Interim Report
H1 2010

PUBLIC SECTOR FINANCE
REAL ESTATE FINANCE

DEUTSCHE
PFANDBRIEFBANK

Ratings

Ratings of Deutsche Pfandbriefbank AG and its covered bonds

as of 3 August 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 Pfandbriefe		AA+[1]	Aaa	AAA
Mortgage Pfandbriefe		AA+[2]	Aa3	AA+[2]

[1] Credit Watch Developing
[2] Credit Watch Negative

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.

Contents

Preface of the CEO

Deutsche Pfandbriefbank AG was created by the merger of Hypo Real Estate Bank AG and DEPFA Deutsche Pfandbriefbank AG in mid-2009, and has been trading under the brand pbb Deutsche Pfandbriefbank since October 2009. Our overriding objective for the current financial year and beyond is to establish pbb Deutsche Pfandbriefbank on the credit and funding markets.
It is essential that we are able to generate sustainable business in public sector finance and real estate finance, and it is also essential for us to be able to fund these operations primarily with Pfandbriefe if we are to meet our medium-term objective.
We wish to ensure that pbb Deutsche Pfandbriefbank is in a position to be reprivatised.

We are currently establishing the conditions for this objective with our plans to transfer non-strategic portfolios from pbb Deutsche Pfandbriefbank to FMS Wertmanagement, which is expected to absorb the relevant assets and liabilities of companies in HRE Group. The preparations are currently ongoing and, subject to the relevant approvals being received from the financial market stabilisation agency and the European Commission, the assets and liabilities are expected to be transferred to FMS Wertmanagement in the fourth quarter of 2010.

The transfer will result in the creation of a specialist bank for public sector and real estate finance which we have defined within the framework of our new strategy. We will retain loans and securities for which the geographical focus, maturities and the type of property (in Real Estate Finance) match our newly defined strategy and which can be primarily funded by way of German Pfandbriefe. This means a new start for pbb Deutsche Pfandbriefbank.

We have also set up a new organisational structure for this new start. Since the end of July, we have pooled all sales activities in our two business areas of Real Estate Finance and Public Sector Finance. In this way, we intend to make better use of the potential offered by our business model and to focus our operations to an even greater extent on our customers and the market.

The results of operations of Deutsche Pfandbriefbank Group are still determined by the Group's specific situation and the fact that the market situation remains difficult, for example in the field of real estate finance. Pre-tax profit was, as expected, negative at € –352 million; however, it was considerably better than the combined figure of € –1,061 million in the corresponding previous year period. As was the case last year, the loss was mainly attributable to significant impairments which mainly affected real estate financing. However, the considerable success achieved in reducing the loss reflects the continuing stabilisation of the Deutsche Pfandbriefbank Group.

Kind regards

Manuela Better
CEO

Interim Financial Review

Interim Financial Review
Business and Conditions

Macro-economic Situation

From the macro-economic point of view, the first half of 2010 was characterised particularly by the severe problems associated with the debt crisis of Greece and the way in which the problems were handled. The financial markets consequently also questioned the solvency of further countries of the Euro zone, and in particular Spain, Ireland, Italy and Portugal. The situation calmed down somewhat only after massive intervention of the European Central Bank, which has intervened for the first time on the markets for government securities, as well as the governments of the European Union. Together with the International Monetary Fund, these governments decided to adopt a «rescue mechanism» in the form of guarantees for government securities of the countries in the Euro zone. So far, these efforts have been successful to the extent that it has been possible for the planned new issues of government securities to be placed on the markets – however, the spreads compared with the securities of other countries in the Euro zone have been considerable, although they have now become somewhat more moderate.

The need to take these measures in order to settle the financial markets further is also demonstrated by the heterogeneous nature of the national developments within the context of a global economy which is recovering again. Following the severe collapses seen in 2009, all major economies in the first half of 2010 have returned to growth. However, this growth is not sufficient, particularly in Europe, to enable the level of added value before the crisis to be attained again.

The national labour markets have also responded in very different ways to the crisis. Whereas in the USA the unemployment rate remained stubbornly at unusually high levels of just below the 10% level in the first half of 2010, unemployment in Germany declined slightly in the same period, after having risen by a surprisingly minor extent during the crisis.

In Germany, the economy is currently following the pattern which has been familiar in previous cycles, namely that of an export-driven recovery. On the other hand, during the first quarter of 2010 for which data are available, private consumption and also investment demand again declined slightly compared with 2009. This is also applicable for construction spending, which is still reflecting the different conditions on the real estate markets.

The problems in Greece have resulted in a certain loss of confidence of international investors in the euro and its role as a stable global currency. In consequence, the euro weakened appreciably against all major currencies, down to a low of just below US$ 1.20 per euro on 8 June (on 30 June 2010: approx. US$ 1.22 per euro); however, it has since recovered slightly from this level.

Sector-specific Situation

Overall Situation of the Banking Sector

There has so far not been any indication of a uniform trend in the development of earnings in the banking sector. Whereas some investment banks are already generating good earnings, the recovery for the remainder of the banking sector is making a more moderate start. Traditional credit institutions in particular are having to continue to streamline their portfolios by eliminating distressed loans and high-risk assets. This is being achieved by intense restructuring efforts, such as the establishment of deconsolidated environments which relieve non-performing assets, or the sale of not strategically necessary assets. In the first half of the year, the market turmoil mentioned above meant that banks had to provide additional collateral for their portfolios of government bonds of countries which are currently the focus of attention.

Public Sector Financing

The crisis in Greece has in recent months increased the sensitivity of financial markets for financial risks. The financial markets consequently evaluated the specific budget figures of the individual economies, thus focusing on the financial risks of additional countries. This increased level of attention, particularly in Europe, has meant that all economies (and not only the countries which have attracted attention as a result of a high state deficit) have defined and communicated detailed and credible budget consolidation measures. Particular attention is focusing on Spain as a result of the size of its economy. Accordingly, the Spanish government has announced additional consolidation measures and has initiated a labour market reform. France and Great Britain have also decided to adopt budget consolidation measures. There was a generally positive reception for the British emergency budget, but the implementation risks involved are considerable. France has also imposed ambitious consolidation measures in order to stop an increase in the debt ratio and accordingly to avoid any risk to its AAA rating. Many economies which have been hit hardest by the crisis are not able to access international capital markets and are reliant on multilateral financing (from the International Monetary Fund and EU commitments). It will be crucial in two respects to meet the financial objectives: in order to assure liquidity and ratings. The uncertainty on the markets has meant that customers from countries on which attention is focused (for instance Spain) have attempted to cover their financing requirement for 2010 and have thus tapped the market more quickly and for larger amounts.

The markets for covered government bonds have remained relatively stable (compared with the developments in margins seen for government bonds). Even within the context of central bank buying with the aim of supporting the markets, there has been a positive performance in terms of the overall volumes of issues (which have been higher than in previous years), because government bonds with a better rating and other conservative forms of investment (in particular Pfandbriefe) are becoming attractive for a wider range of investors in the current climate.

As a result of the volatile markets for government bonds, banks which have portfolios of government paper in their balance sheets have also come under pressure.

Real Estate Financing

The performance of the real estate markets which are relevant for the Bank was moderate in the first half of 2010, although there was evidence of initial positive signals of the recovery in the first half of 2010. Major primary and secondary real estate markets experienced an initial positive boost in the first six months of 2010 as a result of rising transaction figures. On the other hand, the commercial real estate markets are still suffering from falling rents, rising vacancy rates and stagnating purchase prices. Demand benefited from major individual transactions and was frequently limited to the premium or quality segment of the real estate market.

The investment market for commercial real estate in Germany continued to stabilise in 2010 and, with a transaction volume of around € 9 billion as of 30 June, was already considerably higher than the corresponding previous year figure of around € 4 billion[1]. Investor attention is increasingly focusing on the office and retail segments. Following relatively strong demand in Great Britain and France at the end of the fourth quarter of 2009, the volume of real estate turnover fell back again in the first quarter, although it is considerably higher than was the case in the first quarter of 2009. This was due to the fact that demand focused on good quality properties, although there was not sufficient supply in this segment. In Spain, there are signs of a gradual recovery in the market, although turnover volumes are low because there is a wide gap between the prices which vendors wish to achieve and which purchasers are willing to pay. In the USA, transaction volumes have also fallen relatively sharply as a result of more restrictive credit guidelines. Supply has increased in all market segments, whereas demand for office properties in particular has declined appreciably, and the retail segment is suffering from insolvencies, closures and downsized plans for expansion.

The German housing construction market has bottomed out. The number of planning permissions is rising, so that more apartments will be completed in 2010 particularly in the major cities. Because, however, demand still exceeds supply, this is not indicating that there will be any reduction in the strain on rents (particularly in the conurbations with strong economic activity). However, because income growth is weak due to the crisis, rents are not likely to rise strongly.

The level of rents in Germany for the main commercial property types is starting to stabilise in 2010, or will only weaken moderately. Rents for all property types in Great Britain are still declining, with the exception of office and retail properties in the City of London, where rents are remaining constant or are improving. Rents in prime locations in the greater Paris region are stabilising gradually as a result of intense tenant incentives. In Spain, rents of office properties are declining moderately, whereas rents in all other market segments are declining to a greater extent. In the USA the rents for commercial real estate are declining as well.

Vacancy rates in Germany have increased as expected during the past twelve months. Particularly in the field of German office markets, the vacancy rate in the German office locations has settled at a level of 9.5% in the first half of 2010 (9.4 million sqm). However, the increase in the vacancy rate has been moderate in view of the fact that a considerable downturn on the labour market had been anticipated for this year. The constant development in the second quarter of 2010 is also indicating that vacancy rates have now peaked. The vacancy rates in Great Britain have remained constant at best, or have declined (with the exception of the City of London). France has seen a further increase in vacancy rates, and there has been a considerable increase of vacancy rates in Spain. The vacancy rates in the USA also increased for commercial real estate.

The above-mentioned market factors, such as rent levels, vacancy rates and purchase prices, mainly affect the value of the existing credit portfolios of banks. Because there has not yet been any positive impetus in this respect, the sector still needs to actively monitor high-risk exposures and provide more intense support in this respect. A further problematical factor is the rising volume of prolongations which no longer attain the level of value seen at the point at which the loan was initially extended.

In the field of commercial real estate financing, there are signs in the market that the relevant banks/competitors are concentrating to a certain extent on regions, customer groups, core segments and LTVs. In the majority of the markets new business was predominantly originated by domestic banks.

[1] Source: BNP Paribas Real Estate, 2 July 2010

Refinancing Markets

The refinancing markets have continued to stabilise in the initial months of 2010. At the beginning of the year, the market was characterised by a small number of successful benchmark transactions in a wide range of areas. Covered bonds and in particular Pfandbriefe were placed successfully. Smaller private placings have also taken place. The beginning of the crisis of Greece within the European Union in May 2010 and the high levels of volatility in government bonds have resulted in a significant downturn in issuing activity. However, it has still been possible for some benchmark transactions to be successfully placed. Activity on the private placing markets declined appreciably. Lending on the interbank market was also significantly reduced in certain phases.

The stabilisation measures of the ECB, by purchasing government bonds, have settled the markets to a certain extent, although volatilities are still very high. At the same time, long-term rates have fallen to all-time lows and have been at a low level since May 2010.

Company-specific Conditions

Major Events

Measures designed to secure liquidity The liquidity guarantee framework available to HRE, and provided completely via Deutsche Pfandbriefbank AG, amounted to a total of € 102 billion at the end of June 2010. This figure includes the scheduled and contractually agreed repayment of part of the liquidity guarantees since 31 December 2009 (of € 3 billion) as well as an additional liquidity guarantee framework of SoFFin (of € 10 billion) granted on 28 May 2010 due to the current situation on the financial markets. In addition to interest and exchange rate fluctuations, two factors in particular are relevant in this respect: Firstly, central banks have cut refinancing facilities which have previously been available. Secondly, it was necessary for additional collateral to be provided for government bonds of the European countries which are currently the focus of attention. On 24 June 2010, SoFFin extended that part of the guarantee framework for HRE of € 52 billion which originally expired at the end of June 2010 until 25 May 2011. Most of the liquidity guarantee framework of € 62 billion is thus available to HRE until May 2011, and the remaining liquidity guarantee framework of € 40 billion is available until December 2010.

The same conditions are applicable for all liquidity guarantees which HRE has received from SoFFin via Deutsche Pfandbriefbank AG: Deutsche Pfandbriefbank AG pays to SoFFin a proportionately calculated commitment commission of 0.1% p.a. in relation to that part of the guarantee framework which is not utilised. A commission of 0.5% p.a. is payable for guarantees which are issued.

On 11 January 2010, Deutsche Pfandbriefbank AG successfully issued a government Jumbo Pfandbrief with a volume of € 1 billion. The current Pfandbrief has been issued with an annual coupon of 3.375% and has a term of seven years. In the first half of 2010, Deutsche Pfandbriefbank AG also successfully completed private placings on the market for public Pfandbriefe (€ 0.3 billion), mortgage Pfandbriefe (€ 0.5 billion) and senior unsecured transactions (€ 2.3 billion).

Measures designed to secure liquidity for HRE

Type of support measures	Date of granting	Date of maturity, taking account of prolongations	**Original nominal amount** in € billion	**Nominal amount as of 30.6.2010** in € billion
Issue of SoFFin-guaranteed bearer bonds	18.11.2009	25.5.2011[1]	52.0	52.0
Issue of SoFFin-guaranteed bearer bonds	23.12.2009	22.12.2010[2]	23.0	20.0
Issue of SoFFin-guaranteed bearer bonds	30.12.2009	22.12.2010	20.0	20.0
Issue of SoFFin-guaranteed bearer bonds	28.5.2010	25.5.2011	10.0	10.0
Total liquidity support				**102.0**

[1] Prolongation on 24 June 2010
[2] In accordance with Section 5 (1) of the terms of the bond, instalments of € 1.5 billion have to be repaid on 23.3., 23.6. and on 23.9.2010

Recapitalisation measures As a further step in the direction of recapitalisation, HRE received a commitment from SoFFin on 30 April 2010 for the next recapitalisation tranches of up to € 1.85 billion. The capital is to be paid into additional paid-in capital of HRE Holding in at least two tranches as required. This capital measure still has to be given final approval by the EU Commission. In an initial tranche, a figure of € 1.4 billion was paid into the additional paid-in capital of HRE Holding on 20 May 2010. The primary purpose of the capital increase is to fulfil the minimum capital ratios of DEPFA Bank plc. In the first half of 2010, HRE Holding increased the capital of DEPFA Bank plc by € 550 million, in July 2010 with an additional € 200 million. Overall, HRE has thus received capital of € 7.42 billion from SoFFin in 2009 and in the first half of 2010. Of this amount, € 2.3 billion was allocated to Deutsche Pfandbriefbank AG and € 5.12 billion to HRE Holding. In addition, SoFFin has also promised to make available a further figure of € 450 million as required. HRE continues to assume a capital requirement of € 10 billion. SoFFin intends to take a final decision with regard to recapitalisation after the conclusion of the EU aid proceedings and the establishment of a deconsolidated environment for not strategically necessary or distressed assets of the companies of the HRE Group.

Restructuring measures The restructuring process of HRE in 2010 will focus primarily on transferring non-strategic assets to a deconsolidated environment. Further measures in this respect will be the continued reduction of locations in accordance with the restructuring plan, continued implementation of a harmonised IT platform as well as the introduction of a new staff compensation model.

On 21 January 2010, with the approval of SoFFin, HRE submitted an application to the FMSA for establishing a deconsolidated environment for winding down assets in a manner designed to impose minimum strain on value. On 8 July 2010, the FMSA established a deconsolidated environment under the name «FMS Wertmanagement AöR» to which assets and liabilities from HRE companies are to be transferred. The aim of establishing this deconsolidated environment is to remove not strategically necessary and high-risk portfolios from the balance sheets of the Group companies and to further stabilise the Group. In addition, the core bank Deutsche Pfandbriefbank AG will be clearly separated from the non-strategic parts of the company. The purpose of this separation is to enable Deutsche Pfandbriefbank AG to establish an independent presence on the market more easily and to facilitate its capital market operations. Notwithstanding the FMS Wertmanagement which has already been established, this transaction still has to be approved by the FMSA and the EU Competition Commission. The companies of the Group do not have any entitlement to transfer not strategically necessary and high-risk portfolios to the FMS Wertmanagement.

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, and is expected to comprise assets of up to € 210 billion. Loans which accordingly no longer constitute the strategic focus of the core bank can in this way be continued in the interests of customers in a manner designed to impose minimum strain on value. Parts of the Public Sector and Real Estate Finance portfolios of DEPFA Bank plc and Deutsche Pfandbriefbank AG are to be transferred. The Public Sector Finance portfolio contains assets, sovereign borrowers or sub-sovereign borrowers with high credit quality but a low market valuation at present. Parts of the Real Estate Finance portfolio are being affected by the difficult climate in this segment at present. Assets of other Group companies might also be transferred. They might also be accompanied by structured products and trading positions which are exposed to higher default risks and for which impairments have been recognised, where necessary, or which have been included in net trading income. Derivative positions which mainly constitute hedges and hedge asset as well as liability positions might also be transferred to the deconsolidated environment. Plans are being discussed to transfer not only assets but also selected refinancing funds to the FMS Wertmanagement. There are no plans for transferring unsecured refinancing or Pfandbriefe or other covered bonds of Group companies for refinancing purposes. The concept envisages that the Group companies will support the portfolios and provide further services for the FMS Wertmanagement. In parallel with the above, the necessary IT infrastructure is to be established and the processes are to be separated.

In the first half of 2010, one further non-strategic location was closed in Singapore, and previously duplicate office locations in Tokyo were concentrated in one location.

The business and IT transformation program «New Evolution» successfully put projects into production as scheduled in the first half, e.g. a credit limit system used throughout the Group, personnel management software based on SAP and the implementation of the accounts statistics and interest statistics requirements specified by the bank regulator.

New remuneration system for employees

The regulatory climate and the resultant requirements applicable for remuneration in the finance industry have meant that the existing remuneration systems for employees will also have to be fundamentally revised in the HRE Group. The new system will focus on the new regulatory and legal requirements as well as the requirements of owners in addition to the need to harmonise the remuneration approaches in the HRE Group companies which have not been uniform as a result of historical reasons. All major committees have approved the new remuneration system. Implementation will start in the second half of 2010.

Ratings

In the first half of 2010, and up to 3 August 2010, the following important rating actions took place with regard to the ratings of both the bank and covered bonds:

In April 2010, as a result of the introduction of a new rating methodology for covered bonds – a methodology which (amongst other things) links the covered bond rating to that of the bank – Standard & Poor's downgraded the ratings of Deutsche Pfandbriefbank AG for Public Sector Pfandbriefe and Mortgage Pfandbriefe and they continue to be under review.

The current ratings for the Pfandbriefe are shown in the table below.

Personnel

On 10 November 2010, the Supervisory Board of Deutsche Pfandbriefbank AG appointed Dr. Bernhard Scholz to the Management Board with effect from 1 January 2010. He is responsible for the business segment Real Estate Finance and, since 19 July 2010, additionally for Public Sector Finance.

On 25 March 2010, Dr. Axel Wieandt offered the Supervisory Board of Deutsche Pfandbriefbank AG his resignation from his offices in the HRE Group. The members of the Supervisory Board accepted this offer in the same meeting. On 25 March 2010, the Supervisory Board appointed Manuela Better as Chairman of the Management Board of Deutsche Pfandbriefbank AG on an interim basis. She will continue to carry out her duties as Chief Risk Officer.

Ratings of Deutsche Pfandbriefbank AG and their Pfandbriefs

as of 3 August 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 Pfandbriefe		AA+[1)]	Aaa	AAA
Mortgage Pfandbriefe		AA+[2)]	Aa3	AA+[2)]

[1)] Credit Watch Developing
[2)] Credit Watch Negative

Development in Earnings

Deutsche Pfandbriefbank Group

The Deutsche Pfandbriefbank Group is a specialist bank in public sector and real estate finance. 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 Meetings 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 under common control. The assets and liabilities transferred within the framework of the merger were measured at 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 under common control. The assets and liabilities transferred in the course of the merger were measured at 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 2009 required from IAS 1.36. The income statement of the year 2009 includes both companies since the date of the merger respectively the acquisition. However, in order to present the merger and the acquisition as part of a meaningful comparison which makes sense from the economic point of view, the development in earnings of the Deutsche Pfandbriefbank Group have been disclosed in the form of combined figures in the key financials of the financial report of 2009. For preparing the combined income statements, it has been assumed that the merger took place as of 1 January 2009. The recognition, accounting and measurement aspects of the combined financial information have been prepared in accordance with IFRS.

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

Key financials in € million	**1.1.–30.6.2010** **Deutsche Pfandbriefbank**	**1.1.–30.6.2009** **Deutsche Pfandbriefbank combined**	HRE Bank	DEPFA Pfandbriefbank	pbb Services	Consolidation
Operating performance						
Operating revenues	220	105	34	59	35	–23
Net interest income and similar income	330	329	251	80	–	–2
Net commission income	–8	–12	–6	–6	–	–
Net trading income	–48	–108	–109	1	–	–
Net income from financial investments	–17	–28	–28	–	–	–
Net income from hedge relationships	–39	–33	–16	–17	–	–
Balance of other operating income/expenses	2	–43	–58	1	35	–21
Provisions for losses on loans and advances	401	1,049	1,048	1	–	–
General administrative expenses	171	132	107	12	34	–21
Balance of other income/expenses	–	15	13	–	2	–
Pre-tax profit/loss	–352	–1,061	–1,108	46	3	–2
Key ratio in %						
Cost-income ratio	77.7	>100.0	>100.0	20.3	97.1	91.3

The specific situation of Deutsche Pfandbriefbank Group and the continuation of the difficult situation on some markets, such as the real estate financing market, had a considerably negative impact on development in earnings of the Group in the first half of 2010 and in the comparison period, the first half of 2009. In consequence, pre-tax profit/loss amounted to € –352 million, and was thus negative as expected. However, pre-tax profit/loss was much better than the corresponding figure for the first half of 2009 (2009: € –1,061 million), which reflects signs of stabilisation of Deutsche Pfandbriefbank Group. As was the case in the prior year, the loss was mainly attributable to considerable impairments on loans on real estate financings.

Operating revenues Operating revenues amounted to € 220 million, and were thus higher than the corresponding previous year figure of € 105 million. The increase is attributable to almost all single items of operating revenues.

Because positive and negative effects virtually balanced each other out, net interest income of € 330 million was essentially unchanged compared with the previous year figure of € 329 million. Net interest income declined because repayments were considerably higher than new business and interest-bearing assets therefore declined. In addition, the decline was also attributable to one exceptional item of the previous year which had only a minor impact on net interest income in the current year. Accordingly, in the previous year, Deutsche Pfandbriefbank Group was able to utilise lower refinancing costs in conjunction with constant income on the assets side of its balance sheet as a result of declining interest rates on the money market. Such a development in interest rates did not occur in the first half of 2010. On the other hand, at € 11 million, the one-off income from factoring sales, premature repayment penalties as well as returns and repurchases of financial liabilities was higher than the corresponding figure for the previous year (2009: € 7 million).

Net commission income amounted to € –8 million, and was slightly less negative compared with the previous year figure of € –12 million. The negative net commission income is attributable to expenses for the guarantees and the usage in connection with the liquidity support provided by SoFFin. Due to lower guarantee rates after the restructuring of the liquidity support in December 2009, the expenses of € –45 million were lower than the previous year figure of € –57 million. The major part of the received liquidity supports is transferred to the affiliated entity DEPFA Bank plc, but the net commission income of Deutsche Pfandbriefbank Group was not affected. There was a decline in the income from concluding hedges for customers, which amounted to € 11 million compared with € 13 million in the previous year.

Net trading income of € –48 million (2009: € –108 million) is attributable to the higher default risk of customer derivatives of € –73 million (2009: € –48 million). In order to take account of the increased default risk of customer derivatives, Deutsche Pfandbriefbank Group creates a so-called counterparty risk adjustment in line with the higher probability of default of credit receivables. These expenses were opposed by an income from an internal HRE guarantee concerning the failure of a monoline insurer for Commercial Mortgage Backed Securities amounting to € 35 million (2009: € –37 million). No valuation losses were incurred this year from synthetic collateralised debt obligations (CDOs; such losses amounted to € –25 million in the previous year) as a result of the sale of most of the holdings in the second half of 2009.

In the first six months of 2010, net income from financial investments amounted to € –17 million. Profits from the disposal of financial assets which had been impaired in previous financial years (€ 15 million) were overcompensated by impairments on securities (net € –14 million) and additions to portfolio-based allowances in relation to LaR assets (€ –15 million). The net income from financial investments for the previous year of € –28 million was mainly attributable to impairments of € –13 million recognised in relation to cash CDOs and impairments of € –7 million recognised in relation to mortgage-backed securities.

The net income from hedge relationships amounted to € –39 million, and was thus slightly more negative than the corresponding figure for the first six months of 2009 (€ –33 million). A negative valuation result of € –37 million (2009: € –8 million) was attributable to designated at fair value through profit or loss (dFVTPL) assets. The fair values of the dFVTPL assets which were hedged against interest rate risks changed primarily as a result of the unhedged credit spread movements on the market. Hedge inefficiencies within the range of 80% to 125% permissible under IAS 39 resulted in expenses less than € –2 million (2009: € –25 million). In the current year, these expenses resulted from the further decline in interest rates and cumulative hedge effects which had a negative impact on the income statement before the next rate fixing.

The balance of other operating income/expenses amounted to € 2 million (2009: € –43 million), and mainly resulted from income of € 26 million from services, which were provided by pbb Services GmbH to related entities or the HRE Holding. Expenses resulted from currency translation effects (in particular: US $) of € –18 million (2009: € –57 million). The currency translation effect is mainly due to impairments on foreign currency assets.

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 2010 as a result of the still difficult situation on the commercial real estate markets. Overall, additions to provisions for losses on loans and advances amounted to € 401 million (2009: € 1,049 million).

The difficult economic conditions on the real estate markets, due to the high 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 low 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 subordinated financing tranches.

In accordance with IAS 39, portfolio-based allowances are permitted only for receivables for which there are no indications of an individual impairment. Due to the creation of individual allowances on non-performing loans, portfolio-based allowances could be released by € –20 million (2009: additions of € 8 million).

General administrative expenses General administrative expenses increased to € 171 million, from € 132 million in the prior year. Personnel expenses of € 57 million were unchanged (2009: € 57 million). As of 30 June 2010, the workforce comprised 916 employees, and was thus on the level of the previous year (31 December 2009: 915 employees). Operating expenses of € 114 million were higher than the previous year figure of € 75 million. This was due to higher consultancy and IT costs incurred in connection with the project to transfer the non-strategic assets. The cost-income ratio, i.e. the ratio between general administrative expenses and operating revenues, was 77.7% (2009: >100%).

Balance of other income/expenses The balance of other income/expenses amounting to € 0 million, because additions to and reversals of provisions for the strategic refocusing and restructuring of Deutsche Pfandbriefbank Group balanced each other out. In contrast, the balance of other income/expenses of the first half of 2009 included in particular reversals of restructuring provisions amounting to € 13 million.

Pre-tax profit/loss In the first half of the financial year 2010 pre-tax result was negative at € –352 million (2009: € –1,061 million).

Operating Segment Public Sector Finance

Key financials Public Sector Finance in € million	1.1.–30.6.2010	1.1.–30.6.2009[1]
Operating performance		
Operating revenues	45	70
Net interest income and similar income	51	76
Net commission income	–3	–7
Net trading income	8	1
Net income from financial investments	–11	–
Net income from hedge relationships	–	–
Balance of other operating income/expenses	–	–
Provisions for losses on loans and advances	5	2
General administrative expenses	27	22
Balance of other income/expenses	–	–
Pre-tax profit/loss	13	46
Key ratio in %		
Cost-income ratio	60.0	31.4

[1] Combined

The operating segment Public Sector Finance comprises the public sector financing arrangements which are eligible for cover fund purposes under German law.

Pre-tax segment result fell to € 13 million (2009: € 46 million). The decrease is mainly attributable to a lower net interest income and the negative net income from financial investments.

Operating revenues Operating revenues have fallen from € 70 million in the prior year to € 45 million in the current year. Net interest income declined from € 76 million in the first six months of 2009 to € 51 million in 2010. The previous year figure benefited from strong money market income as a result of interest rate cuts. In the first half of 2010, the relatively constant level of short-term interest rates meant that it was not possible for such revenues to be generated. At € –3 million, net commission income is slightly less negative than the corresponding previous year figure (€ –7 million). The net trading income amounting to € 8 million (2009: € 1 million) is due to the measurement of interest rate derivatives. Net income from financial investments of € –11 million was attributable to impairments recognised in relation to securities (2009: € 0 million).

Provisions for losses on loans and advances Additions to the provisions for losses on loans and advances amounted to € 5 million and comprise solely portfolio-based allowances (2009: € 2 million).

General administrative expenses General administrative expenses increased from € 22 million in the previous year to € 27 million due to an increased workforce and higher allocated overhead costs. Because operating revenues declined and the general administrative expenses increased, the cost-income ratio deteriorated to 60.0 % (2009: 31.4 %).

Operating Segment Real Estate Finance

Key financials Real Estate Finance in € million	1.1.–30.6.2010	1.1.–30.6.2009[1]
Operating performance		
Operating revenues	265	340
Net interest income and similar income	311	344
Net commission income	42	47
Net trading income	–79	–48
Net income from financial investments	–5	–1
Net income from hedge relationships	–	–
Balance of other operating income/expenses	–4	–2
Provisions for losses on loans and advances	395	1,047
General administrative expenses	87	85
Balance of other income/expenses	–	–
Pre-tax profit/loss	–217	–792
Key ratio in %		
Cost-income ratio	32.8	25.0

[1] Combined

The operating segment Real Estate Finance comprises all commercial real estate financing activities of the Group.

In the first half of the year 2010, pre-tax segment result amounted to € –217 million, which, however, was less negative than the corresponding figure in the first half of 2009. The reason for the negative pre-tax result was mainly high additions to the provisions for losses on loans and advances. However, provisions in relation to receivables were lower than was the case in the comparison period.

Operating revenues Operating revenues have fallen to € 265 million compared with € 340 million in the previous year. Net interest income has declined to € 311 million (2009: € 344 million). The decline is attributable to the consistent winding down of interest-bearing loans. In addition, net interest income was also affected by the default of borrowers and the corresponding default of interest payments. This effect was partially compensated by the so-called unwinding process, i.e. by extrapolating the present value of the expected future cash flows. Net commission income of € 42 million was lower than the corresponding previous year figure (2009: € 47 million). However, the previous year benefited from the recognition in the income statement of commissions of € 8 million for receivables which were not syndicated as originally planned. As was the case in the previous year, the net trading income of € –79 million (2009: € –48 million) was attributable to the default risk of customer derivatives for which a counterparty risk adjustment had been set. The net income from financial investments of € –5 million (2009: € –1 million) was attributable to impairments of securities. Because the changes in the values of underlyings compensated for the changes in the values of hedging instruments, there was no net income from hedge relationships as was the case in the previous year. The balance of other operating income/expenses amounted to € –4 million (2009: € –2 million).

Provisions for losses on loans and advances In the first half of 2010, the situation on the commercial real estate markets continued to be difficult. The solvency of customers, which in many cases depends to a large extent on the cash flows of the financed properties, was very much affected by the rising vacancy rates and the difficulty of marketing in particular new properties and generally refurbished properties. This development mainly affected commercial real estate financings provided for hotels, offices and retail properties. In the first half of 2010, these problems mainly affected financing in the USA, Great Britain and Japan. Material impairments in Germany also had a considerable impact due to the significance of such exposures in relation to the overall portfolio. Provisions for losses on loans and advances amounted to € 395 million in the first half of 2010. Individual allowances account for € 422 million. Due to the creation of individual allowances, portfolio-based allowances were released by € –26 million. In the previous year, additions to provisions for losses on loans and advances amounted to € 1,047 million.

General administrative expenses General administrative expenses increased from € 85 million in the previous year to € 87 million in the current year. Because operating revenues declined and the general administrative expenses increased, the cost-income ratio deteriorated to 32.8% (2009: 25.0%).

Operating Segment Value Portfolio

Key financials Value Portfolio in € million	1.1.–30.6.2010	1.1.–30.6.2009[1]
Operating performance		
Operating revenues	–46	–201
Net interest income and similar income	–21	–61
Net commission income	–47	–52
Net trading income	23	–61
Net income from financial investments	–1	–27
Net income from hedge relationships	–	–
Balance of other operating income/expenses	–	–
Provisions for losses on loans and advances	1	–
General administrative expenses	16	24
Balance of other income/expenses	–	–
Pre-tax profit/loss	–63	–225
Key ratio in %		
Cost-income ratio	>100.0	>100.0

[1] Combined

The operating segment Value Portfolio comprises non-strategic portfolios of Deutsche Pfandbriefbank Group, e.g. CDOs, Commercial Mortgage Backed Securities and Residential Mortgage Backed Securities.

The pre-tax result of the operating segment Value Portfolio was negative at € –63 million but much less negative than the corresponding previous year figure (2009: € –225 million).

Operating revenues The expenses for the liquidity support which was provided had a negative impact on operating revenues, which amounted to € –46 million compared with € –201 million in the previous year. At € –21 million, net interest income was less negative than the corresponding previous year figure (2009: € –61 million) amongst others due to lower interest expenses for the liquidity support. Mainly as a result of the expenses for the guarantees provided in connection with the liquidity support, the net commission income was very negative (€ –47 million compared with € –52 million in 2009). However, because of the lower guarantee rates after the restructuring of the liquidity support in December 2009, net commission income was slightly less negative than was the case in the previous year. Net trading income was positive at € 23 million (2009: € –61 million). The income resulted from valuation gains of € 35 million (2009: € –37 million), regarding an internal HRE guarantee for the default of a monoliner for Commercial Mortgage Backed Securities which were partly compensated from valuation losses arising from stand-alone derivatives of the bank book. In the net income from financial investments of € –1 million (2009: € –27 million) impairments recognised in relation to CDOs and portfolio-based allowances recognised in relation to LaR financial assets balanced out gains from the disposal of securities, which had been impaired in prior years.

Provisions for losses on loans and advances Additions to the provisions for losses on loans and advances amounted to € 1 million (2009: € 0 million) and comprise solely portfolio-based allowances.

General administrative expenses As a result of the redundancy programme, the closure of locations and the reversal of personnel provisions, general administrative expenses of € 16 million were lower than the corresponding previous year figure (2009: € 24 million). As was the case in the previous year, the cost-income ratio, i.e. the ratio between general administrative expenses and operating revenues, was more than 100%.

Consolidation & Adjustments

Key financials Consolidation & Adjustments in € million	1.1.–30.6.2010	1.1.–30.6.2009[1]
Operating performance		
Operating revenues	–44	–104
Net interest income and similar income	–11	–30
Net commission income	–	–
Net trading income	–	–
Net income from financial investments	–	–
Net income from hedge relationships	–39	–33
Balance of other operating income/expenses	6	–41
Provisions for losses on loans and advances	–	–
General administrative expenses	41	1
Balance of other income/expenses	–	15
Pre-tax profit/loss	–85	–90

[1] Combined

The Consolidation & Adjustments column is used for reconciling the sum of segment results with consolidated results. In addition to consolidations, this column includes certain expenses and income which are not classified under the operating segments.

Consolidation & Adjustments accounted for a negative pre-tax result of € –85 million. However, due to a lower net interest income and a positive balance of other operating income/expenses, pre-tax result was slightly less negative than in the previous year (2009: € –90 million).

Operating revenues The operating revenues at € –44 million were less negative than in the previous year (2009: € –104 million) due to lower charges in net interest income and in the balance of other income/expenses. The net interest income of € –11 million was less negative than the corresponding previous year figure (2009: € –30 million) because liabilities could be reduced in conjunction with the recapitalisation. The net income from hedge relationships of € –39 million (2009: € –33 million) was attributable to hedge inefficiencies within the range permissible in accordance with IAS 39 as well as changes in values of dFVTPL assets. The positive balance of other operating income/expenses of € 6 million (2009: € –41 million) is attributable to income from pbb Services GmbH, which provides services for affiliated companies or HRE Holding. In addition, the balance of other operating income/expenses was depressed by foreign currency translation effects in the previous year.

General administrative expenses General administrative expenses of € 41 million were higher than the corresponding previous year figure of € 1 million, due to consultancy fees incurred in connection with establishing the deconsolidated environment.

Balance of other income/expenses The balance of other income/expenses of the previous year included reversal of restructuring provisions. In the current year there were no comparable effects.

Development in Assets

Assets in € million	**30.6.2010**	**31.12.2009**	Δ in € million
Cash reserve	309	618	–309
Trading assets	1,169	1,435	–266
Loans and advances to other banks	15,303	78,151	–62,848
Loans and advances to customers	67,064	91,221	–24,157
Allowances for losses on loans and advances	–986	–3,326	2,340
Financial investments	18,178	30,914	–12,736
Property, plant and equipment	8	10	–2
Intangible assets	25	28	–3
Other assets	15,513	11,801	3,712
Income tax assets	5,008	4,365	643
Current tax assets	68	131	–63
Deferred tax assets	4,940	4,234	706
Disposal group	107,903	–	107,903
Total assets	**229,494**	**215,217**	14,277

Total assets of Deutsche Pfandbriefbank Group amounted to € 229.5 billion as of 30 June 2010, and were thus € 14.3 billion higher than the figure of € 215.2 billion reported as of 31 December 2009. The increase is attributable to market-related factors. The weakening of the Euro against the US Dollar, the Japanese Yen and GB Pound resulted in an increase of the balance sheet assets presented in Euros because the foreign currency assets and liabilities receive a higher book value in Euros as a result of currency translation. In addition, the market values of the derivatives increased by a total of € 4.2 billion as a result of the changed yield curve and also as a result of currency factors. The adjustments to the fair values of the underlyings recognised in fair value accounting also increased by € 1.3 billion for the same reason. In addition, Deutsche Pfandbriefbank Group had to provide additional collateral for covered refinancing as a result of the downgraded ratings of some countries and the weaker Euro; this resulted in an increase in total assets. Due to the fact that the liquidity requirements of DEPFA Bank plc also increased, additional liquidity supports were transferred which caused higher total assets of Deutsche Pfandbriefbank Group.

Without the market-related factors, total assets would have declined in the first half of 2010 because new business originated according to the new risk policy was considerably lower than the repayments and sales of assets.

Similar to the situation with total assets, the total volume of lending, which comprises loans to customers and credit institutions excluding investments and the contingent liabilities, increased from € 169.9 billion at the end of 2009 to € 181.3 billion as of 30 June 2010 as a result of the market-related factors. However, without the market-related factors, the total volume of lending would also have declined.

The assets which are to be transferred to the deconsolidated environment in line with the plans of Deutsche Pfandbriefbank Group and subject to the approval of the FMSA and the European Commission are disclosed as disposal group in accordance with IFRS 5. The previous year figures do not have to be adjusted.

Development in the Financial Position

Equity and liabilities in € million	30.6.2010	31.12.2009	Δ in € million
Liabilities to other banks	85,166	67,625	17,541
Liabilities to customers	14,329	12,378	1,951
Liabilities evidenced by certificates	78,728	109,193	−30,465
Trading liabilities	2,603	1,872	731
Provisions	148	153	−5
Other liabilities	17,436	13,635	3,801
Income tax liabilities	4,374	3,733	641
Current tax liabilities	84	85	−1
Deferred tax liabilities	4,290	3,648	642
Subordinated capital	3,812	3,895	−83
Disposal group	20,294	–	20,294
Liabilities	**226,890**	**212,484**	14,406
Equity attributable to equity holders	**2,604**	**2,733**	−129
Subscribed capital	380	380	–
Silent participation	999	999	–
Additional paid-in capital	5,037	5,037	–
Retained earnings	−2,805	−1,310	−1,495
Revaluation reserve	−327	−858	531
AfS reserve	−302	−328	26
Cash flow hedge reserve	−25	−530	505
Consolidated loss 1.1.–31.12.	–	−1,515	1,515
Consolidated loss 1.1.–30.6.	−334	–	−334
Amounts recognised in equity relating to disposal group	−346	–	−346
Minority interest in equity	–	–	–
Equity	**2,604**	**2,733**	−129
Total equity and liabilities	**229,494**	**215,217**	14,277

In accordance with IFRS 5, the amounts recognised in equity relating to disposal group were disclosed separately which are transferred to the deconsolidated environment when the assets and liabilities are transferred. This is the AfS reserve of the AfS assets to be transferred and the cash flow hedge reserve of the derivatives to be transferred shown in cash flow hedge accounting.

Equity amounted to € 2.6 billion as of 30 June 2010 (31 December 2009: € 2.7 billion). Revaluation reserve was less negative at € −0.3 billion than at the end of the previous year (31 December 2009: € −0.9 billion). The improvement resulted from the separate disclosure of the amounts recognised in equity relating to disposal group. Without this disclosure AfS reserve would have been more negative. Deteriorations in the market values of the bonds of European countries in focus were the main reasons for that. On the other hand, if the amounts had not been disclosed separately, the cash flow hedge reserve would have been less negative as a result of derivative maturities and also as a result of the changed level of interest rates.

The liabilities which are to be transferred to the deconsolidated environment in accordance with the plans of Deutsche Pfandbriefbank Group and subject to the approval of the FMSA and the European Commission are shown in accordance with IFRS 5 as disposal group. The previous year figures do not have to be adjusted.

Total Group liabilities amounted to € 226.9 billion as of 30 June 2010, compared with € 212.5 billion as of 31 December 2009. As is the case with the assets, this increase is also due to the weaker exchange rate of the Euro and the changed yield curve. This has resulted in an increase mainly in liabilities to other banks and liabilities to customers as well as the market values of the derivatives. Liabilities also increased because the collateral which Deutsche Pfandbriefbank Group had to additionally place on the market as a result of the rating downgrade of some countries and the weaker Euro had to be refinanced. The Deutsche Pfandbriefbank Group was able to refinance part of the higher demand on the market. Liquidity support of SoFFin had to be used for other parts of this higher demand.

The contingent liabilities declined slightly to € 0.6 billion as of 30 June 2010 (31 December 2009: € 0.7 billion). The other obligations declined to € 2.4 billion from a figure of € 2.7 billion at the end of last year. The receivables which have not been paid out, or which have not been paid out in full, are reflected in the irrevocable loan commitments, and amounted to € 2.2 billion as of 30 June 2010 compared with € 2.6 billion as of 31 December 2009. The decline in the irrevocable loan commitments is attributable to the higher drawing rate and the reduction of commitments.

Regulatory Indicators according to German Solvency Regulation

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

Summary

The income statement for the first half of 2010 reflects the specific and extremely difficult situation of Deutsche Pfandbriefbank Group as well as the crisis on the real estate markets. The negative pre-tax result of € –352 million was mainly attributable to the additions to the provisions for losses on loans and advances. However, this figure was much better compared with the first half of 2009, which reflects signs of a stabilisation of Deutsche Pfandbriefbank Group.

Events after 30 June 2010

No notable events have taken place after 30 June 2010.

In the first half of 2010, the situation on the capital markets was characterised by the uncertain development of the debt situation of some European countries which are currently the focus of attention, namely Portugal, Spain, Italy, Ireland and Greece. Credit spreads of these countries increased significantly. Following the considerable downgrading of ratings to non-investment grade, the risk spread, particularly for Greek government bonds, rose to an all-time high at the end of April. The default of one or more of these countries would have an extremely negative impact on the solvency of HRE and therefore also of Deutsche Pfandbriefbank Group in view of the former business model of DEPFA Bank plc, which also comprised public sector finance for the above-mentioned European countries. The rescue package of € 750 billion adopted by the EU on 9 May 2010 has for the time being put an end to the speculation (which was exacerbating the cycle) concerning the default of certain countries in the Euro zone and reduced credit spreads somewhat. However, the weakness of the euro and the considerable level of volatility on the markets are still illustrating that investors do not trust the ability of these countries to service their debt on a permanent basis.

The situation on the real estate markets has improved somewhat. In some countries, real estate transactions are now rising again, albeit starting from a low level. However, there are still considerable volumes of unlet properties which are depressing the prices for commercial real estate. These effects are now increasingly exerting pressure on real estate funds and the corresponding financing. The developments described above are also having a negative impact on the risk situation of Deutsche Pfandbriefbank Group.

In the first half of the year, the refinancing situation was characterised by liquidity problems due to the weakening of the euro against the US dollar. Further major factors are explained in the section «Liquidity Risk» in this risk report. These effects were offset by the liquidity support measures of SoFFin, which are explained in detail in the chapter «Major events» of the Management Report. Deutsche Pfandbriefbank AG was again able to place private placings and benchmark transactions on the market in the first half of 2010.

Deutsche Pfandbriefbank Group is integrated in the enterprise-wide risk management system of HRE which is described in detail in the Risk Report of the Annual Report 2009 of HRE. The actual report focuses on changes of the risk management system compared to year-end 2009.

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 Deutsche Pfandbriefbank Group, HRE has installed a Group-wide risk management and risk controlling system. 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 Deutsche Pfandbriefbank Group.

Organisation and Committees

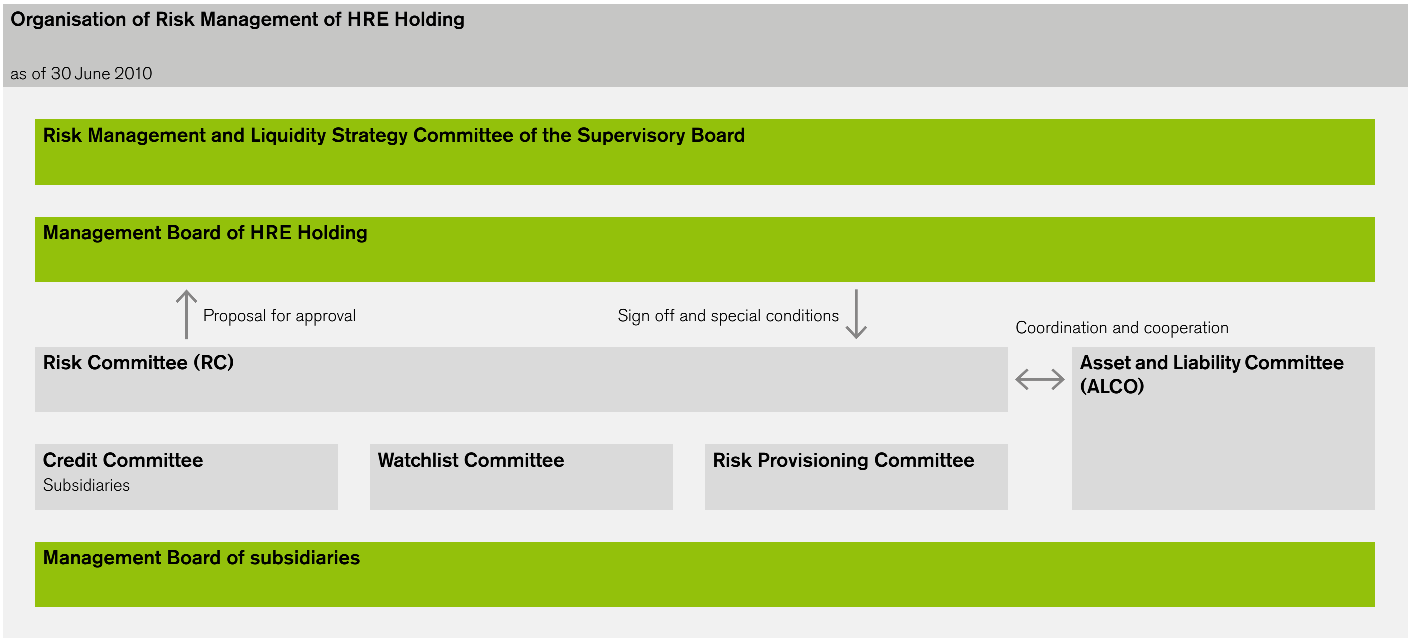
The principles, methods and processes of the risk management system of HRE are specified centrally by risk management and controlling of HRE Holding and are applied in Deutsche Pfandbriefbank Group. In addition to the Credit Committee, which is responsible for credit decisions in Deutsche Pfandbriefbank 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 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 risk organisation. 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 risk management system of HRE is explained in detail in the Risk Report of the Annual Report 2009, and has not fundamentally changed since that time.

The members of the Management Board of Deutsche Pfandbriefbank Group, who also exercise their respective functions in the HRE Management Board, bear overall responsibility for all strategic and operational decisions of Deutsche Pfandbriefbank Group on the basis of the specifications of HRE.

The main activities in the risk management system for which the Management Board is responsible are detailed in the overview:

- Definition, updating and communication of business and risk strategies in line with the business strategies as the basis of business activities and risk-taking for Deutsche Pfandbriefbank Group
- Defining and improving organisation structures for the Group and 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 Deutsche Pfandbriefbank Group informs the Supervisory Board of Deutsche Pfandbriefbank Group regularly of any changes in the group-wide business and risk strategies, the risk profile and the specific business and risk strategies of the Deutsche Pfandbriefbank Group.

The Risk Management and Liquidity Strategy Committee (RLA) of the Supervisory Board on HRE Group level is mainly responsible for controlling the overall risk situation and for monitoring, establishing and improving an efficient risk management system, and is also responsible for the liquidity management and assurance of the Group in which the Deutsche Pfandbriefbank Group is integrated.

The tasks of the Committees have not changed significantly since year-end 2009 and are described in greater detail in the Risk Report of the Annual Report 2009 of Deutsche Pfandbriefbank Group.

Group Chief Risk Officer (CRO) In addition to the above-mentioned committees, the following organisational entities of the Group CRO who is also the CRO of Deutsche Pfandbriefbank Group are an integral component of the risk management system, where Deutsche Pfandbriefbank Group is integrated:

The tasks of these organisational entities of the CRO, in their capacity as risk-monitoring and back-office entities, have not changed significantly compared with the contents described in the Risk Report of the Annual Report 2009.

Credit Quality Control, which was still being set up in 2009, now reports to Risk Management & Control and is responsible as a department for quality assurance of all credit processes in the Group as well as other tasks of risk governance, for instance assuring MaRisk compliance in the Group.

Property Analysis & Validation, which is responsible for the analysis and consistent valuation of real estate collaterals through a market- or a lending-value approach has been transferred to the area of responsibility of the COO.

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

Organisation of the Chief Risk Officer of HRE Holding

as of 30 June 2010

Group CRO

Risk Management & Control	Credit Officer Real Estate	Credit Officer Public Sector, Financial Institutions & Value Portfolio	Global Workout

Risk Strategy and Policies

The currently valid risk strategy, which was adopted in the third quarter of 2009 by the Management Board of HRE Holding and also for the various relevant parts by the Management Board of Deutsche Pfandbriefbank Group reflects the strategic refocusing of the Group as a specialist public sector financier and real estate financier in Germany and Europe with Pfandbrief-oriented refinancing, and is extensively described in the Risk Report of the Annual Report 2009 of HRE.

In the second quarter of 2010, an adjustment was made with regard to the new designation of the operating segments Public Sector Finance, Real Estate Finance and Value Portfolio and the extent of the plan to spin off parts of portfolios (planned as of 30 September 2010) to the newly established deconsolidated environment (FMS Wertmanagement Anstalt des öffentlichen Rechts). A separate strategy is currently being drawn up for the remaining Deutsche Pfandbriefbank Group and will be valid probably starting in the fourth quarter of 2010.

The following are the key components of the strategy which are unchanged compared with December 2009:
> Focusing of new business on the primary market for Pfandbrief-eligible issues in Public Sector Finance operations and Pfandbrief-eligible loans in Real Estate Finance operations
> Provision of financing structures of low complexity in the primary market – secondary market transactions do not form part of the Group's core operations
> Risk-oriented portfolio management of new and existing business of Deutsche Pfandbriefbank Group supported by syndication and securitization 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 Deutsche Pfandbriefbank Group, which is part of the risk strategy of HRE, is broken down into strategies for the intended new business and the strategic and non-strategic portfolio business for the new Public Sector Finance and Real Estate Finance segments. Risk sub-strategies for the major risk types of Deutsche Pfandbriefbank Group are explained in greater detail in the Risk Report of the Annual Report 2009 as well as in the relevant chapters of the actual report.

The risk strategy in HRE is implemented in operational terms via Group-wide applicable risk policies for the individual operating segments and also for all major risk types (credit, market, liquidity and operational risk), which describe risk measurement, risk monitoring and 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

The entire risk reporting of HRE and of Deutsche Pfandbriefbank Group was adjusted and brought into line with the new segment structure in the first half of 2010. The regular reports for the Management Board of HRE and the Management Boards of its subsidiaries include the following:
> Daily liquidity risk report for the liquidity position and preview
> Weekly summary of the markets, the market risk development as well as relevant management information
> Quarterly Group risk and credit risk report
> Monthly, short Group risk report concerning major parameters relevant for management purposes

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

These reports provide the Management Board of Deutsche Pfandbriefbank Group with a comprehensive overview as well as detailed information concerning the risk situation for each risk type. In addition, special reports dealing with specific and acute risk aspects are prepared on an ad hoc basis or at the request of the Management Board or Supervisory Board.

In the individual committees mentioned 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 Deutsche Pfandbriefbank Group respectively 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.

Risk Quantification and Risk Management

At the portfolio level of 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 Risk Report of the Annual Report 2009 of Deutsche Pfandbriefbank Group in the chapters concerning 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 applicable regulations concerning compliance and corporate governance.

At the portfolio level and at the level of individual transactions, risk in Deutsche Pfandbriefbank Group is managed by:

1. Monitoring the risk-bearing capacity of Deutsche Pfandbriefbank Group on the basis of the comparison of economic capital and the risk cover funds of HRE at the portfolio level, with due consideration also being given to stress tests.
2. Monitoring of the risk-weighted assets (RWA) of Deutsche Pfandbriefbank Group by way of stress tests which are intended to ensure that the regulatory total capital ratio does not fall below 8.5%.
3. Operational risk management via
   > The use of Basel-II-compliant risk parameters in the lending business of Deutsche Pfandbriefbank Group. The Basel-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 introduced in Deutsche Pfandbriefbank Group in the first quarter of 2010 for credit risks on HRE Group level on the basis of a standard application which has been tested in the market with a uniform HRE Group-wide risk measurement method
   > Watchlist and management of individual counterparties
   > Monitoring the risk of losses by way of appropriate impairment triggers in accordance with IAS 39

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

Economic Capital and Monitoring of Risk-bearing Capacity

Deutsche Pfandbriefbank Group has established an internal risk-bearing capacity analysis which is based on the Internal Capital Adequacy Assessment Process (ICAAP), in order to ensure that its risk position is consistent with the information in the risk strategy 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 to Deutsche Pfandbriefbank Group is based on the requirements and demands of its business. A further criterion is the need to meet the pillar-2 criteria under Basel II for banks and also specify these criteria in accordance with the German Minimum Requirements applicable for Risk Management (MaRisk). These require 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 Deutsche Pfandbriefbank Group 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%.

Further details concerning the calculation and the limits of the model calculation of economic capital are set out in the Risk Report in the Annual Report 2009 of Deutsche Pfandbriefbank Group.

In order to evaluate the adequacy of Deutsche Pfandbriefbank Group's capital backing, 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 in particular shareholders' equity in accordance with IFRS, components similar to shareholders' equity (subordinate capital and hybrid capital), deferred tax costs as well as the planned result for the next twelve months. These components are suitable for mitigating 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).

The main risk types on the basis of the ICAAP (measured in terms of economic capital and without explicitly recognising the liquidity risk) are the credit risk and the market risk which together account for more than 92 % of the economic capital.

In terms of economic capital, Deutsche Pfandbriefbank Group has been sufficiently capitalised.

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

In the first quarter of 2010, a significant adjustment of the ICAAP method to the changed business strategy of HRE and thus also Deutsche Pfandbriefbank Group has taken place. The strategic refocusing was 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 transfer assets to a deconsolidated environment. Details of the adjustment to measures are set out in the chapter «Result of the risk-bearing capacity analysis».

Major Projects in Risk Management of Deutsche Pfandbriefbank Group

As a result of the complete integration of risk management of 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 Group-wide limit system for credit risks, which covers all borrowers and products of all consolidated legal entities of the Group, was implemented in the first quarter of 2010. Further improvements and upgrades will follow in the second half of 2010.

Management information system MIS Since the beginning of 2010, internal and external credit risk reporting has to a large extent been based on the Group-wide reporting platform «MIS/Risk Cockpit» which was introduced at the beginning of 2010. 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, work in 2009 focused 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 for Deutsche Pfandbriefbank Group.

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 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 Deutsche Pfandbriefbank Group which are not quantified but which are limited by means of suitable reports, guidelines and 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 described in detail in the Risk Report of the Annual Report 2009 of Deutsche Pfandbriefbank Group.

Credit Risk Strategy and Principles

As part of the restructuring process, HRE has broken down the overall credit portfolio into a strategic portfolio and a value portfolio. The new portfolio structure was implemented in the first quarter of 2010. The approved risk strategy already reflects the new structure.

The strategic portfolio is broken down as follows:
- Public Sector Finance (PSF) portfolio, which comprises the Public Sector Finance business of the Deutsche Pfandbriefbank Group
- Real Estate Finance (REF) portfolio, which comprises the former Commercial Real Estate Finance portfolio

The Value Portfolio comprises non-strategic portfolios of Deutsche Pfandbriefbank Group. There are no plans for expanding business activities in the Value Portfolio; instead, the focus is on reducing assets with the aim of maintaining value and imposing the minimum strain on capital.

The exposure of Treasury, which serves the purpose of refinancing the individual segments and which formerly was allocated to Capital Markets & Asset Management, is allocated to the individual segments.

Sub-portfolios from the Strategic Portfolio and also from the Value Portfolio will probably be transferred to a deconsolidated environment (FMS Wertmanagement) by the end of the third quarter; this is described in greater detail in the chapter «Major Events» in this report.

The credit risk strategy is currently being drawn up for the future portfolio of Deutsche Pfandbriefbank Group on the basis of the currently valid risk strategy, and will be applicable when the portfolio transfer process has been completed.

Organisation of Credit Risk Management

As the back-office entities for credit risk management of Deutsche Pfandbriefbank Group, the organisation of the Group CRO covers all areas which are detailed in the previous part under the chapter «Chief Risk Officer». In line with the requirements of MaRisk, the entities are organisationally independent of the sales entities right through to the Management Board.

Credit Risk Reports

The Group risk report and the credit risk report of HRE are discussed and adopted every quarter in the Management Board of Deutsche Pfandbriefbank Group. Together with ad hoc special analyses, the reports show the current portfolio and risk development and, together with the adopted risk strategy, form the basis for decisions regarding necessary management measures.
- The Group risk report comprises the development in overall volumes as well as relevant credit risk management parameters, such as the development in expected loss and unexpected loss via the value at risk. The report shows the credit risk in the context of the overall bank risk and risk-bearing capacity at the Group level and also at the individual institution level; it reports limit utilisations and violations and also identifies risk concentrations.
- The credit risk report contains details of the portfolio and the risk parameters at the Group level and also at the level of the subsidiary institutions.

The Risk Management and Liquidity Strategy Committee of the Supervisory Board of HRE receive requested special analyses as well as both reports for information purposes.

Major parameters, contents and analyses are presented and discussed in the Credit Committee of Deutsche Pfandbriefbank Group as support for taking decisions with regard to new business or adjustment of conditions.

In daily business of 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 Deutsche Pfandbriefbank Group are reported to a wider group.

Risk Quantification via the Economic Capital and the Risk-weighted Assets according to Basel II

Credit portfolio model For calculating the credit risk VaR, which is the basis for determining the economic credit risk capital, Deutsche Pfandbriefbank Group uses a credit portfolio model which is described in greater detail in the chapter «Results of the Risk-bearing Capacity Analysis».

Stress tests The methods applied for the stress tests for economic in credit risk as well as the reverse stress tests for risk-weighted assets (RWA reverse stress test) are unchanged compared with the end of 2009, and are described in the Risk Report of the Annual Report 2009 of Deutsche Pfandbriefbank Group.

Credit risk quantification according to Basel II Deutsche Pfandbriefbank Group – apart from the former DEPFA Deutsche Pfandbriefbank AG (which is now part of the merged Deutsche Pfandbriefbank Group) – has already received regulatory approval to apply the so-called Advanced Internal Rating-Based Approach (Advanced IRBA) for determining the regulatory capital backing. The regulatory audit regarding the introduction of the Advanced IRBA in the former DEPFA Deutsche Pfandbriefbank AG was carried out in the first quarter of 2010. The result of the audit will probably be available at the end of 2010.

EU-wide stress test of capital ratios At the end of June 2010, the European banking regulator CEBS requested the banks, via the local banking regulator, to carry out a stress test for tier 1 capital ratios at Group level for 2010 and 2011. The defined parameters reflect a not very critical base case scenario and an adverse scenario. The banks were also requested to subject their portfolio of government bonds of the trading book (also with defined parameters) to a stress test. On the specified assumption of zero growth, the effects of the stress tests on results and risk-weighted assets were integrated in planning for 2010 and 2011.

The result of the stress test was published by the CEBS on 23 July 2010 for all participating banks.

For HRE Group show the results that HRE fulfils the requested tier 1 capital ratio of 6% in all but the adverse scenario in 2011 both without and with consideration of the additional stress test of the sovereign portfolio in the bank's trading book. HRE meets in all stress scenarios the regulatory minimum tier 1 capital ratio of 4%.

It should be noted that the stress testing outcomes for 2011 have limited relevance for the Group.

For instance, the test has not taken into consideration the transfer of assets worth up to € 210 billion to FMS Wertmanagement – the deconsolidated environment to which assets will be transferred from HRE – which is scheduled for the second half of 2010. This transfer will substantially reduce risk-weighted assets. Furthermore, given that the financial markets crisis has not been fully resolved, HRE Group applied to SoFFin for a recapitalisation in an aggregate amount of € 10 billion, of which € 7.87 billion has been approved to date. Given full recapitalisation, HRE would exceed the 6% tier 1 ratio for all scenarios used in the current stress test.

Deutsche Pfandbriefbank Group did not carry out the stress test separately.

Credit Risk Management and Monitoring

At the portfolio level of Deutsche Pfandbriefbank Group, 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:
> Limiting of country risks
> Definition of strategic risk parameters (e.g. target customers, regions, financing duration)

Monitoring of compliance with the defined limits and the intended risk and return parameters at the portfolio level and individual transaction level of Deutsche Pfandbriefbank Group is based particularly (at the portfolio level) on economic VaR parameters, the analysis of concentration risks and further special regular and ad hoc evaluations.

At the sub-portfolio level and individual transaction level, the development of the markets and relevant portfolios is regularly analysed by the local Credit Risk Management units. In addition, the collateral is regularly evaluated and special reports concerning exposures which are potentially at risk (e.g. «credit issue notes») are prepared.

At the level of individual transactions of Deutsche Pfandbriefbank Group, the HRE Group-wide effective guidelines for credit processes determine the necessary steps for assessing risk in the case of new business and prolongations as well as the process of transferring exposures to the Watchlist or Workout. Details of these processes which are still valid are included in the Risk Report of the Annual Report 2009 of Deutsche Pfandbriefbank Group.

Hedging and Minimising Risk by Collateral

In Deutsche Pfandbriefbank Group, property collateral in the field of Real Estate Finance are 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 Finance business.

The value of the collateral is reviewed as part of the regular (annual) rating assessment of borrowers of 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

Since 31 December 2009, the entire credit portfolio of Deutsche Pfandbriefbank Group has been calculated using a standard method in line with the Basel-II-compliant Exposure at Default (EaD).

The Basel-II-compliant term Exposure at Default (EaD) recognises 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 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.

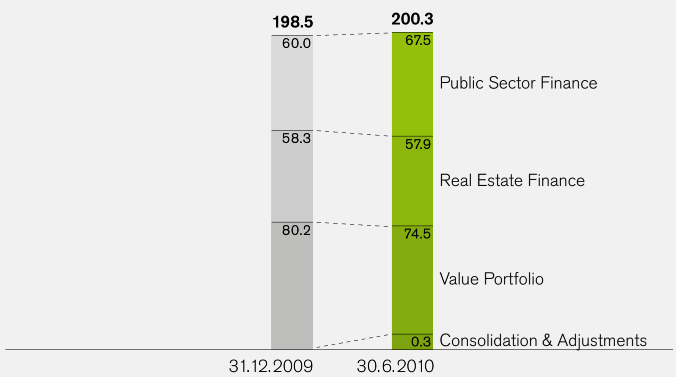
The EaD of the credit portfolio of Deutsche Pfandbriefbank Group amounted to around € 200.3 billion as of 30 June 2010 and was nearly unchanged (+ € 1.8 billion) compared with the corresponding figures as of 31 December 2009 (€ 198.5 billion).

New business of Deutsche Pfandbriefbank Group comprising a total of € 1.4 billion commitments in the operating segments described in the following mainly comprised Real Estate Finance business in Germany and Great Britain (€ 1.0 billion). Of this figure, € 0.7 billion is attributable to selected prolongations of existing business. The remaining business of € 0.4 billion is attributable to the Public Sector Finance segment.

Overview of the total exposure of Deutsche Pfandbriefbank Group: € 200.3 billion EaD The credit portfolio is broken down into the following strategic operating segments:
> Public Sector Finance (PSF)
> Real Estate Finance (REF)
> Non-strategic Value Portfolio (VP) which has been identified for winding-down purposes.

Total exposure: EaD according to operating segments

in € billion



The Value Portfolio comprises within the exposure of € 74.5 billion (€ 80.2 billion as of 31 December 2009) € 59.1 billion (€ 57.6 billion as of 31 December 2009) debt to the affiliated institution DEPFA Bank plc according to passing the liquidity support.

The category «Consolidation & Adjustments» also includes internal reconciliation and consolidation positions as well as a small number of individual positions which cannot be attributed to other positions.

Risk parameters Expected loss The expected loss (EL), which is calculated on the basis of the parameters specified by Basel II, the annual probability of default (PD), the loss-given default (LGD) and the exposure at default (EaD), amounted for Deutsche Pfandbriefbank Group € 1,062 million as of 30 June 2010.

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 expected loss in € million	30.6.2010	31.12.2009
Public Sector Finance	33.9	10.9
Real Estate Finance	968.9	833.2
Value Portfolio	49.4	29.1
Consolidation & Adjustments	10.1	–
Total	**1,062.3**	**873.2**

Using the parameters defined under Basel II, the expected loss (EL) for the Commercial Real Estate portfolio was € 969 million as of 30 June 2010 (€ 833 million as of 31 December 2009). It has accordingly deteriorated reflecting the negative development on the real estate markets.

The increase of the expected loss of the business segment Public Sector Finance is mainly attributed due to one large deal (+ € 19 million EL), where the borrower had problems with due payments.

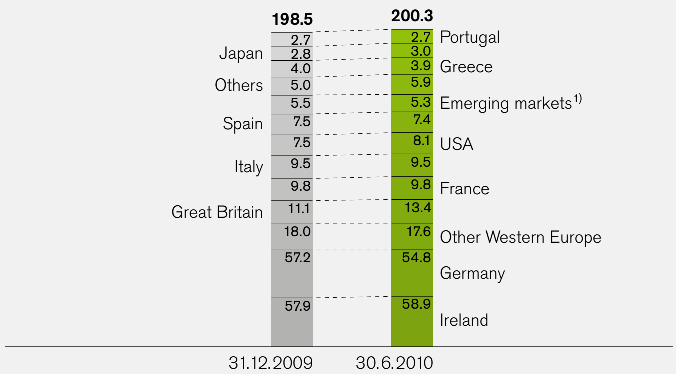
Economic credit risk capital The unexpected loss of the exposure, the credit risk value-at-risk, is calculated using a credit risk portfolio model for a period of one year and a confidence level of 99.95% within the framework of the risk-bearing capacity analysis of HRE. The model is described in the Risk Report of the Annual Report 2009 of Deutsche Pfandbriefbank Group. Details of the calculation of economic credit risk capital are set out in the chapter «Result of the Risk-bearing Capacity Analysis».

Economic credit risk capital amounts for Deutsche Pfandbriefbank Group as of 30 June 2010 € 2.5 billion (31 December 2009: € 2.2 billion) without taking into account diversification effects.

Regional breakdown of the portfolio As was the case at the end of 2009, 92% of the exposure is concentrated on Western Europe. Germany is the main country in this respect (€ 54.8 billion, 27%). The UK, USA and Spain currently account for € 28.9 billion (14%) of the exposure of the Deutsche Pfandbriefbank Group. € 58.4 billion of exposure of Ireland is attributable to receivables due from the affiliated institution DEPFA Bank plc. The following are the main positions included in the Other Western Europe category: Austria with € 7.4 billion (€ 7.7 billion as of 31 December 2009), Sweden with € 2.3 billion (€ 2.1 billion), and Switzerland with € 1.7 billion (€ 1.5 billion). The exposure to emerging markets in accordance with the IMF definition comprises Poland with € 2.1 billion and Hungary with € 1.1 billion. The decline of the portfolio in the USA in local currency is overcompensated by currency effects (the euro declined to the US dollar by 15% since year-end 2009). The increasing of the portfolios of UK, Switzerland and Japan are also mainly due to currency effects.

Total exposure: EaD according to regions

in € billion



1) Emerging markets in accordance with the IMF definition

Public Sector Finance: € 67.5 billion EaD Portfolio development and structure The strategic portfolio of the business segment Public Sector Finance (PSF) amounted to € 67.5 billion as of 30 June 2010, and was thus somewhat higher than the comparison figure of € 60.5 billion applicable at the end of 2009.

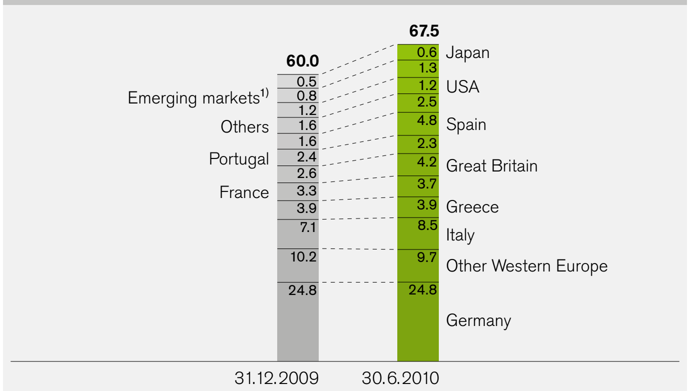
In addition to currency effects with an impact of € +1.9 billion, the increase of € 7.5 billion in the exposure is attributable to the change in the method used for calculating the EaD of the former DEPFA Pfandbriefbank, Eschborn, which has now been merged with Deutsche Pfandbriefbank, Munich; the advanced IRBA is now being used instead of the standard approach. This has had the effect of increasing the EaD particularly for derivatives and repo transactions.

Most of the exposure is attributable to Western Europe. The percentage of emerging markets (in accordance with the definition of the IMF) has increased slightly, namely to 1.9% compared with 1.3% as of December 2009, due to currency factors.

The main countries included under «Other Western Europe» are Austria (€ 7.0 billion compared with € 7.1 billion in December 2009) and Switzerland (€ 1.0 billion compared with € 0.8 billion).

Public Sector Finance: EaD according to regions

in € billion



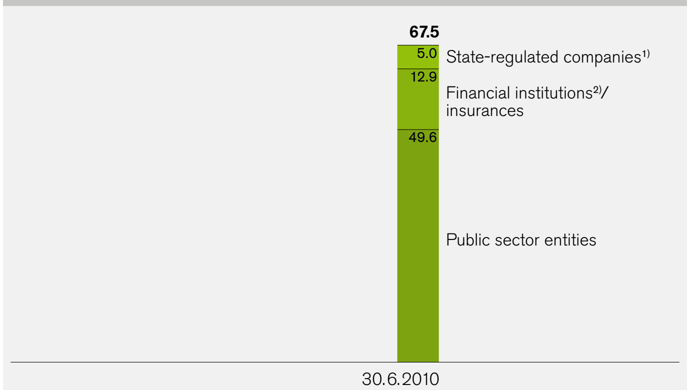
[1)] Emerging markets in accordance with the IMF definition

The counterparty structure in the Public Sector Finance portfolio of Deutsche Pfandbriefbank Group was reviewed and standardised throughout HRE Group in the first half of 2010, and therefore is not comparable with the structure which was published in the Risk Report of the Annual Report at the end of 2009.

Public sector entities comprise sovereigns (30 %), public sector enterprises (30 %) as well as local authorities (40 %).

Public Sector Finance: EaD according to counterparty structure

in € billion

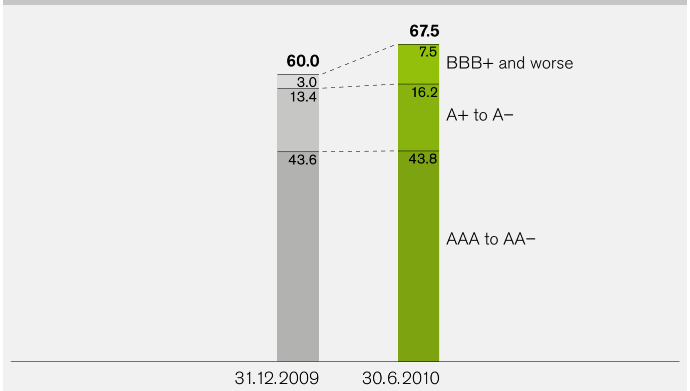


[1)] E.g. water utilities, power supply utilities, etc.
[2)] Financial institutions with a state background or state guarantee

The still unchanged high percentage of borrowers from the public sector, which are still classified as mainly «investment grade», is reflected in the rating. The volume of BBB ratings has increased appreciably from € 2.1 billion to € 6.7 billion, reflecting the downgrading of some banks as well as in particular Greek companies and institutions with a public mission. The exposure to non-investment-grade investments is stated as € 0.8 billion (December 2009: € 0.9 billion) and mainly comprises public sector financing in Canada and Germany.

Public Sector Finance: EaD according to internal ratings

in € billion



Key risk aspects Exposure of Deutsche Pfandbriefbank Group to European countries: Greece, Italy, Portugal, Ireland and Spain The exposure in the Public Sector Finance portfolio in these countries amounted to a total of € 19.5 billion as of 30 June 2010. The increase of € 4.5 billion in the exposure is mainly due to the transfer of exposure of Spanish counterparties from the Value Portfolio.

The direct exposure to the above-mentioned countries is € 7.8 billion, mainly Italy (€ 5.3 billion) and Greece (€ 1.7 billion). Further public sector borrowers account for € 7.1 billion, particularly in Italy (€ 3.2 billion) and Spain (€ 1.6 billion). There is an exposure of € 2.1 billion to banks and insurers, mainly in Spain (€ 1.7 billion, almost exclusively securities).

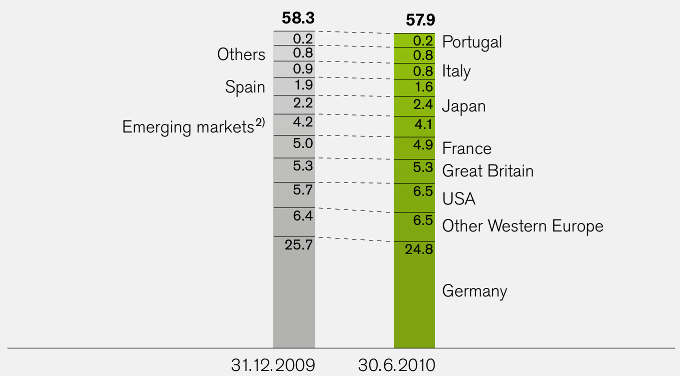
Real Estate Finance: € 57.9 billion EaD Portfolio development and structure The EaD of the Real Estate Finance portfolio of Deutsche Pfandbriefbank Group declined compared with 31 December 2009 by € 0.4 billion in the first half of 2010. The customer derivatives which are included amount to € 1.8 billion compared to € 1.6 billion at year-end 2009.

Compared with December 2009, commitments have declined slightly, by € 1.0 billion to € 56.2 billion. Receivables amount to € 53.9 billion (previous year: € 54.5 billion); the credit lines which have not yet been paid out amounted to around € 2.3 billion, and have declined slightly compared with the end of 2009 (around € 2.7 billion).

The regional structure of the Real Estate Finance portfolio is virtually unchanged compared with the end of 2009, and is spread over 35 countries with the main emphasis in Germany 43 % (44 %) and the other Western European countries (unchanged at 33 %); the USA accounts for 11 % (10 %). As is the case with Japan, this increase is attributable to the weakening of the euro.

Real Estate Finance: EaD according to regions[1]

in € billion



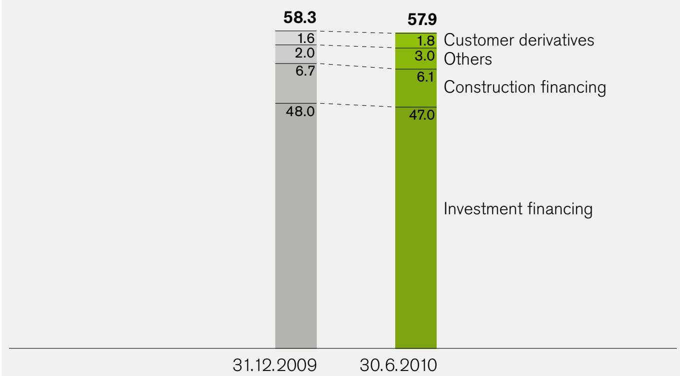
[1] Breakdown including customer derivatives of approx. € 1.8 billion (December 2009: € 1.6 billion)
[2] Emerging markets in accordance with the IMF definition

The distribution of the portfolio according to property types also remained mainly stable compared with the end of 2009. Residential properties (mainly portfolio transactions) account for approximately 19 % (December 2009: 21 %) of the overall portfolio. Commercial properties consist primarily of office buildings and retail properties.

The portfolio is still dominated by investment financing (81 %; December 2009: 82 %). Higher-risk building financing arrangements account for 10 % of the EaD (December 2009: 12 %). Investment financing comprises the financing of real estate for which the capital servicing capacity is based on the ongoing cash flow of the property.

Real Estate Finance: EaD according to loan types

in € billion



Key risk aspects The developments on the real estate markets in 2010 are explained in detail in the «Sector-specific Situation» part of the Management Report. Comments concerning possible future developments are included in the Forecast Report of the Management Report of Deutsche Pfandbriefbank Group.

The real estate markets in Great Britain, Spain and the USA are still the markets which have been hardest hit by the negative market developments. There are initial indications of consolidation on the investment markets in these so-called hot spot countries, mainly in Great Britain and to a significantly lesser extent in the USA; however, it is not possible at present to assume a sustainable turnaround.

The exposure in the above-mentioned countries is still subject to intense monitoring, and, as described in the Risk Report of the Annual Report 2009, has been gradually reduced since 2006. Compared with the situation at the end of 2009, the exposure is virtually unchanged (to some extent due to exchange rate factors). The exposure in these countries is characterised by risk concentrations which are significant in certain cases, and a considerable amount of the overall exposure has already been included in the Watchlist or has been classified under «Non-performing loans» (34 % of the respective portfolios in Great Britain, 53 % in Spain and 67 % in the USA). Corresponding impairments have already been recognised in relation to some exposures (please refer to the chapter «Watchlist Loans and Non-performing Loans»).

Nevertheless, in view of the fact that the liquidity of the secondary market is still very restricted, the options for active risk management of credit risks and long-term loan agreements are limited to loans for which the conditions have to be adjusted, new business and, to a limited extent, credit lines which have not yet been drawn.

Development financing is still in a critical state. The volume of business in this segment amounted to € 6.1 billion EaD as of the reporting date (December 2009: € 6.7 billion), and concentrated on the USA (mainly condominiums) and Germany (mainly commercial properties). The decline in exposure in local currency more than compensated for the currency effect due to the weaker euro. 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 € 3.3 billion as of 30 June 2010) have been affected by the impact of 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, and these are only gradually recovering. The resultant collapse in the cash flows of the financing arrangements and the decline in the value of the financed real estate has meant that numerous hotel loans have been classified as critical or impaired.

Exposure to European countries: Greece, Italy, Portugal, Ireland and Spain The exposure of Deutsche Pfandbriefbank Group in real estate financing in the European countries of Greece, Italy, Portugal, Ireland and Spain amounted to € 2.6 billion as of 30 June 2010, and has declined compared with December 2009 (€ – 0.4 billion). Most of the exposure (€ 1.6 billion) is attributable to Spanish loans, which, as Spain is considered to be one of the hot spot markets, have been subject to intensive monitoring since 2006, and a considerable percentage of the exposures has been the subject of reporting on the Watchlist and non-performing loans. The exposure in Italy (€ 0.8 billion) consists of investment financing (€ 0.6 billion); of this figure, € 0.3 billion has also been included on the Watchlist.

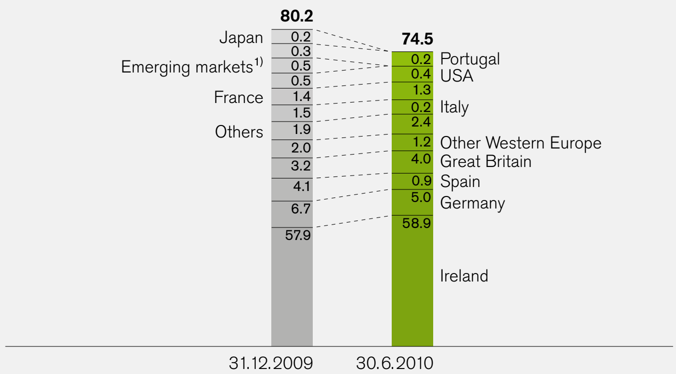
Value Portfolio: € 74.5 billion EaD Portfolio development and structure The Value Portfolio consists of the non-strategic parts of portfolios of the former Public Sector and holdings of the Corporate Center of Deutsche Pfandbriefbank Group, and is to be wound down. This portfolio comprised € 59.1 billion receivables from the affiliated institution DEPFA Bank plc due to forwarded liquidity support.

The exposure has declined compared to 31 December 2009 despite the increasing of exposure to the affiliated institution DEPFA Bank plc by € 5.7 billion.

Without taking into consideration the Ireland exposure which almost exclusively belongs to affiliated institution DEPFA Bank plc the portfolio is regionally well diversified.

Value Portfolio: EaD according to regions

in € billion

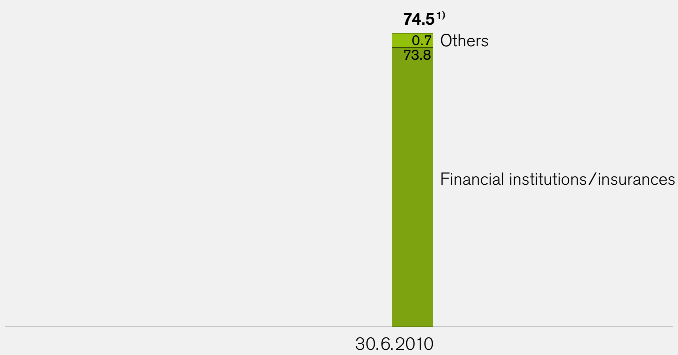


[1] Emerging markets in accordance with the IMF definition

The counterparty structure in the Value Portfolio of Deutsche Pfandbriefbank Group has been revised as part of the process of redefining segments, and the allocation to counterparties has been harmonised throughout the HRE Group. This means that it is not possible for a meaningful comparison to be made with the counterparty structure in December.

Value Portfolio: EaD according to counterparty structure

in € billion



[1] Including receivables with € 59.1 billion due from the affiliated institution DEPFA Bank plc

Key risk aspects Exposure to European countries: Greece, Italy, Portugal, Ireland and Spain The exposure in the Value Portfolio in these countries amounted to a total of € 60.2 billion as of 30 June 2010, whereas contained € 58.7 billion Irish receivable from the affiliated institution DEPFA Bank plc. Without consideration of this effect, the exposure amounts to € 1.5 billion. The decrease compared to December 2009 of € – 4.4 billion contains a transfer of Spanish exposure to the PSF portfolio.

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) and Residential Mortgage-Backed Securities (RMBS) as well as credit-linked investments, e.g. Collateralised Debt Obligations (CDO, in the narrower sense of the term) and Collateralised Loan Obligations (CLO), amounted to € 2.9 billion of as 30 June 2010. The decline of € – 0.3 billion compared with the end of 2009 is mainly due to sales.

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 € 1.39 billion as of 30 June 2010 (€ 1.27 billion MBS, € 0.12 billion CDO).

Total volume of structured securities		30.6.2010			31.12.2009		
in € billion		Nominal value	Internal fair value	Amortised cost of purchase	Nominal value	Internal fair value	Amortised cost of purchase
Real-estate-linked investments							
CMBS	**Total**	**1.54**	**0.79**	**1.26**	**1.62**	**0.76**	**1.34**
	Europe	1.36	0.69	1.15	1.40	0.62	1.18
	USA	0.18	0.10	0.11	0.22	0.14	0.16
RMBS	Europe	**0.62**	**0.48**	**0.58**	**0.71**	**0.54**	**0.63**
Credit-linked investments							
CDO	**Total**	**0.71**	**0.12**	**0.15**	**0.91**	**0.16**	**0.17**
	Europe	0.25	0.11	0.13	0.34	0.15	0.16
	USA	0.46	0.01	0.02	0.57	0.01	0.01
ABS (other)		–	–	–	–	–	–

Special-purpose Vehicles of Deutsche Pfandbriefbank Group

Special-purpose vehicles are generally used for largely 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 mainly uses special-purpose vehicles for reducing risk.

The following table summarises the special-purpose vehicles which have been included in the annual financial statements of Deutsche Pfandbriefbank Group as of 30 June 2010 or as of 31 December 2009 in accordance with IFRS. The assets underlying the consolidation are all classified as loans and receivables (LaR).

Consolidated special-purpose vehicles according to categories Nominal value in € million	30.6.2010	31.12.2009
Refinancing of the Group	134	136
Outplacement of credit risks	304	431
Capital-backed investments	178	633
Investments in ABS structures	796	948
Total	**1,412**	**2,148**

The consolidation of special-purpose vehicles has in particular extended the balance sheet by around € 0.8 billion (31 December 2009: € 0.9 billion) due to securitisation special-purpose vehicles within the framework of investments in ABS structures in which Deutsche Pfandbriefbank Group already holds first-loss tranches which have been written down in full. From the point of view of risk, this means that the volume exposed to risk has declined by € 0.5 billion (31 December 2009: € 0.6 billion).

Watchlist and Non-performing Loans: € 14.5 billion EaD

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. The early warning criteria as well as the impairment criteria are described in the Risk Report of the Annual Report 2009.

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.

Despite initial signs of consolidation, the situation on the national and international real estate markets continued to be difficult in the first half of 2010; rents (and thus the cash flows of the financing) as well as real estate values (and thus the collateral) are far removed from the levels seen before the crisis. This situation has resulted in a further increase of approx. € 2.0 billion in the entire Watchlist and non-performing loans to € 14.3 billion. The most significant increase in the first half was attributable to the USA (€ +0.9 billion), followed by Germany (€ +0.8 billion) as well as Asia (€ +0.1 billion) and Europe (a net € +0.1 billion).

Development of non-performing and Watchlist loans in € million	30.6.2010				31.12.2009			
	Public Sector Finance	Real Estate Finance	Value Portfolio	Total	Public Sector Finance	Real Estate Finance	Value Portfolio	Total
Workout loans	–	714	76	790	–	918	44	962
Restructuring loans	–	8,607	–	8,607	462	8,023	3	8,488
Non-performing loans	**–**	**9,321**	**76**	**9,397**	**462**	**8,941**	**47**	**9,450**
Watchlist loans	**59**	**5,021**	**–**	**5,080**	**16**	**3,449**	**8**	**3,473**
Total	**59**	**14,342**	**76**	**14,477**	**478**	**12,390**	**55**	**12,923**

Impairments and Provisions

Individual allowances and portfolio-based allowances All loans of Deutsche Pfandbriefbank Group are regularly tested for impairment. For the holdings, a test is first carried out to determine whether there are any objective indications of an impairment, and the extent of the impairment is then determined as the difference between the carrying amount and the present value of the cash flows expected in future. Objective indications of an impairment as well as the extent of the impairments are described in detail in the Notes to the Consolidated Financial Statements 2009 or in the risk reporting part.

Portfolio-based allowances are calculated using risk parameters which are compliant with Basel 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.

The individual allowances or credit risks are approved in the Risk Provisioning Committee in which the CROs of all subsidiary institutions and 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.

The increase in the individual impairments reported in the Notes, mainly from € 2.78 billion as of 31 December 2009 to € 3.02 billion as of 30 June 2010, reflects the still difficult situation on the real estate markets as well as the effects of the slow-down in the global economy.

The portfolio-based allowances amounted to € 521 million as of 30 June 2010 (31 December 2009: € 541.8 million) excluding the model reserve for CDOs.

Cover provided for non-performing loans Protection was provided for 36.0 % of the non-performing loans of Deutsche Pfandbriefbank Group in Real Estate Finance as of 30 June 2010 (31 December 2009: 34.8 %). The difference is attributable to an increase of € 0.1 billion in the allowances, whereas the volume of non-performing loans has remained virtually unchanged compared with December 2009.

The provisions for contingent liabilities and other obligations mainly comprised provisions for guarantee risks, letters of credit and irrevocable loan commitments in lending business. They amounted to € 12 million as of 30 June 2010 (€ 11 million as of 31 December 2009.)

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 Deutsche Pfandbriefbank Group are mainly exposed to the following risk types:
> Credit spread risk
> General interest rate risk
> Foreign currency risk

Market Risk Strategy and Organisation of Market Risk Management

The market risk strategy of HRE is unchanged compared with the end of 2009 and is described in the Risk Report of the Annual Report 2009.

In line with the requirements of MaRisk, the market risk positions are monitored by Risk Management & Control of HRE, which is organisationally separate from trading up to the Management Board level.

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 Group. It shows market risk value at risk (VaR), limit utilisations and economic performance figures.
> Daily sensitivity reports comprise analyses for the main risk factors at various levels of detail. They are presented to risk management as well as the Management Board of Deutsche Pfandbriefbank Group.

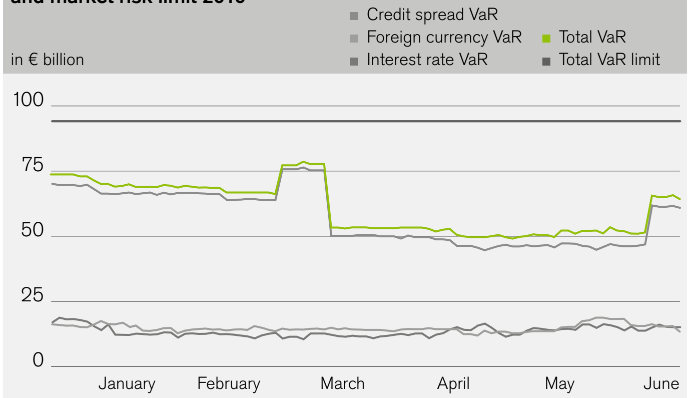
Measurement and Limiting of Market Risk

Market risk Value at risk The method used for daily calculation of the market risk VaR for operational management purposes is unchanged compared with the end of 2009, and is described in the Risk Report of the Annual Report of the Deutsche Pfandbriefbank Group.

The market risk VaR (holding period of ten days, 99% confidence level) is € 65.2 million at 30 June 2010 (€ 74.2 million at 31 December 2010). The market risk limit is unchanged during the whole first half-year 2010 with € 95 million. Risk limit was not exceeded during the period of the report.

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 days, 99%) of individual risk types and market risk limit 2010



The VaR assessment is complemented by further instruments such as sensitivity analyses as well as stress and backtesting.

Sensitivity analyses Sensitivity analyses quantify the impact of a change in individual market parameters on the value of the positions. 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.

Stress testing 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 in a market climate which is particularly disadvantageous for the position of the Bank, stress scenarios show the market risk under extreme conditions. Hypothetical stress scenarios in Deutsche Pfandbriefbank Group throughout 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 200 basis points in the interest rate curve would result in a change of approx. € 94.1 million in the market value for all positions of the Deutsche Pfandbriefbank Group. The corresponding figure for the end of 2009 was € 158.6 million. The Management Board and the corresponding committees are regularly informed of the results of the scenario analyses.

Economic Market Risk Capital

For calculating the economic market risk capital, which is taken into consideration in the risk-bearing capacity analysis, the market risk VaR which is used for daily management is scaled to a period of one year and also to a higher confidence level.

The economic capital for market risk of Deutsche Pfandbriefbank Group amounted to € 378 million as of 30 June 2010 excluding diversification effects (December 2009: € 178 million). The reason for the increase of the market risk capital is explained in the chapter «Result of the Risk-bearing Capacity Analysis».

Market Risk Management, Monitoring and Mitigation

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 compliance with limits by Risk Management & Control
> Escalation processes across all decision-making committees right through to the Management Board

For all provisions, the market risk is monitored by a combination of value-at-risk (VaR) limits as well as monitoring the sensitivities by Risk Management & Control.

Outlook

The establishment of the deconsolidated environment for reducing assets and certain risk positions in a manner designed to impose the minimum strain on value which is described in greater detail in the chapter «Major Events» of the half-year report of Deutsche Pfandbriefbank Group, will also result in the transfer of market risk positions which will reduce the VaR of Deutsche Pfandbriefbank Group.

Development of the Relevant Market Risk Types

General interest rate risk The total general interest rate risk of Deutsche Pfandbriefbank Group amounted to € 15.1 million at 30 June 2010 (compared with € 18.4 million at 31 December 2009). On average, the interest rate risk amounted to € 13.5 million in the first half of 2010 (max. € 19.5 million; min. € 10.5 million), which stayed at a low level continuously (average VaR for 2009: € 15.1 million; max. € 29.3 million; min. € 3.5 million).

Credit spread risk 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 trading books and 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 Deutsche Pfandbriefbank Group, the securities of cover funds account for by far the majority positions which are sensitive to credit spread changes. Accordingly, the credit spread sensitivity of the overall portfolio (including the security holdings classified as LaR) to an increase of all credit spreads simultaneously by one basis point amounted to € 44.0 million at the end of June 2010 (€ 40.3 million at the end of 2009).

Foreign currency risk and other market risks The foreign currency risk which is calculated as a present value amounted to € 14.5 million as of 30 June 2010; the corresponding figure at the end of 2009 was € 15.2 million. The general strategy of the Group 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 happened at HRE – there were no longer sufficient external refinancing possibilities available. Because the continued existence of HRE and Deutsche Pfandbriefbank Group as a going concern very much depends on the guarantees provided by SoFFin, the liquidity risk is currently one of the most significant risks. Therefore Deutsche Pfandbriefbank Group is integrated into the Group-wide liquidity management.

Liquidity Risk Strategy

The liquidity risk strategy is a key component of HRE's as well as Deutsche Pfandbriefbank Group's risk strategy, and is broken down into various modules. This ensures that the short-term as well as the long-term refinancing of Deutsche Pfandbriefbank Group are 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 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 the Asset and Liability Committee of HRE.

Liquidity Risk Report

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 medium-term variances within the cash flows has been installed in order to manage the liquidity risks. Contractual cash flows as well as optional cash flows are taken into consideration in this respect. These data are regularly subjected to backtesting.

The liquidity position, which results from the contractual and optional cash flows, is measured in various scenarios. Various liquidity positions are calculated on a daily basis. The three liquidity scenarios reflect the following:

- Constant market and refinancing conditions (base scenario)
- Business-as-usual (modified risk stress scenario)
- Liquidity stress (risk stress scenario) scenario which is similar to the situation of HRE was set up at the end of 2008

For the short-term liquidity risk, a limit for a period of one month was defined for each of the different liquidity scenarios.

The limit system consists of three key aspects:

- Headroom limit for the liquidity reserve of HRE Group
- Limit for the liquidity stress profile for HRE Group (business-as-usual and risk stress scenario) and trigger for the base scenario
- Limit system for Deutsche Pfandbriefbank Group

Within the limit system of Deutsche Pfandbriefbank Group for the next month for the business-as-usual scenario and the risk stress scenario a buffer of at least € 2.0 billion has been set for the next five trading days, and a positive balance over null has been defined for the rest of the month. On HRE Group level the limit amounts to € 4.5 billion for the next five trading days.

There are also plans for the medium- and long-term liquidity risk to be limited after the balance sheet items of HRE Group have been split over Deutsche Pfandbriefbank AG and FMS Wertmanagement AöR.

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 macro-economic, monetary policy and political causes on the liquidity situation of HRE.

The scenarios are reported to the Management Board of HRE and Deutsche Pfandbriefbank Group and external bodies, e.g. the Bundesbank and 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. A liquidity emergency plan was also adopted in 2009, constituting the specialist and organisational background for handling liquidity shortages.

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 and Deutsche Pfandbriefbank have adequate liquidity reserves.

Hedging and Reduction of Liquidity Risk

A risk tolerance system at HRE Group level is used to limit the liquidity risk. 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, in the framework of stress scenarios, regularly determined and regularly adjusted.

Development of the Risk Position of HRE Group

The liquidity situation deteriorated at 30 June 2010 compared with the situation at the end of last year. The negative liquidity situation is mainly due to euro devaluation against the US dollar and the impact of the financial crisis to some countries in the Euro zone (e.g. Greece).

These external factors led to two minor limit breaches of the (conservative) risk stress scenario.

As of 30 June 2010, there were SoFFin guarantees of € 102 billion. Of this figure, liquidity lines (after deducting haircuts) of around € 8 billion were unutilised. During the first half-year an additional amount of € 10 billion SoFFin guarantees have been utilised and € 3 billion have been repaid to the bank consortium.

Deutsche Pfandbriefbank utilised SoFFin guarantee of € 17.9 billion as of 30 June 2010 which increased liquidity by € 16.9 billion after consideration of haircuts.

Despite the fact that HRE and thus also 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 Deutsche Pfandbriefbank Group will furthermore be dependent 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 Management Report. The support measures are due to expire on 22 December 2010 and on 25 May 2011. Even if the Deutsche Pfandbriefbank Group is able to reestablish itself on the capital market 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 in accordance with the liquidity ordinance amounted to 1.76 in Deutsche Pfandbriefbank Group as of 30 June 2010; it was thus higher than the statutory minimum of 1.0.

Breakdown of remaining terms on the Deutsche Pfandbriefbank Group balance sheet according to IFRS		**30.6.2010**		**31.12.2009**
in € billion	Assets	Equity and liabilities	Assets	Equity and liabilities
Total	**229**	**229**	**215**	**215**
Up to 3 months	87	88	76	67
3 months to 1 year	20	37	17	48
1 year to 5 years	44	37	48	38
From 5 years and over	59	40	60	40
Other assets[1]/liabilities[2]	19	27	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, covered and uncovered issues are available as the main financing instruments to Deutsche Pfandbriefbank Group. 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 particularly applicable for German Pfandbriefe which is the instrument the Group will employ to fund new business and the existing portfolio after the spin-off.

The refinancing markets have continued to stabilise in the initial months of 2010. At the beginning of the year, the market was characterised by numerous successful benchmark transactions in a wide range of areas. In particular, placings of covered bonds and especially Pfandbriefe were carried out successfully. Large numbers of relatively small private placings have also been carried out.

Issuing activity has declined sharply as a result of the debt crisis which occurred in the European Union in May 2010 and also as a result of the high levels of volatility in government bonds. However, it was still possible for some benchmark transactions to be placed. Activity on the private placing markets has declined appreciably. And lending on the interbank market was also very much reduced in individual phases.

The stabilisation measures of the ECB, taking the form of purchasing government bonds, have partially stabilised the markets; however, volatilities are still very high. At the same time, rates at the long end of the market have fallen to all-time lows and have been at this low level since May.

In the first half of 2010, Deutsche Pfandbriefbank AG succeeded with long-term placings on the markets: € 1.3 billion public Pfandbriefe, € 0.5 billion mortgage Pfandbriefe and € 2.3 billion senior unsecured transactions. The volumes consist of only one benchmark transaction (€ 1 billion public Pfandbriefe), and the remainder was taken up by private placement on the market. 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.

The volumes are still not able to reduce the extent of external liquidity support substantially.

Outlook

The plan after the split-up of the balance position is that Deutsche Pfandbriefbank Group will not utilise any SoFFin guarantees and that it will refinance its operations entirely via the money and capital markets.

The extent of the liquidity requirement depends on numerous factors for which possible scenarios have to be defined:
> The future development of the discounts for repo refinancing securities 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

Operational Risk

Operational risk is still associated with most aspects of Deutsche Pfandbriefbank Group business, and comprises 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 inadequate or errored processes, human error, technology failure or external events. The definition includes legal risks, but excludes strategic and reputation risks.

Strategy for Operational Risks

The overriding 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 management. Deutsche Pfandbriefbank Group is attempting to minimise losses arising from 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 Group Operational Risk (GOR) 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.

The processes and methods introduced throughout the Deutsche Pfandbriefbank Group for managing, measuring, monitoring and reporting the operational risks have not changed compared with the end of 2009, and are described in the Risk Report of the Annual Report 2009.

In the first half of 2010, methods, processes and standards in HRE were developed for outsourcing and IT, and were also implemented in Deutsche Pfandbriefbank Group. Crisis management was tested by way of emergency and going-concern exercises. In order to mitigate the operational risks, GOR is also involved in the process of harmonising the process and system landscape of Deutsche Pfandbriefbank Group, and is working on a programme designed to prevent fraud with Compliance.

Risk Measurement

The economic capital for operational risks is € 32 million as of 30 June 2010 (€ 290 million as of 31 December 2009. In view of the calculation method adjustment of economic capitals described in the chapter «Result of the Risk-bearing Capacity Analysis», the contents of the figures for the two dates are no longer comparable.

The minimum capital requirement in accordance with the Basel II standard approach which is calculated annually on HRE Group level amount to € 104 million as of 31 December 2009.

Major Operational Risks of Deutsche Pfandbriefbank Group

The main operational risks are essentially attributable to the ongoing process of restructuring HRE as well as 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 currently in progress 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.

Deutsche Pfandbriefbank is also still exposed to an increased risk of a potential loss of know-how which is necessary for the restructuring processes and also for day-to-day operations. 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.

Deutsche Pfandbriefbank Group suffered losses of € 1 million in total from operational risks in the course of the first half of 2010. The losses are mainly attributable to the incorrect recognition of interest data of loans. 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 to the Consolidated Financial Statements.

Result of the Risk-bearing Capacity Analysis

Economic capital according to risk types Excluding diversification effects in € million	**30.6.2010**	**31.12.2009**	Δ in %
Credit risk	2,474	2,170	14
Market risk	387	178	177
Operational risk	32	290	– 89
Business risk	206	261	– 21
Risk of the Bank's own real estate portfolio	12	80	– 85
Risk of the investment portfolio	2	2	–
Total before diversification effects	**3,113**	**2,981**	4
Total after diversification effects	**2,950**	**2,631**	12
Risk cover funds	4,627	5,585	– 17
Cover surplus/shortfall	1,677	2,954	– 43

Excluding the diversification effects between the individual risk types, the economic capital of Deutsche Pfandbriefbank Group amounted to around € 3.1 billion (December 2009: € 3.0 billion). If these effects are taken into consideration, the economic capital declined to around € 3.0 billion (December 2009: € 2.6 billion).

The negative impact on results of the decline in AfS reserves is the reason why the risk cover funds have declined by € 958 million compared with the previous year due to the negative half-year result and the decline of the AfS reserve.

According to the ICAAP model which is required by the regulator and which determines the economic risk-bearing capacity of the Company, there was a surplus of around € 1.7 billion in economic capital as of 30 June 2010 for a one-year observation period. The spin-off of the deconsolidated environment which is about to take place has not been taken into consideration in this respect.

Methods Used for the Individual Risk Types

The economic capital of each risk type is determined using a quantitative approach, and aggregated with due consideration being given to specific correlations to the overall bank risk. In line with common market standards, the risk types are scaled to a period of one year and a confidence level derived from the target rating (in this case: 99.95 %). In the first quarter of 2010, there was a significant adjustment of the ICAAP method to the changed business strategy of the Group. The strategic refocusing with a much greater focus on the holding period of assets, until held-to-maturity, the new ownership structure, the changed funding profile as well as the imminent spin-off of the deconsolidated environment have been explicitly recognised in the form of the model.

The changes in the method of calculating the economic capital for the individual risk types are explained in the following. One major change – namely the fact that the effects of fluctuations in credit spreads are now recognised in market risk capital instead of, as previously, in credit risk capital – explains the significant change in the economic capital of the two risk types compared with December 2009.

Credit risk Credit portfolio model Deutsche Pfandbriefbank Group uses a credit portfolio model for determining the credit risk VaR. The rating of a borrower, or the borrower is deemed to have defaulted, if certain limits are exceeded. These limits are derived from the rating of the borrower, a migration matrix for the default vector and the volatility of a rating index using an internal credit portfolio model based on the basic idea of credit metrics. The rating 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 of the counterparties are modelled over the systematic components of the rating indices and over a history of more than ten years of relevant statistics. Rating changes are modelled by way of migration matrices by S&P and Fitch and represent a history of more than 30 years.

As a result of adjusting the ICAAP method to the changed business model, the market fluctuations of credit spreads in the IFRS category «available for sale» (AfS) will in future be recognised in the market risk. In order to avoid double counting, the credit portfolio model thus models only credit spread changes which are caused by rating migrations as well as credit defaults. The proportion of AfS positions in relation to the portfolio of HRE Group is approx. 15%. At the end of 2009, the maximum historical spread increases within one year for the AfS positions were recognised in the credit risk. This adjustment results in a considerable shift in economic capital, namely from credit risk to market risks. The main reasons behind this adjustment are as follows:
> Uniform treatment of all IFRS categories which have an impact on the risk cover funds (held for trading, fair value through P&L, available-for sale)
> Harmonisation of the definition of market risk in the ICAAP with internal control
> Pro-cyclical behaviour of market volatilities instead of the previously more static historical scenarios
> Adjustment of the distinction between market and credit risk to the normal standard in the sector

The economic capital for credit risks – calculated from the credit portfolio model – is around € 2.5 billion for a confidence level of 99.95% and a time horizon of one year, disregarding diversification effects with regard to other risk types (December 2009: € 2.2 billion). The increase of € 0.3 billion is mainly attributable to internal rating downgrades of Greece. At the same time the capital for credit risks is reduced as a result of the change of method of ICAAP.

Market risk The VaR used for managing market risk is included in the calculation of the economic capital for market risks. The market risk VaR is scaled accordingly in order to take account of the higher level of confidence and the one-year period of the capital adequacy process. This scaling factor is constantly monitored and is also used to take account of additional effects (auto-correlation effects, volatility fluctuations, granularity corrections), resulting in a more granular presentation of the market risks in the economic market risk capital.

The economic capital for market risks amounted to € 387 million as of 30 June 2010 for a one-year time horizon excluding diversification effects (December 2009: € 178 million). The significant increase in market risk capital is mainly attributable to the shift in credit spread risks of the AfS positions from economic credit risk capital to market risk capital.

Operational risk The result of the calculation using the standard approach in accordance with Basel II is used for calculating the economic capital for operational risks. For the purposes of the capital adequacy procedure, the capital requirement determined for regulatory purposes is scaled to the higher level of confidence (from 99.9% to 99.95%). Economic minimum capital is also maintained for operational risks in certain areas of the Group. This cushion balances out possible weaknesses affecting the model of the standard approach.

The economic capital for operational risks amounted to € 32 million as of 30 June 2010 (€ 290 million as of 31 December 2009). As a result of the change in the method of the ICAAP, the figures for the two dates are not comparable with each other. A fixed percentage in relation to target capital was used until the end of 2009; the current approach harmonises with the standard approach for calculating regulatory capital backing.

Business risk The calculation of risk capital for the business risk has been revised to a large extent within the framework of the introduction of the new ICAAP model. The economic capital is now calculated from the two following components.

1. No income for new business The risk cover funds comprise budgeted figures for net interest income and net commission income for the following four quarters. The calculation of the economic business risk capital is based on the assumption that no new business will be generated for Deutsche Pfandbriefbank Group next year. Accordingly, the risk capital is calculated as that part of the budgeted figures for net interest income and net commission income which is attributable to new business. The maximum unexpected variance in relation to the originally expected figure is assumed.

2. Higher financing costs Higher financing costs can result from the following two reasons:
> Higher financing requirement
> Higher unsecured refinancing rate

Every month, the higher financing requirement resulting from the occurrence of certain market events is simulated in the stress scenario «Further decline» as part of the liquidity risk measurement process. Together with the SoFFin guarantee which has not yet been utilised but which is the subject of a contractual commitment, these parameters form the basis for calculating the risk capital due to higher financing costs. The increase in the unsecured refinancing rate is not relevant for Deutsche Pfandbriefbank Group at present, because SoFFin has guaranteed refinancing at a fixed refinancing rate.

As a result of the change in method, the figures for business risk capital as of 30 June 2010 and as of the end of 2009 are not comparable with regard to their contents. In the past, the figure had been calculated on the basis of scaling of operating costs.

Risks arising from investment holdings and the Bank's own real estate portfolio The risks attributable to the investment holdings and the Bank's own real estate portfolio together account for approx. 0.45% of the economic capital of the Group.

The economic capital for both risk types is derived via the volatility of a market index over a 15-year history. The MSCI World Real Estate Index for share prices in the real estate sector is used for the investment risk. As part of the adjustment of method, the calculation of the real estate index was changed over from this index to the BulwienGesa real estate index for commercial real estate. As a result of the much lower volatility of real estate prices compared with share prices, the economic capital for the real estate risk has declined appreciably. Compared with the previous year figures, there have been only minor changes in the Bank's own real estate holdings and also the value of the investment portfolio.

Liquidity risk As detailed in the Risk Report of the Annual Report 2009, it is not possible for liquidity risks in the narrower sense of the term to be capitalised, nor is this standard practise in the sector. In the broader sense of more expensive refinancing costs, liquidity risks have been presented in the economic capital for the business risk since the adjustment in the method (as detailed above).

Stress tests Stress tests in relation to the economic capital are used in order to develop a better understanding of the sensitivity of results to the risk parameters underlying the models. Deutsche Pfandbriefbank Group carries out stress tests as an instrument for adequate regulatory and economic capital management for eleven individual categories. Further information and specifications concerning the stress tests can be found in the Risk Report of the Annual Report 2009 of Deutsche Pfandbriefbank Group.

Forecast Report

Macro-economic Development

Following the considerable contraction of the world economy in 2009, which had not been experienced to that extent since the world economic crisis, economic forecasts for the whole of 2010 are predicting positive, albeit mostly moderate growth rates. At present, growth of 1.2 % is being predicted, and the corresponding predictions for the EU and the USA are 0.8 % and 3.3 % respectively. Only the Asian economies will probably be able to return to the growth seen before the crisis of 2008/2009, with growth of 5.9 %. Growth rates which are moderate in terms of a historical comparison are also being forecast for a longer time horizon worldwide. In many countries, particularly in Europe, it will probably be several more years before economic activity can return to the level seen before the crisis.

When making these predictions, it is necessary to take account of the risks which are still unusually high. Such risks relate to confidence in currencies, the sustainability of national fiscal policies and, in the final analysis, the solvency of highly indebted governments, and also confidence in the financial sector in general. It is necessary to consider the question of the extent of the financial market regulation which is expected to be implemented in many countries, and particularly in Europe. Because many measures in this particular field are only genuinely effective in conjunction with uniform treatment throughout the world, considerable differences of opinion, particularly between the USA and Great Britain on the one hand and the other European countries on the other – have so far prevented any far-reaching tightening of regulation. A further risk is that one of the European countries might indeed experience payment difficulties, and the rescue facility adopted in May 2010 would have to be activated, with corresponding problems for the other countries.

A major component behind the uncertain and relatively moderate outlook is the expiry of the fiscal measures which are intended to support the economy and which were mostly adopted at the end of 2008. In particular, the debt problems in Greece have meant that many governments intend to, or indeed will have to, adopt a strict policy of savings. The overriding intention of this reorientation is to maintain or restore the confidence of the financial markets in the sustainability of state solvency. A corresponding declaration of intent was achieved by the G20 states at their summit held in Canada at the end of June. The reason why it is so difficult to predict the impact on the economy is that the negative effect of a reduction in state demand has to be offset against the positive effect resulting from (the perception of) greater sustainability of state budgets.

The fears of inflation which have occasionally been expressed recently can be considered to be relatively without foundation at least for the short and medium term. It is true that, until May 2010, the practise of the ECB since that time of directly purchasing government securities is explicitly not included in the range of instruments. However, it is not possible to speak of «government spending being financed by printing money» because only the ECB is responsible for taking decisions with regard to the nature, extent and duration of these exposures. The available indictors in the Euro zone are therefore also pointing in the medium term to inflation expectations in line with the ECB's target, i.e. just below 2 % p.a.

Sector-specific Conditions

Overall Situation of the Bank Sector

The bank sector is still facing major challenges in the second half of 2010. However, the extent of such challenges depend on future economic developments and also on the extent to which the money, capital and currency markets will settle down or return to normal. Whereas investment banks might again benefit in the second half of the year particularly from the economy returning to normal, most traditional credit institutions will have to cope with a high volume of loans which are to be refinanced but for which the parameters have not yet returned to the level seen before the point at which the loans were originally extended. The real estate markets which have not yet recovered and other high-risk assets in particular might result in further problems in this sector. Banks will respond to this situation by intensifying their restructuring methods. If there is no improvement in the ratings of the countries which are currently the focus of attention, it will be necessary for further collateral to be provided for such bonds in the bank portfolios.

Public Sector Financing

In the strategic core markets of Deutsche Pfandbriefbank AG, such as Germany, France, Italy and Spain, local and regional credit institutions have assumed the main role in the public sector financing market. They will use the second half of 2010 to shape the markets according to their needs. In France and Germany, this will result in lower margins only initially. In other countries such as Spain and Italy, discrepancies are expected in the second half of 2010 between the margins which external banks and investors hope to achieve and the margins for public sector loans which will be offered by local providers (in particular government-owned credit institutions).

Even if the financial requirement will remain at a high level, the self-imposed measures in many European countries designed to reduce the high budget deficits have had an impact on demand. In Spain, demand will be limited by a recently imposed ban on Spanish municipalities raising new debt, and this is likely to have a positive impact on the positioning of other investors in other market segments.

For the second half of the year, it remains to be seen to what extent the countries which are currently the focus of attention will make progress with the consolidation efforts, and whether this will be recognised by the capital markets in the form of higher prices for the government bonds of these countries. The greater the progress achieved in this respect, the greater will be the extent to which banks with large state finance portfolios will benefit.

Real Estate Financing

The fundamentally positive economic development in the strategic core markets of HRE will probably also continue in the second half of 2010.

The good macro-economic indications might provide a further boost to demand in the commercial real estate market in the second half of 2010. It remains to be seen whether this will be reflected in improvements in terms of vacancy rates, rent defaults, rents and property values in the second half of 2010. It therefore has to be assumed that credit portfolios of the banks will continue to be affected and that there will be problems associated with prolonging existing loans. However, if growth in the real economy were to be significantly weaker than originally predicted, this would result in lower investment sales and higher initial yields via more negative expectations with regard to the development in rents. Combined with reduced levels of completion of new speculative projects, rents of prime properties might rise again in 2011. If no unexpected new turmoil occurs on the markets, it might be possible for the real estate markets to improve further in 2011/2012.

For Germany, we continue to be positive for the whole of 2010, based on the strong growth seen in the first half of 2010. Because the safety aspect will continue to dominate investor strategy, demand will probably concentrate on prime low-risk products. Investors will probably focus on six German investment centres (Munich, Hamburg, Berlin, Cologne, Frankfurt and Duesseldorf). Great Britain also considers that the most likely scenario for the second half of 2010 will be a gradual recovery of the market. In France, the volume of investment in 2010 will very much depend on the availability of prime properties. For Spain, there are clear indications of an improvement in demand for the office and retail segment; however, a slight downturn in rents must be expected for these two markets. The development of real estate markets in the USA is also likely to be moderate in 2010, even if there were initial positive signs of improvement in the first half of 2010. In the case of office markets, rents are expected to decline further and the number of empty properties is likely to increase in 2010. In the retail sector, which has been hardest hit by the recession, only a very gradual recovery is expected in the course of the next few years. With regard to industrial properties, a further slight decline in rents in conjunction with higher levels of vacant properties is expected for 2010. The situation is not expected to stabilise before 2011. Secondary markets such as Poland, the Czech Republic and Scandinavia have proved much more robust in times when markets have been weak, and offer attractive potential.

In the medium term, unless borrowers provide an injection of additional capital, the bank will not make available any further capital to borrowers with properties of less than prime quality. Exposures in this segment are above average in Germany and Great Britain; each of these countries accounts for 30 % of the total loans extended in Europe. One possibility of portfolio management is to arrange for these loans to be transferred to deconsolidated environments. Another approach is to sell-on non-strategic portfolios to investors.

A significant issue currently being discounted in the market is the question of refinancing expiring financial instruments, which are expected to peak in the period 2011 to 2013, also in view of the expiry of high volumes of structured financial products. As a result of the relatively high LTVs in certain cases for structured financial products which fall due in conjunction with falling real estate values, the demand for refinancing will increase considerably.

Refinancing Markets

The refinancing markets have been very volatile in recent months. The future development depends on the overall market and specific factors in the individual markets. Individual markets will probably continue to selectively achieve stable development – particularly if the government support programmes take effect. The focus in this respect is on the ECB programme for buying up government bonds. The more stable markets will probably also include the Pfandbrief market, even if the ECB programme for buying up covered bonds has expired in this respect. However, in view of the current volatilities, it is questionable whether it will be possible for the risk premiums in the market for unsecured bank issues to stabilise further or even decline. Moreover, it is not likely that the volumes on the money market will increase very rapidly. Overall, it is also possible that there might be longer-term problematical phases for specific phases for sub-markets or the overall market.

The debt situation of the so-called peripheral countries in the Euro zone is the crucial factor which will determine the further development of interest rates in the second half of the year. As long as the future budget deficits are not reduced in a credible and sustainable manner, it is likely that the yield spreads of these countries compared with the swap market will continue to widen. In this context, it is likely that the ECB will hold leading interest rates at a low level for longer than originally expected, which means that rates at the short end of the market will not move.

Nor are there any indications of any significant changes in rates at the longer end of the swap market in the near future. Interest rates are currently at historically very low levels. A continuation of positive economic data might lead to higher long-term rates in the medium term and might thus result in a steeper slope of the rate structure curve.

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 first half of the year 2010.

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.
> Deutsche Pfandbriefbank Group has been given the possibility of reducing assets in a value-preserving manner in a deconsolidated environment.
> No legal reservations, especially EU legal actions, against the liquidity support from SoFFin and the strengthening of the capital base provided by SoFFin and the transfer of assets to the deconsolidated environment 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. The ratings of the companies in Deutsche Pfandbriefbank Group 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.
- 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 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 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.

HRE Holding and 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 even in the event of defaults and impairments recognised in relation to receivables and securities as a result of the financial crisis affecting individual states and corporations. 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 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

Development in earnings Deutsche Pfandbriefbank Group has reported a negative pre-tax result for the first half of the year 2010. However, pre-tax result was better than the corresponding figure of the first half of 2009 which reflects signs of stabilisation of Deutsche Pfandbriefbank Group. 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 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 which might result in the case of disposals would depress net interest income or net income from financial investments.

- Deutsche Pfandbriefbank Group will continue to be very much dependent on liquidity support provided by SoFFin at least until transferring the assets and liabilities to the deconsolidated environment. The corresponding costs will have a very negative impact on net commission income. The additional guarantee means that the costs of liquidity support in the second half of 2010 will probably be higher than the corresponding figure for the first half. However, the costs would decline as a result of the transfer of assets and liabilities to the deconsolidated environment.
- Net income from financial investments may be affected by additional impairments recognised in relation to securities. For instance, further widening of credit spreads and a deterioration in the security pool might result in additional impairments in relation to the CDOs which are still held in the portfolio. It may also be necessary for impairments to be recognised in relation to the holdings which have been reclassified as «loans and receivables» whereas previously they had been classified as «held-for-trading» and «available for sale» in accordance with IAS 39. Because a considerable percentage of the holdings is to be transferred to the deconsolidated environment, the establishment of such a deconsolidated environment would considerably reduce the potential impact on earnings.
- The difficult situation on some markets and the uncertain macroeconomic situation might result in significant impairments recognised in relation to receivables. It is probable that considerable impairments will again have to be recognised in relation to Real Estate Financing in the second half of 2010 mainly as a result of the difficult economic conditions on the commercial real estate markets. Because the situation of some infrastructure customers has also deteriorated, it is also possible that impairments might have to be recognised in relation to these holdings. Overall, provision for losses on loans and advances will probably continue to be at a higher level in the second half of 2010. Deutsche Pfandbriefbank Group intends to transfer some of these holdings to the deconsolidated environment, which would considerably reduce the volume of provisions for losses on loans and advances.
- High fiscal deficits mean that refinancing has become much more difficult for some states; in certain cases, refinancing is only possible with external assistance. It is possible that some states might not be able to service their interest and repayment obligations. In such a case, it might be necessary for considerable impairments to be recognised in relation to securities or loans, and this would mainly have an impact on net income from financial investments and provisions for losses on loans and advances.
- The restructuring of 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 service costs and other administrative expenses also in the second half of 2010.
- 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. The litigation is described in detail 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 has resulted in additional costs due to premature contract termination and may also result in costs to repurchase hedges. Further rating downgrades would result in further terminations of ISDA master agreements. The bank might also incur additional costs as a result of the limited choice of counterparties due to their current long-term ratings.
- 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 significant 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 and banks widen further, 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 risk would be reduced by transferring the assets to the deconsolidated environment. Adhere with the loans and advances the regarding figure of provision for losses on loans and advances will be transferred to the deconsolidated environment.
- 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 focusing on functioning Group areas of activity.
- The difficult situation and the subsequent action taken to stabilise Deutsche Pfandbriefbank Group have resulted in debates on the political scene, in the media and in the public. Overall, the image of 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 that may occur, or the extent to which the following risks might materialise:

> The support measures received and the establishment of the deconsolidated environment 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 Deutsche Pfandbriefbank Group, 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.

> The refinancing of Deutsche Pfandbriefbank Group will continue to be reliant on the support measures provided by SoFFin at least until transferring the assets and liabilities to the deconsolidated environment. 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.

> 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 framework agreements and this may lead to outflows of liquidity. Transferring the items to the deconsolidated environment would lower the risk.

> The capital backing of Deutsche Pfandbriefbank Group and its subsidiaries has improved as a result of the support provided by SoFFin. In the second half of the year 2010, IFRS equity and the regulatory core capital may decline again as a result of the factors detailed above. Based on the assumed support measures by the German Finanzmarktstabilisierungsfonds, it is expected that the going concern of Deutsche Pfandbriefbank Group will not be questioned.

> At present, the regulations of the Basel Committee on banking supervision are being revised under the designation Basel III. The aspects which are being discussed include tighter regulations with regard to capital backing by way of raising minimum capital ratios. In addition, a new capital ratio which is not related to the risk weighting of the assets is to be introduced in the form of the so-called leverage ratio. There are also plans for new parameters for measuring liquidity backing. For Deutsche Pfandbriefbank Group, the revised regulations might result in a higher requirement for shareholders' equity and liquidity. Profitability might also decline as a result of the higher capital requirement.

The new business model may be an opportunity for 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 and in the first half of 2010. Numerous competitors in the field of public sector finance are also affected by the financial market crisis. The experience of Deutsche Pfandbriefbank Group in the Pfandbrief business may be an advantage. In this context, Deutsche Pfandbriefbank Group will continue to search for market opportunities in the second half of 2010 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 finance and public sector finance segments.

On 21 January 2010, and following liaison with SoFFin, the ultimate parent company of Deutsche Pfandbriefbank AG, HRE Holding AG, 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. On 8 July 2010 the deconsolidated environment FMS Wertmanagement AöR was founded. There is no legal right to transfer the assets. Instead, the FMSA has the discretionary authority to transfer it. For HRE and consequently for Deutsche Pfandbriefbank Group, the transfer may be an opportunity because non-strategic positions will be removed from the balance sheet of Deutsche Pfandbriefbank Group and because core business can be freed up more quickly. Deutsche Pfandbriefbank AG is the strategic core bank of HRE which will give further opportunities to Deutsche Pfandbriefbank Group.

The result for the second half of 2010 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/loss. Transferring assets to the deconsolidated environment, Deutsche Pfandbriefbank Group would reduce interest-bearing assets, which might put pressure on net interest income and similar income. Deutsche Pfandbriefbank Group is not assuming that it will also have a loss in the second half of 2010.

Consolidated Interim Financial Statements

Consolidated Interim Financial Statements
Income Statement

Income/expenses in € million	Note | Page	1.1.– 30.6.2010	1.1.– 30.6.2009	Δ in € million	Δ in %
Operating revenues		220	34	186	>100.0
Net interest income and similar income	8 | 65	330	251	79	31.5
Interest income and similar income		2,521	2,373	148	6.2
Interest expenses and similar expenses		2,191	2,122	69	3.3
Net commission income	9 | 65	–8	–6	–2	–33.3
Commission income		46	53	–7	–13.2
Commission expenses		54	59	–5	–8.5
Net trading income	10 | 66	–48	–109	61	56.0
Net income from financial investments	11 | 66	–17	–28	11	39.3
Net income from hedge relationships	12 | 66	–39	–16	–23	<–100.0
Balance of other operating income/expenses	13 | 66	2	–58	60	>100.0
Provisions for losses on loans and advances	14 | 67	401	1,048	–647	–61.7
General administrative expenses	15 | 67	171	107	64	59.8
Balance of other income/expenses	16 | 67	–	13	–13	–100.0
Pre-tax profit/loss		**–352**	**–1,108**	756	68.2
Taxes on income	17 | 67	**–18**	–21	3	14.3
Net income/loss		**–334**	**–1,087**	753	69.3
attributable to: Equity holders (consolidated profit/loss from the parent company)		–334	–1,087	753	69.3

Statement of Comprehensive Income

Statement of comprehensive income	**1.1.–30.6.2010**			**1.1.–30.6.2009**		
in € million	before tax	tax	net of tax	before tax	tax	net of tax
Net income/loss	–352	–18	–334	–1,108	–21	–1,087
AfS reserve [1]	–155	–41	–114	6	2	4
Cash flow hedge reserve [1]	408	109	299	415	114	301
Exchange differences	20	–	20	10	–	10
Total	**–79**	**50**	**–129**	**–677**	**95**	**–772**
attributable to:						
Equity holders (consolidated profit/loss from the parent company)	–79	50	–129	–677	95	–772

[1] Including the amounts recognised in equity relating to disposal group

Disclosure of components of comprehensive income in € million	**1.1.–30.6.2010**	**1.1.–30.6.2009**
Net income/loss	–334	–1,087
AfS reserve [1]	–114	4
Gains arising during the year	–114	4
Cash flow hedge reserve [1]	299	301
Gains/losses arising during the year	299	301
Exchange differences	20	10
Total	**–129**	**–772**

[1] Including the amounts recognised in equity relating to disposal group

Statement of Financial Position

Assets in € million	Note | Page	30.6.2010	31.12.2009	Δ in € million	Δ in %	31.12.2008
Cash reserve		309	618	−309	−50.0	546
Trading assets	19 | 68	1,169	1,435	−266	−18.5	131
Loans and advances to other banks	20 | 68	15,303	78,151	−62,848	−80.4	72,126
Loans and advances to customers	21 | 68	67,064	91,221	−24,157	−26.5	69,938
Allowances for losses on loans and advances	23 | 69	−986	−3,326	2,340	70.4	−1,841
Financial investments	24 | 70	18,178	30,914	−12,736	−41.2	28,934
Property, plant and equipment		8	10	−2	−20.0	12
Intangible assets		25	28	−3	−10.7	23
Other assets	25 | 71	15,513	11,801	3,712	31.5	10,204
Income tax assets	26 | 71	5,008	4,365	643	14.7	4,423
Current tax assets		68	131	−63	−48.1	82
Deferred tax assets		4,940	4,234	706	16.7	4,341
Disposal group	37 | 78	107,903	–	107,903	>100.0	–
Total assets		**229,494**	**215,217**	14,277	6.6	**184,496**

Equity and liabilities

in € million	Note | Page	30.6.2010	31.12.2009	Δ in € million	Δ in %	31.12.2008
Liabilities to other banks	27 | 71	85,166	67,625	17,541	25.9	56,464
Liabilities to customers	28 | 71	14,329	12,378	1,951	15.8	13,985
Liabilities evidenced by certificates	29 | 72	78,728	109,193	–30,465	–27.9	95,461
Trading liabilities	30 | 72	2,603	1,872	731	39.0	1,033
Provisions	31 | 72	148	153	–5	–3.3	168
Other liabilities	32 | 73	17,436	13,635	3,801	27.9	11,118
Income tax liabilities	33 | 73	4,374	3,733	641	17.2	3,576
Current tax liabilities		84	85	–1	–1.2	31
Deferred tax liabilities		4,290	3,648	642	17.6	3,545
Subordinated capital	34 | 73	3,812	3,895	–83	–2.1	2,237
Disposal group	37 | 78	20,294	–	20,294	>100.0	–
Liabilities		**226,890**	**212,484**	14,406	6.8	**184,042**
Equity attributable to equity holders		2,604	2,733	–129	–4.7	454
Subscribed capital		380	380	–	–	380
Silent participation		999	999	–	–	–
Additional paid-in capital		5,037	5,037	–	–	2,988
Retained earnings		–2,805	–1,310	–1,495	<–100.0	688
Revaluation reserve		–327	–858	531	61.9	–1,239
AfS reserve		–302	–328	26	7.9	–275
Cash flow hedge reserve		–25	–530	505	95.3	–964
Consolidated profit/loss 1.1.–31.12.		–	–1,515	1,515	100.0	–2,363
Consolidated loss 1.1.–30.6.2010		–334	–	–334	<–100.0	–
Amounts recognised in equity relating to disposal group	37 | 78	–346	–	–346	<–100.0	–
Minority interest in equity		–	–	–	–	–
Equity		**2,604**	**2,733**	–129	–4.7	**454**
Total equity and liabilities		**229,494**	**215,217**	14,277	6.6	**184,496**

Statement of Changes in Equity (condensed)
Statement of Cash Flows (condensed)

Statement of Changes in Equity (condensed) in € million	Subscribed capital	Silent participation	Additional paid-in capital	Retained earnings (incl. unappropriated net income)	AfS reserve	Cash flow hedge reserve	Consolidated profit/loss	Profit carried forward from prior year	Amounts relating to disposal group	Equity
	Equity attributable to equity holders				Revaluation reserve					
Equity at 1.1.2009	**380**	**–**	**2,988**	**688**	**–275**	**–964**	**–**	**–2,363**	**–**	**454**
Capital increase	–	–	–	–	–	–	–	–	–	–
Treasury shares	–	–	–	–	–	–	–	–	–	–
Distribution	–	–	–	–	–	–	–	–	–	–
Total comprehensive income for the year	–	–	–	10	4	301	–1,087	–	–	–772
Transfer to retained earnings	–	–	–	–2,363	–	–	–	2,363	–	–
Changes in the group of consolidated companies	–	–	751	356	–145	–	55	–	–	1,017
Equity at 30.6.2009	**380**	**–**	**3,739**	**–1,309**	**–416**	**–663**	**–1,032**	**–**	**–**	**699**
Equity at 1.1.2010	**380**	**999**	**5,037**	**–1,310**	**–328**	**–530**	**–1,515**	**–**	**–**	**2,733**
Capital increase	–	–	–	–	–	–	–	–	–	–
Treasury shares	–	–	–	–	–	–	–	–	–	–
Distribution	–	–	–	–	–	–	–	–	–	–
Total comprehensive income for the year	–	–	–	20	–114	299	–334	–	–	–129
Transfer to retained earnings	–	–	–	–1,515	–	–	1,515	–	–	–
Changes in the group of consolidated companies	–	–	–	–	–	–	–	–	–	–
Transfer to amounts relating to disposal group	–	–	–	–	140	206	–	–	–346	–
Equity at 30.6.2010	**380**	**999**	**5,037**	**–2,805**	**–302**	**–25**	**–334**	**–**	**–346**	**2,604**

Statement of Cash Flows (condensed) in € million	**2010**	**2009**
Cash and cash equivalents at 1.1.	**618**	**546**
+/– Cash flow from operating activities	–2,683	–2.587
+/– Cash flow from investing activities	2,568	2.290
+/– Cash flow from financing activities	–195	–55
+/– Effects of exchange rate changes and non-cash valuation changes	1	–
Cash and cash equivalents at 30.6.	**309**	**194**

Notes

1 Principles

Deutsche Pfandbriefbank Group has prepared its consolidated interim financial statements for the period ended 30 June 2010 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 consolidated interim 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). Due consideration has in particular been given to the requirements of IAS 34. 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. Deutsche Pfandbriefbank Group does not apply this type of hedge accounting. Therefore, the consolidated interim 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 IFRS Interpretations Committee (formerly IFRIC) or the former Standing Interpretations Committee (SIC).

The accounting and valuation methods as of 30 June 2010 are the same as those applied in the consolidated financial statements for 2009. The following standards and interpretations were applied initially:
> IFRS 2 (Share-based Payment: Group Cash-settled Share-based Payment Transactions)
> IFRS 3 (Business Combinations, revised 2008)
> IAS 27 (Consolidated and Separate Financial Statements)
> IAS 39 (Financial Instruments: Recognition and Measurement: Eligible Hedged Items)
> IFRIC 17 (Distributions of Non-Cash Assets to Owners)

The amendment to IFRS 2 has clarified accounting of share-based payments with a cash settlement within the Group. Because Deutsche Pfandbriefbank Group has currently not provided any commitment with regard to share-based payments, this accordingly does not have any effect on the Group.

IFRS 3 (revised) has revised the way in which the acquisition method is applied in the case of business combinations. Major changes relate to the measurement of non-controlling interests, the accounting of business combinations achieved in stages and the treatment of contingent considerations and acquisition-related costs. The standard is applicable prospectively. There have so far not been any effects for Deutsche Pfandbriefbank Group, and any such effects will depend in future on potential business combinations.

Major changes to IAS 27 comprise the recognition of transactions in which a company continues to retain control as well as transactions in which control is lost. The standard is applicable prospectively. There have so far not been any effects for Deutsche Pfandbriefbank Group, and any such effects will depend in future on potential transactions.

The amendment to IAS 39 specifies how the existing principles for presenting hedges have to be applied. The changes address the designation of unilateral risks in an underlying and the designation of inflation as a separately identifiable risk. There have not been any effects on the hedge accounting of Deutsche Pfandbriefbank Group.

The interpretation IFRIC 17 specifies how a company has to measure non-cash assets which it distributes as dividend to its owners. IFRIC 17 does not apply to distributions of a non-cash asset which in the final analysis is controlled by the same party or the same parties before and after the distributions. There have so far not been any effects for Deutsche Pfandbriefbank Group.

IFRS 5 «Non-current Assets Held for Sale and Discontinued Operations» has also been amended in connection with IFRIC 17. The regulations of recognition, measurement and disclosure are applicable as well in relation to assets which satisfy the criteria for being classified as «held for distribution to owners». IFRIC 17 effects partly the financial instruments intended to be transferred to the deconsolidated environment. In this consolidated interim report Deutsche Pfandbriefbank describes all financial instruments intended to be transferred to the deconsolidated environment in the note «disposal group».

In addition, various standards and interpretations were amended by the IASB as part of the Annual Improvement Project 2009. Most of the amendments are initially applicable in the financial year starting on 1 January 2010. These amendments have not had any major impact on the presentation of the financial statements in this consolidated interim report and on development in assets, financial position and earnings of Deutsche Pfandbriefbank Group.

Moreover, German Accounting Standards (Deutsche Rechnungslegungs Standards – DRS) published by the Deutsche Rechnungslegungs Standards Committee (DRSC) have been taken into account, except that they are not in accordance with the IFRS.

The Management Board of Deutsche Pfandbriefbank AG has prepared the consolidated interim financial statements on 3 August 2010 under the going concern assumption. In preparing the consolidated interim 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 Deutsche Pfandbriefbank AG and their significant subsidiaries ability to continue as a going concern. The future existence of 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 even in the event of defaults and impairments recognised in relation to receivables and securities as a result of the financial crisis affecting individual states and corporations. External liquidity support is necessary to avert insolvency due to illiquidity of the significant subsidiaries of Deutsche Pfandbriefbank AG or Deutsche Pfandbriefbank AG itself. These liquidity supports must be available until Deutsche Pfandbriefbank AG is capable of raising 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 Deutsche Pfandbriefbank AG and its significant subsidiaries as a going concern it is thus particularly necessary that:

- the German Finanzmarktstabilisierungsfonds provides sufficient support in the 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
- no legal reservations (especially EU legal actions) will be successfully enforced

On 28 March 2009, the German Finanzmarktstabilisierungsfonds confirmed to HRE Holding and Deutsche Pfandbriefbank AG (formerly Hypo Real Estate Bank AG) that it intends to stabilise HRE Holding in a sustainable manner 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, 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, 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 shareholder 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. On 4 November 2009 as a third step in the recapitalisation process, the Steering Committee of the German Finanzmarktstabilisierungsfonds decided to extend the support provided to HRE. As a third step in the recapitalisation process, HRE received a further capital contribution of a total of € 3.0 billion from 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.

As the fourth step of recapitalisation, HRE received the commitment from the Financial Market Stabilisation Fund SoFFin for the next recapitalisation tranches of up to € 1.85 billion on 30 April 2010. The capital is to be paid in at least two tranches into the additional paid-in capital of HRE as required. The capital measure still has to be approved by the EU Commission. In an initial tranche, a figure of € 1.4 billion was paid into the additional paid-in capital of HRE Holding on 20 May 2010.

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

The notes to the single balance sheet items which are affected by disposal group include the amounts of the financial instruments which are intended to be transferred to FMS Wertmanagement. The disclosure excluding disposal group is not made in the single balance sheet items of the notes. The corresponding information for disposal group is summarised in note 37. The following balance sheet items are affected by the transfer to FMS Wertmanagement: trading assets, loans and advances to other banks, loans and advances to customers, allowances for losses on loans and advances, financial investments, other assets, liabilities to other banks, liabilities evidenced by certificates, trading liabilities, deferred tax liabilities, AfS reserve and cash flow hedge reserve.

2 Consolidation

The Annual Report 2009 contains a list of all consolidated and non-consolidated holdings on pages 130 to 133.

Compared with the group of consolidated companies in the Annual Report 2009 the following changes arose:

The special purpose vehicle Liffey 1110 Park LLC, Delaware, was founded and initially consolidated as a wholly controlled subsidiary of Hypo Real Estate Capital Corp., New York, on 1 February 2010. Since 4 March 2010, the special purpose vehicle has had a salvage acquisition in the USA with a carrying amount of US$ 7 million on 4 March 2010 and on 30 June 2010. The initial consolidation has otherwise not had any major impact on the income statement or in the balance sheet.

The special purpose vehicle Little Britain Holdings Limited, Jersey, was initially consolidated on 26 February 2010. The wholly controlled subsidiary of Hypo Property Investments Ltd., London, has taken over a salvage acquisition in Great Britain. The carrying amount of the salvage acquisition amounted to GBP 60 million on the date of initial consolidation and to GBP 65 million on 30 June 2010. The initial consolidation has otherwise not had any major impact on the income statement or the balance sheet.

On 30 March 2010, Deutsche Pfandbriefbank AG acquired an interest of 2.97 % in ÖPP Deutschland Beteiligungsgesellschaft mbH, Berlin. The carrying amount of interest amounted to less than € 1 million on the date of acquisition and on 30 June 2010.

The special purpose vehicles The Greater Manchester Property Enterprise Fund Ltd. i.L., London, and Hypo Real Estate Investment Banking Ltd. i.L., London, have been deconsolidated because the process of liquidating both companies was completed on 30 March 2010. The deconsolidation has not had any major impact on the income statement or balance sheet because the companies did not have any assets and liabilities in the year 2010.

On 1 March 2010, Deutsche Pfandbriefbank AG sold its 5 % interest in ILLIT Grundstücks- und Verwaltungsgesellschaft mbH & Co. KG i.L., Gruenwald, for a price of less than € 1 million. The disposal has not resulted in any profit or loss.

Hypo Real Estate Systems GmbH, Munich, has been renamed pbb Services GmbH.

The special-purpose entities Kiel III Ltd., Kiel IV Ltd. and Kiel V Ltd., St. Helier, Jersey, were unwound as of 26 February respectively 30 April 2010. All assets of the entities were transferred to Deutsche Pfandbriefbank AG in exchange for the tranches issued. The asset swap in the balance sheet had no material impact on the income statement.

3 Notes to segment reporting by operating segment

HRE and consequently Deutsche Pfandbriefbank Group have restructured their business. It is focusing on the viable areas of operation, and this is the reason why the strategic activities have been pooled in the core bank Deutsche Pfandbriefbank AG. The segment structure has also been adjusted and brought into line with this strategic refocusing, and the previous year figures have been drawn up in line with the new segment structure. The strategic business in public sector financing will be pooled in the operating segment Public Sector Finance, and strategic commercial real estate finance business will be pooled in the operating segment Real Estate Finance. Non-strategic business will be pooled in the operating segment Value Portfolio.

Public Sector Finance (PSF) The operating segment Public Sector Finance comprises public sector financings which are eligible for cover fund purposes under German law. New business is to focus on the primary markets, i.e. by direct financing of public sector corporations and with a conservative financing strategy. The aim is to concentrate on Pfandbrief-eligible markets with excellent country ratings. The target group for this business is profitable customer segments with a commensurate risk level: regions, municipalities and public sector authorities as well as state-guaranteed public corporations and guaranteed public-private partnerships.

Real Estate Finance (REF) The operating segment Real Estate Finance comprises all commercial real estate financing operations of the Group. New business will focus on financing existing properties with a conservative refinancing strategy for professional investors. Financing for development projects will be provided only on a selective basis. The main markets of this segment are Germany, Great Britain and France as well as other selected European regions in which Deutsche Pfandbriefbank AG had been operating in the past. Adequate batch sizes and loan-to-value ratios commensurate to the level of risk involved are essential for independent business in this respect. Strategic partnerships will be concluded with other institutions with the aim of achieving higher loan-to-value ratios and larger volumes by way of syndications and syndicate financing for customers.

Value Portfolio (VP) The operating segment Value Portfolio contains the non-strategic portfolios of Deutsche Pfandbriefbank Group, for example CDOs, Commercial Mortgage Backed Securities and Residential Mortgage Backed Securities.

The presentation of the operating segments of Deutsche Pfandbriefbank Group is based on internal reporting, which is drawn up in accordance with IFRS. Income and expenses are apportioned to the segments in line with the principle of causation. The external net interest income is apportioned to the operating segments using the market interest rate method.

The **Consolidation & Adjustments** column is used for reconciling the sum of operating segments results with the consolidated result. In addition to consolidations, it also comprises certain expenses and income which are not covered by the area of responsibility of the operating segments.

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.

4 Income statement, broken down by operating segment

Income/expenses in € million		PSF	REF	VP	Consolidation & Adjustments	**Deutsche Pfandbriefbank**
Operating revenues	1.1.–30.6.2010	45	265	–46	–44	220
	1.1.–30.6.2009	–1	340	–204	–101	34
	Combined figures 1.1.–30.6.2009	70	340	–201	–104	105
Net interest income and similar income	1.1.–30.6.2010	51	311	–21	–11	330
	1.1.–30.6.2009	–	344	–64	–29	251
	Combined figures 1.1.–30.6.2009	76	344	–61	–30	329
Net commission income	1.1.–30.6.2010	–3	42	–47	–	–8
	1.1.–30.6.2009	–1	47	–52	–	–6
	Combined figures 1.1.–30.6.2009	–7	47	–52	–	–12
Net trading income	1.1.–30.6.2010	8	–79	23	–	–48
	1.1.–30.6.2009	–	–48	–61	–	–109
	Combined figures 1.1.–30.6.2009	1	–48	–61	–	–108
Net income from financial investments	1.1.–30.6.2010	–11	–5	–1	–	–17
	1.1.–30.6.2009	–	–1	–27	–	–28
	Combined figures 1.1.–30.6.2009	–	–1	–27	–	–28
Net income from hedge relationships	1.1.–30.6.2010	–	–	–	–39	–39
	1.1.–30.6.2009	–	–	–	–16	–16
	Combined figures 1.1.–30.6.2009	–	–	–	–33	–33
Balance of other operating income/expenses	1.1.–30.6.2010	–	–4	–	6	2
	1.1.–30.6.2009	–	–2	–	–56	–58
	Combined figures 1.1.–30.6.2009	–	–2	–	–41	–43
Provisions for losses on loans and advances	1.1.–30.6.2010	5	395	1	–	401
	1.1.–30.6.2009	–	1,048	–	–	1,048
	Combined figures 1.1.–30.6.2009	2	1,047	–	–	1,049
General administrative expenses	1.1.–30.6.2010	27	87	16	41	171
	1.1.–30.6.2009	8	76	22	1	107
	Combined figures 1.1.–30.6.2009	22	85	24	1	132
Balance of other income/expenses	1.1.–30.6.2010	–	–	–	–	–
	1.1.–30.6.2009	–	–	–	13	13
	Combined figures 1.1.–30.6.2009	–	–	–	15	15
Pre-tax profit	1.1.–30.6.2010	**13**	**–217**	**–63**	**–85**	**–352**
	1.1.–30.6.2009	**–9**	**–784**	**–226**	**–89**	**–1,108**
	Combined figures 1.1.–30.6.2009	**46**	**–792**	**–225**	**–90**	**–1,061**

5 Key ratio, broken down by operating segment

Cost-income ratio in %		PSF	REF	VP	**Deutsche Pfandbriefbank**
Cost-income ratio (based on operating revenues)	1.1.–30.6.2010	60.0	32.8	>100.0	**77.7**
	1.1.–30.6.2009	>100.0	22.4	>100.0	**>100.0**
	Combined figures 1.1.–30.6.2009	31.4	25.0	>100.0	**>100.0**

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

Deutsche Pfandbriefbank AG is according to 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 states 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.

7 Breakdown of operating revenues

Operating revenues by products

Operating revenues by products in € million	**1.1.–30.6.2010**	**1.1.–30.6.2009**
Public Sector financings	45	–1
Commercial Real Estate financings	265	340
Other products	–90	–305
Total	**220**	**34**

Notes to the Income Statement

8 Net interest income and similar income

Net interest income and similar income, broken down by categories of income/expenses in € million	**1.1.–30.6.2010**	**1.1.–30.6.2009**
Interest income and similar income	**2,521**	**2,373**
Lending and money-market business	1,723	1,761
Fixed-income securities and government-inscribed debt	491	516
Current result from swap transactions (balance of interest income and interest expenses)	307	96
Interest expenses and similar expenses	**2,191**	**2,122**
Deposits	532	521
Liabilities evidenced by certificates	1,589	1,546
Subordinated capital	70	55
Total	**330**	**251**

Total interest income for financial assets that are not at fair value through profit or loss, amount to € 2.2 billion (1.1.–30.6.2009: € 2.2 billion). Total interest expenses for financial liabilities that are not at fair value through profit or loss amount to € 2.2 billion (1.1.–30.6.2009: € 2.1 billion).

Net interest income and similar income includes income of € 44 million (1.1.–30.6.2009: € 56 million) due to the increase in the present value of the adjusted allowances resulting over a period of time and an expense of € –8 million (1.1.–30.6.2009: € – 12 million) due to the increase in the present value of the adjusted liabilities over a period of time.

9 Net commission income

Net commission income in € million	**1.1.–30.6.2010**	**1.1.–30.6.2009**
Securities and custodial services	–5	–2
Lending operations and other service operations	–3	–4
thereof: Expenses of the liquidity support	–45	–57
Total	**–8**	**–6**

The net commission income resulted completely from financial assets and financial liabilities which are not measured at fair value through profit or loss.

10 Net trading income

Net trading income in € million	1.1.– 30.6.2010	1.1.– 30.6.2009
from interest rate instruments and related derivatives	–83	–47
from credit risk instruments and related derivatives	35	–62
Total	**–48**	**–109**

11 Net income from financial investments

Net income from financial investments in € million	1.1.– 30.6.2010	1.1.– 30.6.2009
Income from financial investments	42	6
Expenses from financial investments	59	34
Total	**–17**	**–28**

Based on measurement categories, net income from financial investments is broken down as follows:

Net income from financial investments by IAS 39 categories in € million	1.1.– 30.6.2010	1.1.– 30.6.2009
Available-for-sale financial investments	–2	5
Loans-and-receivables financial investments	–15	–33
Total	**–17**	**–28**

12 Net income from hedge relationships

Net income from hedge relationships in € million	1.1.– 30.6.2010	1.1.– 30.6.2009
Result from fair value hedge accounting	–	–8
Result from hedged items	4	8
Result from hedging instruments	–4	–16
Result from dFVTPL investments and related derivatives	–37	–8
Result from dFVTPL investments	–24	7
Result from derivatives related to dFVTPL investments	–13	–15
Ineffectiveness from cash flow hedge accounting affecting income	–2	–
Total	**–39**	**–16**

13 Balance of other operating income/expenses

Balance of other operating income/expenses in € million	1.1.– 30.6.2010	1.1.– 30.6.2009
Other operating income	31	5
Other operating expenses	29	63
Balance of other operating income/expenses	**2**	**–58**

The balance of other operating income/expenses comprises effects from foreign currency translation amounting to € –18 million (1.1.–30.6.2009 € –57 million).

14 Provisions for losses on loans and advances

Provisions for losses on loans and advances in € million	**1.1.– 30.6.2010**	**1.1.– 30.6.2009**
Provisions for losses on loans and advances	402	1,047
Additions	475	1,069
Releases	–73	–22
Provisions for contingent liabilities and other commitments	–	2
Additions	–	2
Releases	–	–
Recoveries from impaired loans and advances	–1	–1
Total	**401**	**1,048**

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

15 General administrative expenses

General administrative expenses in € million	**1.1.– 30.6.2010**	**1.1.– 30.6.2009**
Personnel expenses	57	47
Wages and salaries	43	39
Social security costs	8	5
Pension expenses and related employee benefit costs	6	3
Other general administrative expenses	106	53
Depreciation/amortisation	8	7
on software and other intangible assets excluding goodwill	6	5
on property, plant and equipment	2	2
Total	**171**	**107**

Cost-income ratio in %	**1.1.– 30.6.2010**	**1.1.– 30.6.2009**
Cost-income ratio	77.7	>100.0

16 Balance of other income/expenses

Balance of other income/expenses in € million	**1.1.– 30.6.2010**	**1.1.– 30.6.2009**
Other income	9	21
thereof: Releases of restructuring provisions	9	21
Other expenses	9	8
thereof: Additions to restructuring provisions	9	8
Balance of other income/expenses	**–**	**13**

17 Taxes on income

Breakdown in € million	**1.1.– 30.6.2010**	**1.1.– 30.6.2009**
Current taxes	6	6
Deferred taxes	–24	–27
thereof: Deferred taxes on capitalised losses carried forward	–	1
Total	**–18**	**–21**

18 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	**1.1.– 30.6.2010**	**1.1.– 30.6.2009**
Loans and receivables	–391	–1.039
Available for sale	–2	5
Held for trading	–48	–88
Designated at fair value through P&L	–37	–8
Financial liabilities at amortised costs	2	321

Notes to the Statement of Financial Position

19 Trading assets

Trading assets in € million	30.6.2010	31.12.2009
Positive fair values from derivative financial instruments	683	360
Stand-alone derivatives (bank book)	1,391	1,075
Total	**2,074**	**1,435**

20 Loans and advances to other banks

Loans and advances to other banks, broken down by type of business in € million	30.6.2010	31.12.2009
Loans and advances	90,416	77,967
Public sector loans	7,682	9,126
Real estate loans	34	42
Other loans and advances	82,700	68,799
Investments	44	184
Total	**90,460**	**78,151**

Loans and advances to other banks, broken down by maturities in € million	30.6.2010	31.12.2009
Repayable on demand	4,850	4,167
With agreed maturities	85,610	73,984
up to 3 months	73,954	63,858
from 3 months to 1 year	4,745	3,142
from 1 year to 5 years	2,370	2,502
from 5 years and over	4,541	4,482
Total	**90,460**	**78,151**

21 Loans and advances to customers

Loans and advances to customers, broken down by type of business in € million	30.6.2010	31.12.2009
Loans and advances	90,299	91,221
Public sector loans	35,925	36,277
Real estate loans	53,820	54,303
Other loans and advances	554	641
Investments	–	–
Total	**90,299**	**91,221**

Loans and advances to customers, broken down by maturities in € million	30.6.2010	31.12.2009
Unspecified terms	1	1
With agreed maturities	90,298	91,220
up to 3 months	7,002	6,539
from 3 months to 1 year	12,634	10,765
from 1 year to 5 years	33,374	35,814
from 5 years and over	37,288	38,102
Total	**90,299**	**91,221**

22 Volume of lending

Volume of lending in € million	30.6.2010	31.12.2009
Loans and advances to other banks	90,416	77,967
Loans and advances to customers	90,299	91,221
Contingent liabilities	610	689
Total	**181,325**	**169,877**

23 Allowances for losses on loans and advances

Development in € million	Individual allowances on loans and advances	Portfolio-based allowances	**Total**
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
Additions 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**
Balance at 1.1.2010	**2,776**	**550**	**3,326**
Changes affecting income	378	– 21	357
Gross additions	471	4	475
Releases	– 49	– 24	– 73
Increase of the present value due to passage of time (unwinding)	– 44	–	– 44
Release model reserve	–	– 1	– 1
Changes not affecting income	– 130	– 1	– 131
Additions and disposals in the group of consolidated companies	–	–	–
Use of existing loan-loss allowances	– 315	-1	– 316
Reclassifications	–	–	–
Effects of currency translations and other changes not affecting income	185	–	185
Balance at 30.6.2010	**3,024**	**528**	**3,552**

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

24 Financial investments

Breakdown in € million	30.6.2010	31.12.2009
AfS financial investments	2,778	2,811
Shares in non-consolidated subsidiaries	2	2
Participating interests	8	7
Debt securities and other fixed-income securities	2,766	2,799
Equity securities and other variable-yield securities	2	3
dFVTPL financial investments	860	925
Debt securities and other fixed-income securities	860	925
LaR financial investments	25,452	27,178
Debt securities and other fixed-income securities	25,452	27,178
Total	**29,090**	**30,914**

The carrying amounts of the LaR financial investments were reduced by portfolio-based allowances amounting to € 48 million (31 December 2009: € 33 million).

Financial investments, broken down by maturities in € million	30.6.2010	31.12.2009
Unspecified terms	12	12
With agreed maturities	29,078	30,902
up to 3 months	1,130	736
from 3 months to 1 year	2,291	2,682
from 1 year to 5 years	8,675	9,549
from 5 years and over	16,982	17,935
Total	**29,090**	**30,914**

Deutsche Pfandbriefbank Group had applied 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 respectively € 9.5 billion (total € 30.2 billion).

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

Since the date of reclassification, financial assets with a (reclassified) carrying amount of around € 5.8 billion became due.

In the first six months of the financial year 2010 securities with a reclassified carrying amount of € 0.3 billion (2009: € 1.3 billion) were sold due to the decided reduction of portfolios. Thereby net gains of € 1 million were realised (2009: net loss € –103 million. 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 30 June 2010 respectively 31 December 2009 as well as fair value gains and losses that would have been recognised in the first half of 2010 respectively in the business year 2009 if the financial assets had not been reclassified.

Reclassifications 2010					
	into: Financial investment loans and receivables (LaR)			Effect in reporting period if no assets would have been reclassified (1.1.–30.6.2010)	
		30.6.2010			
	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	22.8	21.5	–27	–673

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

25 Other assets

Other assets in € million	30.6.2010	31.12.2009
Positive fair values from derivative financial instruments	15,303	11,389
Hedging derivatives	15,303	11,389
Micro fair value hedge	3,731	2,884
Cash flow hedge	11,572	8,505
Salvage acquisitions	185	108
Other assets	259	285
Deferred charges and prepaid expenses	26	19
Capitalised excess cover of qualified insurance for pension provisions	–	–
Total	**15,773**	**11,801**

26 Income tax assets

Income tax assets in € million	30.6.2010	31.12.2009
Current tax assets	68	131
Deferred tax assets	4,940	4,234
Total	**5,008**	**4,365**

27 Liabilities to other banks

Liabilities to other banks by maturities in € million	30.6.2010	31.12.2009
Repayable on demand	1,343	895
With agreed maturities	84,025	66,730
up to 3 months	78,219	57,608
from 3 months to 1 year	2,904	7,034
from 1 year to 5 years	2,155	1,158
from 5 years and over	747	930
Total	**85,368**	**67,625**

28 Liabilities to customers

Liabilities to customers by maturities in € million	30.6.2010	31.12.2009
Repayable on demand	312	53
With agreed maturities	14,017	12,325
up to 3 months	728	205
from 3 months to 1 year	1,621	1,572
from 1 year to 5 years	4,705	3,809
from 5 years and over	6,963	6,739
Total	**14,329**	**12,378**

29 Liabilities evidenced by certificates

Liabilities evidenced by certificates, broken down by maturities in € million	30.6.2010	31.12.2009
With agreed maturities		
up to 3 months	7,488	8,225
from 3 months to 1 year	32,396	39,141
from 1 year to 5 years	29,324	31,664
from 5 years and over	29,503	30,163
Total	**98,711**	**109,193**

30 Trading liabilities

Trading liabilities in € million	30.6.2010	31.12.2009
Negative fair values from derivative financial instruments	467	452
Other trading liabilities	2	2
Stand-alone derivatives (bank book)	2,136	1,418
Total	**2,605**	**1,872**

31 Provisions

Breakdown in € million	30.6.2010	31.12.2009
Provisions for pensions and similar obligations	5	5
Restructuring provisions	95	100
Provisions for contingent liabilities and other commitments	12	11
Other provisions	36	37
Total	**148**	**153**

As of 1 January 2005, Deutsche Pfandbriefbank Group 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.

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 Bodencredit-bank 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-eight-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 cooperation contract.

The decision of the Management Board not to pay any discretionary variable compensation for 2008 has since resulted in several pending or threatened labour court proceedings with employees in Germany. The question as to whether, and if so to what extent, employees have any bonus claims for 2008 is a matter of interpretation, and in particular the interpretation of reasonable discretion and the application of the Law of the General Terms and Conditions in individual cases. So far, five first-instance verdicts have been issued against Deutsche Pfandbriefbank AG and one first-instance verdict against pbb Services GmbH have been issued against with regard to the bonus for 2008 (Labour Court Munich). These verdicts have confirmed the bonus actions of differing extents. However, two first-instance verdicts have since been issued in favour of the Bank (Labour Court Munich and Labour Court Stuttgart, the latter verdict from July 2010); these verdicts completely rejected the bonus actions. The Company intends to appeal against the verdicts which have allowed the bonus actions (partially), and has already done so in five cases. It is possible that further employees might successfully enforce bonus claims for 2008; however, the verdicts of the Labour Courts in Munich and Stuttgart which have been issued in favour of the Bank show that the courts can also use their discretion to completely reject the actions.

Employees have also claimed bonuses for 2009, by legal action in certain cases. The Management Board has decided that no discretionary variable compensation will be paid for 2009. Again, it is possible that further employees might successfully submit claims for bonuses for 2009. However, we are assuming that, as a result of the alternative solution involving an offer of a voluntary one-off payment for the failure to pay any discretionary variable compensation for 2009 (in return for a waiver in Germany) will mean that legal action relating to the payment of discretionary compensation for 2009 will tend to be the exception rather than the rule.

32 Other liabilities

Other liabilities in € million	30.6.2010	31.12.2009
Negative fair values from derivative financial instruments	16,850	13,087
Hedging derivatives	16,775	13,020
Micro fair value hedge	5,062	3,784
Cash flow hedge	11,713	9,236
Derivatives hedging dFVTPL financial instruments	75	67
Other liabilities	506	451
Deferred income	80	97
Total	**17,436**	**13,635**

33 Income tax liabilities

Income tax liabilities in € million	30.6.2010	31.12.2009
Current tax liabilities	84	85
Deferred tax liabilities	4,397	3,648
Total	**4,481**	**3,733**

34 Subordinated capital

Breakdown in € million	30.6.2010	31.12.2009
Subordinated liabilities	3,547	3,626
Participating certificates outstanding	2	13
Hybrid capital instruments	263	256
Total	**3,812**	**3,895**

Subordinated capital, broken down by maturities in € million	30.6.2010	31.12.2009
With agreed maturities		
up to 3 months	60	32
from 3 months to 1 year	297	217
from 1 year to 5 years	1,189	1,353
from 5 years and over	2,266	2,293
Total	**3,812**	**3,895**

35 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 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» of the Annual Report 2009 of Deutsche Pfandbriefbank Group.

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 30.6.2010 in € million	Total	Level 1	Level 2	Level 3
Assets				
Financial assets at fair value through P&L	6,665	753	5,878	34
Trading assets	2,074	–	2,061	13
dFVTPL financial investments	860	753	107	–
Hedging derivatives	3,731	–	3,710	21
Financial assets at fair value not affecting P&L	14,340	2,759	11,529	52
AfS financial investments[1]	2,768	2,759	9	–
Cash flow hedge derivatives	11,572	–	11,520	52
Total	**21,005**	**3,512**	**17,407**	**86**
Liabilities				
Financial liabilities at fair value through P&L	7,742	–	7,294	448
Trading liabilities	2,605	–	2,164	441
Hedging derivatives	5,062	–	5,055	7
Derivatives hedging dFVTPL financial instruments	75	–	75	–
Financial liabilities at fair value not affecting P&L	11,713	–	11,696	17
Cash flow hedge derivatives	11,713	–	11,696	17
Total	**19,455**	**–**	**18,990**	**465**

[1] Excluding shares in non-consolidated subsidiaries and participating interests

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 derivatives	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 derivatives	9,236	–	9,218	18
Total	**14,959**	**–**	**14,698**	**261**

[1] Excluding shares in non-consolidated subsidiaries and participating interests

Due to changes in market conditions for certain financial instruments, quoted prices in active markets were no longer available for specific instruments in the first half of 2010. However, there was sufficient information available to measure fair values of these instruments based on observable market inputs. Hence, financial assets with a fair value of € 56 million (2009: € 63 million), were transferred from Level 1 to Level 2 of the fair value hierarchy.

Reclassifications from Level 2 to Level 1 were not accomplished in the financial year 2010 and in 2009.

The following tables present the changes in Level 3 instruments carried out in the first half of 2010 as well as in the financial year 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 recognised in				
Income statement	4	15	–	19
Equity	–	–	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**
Balance at 1.1.2010	**9**	**18**	**48**	**75**
Comprehensive income recognised in				
Income statement	4	10	–	14
Equity	–	–	4	4
Purchases	–	–	–	–
Sales	–	–	–	–
Issues	–	–	–	–
Settlements	–	–	–	–
Transfers into Level 3	–	–	–	–
Transfers out of Level 3	–	–7	–	–7
Balance at 30.6.2010	**13**	**21**	**52**	**86**

Changes in Level 3 financial liabilities

in € million	Trading liabilities	Financial liabilities at fair value through P&L Hedging derivatives	Financial liabilities at fair value not affecting P&L Cash flow hedge derivatives	**Total**
Balance at 1.1.2009	**−610**	**−35**	**−15**	**−660**
Comprehensive income recognised in				
Income statement	−14	28	–	14
Equity	–	–	−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**
Balance at 1.1.2010	**−236**	**−7**	**−18**	**−261**
Comprehensive income recognised in				
Income statement	−30	–	–	−30
Equity	–	–	1	1
Purchases	–	–	–	–
Sales	–	–	–	–
Issues	–	–	–	–
Settlements	–	–	–	–
Transfers into Level 3	−175	–	–	−175
Transfers out of Level 3	–	–	–	–
Balance at 30.6.2010	**−441**	**−7**	**−17**	**−465**

The balance of gains or losses affecting the income statement of the first half of 2010 amounted to € −16 million and relates to dFVTPL assets and liabilities held on 30 June 2010. The gains or losses resulting from dFVTPL assets (thereof € 4 million from trade assets and € 10 million from hedging derivatives) were recognised in the net trading income (€ 4 million) and in the net income from hedge relationships (€ 10 million). The gains or losses resulting from dFVTPL liabilities (€ −30 million) were recognised solely in the net trading income.

All gains or losses recognised directly in equity (€ 5 million) relate to cash flow hedge derivatives 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 tables show the fair value sensitivity of Level 3 measurements to reasonably possible alternative assumptions at 30 June 2010 and 31 December 2009:

Sensitivities of Level 3 instruments at 30.6.2010 in € million	Favourable changes	Unfavourable changes
Assets		
Financial assets at fair value through P&L		
Hedging derivatives	1.5	– 1.3
Total	**1.5**	**– 1.3**
Liabilities		
Financial liabilities at fair value through P&L		
Trading liabilities	1.3	– 1.3
Hedging derivatives	0.1	– 0.1
Total	**1.4**	**– 1.4**

Sensitivities of Level 3 instruments at 31.12.2009 in € million	Favourable changes	Unfavourable changes
Assets		
Financial assets at 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 hedge 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.

36 Assets and liabilities according to measurement categories and classes

Assets and liabilities according to measurement categories and classes in € million	**30.6.2010**	**31.12.2009**
Assets		
Loans-and-receivables (LaR)	202,659	193,224
Available-for-sale (AfS)	2,778	2,811
Held-for-trading (HfT)	2,074	1,435
dFVTPL-assets (dFVTPL)	860	925
Cash reserve	309	618
Positive fair values from hedging derivatives	15,303	11,389
Liabilities		
Held-for-trading (HfT)	2,605	1,872
Financial liabilities at amortised costs	202,386	193,238
Negative fair values from hedging derivatives	16,850	13,087

37 Disposal group

In January 2010, HRE Holding as parent company of Deutsche Pfandbriefbank AG submitted an application to the FMSA for the establishment of a deconsolidated environment. This application was approved by the FMSA on 8 July 2010, and the deconsolidated environment FMS Wertmanagement AöR was established. HRE and Deutsche Pfandbriefbank Group wish to transfer non-strategic or non-performing assets to this deconsolidated environment. The assets and liabilities which have been identified for this transfer consist exclusively of financial instruments, but, notwithstanding the fact that the deconsolidated environment has already been established, the transfer has yet to be approved by the FMSA and the European Commission.

Assuming that approval of the FMSA and the European Commission is forthcoming, it is intended that all identified financial instruments will be transferred in the second half 2010 by technical as well as accounting means, so that the deconsolidated environment will become the (beneficial) owner of the financial instruments at that time.

In general, the financial instruments will be transferred to the deconsolidated environment in the form of a demerger or singular succession (both hereinafter referred to as «true sale»). If a true sale is not possible as a result of legal or operational restrictions, the financial instruments will be transferred by way of granting sub-participations. Whereas title is transferred directly in the event of a true sale, beneficial ownership is normally transferred in the event of a sub-participation. If a transfer of beneficial ownership, either by true sale or sub-participation, cannot be carried out as a result of legal or technical restrictions, offsetting transactions will be concluded with the deconsolidated environment in exceptional cases in order to transfer the market risks and/or liquidity risks. Such offsetting transactions do not qualify for derecognition in accordance with IAS 39.17 et seq.

In return for transferring the financial instruments to the deconsolidated environment, HRE will acquire a claim for compensation from the deconsolidated environment. In addition, the Financial Market Stabilisation Fund in its capacity as the indirect sole shareholder of Deutsche Pfandbriefbank AG will obtain shares in the deconsolidated environment. Accordingly, Deutsche Pfandbriefbank Group has classified all assets and liabilities identified for transfer as disposal group in accordance with IFRS 5.

The financial instruments identified for transfer are disclosed separately in the balance sheet as disposal group. Apart from this note the notes to the statement of financial position contain the total assets and liabilities. Hence, it is not distinguished whether or not the financial instruments are classified as disposal group. In detail, Deutsche Pfandbriefbank Group plans to transfer the following financial instruments to the deconsolidated environment:

Disposal group Carrying amount in € million	**30.6.2010**
Assets	
Trading assets	905
Loans and advances to other banks	75,157
Loans and advances to customers	23,235
Allowances for losses on loans and advances	–2,566
Financial investments	10,912
Other assets	260
Total assets	**107,903**
Equity and liabilities	
Liabilities to other banks	202
Liabilities evidenced by certificates	19,983
Trading liabilities	2
Deferred tax liabilities	107
Liabilities	**20,294**
Revaluation reserve	–346
AfS reserve	–140
Cash flow hedge reserve	–206
Equity	**–346**
Total equity and liabilities	**19,948**

All financial instruments are measured in accordance with IAS 39. Any cumulative income or expenses recognised in the revaluation reserve, related to the transferred assets, are also disclosed separately within equity.

The intended transferred non-strategic or distressed assets stem from all operating segments of Deutsche Pfandbriefbank Group, but without transferring an operating segment completely.

38 Past due but not impaired assets

LaR assets

LaR assets: past due but not impaired (total investment) in € million	30.6.2010	31.12.2009
up to 3 months	362	761
from 3 months to 6 months	205	288
from 6 months to 1 year	107	205
from 1 year and over	648	222
Total	**1,322**	**1,476**

Carrying amounts LaR assets in € billion	30.6.2010	31.12.2009
Carrying amount of LaR assets that are neither impaired nor past due	200.8	192.1
Carrying amount of LaR assets that are past due but not impaired (total investment)	1.3	1.5
Carrying amount of individually assessed impaired LaR assets (net)	3.6	2.4
Balance of portfolio-based allowances	0.6	0.6
Total	**206.3**	**196.6**
thereof: Loans and advances to other banks (including investments)	90.5	78.2
Loans and advances to customers (including investments)	90.3	91.2
Financial investments (gross)	25.5	27.2

Other Notes

39 Contingent liabilities and other commitments

Contingent liabilities and other commitments in € million	30.6.2010	31.12.2009
Contingent liabilities	**610**	**689**
Guarantees and indemnity agreements	610	689
Loan guarantees	31	39
Performance guarantees and indemnities	579	650
Other commitments	**2,396**	**2,691**
Irrevocable loan commitments	2,169	2,649
Book credits	469	558
Guarantees	95	60
Mortgage and public sector loans	1,605	2,031
Other commitments	227	42
Total	**3,006**	**3,380**

40 Key regulatory capital ratios (based on German Commercial Code)

Deutsche Pfandbriefbank AG is according to 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.

41 Employees

Average number of employees	30.6.2010	31.12.2009
Employees (excluding apprentices)	912	858
Apprentices	4	6
Total	**916**	**864**

Munich, 3 August 2010

Deutsche Pfandbriefbank Aktiengesellschaft
The Management Board

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 for interim financial reporting, the interim consolidated financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the group, and the interim management report of the group 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 for the remaining months of the financial year.

Munich, 3 August 2010

Deutsche Pfandbriefbank Aktiengesellschaft
The Management Board

Manuela Better

Dr. Kai Wilhelm Franzmeyer

Frank Krings

Dr. Bernhard Scholz

Alexander von Uslar

Review Report

We have reviewed the condensed interim consolidated financial statements of the Deutsche Pfandbriefbank AG, Munich – comprising the balance sheet, the income statement, the statement of comprehensive income, the condensed statement of changes in equity, the condensed cash flow statement and condesed notes – together with the interim group management report of the Deutsche Pfandbriefbank AG, Munich for the period from 1 January to 30 June 2010 that are part of the semi-annual financial report according to § 37w WpHG [«Wertpapierhandelsgesetz»: «German Securities Trading Act»]. The preparation of the condensed interim consolidated financial statements in accordance with those IFRS applicable to interim financial reporting as adopted by the EU, and of the interim group management report in accordance with the requirements of the WpHG applicable to interim group management reports, is the responsibility of the company's management. Our responsibility is to issue a report on the condensed interim consolidated financial statements and on the interim group management report based on our review.

We performed our review of the condensed interim consolidated financial statements and the interim group management report in accordance with the German generally accepted standards for the review of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW). Those standards require that we plan and perform the review so that we can preclude through critical evaluation, with a certain level of assurance, that the condensed interim consolidated financial statements have not been prepared, in material aspects, in accordance with the IFRS applicable to interim financial reporting as adopted by the EU, and that the interim group management report has not been prepared, in material aspects, in accordance with the requirements of the WpHG applicable to interim group management reports. A review is limited primarily to inquiries of company employees and analytical assessments and therefore does not provide the assurance attainable in a financial statement audit. Since, in accordance with our engagement, we have not performed a financial statement audit, we cannot issue an auditor's report.

Based on our review, no matters have come to our attention that cause us to presume that the condensed interim consolidated financial statements have not been prepared, in material respects, in accordance with the IFRS applicable to interim financial reporting as adopted by the EU, or that the interim group management report has not been prepared, in material respects, in accordance with the requirements of the WpHG applicable to interim group management reports.

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 one. 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 even in the event of defaults and impairments recognised in relation to receivables and securities as a result of the financial crisis affecting individual states and corporations. 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 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, 12 August 2010

KPMG AG
Wirtschaftsprüfungsgesellschaft
[Original German version signed by:]

Dielehner	Wiechens
Wirtschaftsprüfer	Wirtschaftsprüfer
[German Public Auditor]	[German Public Auditor]

Service Chapter

Service Chapter
Financial Calendar
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Internet Service

Financial Calendar	
13 August 2010	Publication of the results for the second quarter of 2010
16 November 2010	Publication of the results for the third quarter of 2010

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.

Internet Service

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