfer by shareholders on the basis of profit and loss transfer agreement
2) Profit transferred by Meridies Grundbesitz- und Bebauungsgesellschaft mbH, Munich, on the basis of profit and loss transfer agreement
3) General partner liability (Komplementärhaftung) of Deutsche Pfandbriefbank AG
4) Result including dividend distributions received/paid
5) Figures for this company were not available at the time of preparation.

Exchange rates 1 € equates to		31.12.2009
Australia	AU$	1.6008
Great Britain	GB£	0.8881
Hong Kong	HK$	11.1709
India	INR	67.0400
Japan	JP¥	133.1600
Romania	RON	4.2363
Singapore	SG$	2.0194
USA	US$	1.4406

Munich, 16 March 2010

Deutsche Pfandbriefbank Aktiengesellschaft
The Management Board

Dr. Axel Wieandt

Manuela Better

Dr. Kai Wilhelm Franzmeyer

Frank Krings

Dr. Bernhard Scholz

Alexander von Uslar

Responsibility Statement

To the best of our knowledge, and in accordance with the applicable reporting principles, the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group, and the Group Management Report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the principal opportunities and risks associated with the expected development of the Group.

Munich, 16 March 2010

Deutsche Pfandbriefbank Aktiengesellschaft
The Management Board

Dr. Axel Wieandt

Manuela Better

Dr. Kai Wilhelm Franzmeyer

Frank Krings

Dr. Bernhard Scholz

Alexander von Uslar

Auditor's Report

We have audited the consolidated financial statements prepared by Deutsche Pfandbriefbank AG, Munich (until June 28 June 2009 Hypo Real Estate Bank AG), – the balance sheet, the income statement, the statement of comprehensive income, statement of changes in equity, cash flow statement and notes to the consolidated financial statements – together with the group management report for the business year from 1 January to 31 December 2009. The preparation of the consolidated financial statements and the group management report in accordance with IFRSs, as adopted by the EU, and the additional requirements of German commercial law pursuant to § 315a Abs. 1 HGB [Handelsgesetzbuch «German Commercial Code»] are the responsibility of the parent company's management. Our responsibility is to express an opinion on the consolidated financial statements and on the group management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with § 317 HGB [Handelsgesetzbuch «German Commercial Code»] and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements in accordance with the applicable financial reporting framework and in the group management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the consolidated financial statements and the group management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of those entities included in consolidation, the determination of entities to be included in consolidation, the accounting and consolidation principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements and group management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the consolidated financial statements comply with IFRSs, as adopted by the EU, the additional requirements of German commercial law pursuant to § 315a Abs. 1 HGB and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. The group management report is consistent with the consolidated financial statements and as a whole provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development.

Without qualifying our opinion we refer to the passages in the group management report concerning «Risks threatening the existence» [«Bestandsgefährdende Risiken»] as well as in the condensed notes under number two. There it is mentioned that the future existence of the Deutsche Pfandbriefbank AG as a going concern is dependent on the assumption that sufficient equity will be provided to the Deutsche Pfandbriefbank AG to avoid a situation of sustained over-indebtedness. External liquidity support is necessary to avert insolvency due to illiquidity of the significant subsidiaries of the Deutsche Pfandbriefbank AG or the Deutsche Pfandbriefbank AG itself. These liquidity supports must be available until the Deutsche Pfandbriefbank AG is capable to raise sufficient liquidity on the money and capital market by itself, and until the agreed restructuring arrangements are implemented and the equity capital increase is performed as scheduled.

To ensure the future existence of the Deutsche Pfandbriefbank AG and its significant subsidiaries as a going concern it is thus particularly necessary that

> the German Finanzmarktstabilisierungsfonds provides sufficient support in form of equity capital,
> the German Finanzmarktstabilisierungsfonds and the Deutsche Bundesbank maintain their liquidity support and, if necessary, provide further liquidity assistance,
> refinancing with sustainable conditions on the money and capital market occurs,
> the restructuring arrangements will be implemented as scheduled the appropriate authorities do not take regulatory actions, and
> no legal reservations (especially EU legal actions) will be successfully enforced.

Munich, 16 March 2010

KPMG AG
Wirtschaftsprüfungsgesellschaft
(Original German version signed by:)

Dielehner Wirtschaftsprüfer [German Public Auditor]	Wiechens Wirtschaftsprüfer [German Public Auditor]

UBS Global Property Fund & Shaftesbury AM Atlantic Haus

€ 65 million

Investment Financing
Real Estate Finance, France
September 2009

«Atlantic Haus» is a prime office building located in Hamburg's «Neue Hafenkrone» development area in the St. Pauli district, owned by UBS Wealth Management – Global Property Fund Ltd. with Shaftesbury AM acting as asset manager. It consists of a 21-storey tower and three 8-storey wings and was completed in March 2007. It comprises 32,466 sq.m.

Service Chapter

Members of the Management Board of pbb Deutsche Pfandbriefbank

Dr. Axel Wieandt
Chairman of the Management Board, Chief Executive Officer

Date/place of birth	19 September 1966 in Bochum/Germany	
Professional career	from 12/2008	Deutsche Pfandbriefbank AG, Munich/Germany (until 6/2009 Hypo Real Estate Bank AG, Munich/Germany) Chairman of the Management Board, Chief Executive Officer
	from 10/2008	Hypo Real Estate Holding AG, Munich/Germany Chairman of the Management Board, Chief Executive Officer
	4/1998–10/2008	Deutsche Bank Group, Frankfurt am Main/Germany
	2/2003–10/2008	Global Head of Corporate Investments Vice Chairman of the Group Investment Committee Member of the Capital and Risk Committee Member of the Corporate and Investment Bank Principal Investment Commitment Committee Member of the Dual Shareholder Creditor Risk Committee
	4/2000–10/2008	Divisional Board Member Corporate Center, Global Head Corporate Development
	12/1999–3/2000	Deutsche Asset Management International GmbH and Deutsche Asset Management Europe GmbH, Frankfurt am Main/Germany Managing Director Marketing, Sales, Business Development Europe ex Germany
	4/1998–11/1999	Global Head Corporate Strategy
	8/1997–3/1998	Morgan Stanley & Co. Ltd., London/United Kingdom Senior Associate, M&A/Corporate Finance, Financial Institutions Group
	5/1993–7/1997	Mc Kinsey & Company Inc. Duesseldorf and Boston/USA Associate, Senior Associate, Engagement Manager, Senior Engagement Manager, Financial Institutions Group
Supervisory Board memberships and equivalent mandates	from 2/2009	DEPFA Bank plc, Dublin/Ireland Chairman of the Board of Directors (Non-Executive Director)
	from 5/2007	Rasmallah Investments Ltd., Dubai/United Arab Emirates Member of the Supervisory Board
	from 12/2003	Atradius N.V., Amsterdam/The Netherlands Member of the Supervisory Board

Manuela Better
Member of the Management Board, Chief Risk Officer

Date/place of birth	11 November 1960 in Munich/Germany	
Professional career	from 10/2003	HRE Group
	from 2/2009	Deutsche Pfandbriefbank AG, Munich/Germany (until 6/2009 Hypo Real Estate Bank AG, Munich/Germany) Member of the Management Board, Chief Risk Officer
	from 2/2009	Hypo Real Estate Holding AG, Munich/Germany Member of the Management Board, Chief Risk Officer
	from 10/2008	DEPFA Bank plc, Dublin/Ireland Member of the Board of Directors (Executive), Chief Risk Officer
	4/2007–9/2008	Hypo Real Estate Bank International AG, Stuttgart/Germany and Hong Kong Member of the Management Board, Head of Commercial Real Estate Origination Asia
	1/2004–3/2007	Hypo Real Estate Bank AG, Munich/Germany Member of the Management Board, Chief Risk Officer
	10/1988–9/2003	HVB Group and its predecessors
	1/2000–12/2003	Member of the Management Board
	10/1998–12/2003	FGH Bank, Utrecht/The Netherlands
	10/1998–12/1999	Head of Business Development, IT and Special Projects
	1/1990–9/1998	Bayerische Vereinsbank AG, Munich/Germany
	1/1994–9/1998	Head of International Real Estate Financing Department
	5/1992–12/1993	Office Manager, International Real Estate Financing Department
	2/1990–4/1992	Specialist Real Estate Business UK, International Real Estate Financing Department
	10/1988–1/1990	Trainee, Real Estate Department in Frankfurt am Main/Germany and London/United Kingdom
Supervisory Board memberships and equivalent mandates	from 5/2008	Hypo Real Estate Capital Japan Corp., Tokyo/Japan Member of the Board of Directors
		Flint Nominees Limited, London/Großbritannien Member of the Board of Directors

Dr. Kai Wilhelm Franzmeyer
Member of the Management Board, Group Treasurer

Date/place of birth	24 November 1963 in Minden/Germany	
Professional career	from 12/2008	Deutsche Pfandbriefbank AG, Munich/Germany (until 6/2009 Hypo Real Estate Bank AG, Munich/Germany) Member of the Management Board, Group Treasurer
	seit 10/2008	Hypo Real Estate Holding AG, Munich/Germany Member of the Management Board, Group Treasurer
		Commerzbank AG, Frankfurt am Main/Germany:
	6/2006–9/2008	Group Treasurer
	6/2002–5/2006	Global Head of Liquidity and Balance Sheet Management
	2/2001–5/2002	Global Head of Treasury Derivatives Trading
	9/1998–1/2001	IR-Swap Desk, Group Division Global Securities
	10/1996–8/1998	Wood & Co./Wood Commerz, Prague/Czech Republic (CEE fixed income products) Member of the Executive Management
	1/1992–9/1996	Group Sydication Department, Group Finance Department, Group Strategy Department
Supervisory Board memberships and equivalent mandates	from 2/2009	DEPFA Bank plc, Dublin/Ireland Non-Executive Director
Other selected positions	from 6/2009	Member of the Management Board Verband deutscher Pfandbriefbanken (vdp) e.V. (Association of German Pfandbrief Banks)
	from 6/2006	Member of the European Bank Treasurers' Club
	from 2004	Member of the Treasury Management Committee Bundesverband deutscher Banken, Berlin/Germany

Frank Krings
Member of the Management Board, Chief Operating Officer

Date/place of birth	16 April 1972 in Cologne/Germany	
Professional career	from 12/2008	Deutsche Pfandbriefbank AG, Munich/Germany (until 6/2009 Hypo Real Estate Bank AG, Munich/Germany) Member of the Management Board, Chief Operating Officer
	from 10/2008	Hypo Real Estate Holding AG, Munich/Germany Member of the Management Board, Chief Operating Officer
	9/1996–10/2008	Deutsche Bank Group
	11/2004–10/2008	Chief Operating Officer Europe Member of the Management Committee Germany Chairman of the Operating Committee Germany Chief Operating Officer of Regional Management Member of the Regional Management Executive Committee
	1/2004	Deputy Global Head of Corporate Investments (CI) Managing Director in Corporate Development (AfK)
	2/2003	Chief Operating Officer of Corporate Investments (CI) Managing Director in Corporate Development (AfK)
	2/2002	Managing Director Chief of Staff in Corporate Development (AfK)
	1/1999–10/2004	Staff Division Corporate Development (AfK) Strategy Development, Corporate M & A, Investment and Participation Management, Restructuring, Outsourcing
	4/1998–12/1998	Retail & Private Banking Division
	10/1997–3/1998	Global Custody Services Division
	2/1997–9/1997	Deutsche Morgan Grenfell Inc., New York/USA Global Corporates & Institutions Division Operations & Technology Management
Supervisory Board memberships and equivalent mandates	from 2/2009	DEPFA Bank plc, Dublin/Ireland Member of the Board of Directors (Non-Executive Director)
	from 4/2008	Deutsche Bank S.p.A., Milan/Italy Member of the Supervisory Board
	from 12/2007	Operation HOPE, Inc., Los Angeles, California/USA Member of the Global Board of Advisors (non-profit)

Dr. Bernhard Scholz
Member of the Management Board, Real Estate Finance

Date/place of birth	15 February 1958 in Munich/Germany	
Professional career	from 1/2010	Deutsche Pfandbriefbank AG, Munich/Germany Member of the Management Board, Real Estate Finance
	from 1/2010	Hypo Real Estate Holding AG, Munich/Germany Member of the Management Board, Real Estate Finance
	2004–2009	Münchener Hypothekenbank eG, Munich/Germany Member of the Management Board
	from 2007	Sales & Acquisition and IT with core responsibility for Commercial Real Estate Finance
	until 2006	Credit, Back Office Processing & Control and IT
	1998–2004	Bayerische Hypo- und Vereinsbank AG, Munich/Germany (later Hypo Real Estate Bank AG, Munich/Germany) Senior Risk Manager for Real Estate Investors and Developer with supra-regional responsibility
	from 2001	Head of Commercial Real Estate Finance after spin-off of Hypo Real Estate Head of Workout
	1990–1998	Bayerische Hypotheken- und Wechsel-Bank AG, Munich/Germany
	from 1995	Head of Regensburg Branch, responsible for Commercial Real Estate Finance
	from 1991	Head of Internal Rationalisation
	from 1990	Officer
	1985–1990	Management Consultant with primary relationship to former Bayerische Hypotheken- und Wechsel-Bank AG, Munich/Germany

Alexander Freiherr von Uslar-Gleichen
Member of the Management Board, Chief Financial Officer

Date/place of birth	11 July 1966 in Munich/Germany	
Professional career	from 10/2009	Deutsche Pfandbriefbank AG, Munich/Germany Member of the Management Board, Chief Financial Officer
	seit 10/2009	Hypo Real Estate Holding AG, Munich/Germany Member of the Management Board, Chief Financial Officer
	6/2000–6/2009	DAB bank AG, Munich/Germany
	12/2001–6/2009	Member of the Management Board, Chief Financial Officer
	6/2000–11/2001	Executive Vice President
	1996–2000	Solicitors BBLP Beiten Burkhardt Mittl & Wegener, Munich/Germany Lawyer for the areas of Bank, Commercial, Society, Tax Law
	from 2000	Partner

Glossary

Advanced approach Under the advanced approach method, a bank with a sufficiently developed internal capital allocation procedure (strict criteria in terms of methodology and disclosure) is permitted to use its internal assessments regarding the credit standing of a debtor when assessing the lending risk within its portfolio.
There are specialised analysis procedures for different types of loan commitments – e.g. loans to companies and retail customers – that exhibit different loss characteristics.

Asset/liability management Measures by a bank to control the balance sheet structure and to limit the risks resulting from differences in time periods and insufficient liquidity.

Asset-Backed security A bond or note that is based on pools of assets.

Assets book Risk-carrying positions that are not allocated to the >>trading book.

Asset finance Asset finance is funding to acquire additional assets to drive a business forward. Virtually any asset can be financed including IT, software, refurbishment, machinery, etc.

Available-for-sale assets Financial assets that are available for the company to sell and that do not relate to loans, financial instruments held for trading or >>held-to-maturity financial instruments. Available-for-sale financial instruments include in particular fixed-income securities that cannot or should not be held to maturity and also equity instruments with no final maturity.

Basle II The term Basle II stands for a new capital adequacy framework, which was presented by the Basel Committee on Banking Supervision in summer 2004. The committee meets on a regular basis at the Bank for International Settlements (BIS) and is formed by representatives of the central banks and banking supervisors of the major developed nations. It gives general strategic recommendations on the framework and standards for banking supervision. In comparison to the first capital adequacy framework (Basle I) from 1988, Basle II will define new general conditions for the measurement of risk-weighted assets and the minimum capital requirements for credit institutions.

BIS Bank for International Settlements headquartered in Basle; as the central bank of the central banks, it is in particular responsible for cross-border banking supervision and for the establishment of internationally valid equity capital requirements for supraregionally operating banks.

BIS equity funds Equity capital that is recognised for regulatory purposes and complies with the Recommendation on Equity issued by the Basle Committee for Banking Supervision in July 1988 (last amended in January 1996) for financial institutes operating on the international stage. It comprises liable equity capital (core capital and supplementary capital) and Tier III capital:

- > **Core capital or Tier I capital** largely subscribed capital, reserves and certain hybrid capital instruments.
- > **Supplementary capital or Tier II capital** includes in particular participatory capital, long-term subordinated liabilities, unrealised gains from listed securities and other valuation adjustments for inherent risks.
- > **Tier III capital** mainly comprises short-term subordinated liabilities and surplus supplementary capital.

Bonds Term used in English-speaking countries for fixed-income securities and/or debentures.

Calculated mortgage lending value, also: loan-to-value (LTV) Relationship between the funds loaned to the borrower and the value of the collateral.

Capacity to meet interest payments Degree to which the rental income from a financed building must, in longterm financing, at least cover the interest service payments. Ratio: DSC (debt service coverage).

Cash flow Equals cash receipts minus cash payments over a given period of time.

Cash-flow hedge Security against the risk of loss of future interest payments under a variable-interest balance sheet transaction obtained by means of a >>swap.

Collateralised Debt Obligation (CDO) Collateralised Debt Obligations (CDOs) represent a segment of >>asset-backed securities. It represents a debenture bond that is secured by a diversified debt portfolio. A collateralised debt obligation is usually divided into different slices of varying creditworthiness. Usually CDOs are classified according to the object of their investment. If debenture bonds are sold, then one is dealing with so-called cash CDOs – if, however, instead of real bonds their risks alone are sold, these are called synthetic CDOs.

Commercial mortgage-backed security (CMBS) A type of >>mortgage-backed security (MBS) on commercial real estate.

Commercial paper (CP) Money market instruments in the form of bearer instruments that do not have standardised maturities but can be geared to individual investment requirements and are paid on a discount basis. Their ma-turities vary between 1 and 270 days. They are issued on the money market by debtors with an irreproachable credit standing, usually first-class industrial corporations; they are issued in high amounts and with high minimum nominal values.

Concentration risk Risk resulting from concentration of the credit risk on a single party (counterparty, issuer, country or borrowing customer) in the portfolio or among a group of parties that over a period of time exhibit a parallel development in terms of probability of default caused, for example, by similar economic dependencies. Synonym: cluster risk.

Corporate governance Corporate governance refers to the legal and factual framework for managing and monitoring companies. The recommendations of the Corporate Governance Code create transparency and are intended to strengthen confidence in a good and responsible management; they are primarily aimed at protecting shareholders.

Cost-income ratio Relationship between general administrative expenses and the total of net interest income and similar income, net commission income, net trading income, net income from investments and balance of other operating income/expenses; a low cost-income ratio indicates high productivity.

Counterparty risk Risk that, as a result of default on the part of a contracting partner, it will no longer be possible to collect an unrealised profit from outstanding interest and currency-related derivative and futures transactions. The counterparty risk is differentiated according to performance risk (from the value date until performance) and exchange/pre-settlement risk (from the date of conclusion until the value date).

Country risk Risk that a business partner in a certain country will be unable to fulfil his contractually agreed obligations due to political or social unrest, nationalisation or expropriation, non-recognition by governments of foreign debts, currency controls or a devaluation of the national currency.

Credit default swap (CDS) Financial contract where the risk of a credit event that is specified in advance (e.g. insolvency or deterioration in credit standing) is transferred by an assignee to a guarantor. Irrespective of whether or not the credit event materialises, the guarantor receives a regular premium payment from the assignee for assuming the lending risk.

Credit derivatives Derivative financial instruments that allow one party to the transaction (assignee) to transfer the lending risk relating to a loan or a security to another party (guarantor) against payment of a premium. The risk purchaser therefore bears the lending risk relating to the loan or security without actually having to purchase it (e.g. >>credit default swap, >>total return swap or >>credit-linked note).

Credit-linked notes (CLN) A note issued by an assignee that is only repaid at the nominal value on maturity if a previously specified credit event does not materialise on the side of the debtor. If the credit event does actually occur, the credit-linked note is repaid after deducting the agreed compensatory amount. In contrast to credit default swaps and total return swaps, the guarantor receives his monetary payment in advance from the assignee.

Credit risk Credit risks include the loan default risk, counterparty risk, issuer risk and country risk; they refer to the potential loss that could result from the default or deterioration in credit ratings of loan customers, of issuers of borrowers' note loans, promissory notes and debt securities, or of counterparties in money market, securities and derivatives transactions.

Debt service coverage margin Relationship between the net income that can be earned from a property and the debt service applicable to the property in question.

Default probability Expected average probability that a business partner will fail to fulfil his obligations, based on statistical analyses of historic default patterns.

Default risk Risk of partial or total loss of a loan.

Deferred compensation An arrangement in which a portion of the wage is paid out at a date after which that income is actually earned.

Deferred taxes Taxes on income that are payable or receivable at a future date and that result from different carrying amounts being shown in the financial and commercial balance sheets. On the reporting date, they do not yet represent actual receivables or liabilities vis-à-vis tax authorities.

Developer Developers develop and execute real estate projects (generally large commercial projects) with the aim of securing a swift sale.

Earnings per share Indicator comparing the net income for the year after taxes with the average number of ordinary shares.

Fair value Amount at which an asset would be exchanged or a debt settled between expert, independent, willing business partners; often identical with the market price.

Fair-value hedge Hedging of a fixed-income balance sheet position (e.g. a receivable or a security) against the market risk by means of a >>swap; it is valued at market value (>>fair value).

Financial Market Stabilisation Act (FMStG) This was fast-tracked through Parliament on 17 October 2008. The act enables a package of measures to be implemented for stabilising the financial market. The main component of the act is the establishment of the financial market stabilisation fund.

Financial market stabilisation fund (SoFFin) This was created by the Financial Market Stabilisation Act on 17 October 2008. The aim of the fund is to stabilise the German financial system, to overcome the liquidity shortages and to strengthen the capital base of financial companies. The range of services provided by the fund includes the provision of guarantees (up to € 400 billion) as well as recapitalisation and risk acceptance (up to € 70 billion).

Financial instruments This term is in particular used to summarise credits and loans extended, interest-bearing securities, shares, participating interests, liabilities and derivatives.

Forward transactions The purchase/sale of financial instruments on a fixed date and at a fixed price; a distinction is made between contingent forward transactions (>>options) and unconditional forward transactions (>>futures). In contrast to spot transactions, the date when the contract is concluded and the date of performance for the contract are different.

Futures Contracts that are standardised in terms of volume, quality and settlement date under which a trading item belonging to the money market, investment market, precious metals market or currency market is to be delivered or purchased on a specific future date at the specified market price. In many cases, a balancing payment has to be effected in place of delivering or purchasing securities.

German Minimum Requirements for the Conduct of Lending Business (MaK) Minimum requirements that must be met by all lending institutes in order to limit risks from lending business, taking into account the respective type and extent of business conducted.

German Minimum Requirements for the Conduct of Trading Operations (MaH) Minimum requirements that must be complied with by all financial institutes in order to secure solvency and must be supplemented/specified in more detail in internal instructions, taking into account the respective type and extent of trading activities. They include requirements with regard to risk control and risk management, the organisation of trading operations and auditing, as well as regulations for specific transaction types. They were issued in October 1995 by the Federal Banking Supervisory Office (BaKred), which is now known as the Federal Financial Supervisory Office (BaFin).

Goodwill Amount that a purchaser of a company pays in excess of the >>fair value of the individual assets after deducting debts (= intrinsic value), taking into account future expected earnings (= net income value).

Hedge accounting Depiction of contrary developments in the values of a hedging transaction (e.g. an interest rate swap) and an underlying transaction (e.g. a loan). Hedge accounting aims to minimise the impact on the income statement of the valuation and the recording of valuation results from derivative transactions where such valuation and recording affects net profit or loss.

Hedging Transactions aimed at protecting against the risk of unfavourable price trends (e.g. currency and interest rate risks). A matching position is set up for each position, so that the risk is offset either in whole or in part.

Held to maturity (HtM) Financial assets acquired by third parties that have a fixed maturity and fixed or determinable payments, where the holder intends or is able to hold the asset until final maturity.

Hybrid capital instruments Investment instruments that are characterised by profit-related interest payments. Where interest payments that have not been made when losses have occurred are not paid at a later date (noncumulative hybrid capital instruments) and the instruments do not have a fixed maturity date and/or cannot be terminated by the creditor, then in accordance with regulatory requirements such instruments belong to the core capital. In all other cases, they must be allocated to the supplementary capital (e.g. cumulative hybrid capital instruments).

International Accounting Standards (IAS) Accounting standards issued by the IASC (International Accounting Standards Committee), a specialist international organisation backed by professional associations that deal with accounting issues. The aim is to develop transparent and comparable international accounting systems.

International Financial Reporting Standards (IFRS) The IFRS include the present International Accounting Standards (>>IAS) and the interpretations of the Standing Interpret-ations Committee as well as all standards and interpret-ations issued in future by the IASB (International Accounting Standards Board).

Issuer risk Losses of own-portfolio securities due to a deterioration in the credit standing of or default on the part of an issuer.

Lending risk Risk that a business partner will not fulfil his contractual payment obligations. The lending risk includes >>default, >>country and settlement risks.

Liquidity facility The obligation to provide liquidity to a contract partner. The purpose of the liquidity facility is to ensure that the payments are forwarded smoothly and on time. It provides a cushion for the risk if any payment problems arise. Regulatory conditions are attached to the drawing of a liquidity facility.

London Interbank Offered Rate – LIBOR Benchmark rate in interbank operations, which is determined daily by the main international banks of the British Banker's Association in London. Banks are able to raise funds or be offered funds from other banks on the basis of the rates.

Loss-given-default (LGD) LGD is the fraction of exposure at default that will not be recovered following default.

Market risk Results from uncertainty surrounding changes in market prices and rates (including interest rates, share prices, exchange rates and commodity prices) and also from the correlations between them and their levels of volatility.

Market risk position The market risk position pursuant to Principle I includes foreign currency, commodity and options risks as well trading-book risk positions such as risks relating to interest rates and share prices as well as ≫credit risks pertaining to the trading book.

Mezzanine finance Term used to describe forms of finance that have characteristics of both debt and equity.

Monoliner A monoline insurer, in the context of financial markets, guarantees the repayment of bonds.

Mortgage-backed securities (MBS) Securitisation of mortgage loans for precise control and reduction of lending risks. MBS are securities whose interest and redemption payments are linked to the payment performance of a pool of loans secured by real estate liens.

On-balance-sheet lender A loan creditor who is able to incur risks on his own balance sheet.

Operational risk The risk of direct or indirect losses resulting from the inappropriateness or failure of human beings, technical systems, internal procedures or external events (definition pursuant to Basle II).
Operational risks are not usually entered into consciously; such risks are not subject to diversification and are difficult to narrow down.
Examples: human error, faulty management processes, criminal actions, fraud, natural disasters (fire, etc.), technical failures, departure of key employees.

Option An option grants the purchaser the right to purchase (= purchase option or call) or sell (= put option or put) a specific quantity of the item underlying the option (e.g. a security or currency) from or to a contracting partner (option writer) at a price determined when the contract is concluded (= strike). The option can be exercised either on a date specified in advance or during a period specified in advance; the purchaser pays an option premium for this right.

Participation certificate Certification of participatory rights issued by companies of all legal forms and admitted to official (stock exchange) trading. Under certain circumstances, participatory certificates may be allocated to liable equity capital.

Rating Risk rating of a debtor (internal) and/or assessment of the credit standing of an issuer and its debt instruments by specialised agencies (external).

Repo transaction Short-term money-trading transaction backed by securities.

Return on equity Ratio showing the relationship between the net income for the year, or a pre-tax performance measure (e.g. pre-tax profit), and average equity capital; indicates the return on the capital put to work by the company or its owners.

Risk assets To be able to map the assets-book ≫credit risks resulting from the differing credit standings of issuers and/or business partners in accordance with regulatory requirements, balance-sheet assets, off-balancesheet transactions (e.g. warranties and guarantees for balance-sheet assets) as well as ≫forward transactions, ≫swaps and ≫option rights are weighted with respect to risk using rate-weighting factors that depend on the rating category of the issuers and/or business partners. Under Principle I, these risk-weighted assets must be backed by 8% liable equity capital.

Risk control Risk Control is responsible for implementing the risk policy prescribed by the Executive Board, for the neutral monitoring of lending, market and operational risks, as well as for analysing and reporting on the current and future risk situation. Risk Control is also responsible for specifying measurement and evaluation methods as well as for subsequently carrying out measurements and evaluations of risk and risk results and/or limit controls.

Risk management The taking of business decisions at operational level, portfolio management and/or optimisation of risks in the widest sense of the word on the basis of risk/reward factors (e.g. assignment of lines for credit risks, credit derivatives, etc.) within the strategic framework defined by the Executive Board and in accordance with the authorisations issued by the Executive Board bestowing direct responsibility for risks and results.

Secondary risk Risk that any losses in rental income on the part of the borrower may jeopardise the capacity to meet interest payments.

Securitisation Securities-based collateralisation and/or conversion of loans (e.g. through bonds) to procure funds. The prime aim is to make the loans tradable on organised investment markets (e.g. stock exchanges). The supplier of capital (= creditor) and therefore the purchaser of the securitised loan assumes the risk of fluctuations in market prices and of loan losses; the borrower (= debtor) must provide regular public proof of his credit standing by means of regular reporting and/or of the highest possible rating by a rating agency.

Segment reporting Breakdown of the total consolidated values by individual segments, e.g. by areas of activity (divisions) or geographical characteristics (regions); this enables conclusions to be drawn regarding performance in individual segments and their contribution to the consolidated result.

Self-assessment Self-assessment is a process whereby the operational risks and the measures taken to minimise risks are regularly identified and evaluated by procedure offi-cers, i.e. by those individuals who are best able to assess the strengths and weaknesses of procedures.
In addition to identifying and evaluating risks, self-assessment also provides the basis for drawing up an action plan to open up opportunities for improvement, as well as for the development of risk awareness at all levels within the Bank.

Senior lender Financer of first priority loans.

Solvency The extent to which an isurer or credit institution is provided with own funds. Own funds back the claims of policy holders or creditors. The greater the solvency, the greater is the backing for these claims.

Standard risk costs Average risk costs and/or valuation adjustments due to loan losses that are expected within a given year.

Swap In principle, an exchange of payment flows: an exchange of fixed and variable interest-payment flows in the same currency (= interest rate swap) and/or exchange of payment flows in different currencies (= currency swap).

Tier I ratio This ratio is also referred to as the BIS core capital ratio and represents the ratio of a company's risk assets determined in accordance with the provisions of the Bank for International Settlements (BIS) plus its market risk positions to its core capital (see also BIS equity funds).

Total return swap Swap between the assignee and the guarantor with respect to the income from and changes in valu-ation of the underlying financial instruments. In addition to the lending risk, the guarantor also assumes the price risk resulting from the underlying financial instrument, in return for a corresponding interest payment.

Trading book Banking regulatory term for positions in financial instruments, interests and tradable loans that are held by a financial institute for the purpose of short-term resale, benefiting from price and interest rate fluctuations. This also includes transactions that are closely related to trading-book positions (e.g. for hedging purposes). Risk-carrying positions that do not belong in the trading book are assigned to the ≫assets book.

Treasury Division pooling the areas of refinancing and liquidity control, asset/liability management, fixed-income and own-account trading.

Vacancy rate Average percentage of all real estate space that is not used or rented out.

Value at risk Method for quantifying risk; measures the potential future losses that with a certain degree of probability will not be exceeded within a specified period of time.

Financial Calendar

Financial Calendar	
26 March 2010	Publication of the results for the year 2009
7 May 2010	Publication of the results for the first quarter of 2010
13 August 2010	Publication of the results for the second quarter of 2010
5 November 2010	Publication of the results for the third quarter of 2010

Future-oriented Statements
Internet Service

Future-oriented Statements

This report contains future-oriented statements in the form of intentions, assumptions, expectations or forecasts. These statements are based on the plans, estimates and predictions currently available to the management of Deutsche Pfandbriefbank AG. Future-oriented statements therefore only apply on the day on which they are made. We do not undertake any obligation to update such statements in light of new information or future events. By their nature, future-oriented statements contain risks and factors of uncertainty. A number of important factors can contribute to actual results deviating considerably from future-oriented statements. Such factors include the condition of the financial markets in Germany, Europe and the USA, the possible default of borrowers or counterparties of trading companies, the reliability of our principles, procedures and methods for risk management as well as other risks associated with our business activity.

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