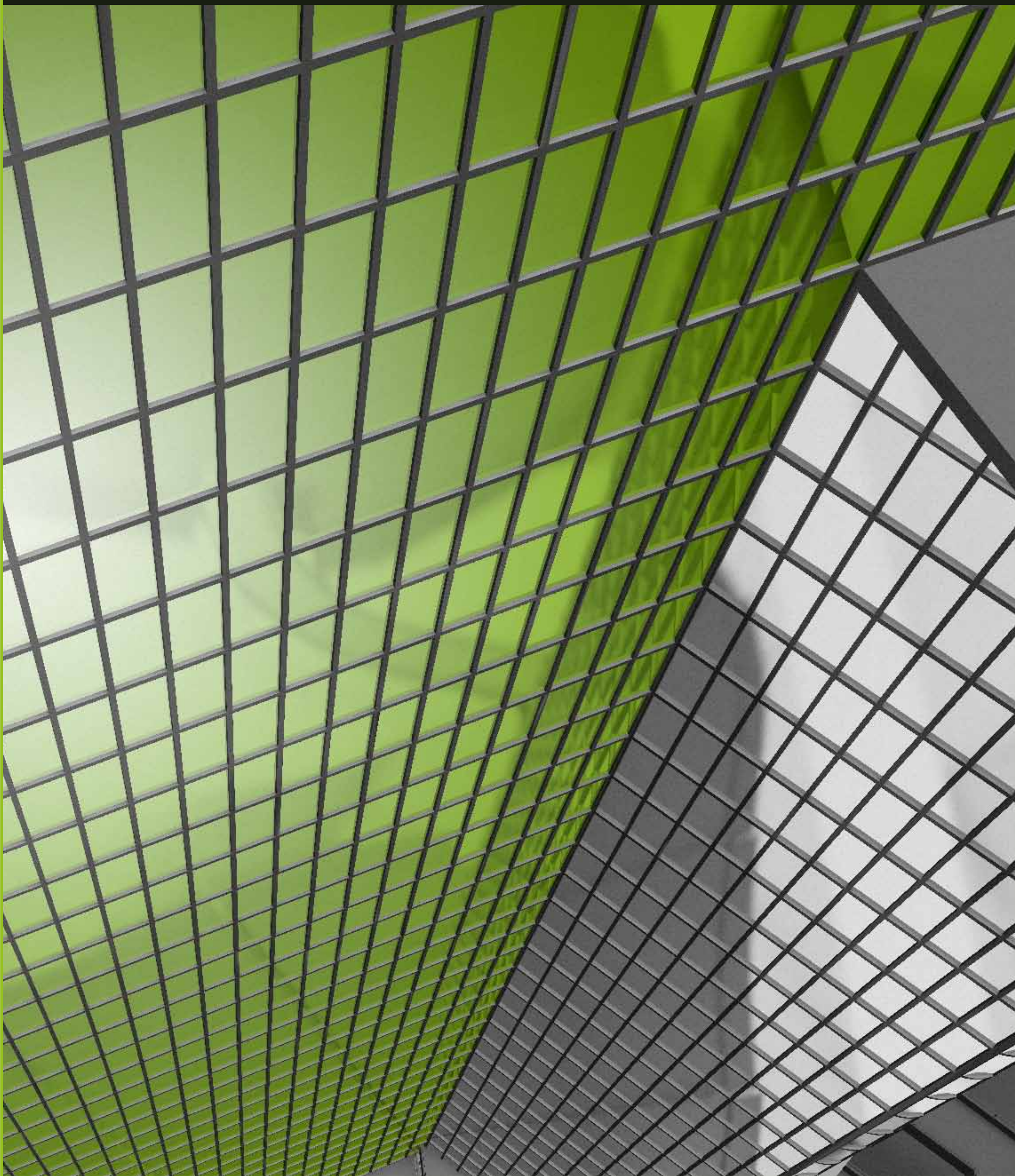
Annual Report 2014

PUBLIC SECTOR FINANCE
REAL ESTATE FINANCE

pbb

DEUTSCHE
PFANDBRIEFBANK



Overview

pbb Group		2014	2014[1]	2013
Operating performance according to IFRS				
Profit or loss before tax	in € million	54	174	165
Net income/loss	in € million	4	116	160
Key ratio				
Return on equity before tax	in %	1.6	5.0	5.0
Return on equity after tax	in %	0.1	3.4	4.9
Cost-income ratio[2]	in %	77.0	57.3	64.7
Balance sheet figures		**31.12.2014**	**31.12.2014[1]**	**31.12.2013**
Total assets	in € billion	75.5	75.6	74.6
Financial position equity (excluding revaluation reserve)	in € billion	3.4	3.5	3.4
Financial position equity	in € billion	3.5	3.6	3.5
Key capital ratios[3]		**31.12.2014[4]**	**31.12.2014[1]**	**31.12.2013[5][6]**
CET1 ratio	in %	21.7	21.8	18.5
Own funds ratio	in %	26.1	26.1	23.2
Personnel				
Employees		844	844	852

[1] Without the valuation adjustment of Heta Asset Resolution AG (Heta) exposure.
[2] The cost-income ratio is the ratio of general and administrative expenses and operating income.
[3] In accordance with the waiver regulation set out in Section 7 of the Capital Requirements Regulation (CRR), pbb is exempted from the requirement to establish the equity and core capital ratios at institution level. pbb Group voluntarily discloses these figures.
[4] Consolidated in accordance with CRR
[5] Consolidated in accordance with CRR (Pro forma Basel III figure, following the appropriation of net profit 2013)
[6] Adjusted due to IAS 8.42. Details are disclosed in Note «Consistency».

Senior unsecured ratings and ratings for Pfandbriefe of pbb[1]			31.12.2014			31.12.2013
	Fitch Ratings	Moody's	Standard & Poor's	Fitch Ratings	Moody's	Standard & Poor's
Long-term rating	A–	Baa2	BBB	A–	Baa2	BBB
Outlook	negative	negative	negative	stable	negative	stable
Short-term rating	F1	P–2	A–2	F1	P–2	A–2
Public sector Pfandbriefe	–	Aa1	AA+[2]	–	Aa1	AA+[3]
Mortgage Pfandbriefe	–	Aa2	AA+[2]	–	Aa2	AA+[3]

[1] Ratings from mandated rating agencies
[2] Negative outlook
[3] Stable outlook

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.

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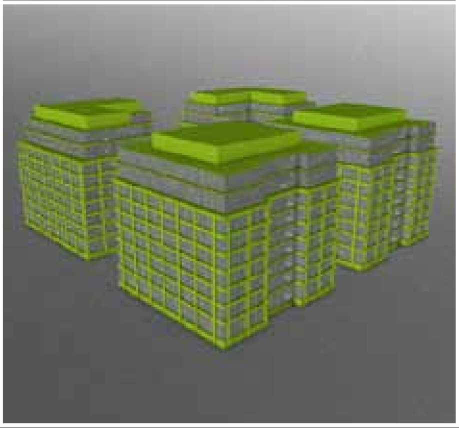


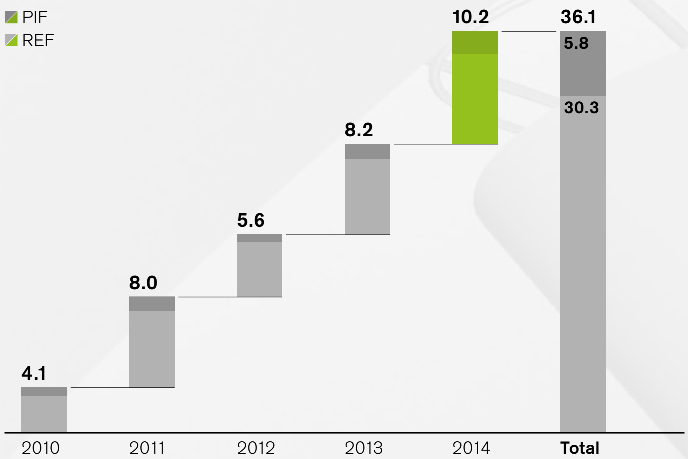
pbb Deutsche Pfandbriefbank is a specialist bank for real estate finance and public investment finance. We are active in selected European countries; in addition to Germany, we focus on the United Kingdom, France, the Nordic region and specific countries in Central and Eastern Europe.

Real Estate Finance (REF)
We structure medium to large financing transactions for professional real estate investors in office, retail, residential and logistics properties in particular. Our customers benefit from our mix of local and international expertise.

Public Investment Finance (PIF)
We finance public sector investment in infrastructure projects, for example public housing, utilities and waste disposal, health care and nursing care properties, as well as child care and educational facilities. We also provide government-backed export finance.

New Business

in € billion (commitments, including extensions > 1 year)

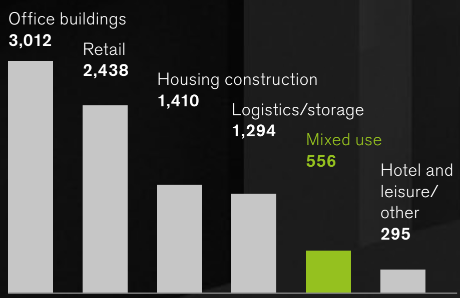


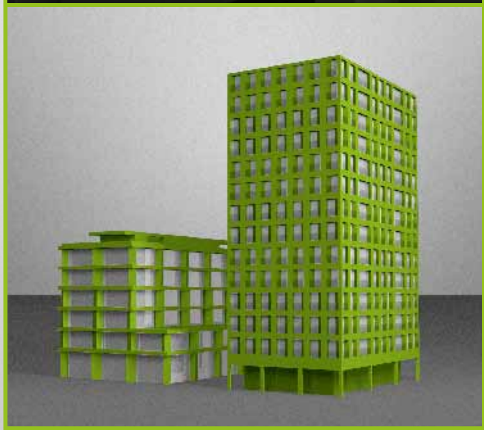
Schwabinger Tor Munich
€ 388 million

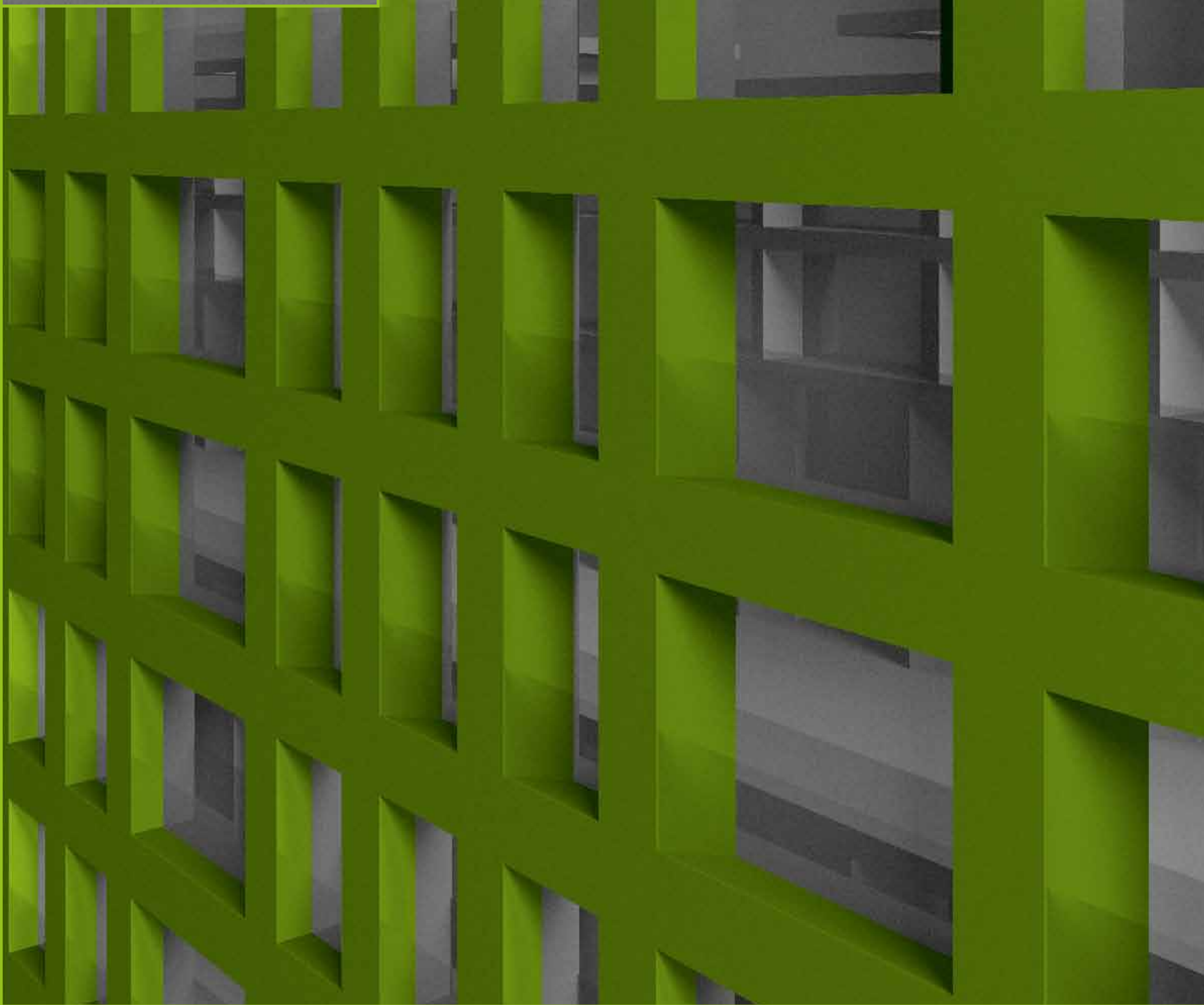
Construction and investment finance
Germany
May 2014

The «Schwabinger Tor» in Munich is currently one of the largest inner-city real estate development projects in Germany. Nine buildings are being created in Schwabing, with a space of 90,000 m² (approx.). The special feature of this project is the vertical mixed use of the space for retail, restaurants, offices and apartments, combined with a five star-plus hotel and integrated conference centre. The project manager and land owner is the Jost Hurler Group. pbb acted as arranger, structuring the loan with a volume of € 388 million and a loan period of 20 years. pbb involved ERGO Life Insurance as a partner. As financer, pbb provides € 188 million of the loan, whilst ERGO provides € 200 million.

New business 2014 according to property type
in € million (commitments, including extensions > 1 year)







Foreword of the Management Board
Report of the Supervisory Board

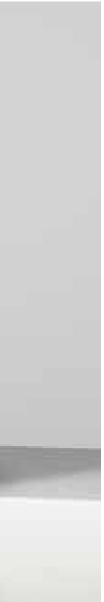
Foreword of the Management Board

In 2014, Deutsche Pfandbriefbank Group (pbb Group) once again recorded a significant increase of almost 25% in the volume of new business, reaching a new high of €10.2 billion. With this high level of new business, which was carried out maintaining our high risk standards and at high margin levels, both the strategic portfolios and the portfolio margins grew. Overall, net interest income rose by more than 30% to €421 million, thereby significantly improving operational profitability. Pre-tax profit was burdened by a value adjustment for debt securities issued by Heta Asset Resolution AG, a wind-down entity owned by the Republic of Austria, and amounted to an adjusted €174 million. The securities are covered by a letter of indemnity issued by the Austrian federal state of Carinthia. As a result of this extraordinary effect, pre-tax profit for 2014 sank to €54 million. Against this background, return on equity before tax amounted to 1.6%. Based on the adjusted pre-tax profit, return on equity before tax amounted to 5.0%. Excluding the silent participation of the Financial Market Stabilization Fund, the repayment of which is expected in 2015 as part of the planned privatisation, the return on equity before tax would have been significantly higher.

The macroeconomic environment has been somewhat more agreeable in Europe on the whole, however, the banking industry was affected by an increase in competition in both Real Estate Finance and Public Investment Finance. In this environment, pbb Group significantly exceeded its targets for new business and operational profitability for 2014, continuing the company's success. The overall success of 2014 is due to the continued commitment and dedication shown by the Group's employees, and for this we, once again, owe them our special thanks.

Since 2010, when pbb Group returned to the lending and capital markets with any significant volumes, loans with a nominal volume of more than €36 billion have been issued, of which more than €18 billion alone have been issued within the last two financial years. This loan volume highlights the excellent market position that pbb Group has established among its customers. Market penetration has improved further, particularly with the three new origination locations in Germany as well as the new office in Stockholm, which assumed full operations in the course of 2013. In the area of commercial Real Estate Finance, the larger of the two strategic areas, pbb Group is one of the leading financiers in Germany. The Group has also established a leading position in the capital markets and – measured on outstanding volume – is now the largest Pfandbrief issuer. We extend our sincere thanks to our business partners for their trust in pbb.

Management Board of Deutsche Pfandbriefbank AG from left to right:
Andreas Schenk, Andreas Arndt, Dr. Bernhard Scholz, Thomas Köntgen, Wolfgang Groth



pbb Group also made excellent progress in 2014 in areas beyond the operating business. The organisational and IT separation from the sister company, DEPFA, was carried out successfully, thus creating the prerequisite for the parent company, Hypo Real Estate Holding AG, to transfer the DEPFA subgroup to FMS Wertmanagement at the end of 2014. Having ended servicing for DEPFA and following the termination of the servicing for FMS Wertmanagement in 2013, pbb Group has now concluded a large part of its services for third parties and is placing even greater focus on its core business.

Overall in 2014, pbb Group established good prerequesits for the privatisation in 2015, both from an organisational point of view as well as in terms of origination strength and improving operational profitability. The actual privatisation project was launched by Hypo Real Estate Holding AG in summer 2014. Since then, preparations for a sale of pbb in the context of a tender process or an IPO have been ongoing.

We continue to work on increasing our operational profitability. The key to this lies in new business: We intend to further develop our strategic portfolio and replace our existing portfolio with new business with higher margins. In doing so, we aim to retain our conservative risk profile. In addition, we will continue to increase the efficiency of our processes and make a contribution to increasing profitability on the costs side in order to ultimately be even better positioned for the future.

Yours sincerely,

Andreas Arndt **Thomas Köntgen**

Wolfgang Groth **Andreas Schenk** **Dr. Bernhard Scholz**

Report of the Supervisory Board

The Supervisory Board of Deutsche Pfandbriefbank AG (pbb) hereby reports on the focuses of its supervisory and advisory activities for the 2014 financial year.

As in the previous year, the entire macroeconomic environment was significantly influenced by the stabilisation of the global economy and the attenuation of the crisis in the eurozone. This enabled pbb to focus more on new business, particularly in the area of commercial real estate finance and public investment finance. This development dominated the supervisory and advisory activities of the Supervisory Board.

Furthermore, the preparation of privatisation measures, the continued development of sales performance and the increase in profitability for pbb were regularly the subject of consultation. In addition, the Supervisory Board consulted and decided on important changes to members of the Executive Board.

Corporate Governance

The Supervisory Board continually monitored the Management Board in the financial year 2014, as in the past, and provided it with regular advice on the management of the Company.

It assured itself in all cases that the management measures taken by the Management Board were lawful, appropriate, and due and proper. The Management Board fulfilled its duties to provide information and informed the Supervisory Board in a regular, timely and comprehensive manner, both in writing and orally, about matters and measures relevant to the Company. This also included information on variances between target and actual figures. The members of the Supervisory Board had sufficient opportunity at all times to critically assess the reports and proposed resolutions submitted by the Management Board and to make its own suggestions in the Supervisory Board committee meetings and in the plenary sessions.

In particular, the Supervisory Board held in-depth discussions on, and reviewed the plausibility of, all business transactions material to the Company on the basis of written and oral reports by the Management Board.

On 5 March 2015, the Supervisory Board again resolved the declaration of conformity with the Public Corporate Governance Code of the Federation, which is published online on pbb's website (www.pfandbriefbank.com). Please also refer to the Group's remuneration report, which is printed in this annual report and is also published on pbb's website. With respect to the requirement of the Public Corporate Governance Code of the Federation to disclose the proportion of women in supervisory bodies, please refer to the table showing the composition of the Supervisory Board and its committees.

Supervisory Board Meetings

The Supervisory Board of pbb held ten meetings in 2014, three of which took the form of conference calls, and passed five resolutions outside the meetings.

All regular meetings addressed the current business position of pbb Group, which was discussed in detail with the Management Board in each case. The Management Board informed the Supervisory Board regularly and in a timely manner about pbb Group's economic and financial development. During the regular meetings, the Supervisory Board also received reports on the risk position, risk management, new business in subgroup Deutsche Pfandbriefbank and the liquidity strategy, as well as on significant events that are of material importance to the assessment of the Company's position, development and management.

Alongside the regular topics already mentioned, the ordinary meeting on 26 February 2014 primarily discussed the business and risk strategies of pbb and decided to set up a Presidential and Nominations Committee and a Remuneration Control Committee. Moreover, the Supervisory Board discussed the current status of the IT of pbb Group along with the recovery plan pursuant to the German Banking Act (Kreditwesengesetz)[a)]/Minimum Requirements for the Design of Recovery Plans (Mindestanforderungen an die Ausgestaltung von Sanierungsplänen). The Supervisory Board decided on the multi-year planning of pbb and to carry out an examination of the efficiency of the activities of the Supervisory Board and its committees. The Supervisory Board appointed Andreas Schenk to the Management Board of pbb with effect from 1 March 2014 and extended the appointment of Wolfgang Groth. On 7 March 2014, Andreas Arndt was also appointed to the Management Board of pbb with effect from 15 April 2014. In the accounts review meeting held on 2 April 2014, the consolidated financial statements for 2013 were approved and the annual financial statements were adopted. Furthermore, the annual general meeting was also prepared, the remuneration report for 2014 was discussed, and the Corporate Governance Report was determined.

The meeting on 28 May 2014 mainly concerned the reporting on the first quarter of 2014, the current status of the Comprehensive Assessment by the ECB, and the preparations for the privatisation of pbb. In a telephone conference on 3 June 2014, the Supervisory Board responded to the request by Manuela Better to stand down as a member of the Executive Board with effect from 3 June 2014. The interim report from 30 June 2014 was discussed by the Supervisory Board in its meeting on 13 August 2014. In this regard, the Supervisory Board was informed about the status of legal action in relation to participation certificates and further preparations for the privatisation of pbb. Furthermore, the Supervisory Board re-appointed Dr. Bernhard Scholz as a member of the Management Board of pbb with effect from 1 September 2014.

In its meeting on 26 August 2014 in the course of a telephone conference, the special election of the new Chairman and the members and Chairman of the Committees of the Supervisory Board took place.

On 12 September 2014, the Supervisory Board appointed Thomas Köntgen as a member of the Management Board of pbb with effect from 1 October 2014. In addition, it also nominated Andreas Arndt and Thomas Köntgen as Co-CEO. In this extraordinary meeting, the Supervisory Board discussed the initial demands placed on the unbundling of staff of HRE Holding and pbb. In a telephone conference on 24 October 2014, the Management Board reported on the current status of the Comprehensive Assessment.

[a)] The corresponding regulations in German Banking Act (Kreditwesengeetz – KWG) were replaced with the Restructuring and Liquidation Act (Sanierungs- und Abwicklungsgesetz – SAG) only with effect from 1 January 2015.

On 13 November 2014, in addition to the quarterly financial statements, the privatisation strategy of pbb was discussed with regard to new business planning for the segments Real Estate Finance and Public Investment Finance. In addition, the adjusted multi-year planning of pbb, which was examined during the meeting in February, and the implementation of requirements pursuant to section 25 d (11) of the German Banking Act (Kreditwesengesetz) were both determined.

The Supervisory Board checked that the auditors, KPMG AG Wirtschaftsprüfungsgesellschaft (KPMG), complied with the independence requirements, engaged the auditors, and agreed the fee with them.

The CEO respectively the Co-CEOs were in continual contact with the Chairman of the Supervisory Board with regard to important developments.

Supervisory Board Committees

In the period from 1 January 2014 to 31 December 2014, the Supervisory Board of pbb had an Audit Committee and a Risk Management and Liquidity Strategy Committee (RLA). In the period from 26 February 2014 to 31 December 2014, a Presidential and Nominations Committee and a Remuneration Control Committee were also set up. During this period, the Committees were comprised as follows:

The **Presidential and Nominations Committee** held five meetings and focused on strategic and current Group topics, as well as Management Board matters on which it issued corresponding suggestions to the whole Supervisory Board. In particular, it consulted on the above-mentioned Management Board appointments and decided on corresponding suggestions for the plenum. Moreover, it prepared the evaluation by the Management Board and the Supervisory Board. It was staffed by Dr. Bernd Thiemann (Chairman until 26 August 2014), Dr. Günther Bräunig (Member until 26 August 2014, Chairman from 26 August 2014), Dagmar Kollmann and Joachim Plesser (Member from 26 August 2014).

The **Audit Committee** held a total of seven meetings and comprised Dagmar Kollmann (Chairperson), Dr. Günther Bräunig, Joachim Plesser (member from 26 August 2014), Dr. Bernd Thiemann (member until 26 August 2014) and Dr. Hedda von Wedel.

Its meetings reviewed and discussed the annual financial statements and consolidated financial statements for 2013, the interim reports and the reports by Internal Audit and KPMG on internal and external audit findings. In addition, the Audit Committee discussed the effects of current regulatory topics with the Management Board and was informed of the development of ongoing audits, such as the Comprehensive Assessment. What is more, the Audit Committee addressed the proposal for the election of the auditors and the audit plan for financial year 2014, as well as the effects of current regulatory developments on the Bank; it was also informed by the Management Board of pbb and KPMG respectively about various individual topics, such as legislative requirements regarding the appointment of an auditor and the comprehensive analysis of net interest income. Furthermore, regular reports were received on the internal control system and the monitoring of the key controls that have been established, existing legal disputes, compliance issues, as well as Internal Audit's audit planning and its implementation.

The **Risk Management and Liquidity Strategy Committee (RLA)** held four regular meetings and also discussed credit exposures, usually during monthly conference calls. It comprised Dr. Günther Bräunig (Chairman until 26 August 2014, member from 26 August 2014), Joachim Plesser (Chairman from 26 August 2014), Dagmar Kollmann, Dr. Bernd Thiemann (until 26 August 2014) and Dr. Hedda von Wedel (from 13 November 2014).

The RLA supported the Supervisory Board's supervision of risk management and liquidity management, reviewed the Management Board's risk reporting and was involved in the credit approval process to the extent laid down in the rules of procedure. The RLA also regularly discussed the situation with respect to new business, liquidity and funding. In 2014, it also dealt with salvage acquisitions and development loans, specific allowances, reporting of own funds according to SolvV, country limits and asset/liability management.

In addition, the RLA addressed individual credit exposures on numerous occasions, usually in conference calls. These related to regular resubmissions and approvals for change applications and new business required to be submitted under the RLA's rules of procedure.

The **Remuneration Control Committee** held two meetings and comprised Dr. Bernd Thiemann (Chairman until 26 August 2014), Dr. Günther Bräunig (member until 26 August 2014, Chairman from 26 August 2014), Dagmar Kollmann and Joachim Plesser (member from 26 August 2014). It also dealt with necessary measures in preparation of pbb's privatisation, the remuneration and job titel review 2015 as well as risk analysis and the identification of risk takers.

The Supervisory Board of pbb was comprised as follows between 1 January 2014 and 31 December 2014:
> Dr. Bernd Thiemann (Chairman until 26 August 2014)
> Dr. Günther Bräunig (member until 26 August 2014, Chairman from 26 August 2014)
> Dagmar Kollmann (Deputy Chairperson)
> Dr. Alexander Groß (until 25 February 2014)
> Joachim Plesser (from 26 August 2014)
> Dr. Ludger Schuknecht
> Dr. Hedda von Wedel
> Dr. Jeromin Zettelmeyer (from 15 April 2014)

Supervisory Board of pbb
in financial year 2014

Name and place of residence	Principal activity	**Supervisory Board function and meeting attendance**	**Committee function and meeting attendance**			
			Presidential and Nominations Committee	Audit Committee	Risk Management and Liquidity Strategy Committee	Remuneration Control Committee
Dr. Bernd Thiemann Münster, Germany	Former Chairman of the Management Board of DG Bank AG	Chairman until 26.8.2014 5 of 5	Chairman until 26.8.2014 3 of 3	Member until 26.8.2014 4 of 6	Member until 26.8.2014 4 of 6	Chairman until 26.8.2014 1 of 2
Dr. Günther Bräunig Frankfurt am Main, Germany	Member of the Management Board of KfW	Chairman from 26.8.2014[1] 10 of 10	Chairman from 26.8.2014 5 of 5	Member 7 of 7	Chairman from 26.8.2014[2] 18 of 18	Chairman from 26.8.2014 2 of 2
Dagmar Kollmann Vienna, Autria	Businesswoman	Deputy Chairperson 10 of 10	Member 5 of 5	Chairperson 7 of 7	Member 18 of 18	Member 2 of 2
Dr. Christian Gebauer-Rochholz Hochheim, Germany	Bank employee	Employee representative 10 of 10				
Dr. Alexander Groß Teltow, Germany	Head of Department I, Economic Policy, in the Federal Ministry for Economic Affairs and Energy	Member until 25.2.2014 1 of 3				
Georg Kordick Poing, Germany	Bank employee	Employee representative 10 of 10				
Joachim Plesser Ratingen, Germany	Former member of the Management Board of Eurohypo AG	Member from 26.8.2014 4 of 4	Member from 26.8.2014 2 of 2	Member from 26.8.2014 1 of 1	Chairman from 26.8.2014 7 of 7	Member from 26.8.2014 1 of 1
Dr. Ludger Schuknecht Frankfurt am Main, Germany	Head of Department, Fiscal Policy and Macroeconomic Affairs, International Financial and Monetary Policy in the Federal Ministry of Finance	Member 8 of 10				
Heike Theißing Munich, Germany	Bank employee	Employee representative 10 of 10				Member 2 of 2
Dr. Hedda von Wedel Andernach, Germany	Retired President of the Bundesrechnungshof (Federal Court of Audit)	Member 10 of 10		Member 7 of 7	Member from 13.11.2014 3 of 3	
Dr. Jeromin Zettelmeyer Berlin, Germany	Head of Department I, Economic Policy, in the Federal Ministry for Economic Affairs and Energy	Member from 15.4.2014 7 of 7				

[1] Dr. Bräunig had been a member in all committees which he has been chairing since 26 August 2014.
[2] Member from 26 August 2014

Training and Further Education

Members of the Supervisory Board were personally responsible for ensuring they received the training and further education necessary for their duties.

Annual Financial Statements

The auditors of the annual and consolidated financial statements elected by the Annual General Meeting, KPMG, audited the annual and consolidated financial statements of pbb dated 31 December 2014, including the management reports, and issued them with an unqualified audit opinion. The financial statement documents and audit reports were submitted to all Supervisory Board members in good time. The Audit Committee addressed the financial statement documents in its meeting on 23 March 2015. The annual financial statements and consolidated financial statements, as well as the management reports and audit reports, were discussed with the Management Board and representatives of the auditors in detail. Following its own review, the Supervisory Board did not raise any objections to the result of the auditors' audit. In the meeting on the financial statements, the Supervisory Board approved the consolidated financial statements prepared by the Management Board and adopted the annual financial statements.

The Supervisory Board wishes to thank the Management Board, all employees and the employee representatives for their dedication and achievements in the past financial year.

The Committee regrets Dr. Bernd Thiemann's and Dr. Alexander Groß' withdrawal from the Supervisory Board and Manuela Better's and Alexander von Uslar's withdrawal from the Management Board and thanks them for their commitment and their achievements they have brought to pbb. The Supervisory Board wishes Dr. Bernd Thiemann, Dr. Alexander Groß, Manuela Better and Alexander von Uslar all the best and continued success in the future.

For the Supervisory Board

Dr. Günther Bräunig
Chairman

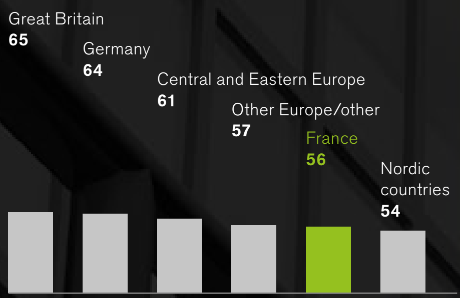
Beacon Tour First Paris

€ 515 million

Syndicated investment finance
France
September 2014

Tour First is an iconic office tower located in La Défense, a major business district in the Paris Metropolitan Area. With 50 upper floors and a total height of 231 meters it is the tallest office building in France and the second tallest structure after the Eiffel Tower. Aareal Bank AG and pbb acted as Joint Mandated Lead Arrangers co-underwriting a € 515 million senior loan facility to an affiliate of Beacon Capital Partners, LLC for the purchase of the building. By the way of syndication, the Senior European Loan Fund 1 managed by AEW Europe and M&G Investments, as well as another banking partner, agreed to the loan facility as further lenders. In this transaction, pbb also acted as the facility and security agent.

REF portfolio: average weighted LTVs
in %



Group Management Report

Group Management Report

Fundamental Information about the Group

Group Structure

Deutsche Pfandbriefbank AG (pbb) is the parent company of Deutsche Pfandbriefbank Group (pbb Group). It is a wholly owned subsidiary of Hypo Real Estate Holding AG (HRE Holding). HRE Holding is wholly owned by the Financial Market Stabilisation Fund (Finanzmarktstabilisierungsfonds-FMS), which is administered by the Financial Market Stabilisation Agency (FMSA). FMSA is an institution of the Federal Republic of Germany. pbb has branches at various locations in Germany as well as in its core markets. The Bank's headquarters are in Munich.

Sales branches

Business Model and Strategy

pbb Group specialises in commercial real estate finance and public investment finance. The Group is active in both areas in selected European countries. The focus is on Germany, Great Britain, France, the Nordic countries as well as some Central and Eastern European countries. The Group's core businesses medium- to long-term lending: pbb Group plays an important role in this area, providing credit to the real estate industry and supporting the public sector with financing for projects for the provision and improvement of public infrastructure. pbb Group's focus is on primary customer business. Besides traditional financing solutions tailored to customers' needs, the Group offers its customers derivatives for hedging credit transaction risk. It does not maintain a trading book for securities portfolios held to realise short-term gains.

In the lending business, pbb Group either acts as a sole lender or – particularly for large-volume transactions – works together with financing partners. In this regard, the Group has a wide network of banking partners and other partners, in areas such as insurances or private equity. In this syndicate business, when acting as Arranger, the Group sometimes takes over the complete coordination between the syndicate and the borrower or, in the role of an Agent, deals with tasks in connection with the management of syndicated loans.

In addition, the Group acts as an underwriter initially being the sole provider of financing and then selling parts of this loan to interested partners in the context of syndication.

Competitive Position

In commercial real estate finance, pbb Group is one of the leading financing providers in its target markets and segments. In its core markets, pbb has a strong local presence and expertise across the entire process chain – from sales, over real estate experts, property law specialists and financing experts, to the management of loan exposures. pbb Group uses this local expertise actively to also support customers with international transactions.

Strategic Portfolios

In Commercial Real Estate Finance, services are aimed at medium to long-term oriented, professional national and international property investors, such as real estate companies, institutional investors, real estate funds as well as, in Germany, customers with a regional focus. pbb Group targets more medium to larger financing volumes. The focus is on property types with little market price fluctuation such as office buildings, retail properties, residential real estate and logistics properties. The Group's regional focus is on the core European Pfandbrief markets – namely Germany, Great Britain, France and the Nordic countries, as well as selected countries in Central and Eastern Europe. Here, pbb Group offers both local and cross-border financing expertise. A large majority of the loans granted are for investment loans, i.e. loans for the acquisition or follow-up financing of existing properties with existing cash flows. Construction financing has substantially lower significance – it is primarily of a non-speculative nature and relates in particular to the property developer business in Germany.

In Public Investment Finance, pbb Group finances medium to long-term, Pfandbrief-eligible projects for the provision and improvement of public infrastructure. The focus here is on public institutions, municipal and social housing, buildings for the utilities and waste disposal market, transport infrastructure as well as healthcare and nursing facilities. In addition, pbb Group is active in the field of government-backed export finance. It provides financing to public sector borrowers, companies operating under public or private law and publically guaranteed special-purpose vehicles. The Group's regional focus is on Germany, France and the Nordic countries. pbb Group is also active in selected European regions.

Run-down Portfolios

In addition to the portfolios of the two strategic business fields, pbb Group has a non-strategic portfolio: the Value Portfolio. This portfolio consists almost entirely of existing business in non-specific financing to the public sector (budget financing). The portfolio is primarily refinanced at matched maturities. It generates interest income and runs-off in accordance with the underlying fixed maturities. The Group is not involved in active new business in this area due to a condition imposed by the European Commission as part of the state aid proceedings in 2011. Individual transactions are permitted and are carried out in order to manage the cover pools or secure liquidity. In the Value Portfolio, there are also a few remaining structured products (€0.7 billion fully state-guaranteed; €0.1 billion non-state guaranteed but almost completely written off) and other non-strategic loans within the other portfolios' segments.

Funding

Loans are largely funded using matching maturities and primarily via the Pfandbrief market, supplemented with unsecured funding. Issues are regularly placed on the international capital market in the benchmark format as well as in the form of bilateral private placements. pbb Group structures private placements as bearer or registered securities in accordance with investors' requirements, i.e. the term and interest structure can, for instance, be negotiated on an individual basis. In accordance with the lending business, issues are denominated in various currencies with a focus on the euro.

pbb issues Mortgage Pfandbriefe and Public Sector Pfandbriefe, and is the largest issuer of Pfandbriefe when measured by outstanding volume. The Pfandbrief market is distinguished by its high liquidity and a broad investor base. After the market for public sector bonds, it is the second largest market for fixed-income securities in Germany. Promissory notes and bearer bonds are the main vehicles used for unsecured funding.
Source: vdp

Investors in debt instruments are mainly banks, funds and insurance companies as well as central banks and government funds. The Group does not sell debt instruments directly to private investors.

Since March 2013, pbb Group has added retail deposit business with private investors in Germany to its range of activities. Via the www.pbbdirekt.com online platform, pbb Group offers call money and term deposit accounts with various maturities.

Strategy

The strategy of pbb Group focuses on sustainable business success without the use of speculative elements. On the one hand, the assessment and appropriate pricing of credit risk in the lending business and, on the other, access to the funding markets at adequate conditions are crucial to business success. An additional significant success factor is the management of the existing portfolio with a view to identifying changing risks at an early stage and mitigating them by taking appropriate measures.

According to the European Commission's ruling in the state aid proceedings of July 2011, the Federal Republic of Germany (as the ultimate owner) shall privatise pbb by the end of 2015. A project was initiated in 2014, enable the bank to be privatised.

The Management Board has set itself the goal of further increasing profitability before the pending privatisation. The aim is to further increase the income basis through more profitable new business with simultaneous growth in the strategic portfolios; it is intended to further reduce the operative cost base by means of strict cost discipline.

Within this context, and in addition to strengthening of origination units, in the summer of 2014, pbb initiated a project to identify potential and further increase efficiency in processes, products and systems. Emphasis is placed on the optimisation of existing processes by «closing gaps» in workflows as well as in IT systems and interface functions. Furthermore, by creating a higher level of transparency across all company processes, a better level of process steering should be achieved. The main focus is placed on the credit process in Real Estate Finance as well as selected processes in the areas Finance, Risk Management, Operations and IT. From a total of 27 sets of measures, more than half have already been implemented successfully. The implementation of further measures is planned for 2015.

Internal Management System

pbb Group's internal management system is pursuing a sustainable enhancement in value of the Group considering aspects of risks and regulatory requirements. The key objective is to achieve a balanced risk/return ratio. Risks should be compatible with external and internal risk-bearing capacity guidelines generating an adequate return on capital.

Monitoring and stearing at pbb Group are based on a consistent and integrated key performance indicator system (KPI system), which assists executives in the management of the Group. The KPI system comprises the dimensions of profitability, growth in the strategic real estate finance and public investment finance portfolios, risk limitation and capital. Regular plan-actual comparisons and related analyses disclose the reasons for any deviations in the key performance indicators. Current market developments, such as the change on interest rate levels, are also displayed. In addition to strategic planning for the Bank as a whole, regular medium-term projections of profitability indicator and (stress) scenario forecasts ensure the management has a comprehensive overview of the Group's future business development.

No material changes were made to the internal management system year-on-year. Non-financial key performance indicators are not explicitly managed. The following financial key performance indicators have been defined:

> One key profitability indicator is the return on equity after tax. It is calculated by dividing IFRS net income/loss by the average IFRS equity available in the financial year excluding the revaluation reserve. Profit or loss before tax is a further financial key performance indicator. The aim is to increase it both by generating higher revenues and through strict cost discipline. Cost discipline and efficiency are monitored using the cost-income ratio, i.e. the ratio of general and administrative expenses to operating income.
> The notional amount of the funding in the strategic Real Estate Finance (REF) and Public Investment Finance (PIF) segments is a significant factor influencing the future earning power and has therefore been redefined as an additional financial key performance indicator. The financing volume can be controlled, above all, by the volume of new business including prolongations with maturities of more than one year, which also represent a financial key performance indicator. A present value approach is used for managing and calculating new business. In line with the management of the Bank as a whole, each new business transaction should make a positive value contribution to the Bank's overall income after the deduction of all costs (full cost approach).
> Risk management is based on two risk bearing capacity approaches, the gone concern approach and the going concern approach. Management using the going concern approach ensures that pbb Group can still meet the regulatory minimum capital ratios even after an adverse economic scenario, which occurs at a maximum of once every 20 years. The gone concern approach, on the other hand, is based on the assumption that pbb Group, in the hypothetical event of the institute being liquidated, is able to fully service its unsubordinated debt instruments even in an extreme loss event. A precondition for demonstrating the risk bearing capacity in both cases is that the risk covering potential exceeds the required economic risk capital. The methods and results of the risk bearing capacity assessment and the methods used are described in detail in the opportunity and risk report.
> In accordance with the waiver rule set out in Section 7 of the Capital Requirements Regulation (CRR), pbb is exempted from the requirement to comply with regulatory capital ratios. However, the CET1 ratio, a key management indicator, is calculated for pbb Group regularly on a pro forma basis. CET1 ratio is calculated by dividing the Common Equity Tier 1 (CET1) by the risk-weighted assets (RWA). During the course of the targeted privatisation, pbb Group will be separated from HRE Holding. In this connection, the exemption offered by the waiver is expected to be lifted. As a consequence the regulatory ratios will have to be determined at the level of pbb in the future. For all portfolios which were requested for approval the Advanced Internal Rating Based Approach (Advanced-IRBA) has been applied to calculate the regulatory capital backing after authorisation by BaFin.

pbb Group as an Employer

pbb Group employed a total of 844 people at the end of 2014 (previous year: 852 employees). The Group's adjusted turnover rate[1] was 14.0% in 2014 (previous year: 12.0%).

The necessary organisational changes relating to the implementation of the target model – a specialised Pfandbrief bank – as well as the required privatisation of pbb and the intended sale of its fellow subsidiary DEPFA to FMS-Wertmanagement, were successfully implemented in 2014. Besides the unbundling of pbb and DEPFA, further work was carried out on the implementation of a lean organisational structure with efficient processes.

As pbb bases its business model to a large extent on highly qualified experts, further education and training measures in pbb Group are an integral part of staff development. The continuous professional development (CPD) offering was therefore continued in 2014 and further adapted to departmental and employee training requirements. After focusing on internal management seminars and external training in appraiser training, the offering was expanded to include new external courses and training both on specialist topics (e.g. in connection with regulatory requirements and new developments in capital markets law, credit risk and interest rate derivatives) and on soft skills and methodological know-how.

€ 0.8 million (previous year: € 0.9 million) was spent on internal and external training measures for pbb Group employees in 2014.

Remuneration Report

The remuneration report follows the recommendations of the German Public Corporate Governance Code and contains the information in accordance with German commercial law and the International Financial Reporting Standards (IFRS). It provides a detailed overview of the individual components of the remuneration of the Management Board and the Supervisory Board as well as the principles governing employee remuneration. The Supervisory Board regularly engages with the topic of executive remuneration and the principles governing employee remuneration. As the Management Board members are currently not paid any variable remuneration and thus only receive fixed remuneration not exceeding € 500,000 p.a., the Supervisory Board only deals with this topic as the situation arises. Supervisory Board or Administrative Board mandates undertaken by individual board members within the Group are not remunerated separately. The Management Board of HRE Holding is at the same time also the Management Board of pbb. Previously, the contracts of the members of the Management Board were solely with HRE Holding. In connection with the sale of DEPFA and the planned privatisation of pbb, the contracts of the members of the Management Board were concluded with pbb during 2014. However, a full cost allocation of the remuneration of the Management Board from pbb to HRE Holding will be undertaken until the implementation of the unbundling of HRE Holding and pbb.

[1] The adjusted turnover rate is defined as turnover as a result of termination by the employee or the Bank, the expiration of temporary contracts, or of termination agreements being signed. It does not include cessation of employment due to death, retirement, early retirement, or Group transfers.

Management Board

Basic principles The determination of the remuneration for the members of the Management Board of pbb should, in principle, ensure performance-based payment and be in line with the international activity and size of the company. In doing so, Management Board remuneration at corresponding companies in Germany and abroad is compared and the economic and financial position of the Group is also taken into account. The Supervisory Board provides advice on the structure and amount of the remuneration of the Management Board taking these criteria into account. Based on the granting of stabilisation measures in accordance with the Financial Markets Stabilisation Act (Finanzmarktstabilisierungsgesetz: FMStG), the service agreements of the Management Board members provide for a limit of a maximum annual monetary remuneration of €500,000 per Management Board member for the duration of the stabilisation measures or another period prescribed by Finanzmarktstabilisierungsfonds-FMS. Variable remuneration will not be paid for the period defined above. The principle of performance-based payment is therefore deviated from for this period. After completion of the company's reorganisation, at the latest on termination of the service agreement, the contracts include a clause, that the company states that there is a prospect of a one-off special payment to the Management Board members, with the exception of Wolfgang Groth, although there is no contractual entitlement to such a special payment. The service contracts of the Management Board members take into account the requirements of Finanzmarktstabilisierungsfonds-FMS.

Remuneration components In principle, the following remuneration components arise from the service agreements concluded with the Management Board members:
> Fixed remuneration (monetary compensation) and benefits in kind
> Profit-related variable remuneration
> Pension commitment

Fixed remuneration The fixed remuneration is, in principle, reviewed on the basis of an external market comparison at regular intervals and, if applicable, adjusted. There is no automatic adjustment. Due to the applicable limitation of the annual monetary remuneration to a maximum of €500,000, there is currently no regular review. In addition, the company provides fringe benefits (benefits in kind) to Management Board members. These payments include, inter-alia, the provision of a company car including payment of all the costs arising in connection with the car. In addition, the Management Board members have a Group accident insurance policy. The taxes arising on these non-cash benefits are paid by the members of the Management Board.

Variable remuneration Based on the regulations of the FMStFG as well as the framework agreement on the granting of stabilisation measures between Finanzmarktstabilsierungsfonds-FMS and HRE Holding respectively pbb, the Management Board does not receive variable remuneration during the period in which the stabilisation measures are granted.

Conclusion of new service agreements or termination agreements in 2014 The service agreement of Wolfgang Groth with HRE Holding was terminated as of 28 February 2014 and a new contract under the same conditions was concluded with pbb as from 1 March 2014 until 31 December 2015. In addition, Andreas Schenk joined the Management Board of HRE Holding and pbb as of 1 March 2014. His employment contract with pbb existing until that time was terminated as of 28 February 2014 and a new service agreement with effect from 1 March 2014 to 28 February 2017 was concluded with pbb.

Andreas Arndt joined the Management Board of HRE Holding and pbb as of 15 April 2014. His service agreement with pbb ends on 14 April 2017.

The service agreement of Dr. Bernhard Scholz with HRE Holding was terminated as of 31 August 2014 and replaced with a new service agreement under the same conditions with pbb as from 1 September 2014 and ending on 30 April 2017.

Thomas Köntgen was appointed to the Management Board of HRE Holding and pbb with effect from 1 October 2014. His service agreement with pbb ends on 30 September 2017.

Alexander von Uslar resigned his office as Management Board member as of 16 May 2014. He left the company on 30 September 2014 when his service agreement expired. A one-off special payment, severance payment or interim payment was not paid.

Manuela Better requested the Supervisory Board to relieve her of her offices with effect from 3 June 2014. The Supervisory Board complied with this request and concluded an agreement to terminate the service agreement with Manuela Better. After including the remaining leave as of 12 August 2014, the service agreement was also terminated without payment of a one-off special payment, severance payment or a interim payment.

Group remuneration paid to members of the Management Board of pbb			**2014**			**2013**
in € thousand	Monetary remuneration	Non-cash benefits[1]	**Total**	Monetary remuneration	Non-cash benefits[1]	**Total**
Andreas Arndt[2] (from 15.4.2014)	341	16	357	–	–	–
Manuela Better[2] (until 12.8.2014)	308	12	320	500	17	517
Wolfgang Groth	500	17	517	500	18	518
Thomas Köntgen[2] (from 1.10.2014)	120	9	129	–	–	–
Andreas Schenk (from 1.3.2014)	400	18	418	–	–	–
Dr. Bernhard Scholz[2]	500	15	515	500	16	516
Alexander von Uslar[2] (until 30.9.2014)	375	14	389	500	23	523
Total	**2,544**	**101**	**2,645**	**2,000**	**74**	**2,074**

[1] Included: Administrative expenses for customary fringe benefits subject to taxation
[2] In addition, there are individual contractual commitments for retirement benefits comprising a percentage of the fixed annual remuneration.

Pension commitments With the exception of Wolfgang Groth and Andreas Schenck, the members of the Management Board have individual contractual pension commitments on pensions from the age of 60 years or from 62 years of age and in the event of disability and incapacity to work.

The following applies with respect to the amount of the pension received by the members of the Management Board for the commitments previously granted by HRE Holding: Management Board members receive a pension of 30% of their annual basic salary (base amount). The pension increases by 1%, however up to a maximum of 50%, for each completed year of service as Management Board member. On their exit, Manuela Better and Alexander von Uslar will have each reached a percentage of 35%. The vested entitlement of Dr. Bernhard Scholz earned on termination of the contract with HRE is 34.67%.

For the commitments granted by pbb, Andeas Arndt and Thomas Köntgen will receive a pension amounting to 5.2% of their annual basic salary, however up to a maximum of 60%, per year of service completed as Management Board member. The pension entitlements will vest on expiry of the 3-year service agreement. Based on his vested entitlement earned at HRE Holding, Dr. Bernhard Scholz will receive an annual pension of 1% per year of service completed as Management Board member, maximum 15%.

For the period starting 1 September 2016 until the end of the contract on 30 April 2017, the percentage rate of increase will be determined on a pro rata basis and therefore amounts to 0.67%.

Section 16 of the German Company Pensions Act (Betriebsrentengesetz) applies with respect to the review for adjusting pension benefits.

If a Management Board member becomes deceased, their surviving spouse will receive 60% of the Management Board member's pension entitlement. In addition, there is a pension for half-orphans and orphans until the children reach 18 years of age. If a child is still completing their vocational training after they have reached 18 years of age, the orphan's allowance will be paid until the vocational training is completed, however, no later than 25 years of age. The total amounts received by the half-orphans may not exceed 30% of the pension entitlement of the deceased parent as long as the surviving spouse receives survivor benefits. Full orphans will jointly receive up to 60% of the pension of the deceased parent.

Surviving spouses and children from a marriage that the Management Board member enters into after retirement are not entitled to receive a survivor's pension and orphan allowances.

Pension commitments to members of the Management Board of HRE Holding				**2014**	**2013**
in € thousand	Present value of pension claims vested	Interest expense	Outstanding past service cost	**DBO as of 31.12.**[1]	**DBO as of 31.12.**
Andreas Arndt (from 15.4.2014)	–	–	–	–	–
Manuela Better (until 12.8.2014)	104	146	–	4,966	4,160
Thomas Köntgen (from 1.10.2014)	–	–	–	–	–
Dr. Bernhard Scholz	113	132	–	4,596	3,786
Alexander von Uslar (until 30.9.2014)	108	125	–	4,055	3,569
Total	**325**	**403**	**–**	**13,617**	**11,515**

[1] The significant increase in comparison with the prior year is primarily due to a decrease in the discount interest rate that, pursuant to IAS 19 must be based on the long-term interest rate for first class, fixed.interest corporate bonds as of the closing date

Other regulations If the company does not extend the employment relationship for reasons that are not inherent in the person of the Management Board member, the service agreements of the members of the Management Board, with the exception of Wolfgang Groth, will contain a clause stating that they will receive a interim payment in accordance with the FMSA or SoFFin remuneration principles in the amount of six months' annual basic salary per five years of service completed as member of the Management Board for the company. Dr. Bernhard Scholz will receive an interim payment in the amount of € 500,000 in accordance with his original service contract. Payments made on early termination of the Management Board appointment without good cause will not exceed the value of two annual salaries (upper payment limit), including fringe benefits, and compensate no more than the remaining period of the service contract.

Supervisory Board

The members of pbb's Supervisory Board receive annual remuneration of € 10,000 in accordance with Article 10 (1) of the Articles of Association. No additional remuneration is paid for committee work. Remuneration entitlements accrue on a pro rata basis for the period of the appointment in each case. The Bank reimburses travel expenses; no attendance fees are paid.

Provision for the remuneration of the Supervisory Board of pbb in €			**2014**	**2013**
	Remuneration	VAT	**Total**	**Total**
Dr. Günther Bräunig	10,000	1,900	11,900	11,900
Dr. Christian Gebauer-Rochholz[1) 2)]	10,000	–	10,000	10,000
Dr. Alexander Groß[3)] (until 25.2.2014)	1,534	–	1,534	10,000
Dagmar Kollmann[4)]	10,000	–	10,000	10,000
Georg Kordick[1)]	10,000	1,900	11,900	11,900
Joachim Plesser (from 26.8.2014)	3,507	666	4,173	–
Dr. Ludger Schuknecht[3)]	10,000	–	10,000	10,000
Heike Theißing[1) 2)]	10,000	–	10,000	10,000
Dr. Bernd Thiemann (until 26.8.2014)	6,521	1,238	7,759	11,900
Dr. Hedda von Wedel	10,000	1,900	11,900	11,900
Dr. Jeromin Zettelmeyer[3)] (from 15.4.2014)	7,151	–	7,151	–
Total	**88,713**	**7,605**	**96,318**	**99,500**

1) Employee representative
2) Based on the so-called «small business regulation», income from these activities is not subject to VAT.
3) Since the government ministry representatives perform their Supervisory Board activities on their employer's instructions, income from these activities is not subject to VAT.
4) Due to the place of residence abroad not subject to VAT. Supervisory Board Tax and VAT are paid to the tax office by the Company instead.

Employee Remuneration

Employees are remunerated in accordance with regulatory and statutory requirements, in particular the Restrukturierungsgesetz (German Restructuring Act) and the Institutsvergütungsverordnung (Remuneration Regulation for Institutions). In the course of the implementation of these requirements, the new remuneration system introduced in financial year 2010 was adapted to reflect the special provisions and requirements prohibiting variable remuneration. It remains in place as a target-based system, but its variable remuneration component is still suspended. As a result, it was once again impossible to fully take into account the regulatory requirements derived among other things from the Institutsvergütungsverordnung (InstitutsVergV – Remuneration Regulation for Institutions) and governing, for example, the long-term nature of remuneration, its sustainability and an appropriate management and incentive effect. In cooperation with employee representatives, a functional bonus was introduced in 2011 in order to maintain the Company's operational capacity to act. However, this is well below the variable remuneration originally planned, both in the aggregate and in the individual cases. The bonus was agreed with both the Supervisory Board and the owner. Against the background of the planned privatisation, a project group analysed the remuneration system and identified the required adjustments to the regulatory requirements. In 2015, regulations for variable remuneration that may be re-introduced after successful privatisation will be prepared in accordance with the applicable regulatory requirements.

Remuneration Supervisory Committee and Remuneration Officer

pbb's remuneration committee was dissolved in 2014 due to the change in the Remuneration Regulation for Institutions (Institutsvergütungsverordnung). A remuneration supervisory committee in the Supervisory Board was formed instead and a Remuneration Officer was nominated.

Risk Takers

The criteria for identifying functions, which significantly influence the risk profile of the Bank (so-called risk takers) identified by pbb's remuneration committee in the previous year pursuant to section 18 Institutsvergütungsverordnung were, to the extent required, adjusted to the criteria published by the European banking regulator (EBA) in connection with the execution of the consultation process on the Regulatory Technical Standards (EBA/CP/2013/11). In total, besides the Management Board, 127 employees (2013: 124 employees) were identified as holders of risk-taking positions.

Sustainability

Companies have to assume responsibility for their actions in the environment in which they operate: towards their employees, their customers their investors and also society and the environment. pbb Group integrates this responsibility in its corporate responsibility programme.

The key principle of pbb Group's corporate responsibility philosophy is that of sustainability. This means long-term, responsible actions taking into account the consequences for all the Company's stakeholders and for the environment.

pbb Group is convinced that sustainable and responsible business practices can contribute to securing the Company's future and increasing its value.

Compliance

Transparent, fair, responsible and honest conduct with the required degree of expertise, professionalism and integrity in dealings with one other and in relation to customers and business partners, competitors and the public form the basis of pbb's business success. This trust is based not least on the implementation of, and adherence to, the relevant legal, supervisory and internal requirements as well as other relevant laws and regulations.

Besides adherence to the legal and regulatory requirements, pbb Group's code of conduct sets out the ethical and legal framework within the company. The code of conduct is available to the public on the Deutsche Pfandbriefbank AG website and details the non-negotiable requirements that pbb Group expects of all its employees.

In addition, the Management Board has decided that pbb, as a company which is indirectly wholly owned by the Federal Republic of Germany, is to apply the Public Corporate Governance Code of the Federal Government under application of the «comply or explain» principle. The Public Corporate Governance Code of the Federal Government reflects the current international developments and standards of good corporate management.

Furthermore, it includes precautionary measures for adherence to the data protection policy as well as for the prevention of money laundering, the financing of terrorism, other criminal acts (fraud) and insider trading. In addition, the employees of pbb Group are regularly trained on the prevention of money laundering and other criminal acts (fraud) as well as general compliance issues. The content and execution of the trainings are reviewed on a regular basis by means of internal and external audits.

Employees

Employees are an important factor for the bank's success. pbb Group employs men and women from many different nationalities and diverse specialist backgrounds. Particular importance is placed on diversity. pbb Group has been a signatory to the «Diversity Charter» since 2010 and is thus fundamentally committed to the economic benefit that comes with diversity, tolerance and fairness of people in a company as well as its customers and business partners. It obligates the company to provide a working environment free from prejudices and exclusion and to establish an open corporate culture based on mutual respect and inclusion of participants. The different abilities and talents of employees are used purposely to serve the markets and be economically successful in the best possible way.

This diversity of employees offers great potential and pbb Group accordingly promotes the technical, professional and personal development of its employees in a targeted way. For this purpose, pbb Group offers a variety of internal training and qualification programmes.

The mainstays of the bank's further education and training programme are a series of in-house seminars. With predefined company programmes, pbb Group supports and promotes the long-term further education of its employees. Focus is placed on both professional qualification as well as on the development of management skills, so that employees are better able to take on an active management role in day to day management activities or within the project landscape. In addition to the permanent series of seminars offered, the bank offers a constantly expanding range of in-house seminars on professional qualifications and qualifications in the areas of social and methodological competencies as well as language training. Any further requirements for training are met by external providers.

An important strategic management instrument to align employees' activities and priorities to the objectives and success of the company is the annual employee appraisal in which, not only performance is reviewed, but in which personnel development and qualification measures are also agreed.

Customers and Products

As a specialist bank, pbb finances commercial real estate finance projects and public sector infrastructure projects. In both business areas, pbb sets high standards when granting loans, taking into account sustainability aspects. This process involves prioritising financing that meets the requirements for sustainability.

Commercial real estate financing mainly involves real estate such as office buildings, retail properties, properties for residential use and logistics properties. pbb Group does not finance industrial plants. In order to promote sustainability aspects in the real estate industry and the real estate financing business, pbb Group is, for example, involved in the working groups of the Association of German Banks (Bundesverband deutscher Banken: BdB) and the Association of German Pfandbrief Banks (Verband deutscher Pfandbriefbanken: vdp).

In public sector finance, pbb makes a major social contribution by financing projects for the provision and improvement of public infrastructure. The focus here is on public institutions (e.g. administrative and special purpose buildings, buildings for education, childcare and cultural institutions as well as sports facilities), municipal or social housing construction, buildings for the utilities and waste disposal market (e.g. power generation, water collection and supply, waste water disposal and treatment, waste disposal and recycling), transport infrastructure as well as healthcare and nursing facilities.

Investors

pbb Group is a commercial enterprise which aims to generate a sustainable and adequate return on its owners' investments. The criteria for loan and investment decisions are primarily of a commercial nature. However, they also include a range of social and environmental factors.

Today, institutional investors increasingly take independent evaluations of an issuer's performance in the area of corporate responsibility into account when making investment decisions. pbb Group currently meets these investor requirements with two actively supported corporate responsibility ratings provided by the agencies oekom and imug.

Corporate Responsibility Ratings

The rating agency oekom currently rates pbb Group as «Prime». oekom awards the «Prime» status to companies that are amoung the leaders in their industry in the context of oekom's corporate ratings and that meet the industry-specific minimum requirements. Around 3,500 companies are regularly rated by oekom, and of those around 550 companies have currently achieved «Prime» status.

The rating agency imug rates pbb's debt instruments. pbb's Pfandbriefe are currently classed as above-average with a «positive» rating. The mortgage Pfandbriefe and unsecured bonds are classed as average with «neutral». imug currently analyses and rates approximately 70 German and European bank bond issuers and covered bonds.

Social Responsibility

pbb Group fulfils its responsibility towards society by means of its two charitable foundations, pbb Stiftung Deutsche Pfandbriefbank and pbb Stiftung für Kunst und Wissenschaft. The foundations, based in Munich, are independently funded with their capital being ringfenced from the Bank and being used solely to fulfil the foundations' purposes.

> pbb Stiftung Deutsche Pfandbriefbank supports projects aimed at promoting art and culture with a particular focus on the targeted support of young talent.
> pbb Stiftung für Kunst und Wissenschaft promotes works in the Federal State of Baden-Württemberg, focusing on intellectual and artistic work primarily in the fields of literature, painting, sculpture, music, theatre, architecture/design, regional and cultural studies and traditions.

pbb Group complements its primarily cultural and academic endeavours with commitments to social projects. It supports the Kinderhospiz St. Nikolaus children's hospice based in the Allgäu region. This is a care and rest home for families of chronically or terminally ill children. In addition, the Group funds projects near the company's branches. Since 2013, this includes the «JugendKulturHaus Gleis 1» youth centre near the Unterschleißheim branch. pbb Group supported the mobile youth work and the acquisition of the IT equipment for a «job application terminal» as first projects with the centre. pbb Group also supports its employees personal, voluntary commitment of other social projects.

pbb Group has also donated its collection of historical paper money from Württemberg as a permanent loan to the HVB Stiftung's bank note collection. It comprises around 8,000 notes from every period of Württemberg's monetary history and is the largest and most significant special collection of Württemberg paper money. The complete pbb Group collection remains intact as part of the HVB Stiftung's bank note collection and is accessible to interested members of the public.

Environment

With the code of conduct, pbb Group has obligated itself to conducting its business in a sustainable and environmentally friendly way and identifying environmental risks that may arise in its business activities. The Group is aware that certain resources are limited and must be handled responsibly. Although the Group does not currently put together an explicit environmental report it has set a goal of minimising its requirements for energy and raw materials as its active contribution to climate protection. With this goal in mind, pbb Group has driven the following significant initiatives forward:

The buildings of the Group's headquarters in Unterschleißheim near Munich are highly energy-efficient. For instance, they have energy-efficient cooling ceilings instead of a conventional air conditioning system. Since 2011, all the electricity requirements there have been met with green power.

Work processes are designed to save paper. Only paper certified as environmentally friendly is used. 100% of the remnants from destroyed files are recycled. In addition, various electronic systems are used that largely replace paper-based processes such as electronic employee services (recording of working hours, payroll calculations, wage tax and social insurance documents, travel expense reports, etc.), electronic accounts and contract management, electronic credit files and document rooms. Since 2014, pbb Group has also refrained from making printed copies of its interim financial reports.

For business trips, pbb Group principally requires that employees use the train for travel between the company's branches in Unterschleißheim, near Munich, and Eschborn, near Frankfurt, as well as within Germany. The installation of videoconferencing facilities at the company has made it possible to further reduce costs resulting from business travel.

Company vehicles must adhere to certain limits in terms of CO_2 emissions within the context of ecological compatibility. Vehicles with higher CO_2 emissions are given a financial penalty or may not be purchased. The regulations are designed to the current development standards and may be adjusted according to technological advances.

In 2014, pbb Group further implemented the new IT concept initiated in 2013. The aim of this concept is to halve the number of printers and copiers. A «One User – One PC» policy has also been implemented to reduce the number of PCs and notebooks by around 25%. As a result, the number of printers and copiers, as well as the number of PCs and notebooks, were again significantly reduced in 2014. In addition, the company aims to reduce server instances by around 1/3. Environmental aspects play a significant role here too. This results in a significant saving of resources and significantly reduces future energy requirements in a sustainable way. All devices bear the latest green IT label, the «ENERGY STAR», for maximum energy efficiency.

Report on Economic Position

Macroeconomic Environment

Global economic growth failed to gain momentum in 2014. The relatively weak growth was mainly due to the restraint in private and public investments. In the eurozone, real gross domestic product (GDP) rose slightly in 2014, which nevertheless represents an improvement in the economic development compared to the recession of the two previous years. However, the increase does not distract from the fact that the original growth expectations had proven to be too optimistic. The development of individual eurozone countries again proved to be highly varied. In Germany, growth was weaker than expected but still stronger than in the eurozone as a whole. In France the economic stagnation is likely to have continued and in Italy the recession, ongoing since 2012, continued for another year – even if in a significantly weaker form. In contrast, positive developments were seen on the Iberian peninsula with Spain and Portugal having to deal with a significantly shrinking economy in 2013 but returning to positive growth rates in 2014. In Great Britain, the recovery of the recent years continued. At the same time, the economic situation in the Nordic countries also improved. The development of the economy in some markets in central and eastern Europe, such as in Poland and the Czech Republic, was also positive.

In 2014, the interest rate levels in the markets relevant to pbb Group again tended to be near the historical lows or reached new lows during the year. In the eurozone, the European Central Back bank (ECB) once more reduced the key interest rate to a record low of 0.05% (31 December 2013: 0.25%) introducing a negative deposit rate for banks of –0.2%. Inflation in the eurozone also significantly decreased again.

The currency markets reflected the central bank decisions for a looser monetary policy in the eurozone and in Japan and the expectations of a future tightening of monetary policy in the United States and Great Britain. As from the second quarter 2014, the euro lost significantly in value in respect of the US dollar particularly as the yield advantage of US dollar investments again increased. Since the beginning of 2014, the euro came increasingly under pressure against the British pound. The exchange rate between the euro and the Japanese yen was mainly characterised by increased volatility during 2014. The euro only recorded exchange rate gains towards the end of the year as the yen came under strong selling pressure against the US dollar.

Sources: Bloomberg, ECB, IMF

Sector-specific Environment

Overall Situation in the Banking Sector

Tensions on the international financial markets eased somewhat again in 2014. On the one hand, this may have been due to somewhat more dynamic economic growth in the industrial countries, on the other hand, the still unusually loose monetary policy of the central banks continued to have a positive effect on the assessment of credit risks. The credit default swap (CDS) spread related to the credit risks of the Western European countries once more declined and dropped from a level of just over 60 basis points at the end of the previous year to approximately 30 basis points in December 2014.

The low interest level again presented the banking sector with challenges concerning business models and profitability in 2014. In the European countries in which the economic upswing had previously been weak, such as in France, or which had even remained in recession, such as Italy, the loan loss provisions continued to have a negative effect on the profitability of the sector and the consolidation pressure remained high.

The review of banks' asset quality (AQR) and the stress test of the European Banking Authority, which was carried out directly prior to the transfer of the supervisory obligation over the largest European banks to the ECB, was primarily interpreted by the market as a trust-creating measure. The resulting capital requirement for the banking sector was low, in particular as the institutions had taken up ample equity at relatively favourable financing conditions on the capital market prior to the review of their balance sheets.

In the eurozone, lending standards in the banking sector relaxed somewhat during 2014, which is not yet however reflected in a noticeable increase in lending by banks due to the weakness of overall economic demand. Banks' demand for liquidity in the newly created ECB facility for targeted longer-term funding transactions, which was introduced in respect of increased lending to consumers and companies as required by the ECB, also developed relatively slowly in 2014.

Whilst low interest rates, continued pressure on margins due to increased competition as well as a persistently low lending volumes continued to negatively affect banks' earnings situation, higher regulatory requirements also contributed to increased complexity in the operating business environment.
Sources: Bloomberg, ECB

Real Estate Finance

The REF business segment comprises commercial real estate finance.

The commercial real estate investment class developed positively in 2014. Transaction volumes again reached higher levels in various European real estate markets than in the previous year. Whilst in particular in the recent past, investors preferred real estate, which is part of the top segment («core real estate»), the investment volume expanded noticeably to the segment of standard real estate and second-best locations in 2014. Investors' risk appetite therefore increased significantly. However, investors' equity investments continued to remain high.

Purchase prices for high-quality real estate rose significantly, in particular in the office and commercial segments. The demand for space in the office segment was not noticeably higher taking into account the moderate economic growth and the continuing high level of uncertainty of companies in most European markets.

In Germany, the dynamic in the investment markets observed in the first half of 2014 continued in the second half of 2014. Office properties and retail properties dominated the marketplace. In France, the investment volume significantly exceeded the average of the last 10 years. The share in the Ile-de-France region (including the metropolitan area of Paris) amounted to approximately 75% of the French transaction volume. In the United Kingdom, the demand for property also developed positively in 2014. In addition to London, investors again engaged in regional markets. The markets that had been affected more severely by the euro crisis also recovered again in 2014. Thus, in Spain investments in commercial property increased significantly. This indicates that opportunistic investors are also returning to Europe and are focusing on recovering markets.

In addition, the demand for property had a positive effect on the business of financing banks and non-banks. The German Pfandbrief banks increased their new business year-over-year. The improvement in the funding situation was seen across all usage types. Nevertheless, competition resulted in continued pressure on credit margins. Alternative lenders, such as insurance companies, pension schemes and funds also contributed to the increased competition.
Sources: CBRE research, Association of German Pfandbrief Banks

Public Investment Finance

Public investment finance is included in the PIF business segment.

The situation in all segments of the municipal financing market has normalised. Countries that had been badly affected by the sovereign debt crisis saw continuing promising developments: Spain's credit rating was upgraded by one level at the beginning of 2014; Portugal has returned to the capital market.

The financing provided by retail banks and development banks for municipal financing was sufficient to fund the majority of relevant municipal investment projects, particularly in the countries less affected by the sovereign debt crisis. Nevertheless, the financing banks and investors continued to hold a critical view of the financial situation in the countries in focus, such as Spain and Ireland, including their sub-sovereign level. The resulting differences in the credit quality assessments of municipalities and local authorities thus continued in the course of the year.

In Germany, the market provided sufficient demand for public investment finance. Nevertheless, financing with extremely long-term loans remained popular and were granted at very low margins by local competitors (primarily public sector and development banks). The traditional public investment finance market was thus highly challenging for other providers. In contrast, competition picked up again on the French market, which was reflected in deteriorating margins during the year. In the Northern European countries, it was possible to enter into transactions with attractive risk-return profiles. This was mainly due to the withdrawal of, or discontinuation of, business activities by other international competitors and the withdrawal of local banks.

Public Budget Finance

The non-strategic portfolio of public budget financing is included in the VP business segment in which pbb Group has no new business.

The returns on government bonds narrowed sharply in almost all European countries. One of the few exceptions is Greece. In many countries, which had to offer higher returns in the past, such as Spain, Italy and Portugal, the risk premiums decreased significantly.

Funding Markets

As in previous years, the low-interest environment prevailed as the «new normal» for market players in 2014. Driven by the monetary policy measures introduced by the central banks, the capital markets continued to be caught in the trade-off of excess liquidity in search for investment opportunities and low returns. From investors' point of view, the situation with the decline in the 10-year yield of approx. 100 basis points was significantly exacerbated resulting in the focus shifting towards longer terms and along the credit curve. This was evidenced by the greater interest shown by investors in unsecured issues as well as capital transactions.

Geopolitical risks, such as the distortions in the emerging markets in the first quarter of 2014 followed by the conflict in the Ukraine and the fight against IS terrorism, only affected the markets in the short term. In an environment that continues to be strongly influenced by the regulator, banks had to face new challenges such as the comprehensive assessment by the ECB and the Capital Requirements Regulation, which will also have a significant impact on the offering by issuers in the future.

The central banks continue to provide the impetus for the capital markets. Whilst the FED tested an exit in light of a stronger US economy from the liquidity measures, the ECB expanded its influence by further interest rate decreases and long-term tenders (TLTRO). Since the beginning of the fourth quarter 2014, market players in the euro area have faced the challenge of a new purchase program for covered bonds and ABSs (CBPP3). The central bank demand fuelled by the purchase program resulted in a further narrowing of spreads on the Pfandbrief market and showed tendencies of crowding out the groups of investors already known. Pfandbriefe were placed at a low level thanks to the high central bank share.

Course of Business

In 2014 pbb Group basically continued to build on the success of previous years. However, net income was burdened extraordinarily by €–120 million due to value adjustments of the non-strategic exposure to Heta Asset Resolution AG (Heta) and changes in the market value of the related hedging derivatives. Without taking into account the hit from from the Heta exposure, profit or loss before tax of €174 million was above the target of a minimum of €140 million as forecasted and, in addition, exceeded the previous year's result of € 165 million. Excluding the hit from Heta exposure, return on equity after tax amounted to 3.4% and the cost-income ratio 57.3%.

Including the burden from the Heta exposure, pbb Group realised profit or loss before tax of € 54 million, return on equity after tax of 0.1% and a cost-income ratio in the amount of 77.0% in 2014. These key performance indicators were therefore below the forecast published at the beginning of 2014, which provided for profit or loss before tax of at least € 140 million, return on equity after tax of at least 3.7% and, for the cost-income ratio, a slight improvement compared to 2013 (64.7%). The risk bearing capacity was ensured at all times despite the negative effects from the exposure to Heta as forecasted in the gone-concern perspective and the going-concern perspective. The CET1 ratio amounted to 21.7% as of December 2014 and therefore increased in comparison with the previous year and did not drop as forecasted.

As of 31 December 2014, pbb Group held a non-strategic portfolio in respect of Heta amounting to nominal € 395 million for which there is a guarantee by the Austrian federal state of Carinthia. These relate to eight securities and a borrower's note loan. pbb Group responded to a decision by the Austrian financial market supervisory authority (FMA) dated 1 March 2015, which included a deferment of the due date of debt instruments, including interest payments, of Heta to 31 May 2016. As the information indicates that a full coverage could not have been expected at the balance sheet date, this is a post-balance sheet effect to be taken into account in 2014. pbb Group is going to use the right to appeal against the moratorium of the FMA and intends to pursue all legal means to achieve that all claims will be satisfied. The total liability of €–120 million related to net income from financial investments (€–109 million), loan loss provisions (€–8 million) and net trading income (€–3 million).

The basically positive development in pre-tax profits was supported by all the significant earnings components. One reason was the increase in the REF and PIF financing volume (€ 29.8 billion; 31 December 2013: € 27.6 billion) resulting from the high level of new business. At € 10.2 billion, the volume of new business including prolongations with maturities of more than one year, increased significantly year-over-year reaching the highest level in five years. The success in new business resulted in an increase in interest-bearing assets. The continued high level of new business margins contributed to a significant improvement in net interest income. There was a significant increase in net interest income from € 319 million in the previous year to € 421 million. As expected, accounting-related changes in estimates played less of a part in net trading income than in the previous year thus resulting in a slightly lower negative balance. In 2014 net income from financial investments was hit by Heta exposure with €–109 million as well as boosted by earnings of € 21 million from the disposal of DEPFA Finance N.V.; in 2013, earnings of € 92 million resulted from the sale of Little Britain Holdings (Jersey) Ltd. Both net other operating income/expenses as well as general and administrative expensees decreased as expected as the services for the portfolio of FMS Wertmanagement were largely terminated. In this regard financial years 2014 and 2013 can only be compared to a limited extent. In total, overall expenses decreased with simultaneous higher income from the operating core business. Loan loss provisions exceeded the prior year figure, however continued to remain at a low level and thus developed better than forecasted; this was due to the positive situation on the markets and the successful risk policy of the Group.

No significant change was forecast for total net assets, which increased by a negligible 1% to € 75.5 billion.

Development in Earnings

pbb Group

Net income/loss in comparison to the previous year is presented as follows:

pbb Group		2014	2013	Change
Operating performance				
Operating income	in € million	326	482	−156
Net interest and similar income	in € million	421	319	102
Net fee and commission income	in € million	1	9	−8
Net trading income	in € million	−30	−51	21
Net income from financial investments	in € million	−77	96	−173
Net income from hedging relationships	in € million	−3	9	−12
Net other operating income/expenses	in € million	14	100	−86
Loan loss provisions	in € million	−21	−8	−13
General and administrative expenses	in € million	−251	−312	61
Net miscellaneous income/expenses	in € million	–	3	−3
Profit or loss before tax	in € million	54	165	−111
Income taxes	in € million	−50	−5	−45
Net income/loss	in € million	4	160	−156
Key ratios				
Cost-income ratio	in %	77.0	64.7	
Return on equity before tax	in %	1.6	5.0	
Return on equity after tax	in %	0.1	4.9	

Operating Income Operating income amounted to € 326 million, after € 482 million in financial year 2013. Without taking into account effects in connection with the Heta exposure as well as effects from the deconsolidation of subsidiaries in 2014 and 2013, an increase in operating income of € 27 million would arise.

Net interest income significantly exceeded the prior-year figure at € 421 million (previous year: € 319 million). This was partly due to the margins realised in the new business, which were higher than that of the portfolio of existing business. The net income from prepayment penalties arising from early loan repayments was € 51 million (2013: € 27 million). A special effect of € 15 million arose from the redemption of liabilities in respect of DEPFA Finance N.V. prior to maturity in the amount of € 150 million. The liabilities were presented in micro fair value hedge accounting. After the liabilities were redeemed and the related hedging derivatives terminated, the hedge adjustment of the underlying was reversed through profit and loss. Further effects in connection with DEPFA Finance N.V. are included in net income from financial investments. In addition, favourable funding and the optimisation of liquidity portfolio had a positive effect on net interest income of which could partly be offset the negative effects from the even lower interest level on liquidity portfolio and the investment of equity.

Net fee and commission income amounted to €1 million (2013: € 9 million). A key reason for the decline was lower, non-accruable fees from the lending and other services business.

Net trading income stood at €–30 million in the reporting period, after amounting to €–51 million in the previous year. The subsequent valuation of derivatives, taking account of the bilateral credit value adjustment, i.e. the default risk of the respective counterparties and of pbb Group, resulted in an effect of €–12 million (2013: €7 million). The movement of the net present value of derivatives to nil on their maturity date (pull to par effect) and the lower market interest rate level in the long-term maturity bands also had a negative effect. Furthermore, slight losses (€–3 million) resulted from interest-hedge derivatives in connection with the Heta exposure, which are no longer in an effective hedging relationship.

Net income from financial investments (€–77 million; 2013: €96 million) was burdened with €–109 million primarily due to the valuation adjustments on the securities issued by Heta. In addition, net income from financial investments included an amount of €21 million from the disposal of DEPFA Finance N.V. on 18 July 2014. Due to the deconsolidation of the subsidiary, the liabilities of pbb in respect of DEPFA Finance N.V. were no longer to be eliminated and were valued at fair value for the first time. Further effects arose from the net reversal of portfolio-based allowances (€5 million; 2013: net additions of €–1 million) mainly as a result of changed risk estimates of securities in Portuguese regions as well as profits from securities sales in the amount of €6 million (2013: €4 million). In the previous year, income of €92 million was realised from the sale of Little Britain Holdings (Jersey) Ltd.

Net income from hedging relationships of €–3 million (2013: €9 million) was mainly due to hedge inefficiencies of micro fair value hedge relationships, which are largely admissible according to IFRS.

Net other operating income/expenses decreased to €14 million in 2014 (2013: €100 million). The reason for this was primarily the general termination of the services of the FMS Wertmanagement portfolio at the end of the third quarter in 2013. The remaining income from services (€1 million; 2013: €60 million) was generated by a Japanese subsidiary. IT services provided to DEPFA resulted in net income of €30 million (2013: €36 million). The services were largely terminated at the end of 2014. Additional income was attributable to real estate rental income in the amount of €10 million (2013: €11 million); €4 million was attributable to currency translation (2013: less than €1 million). Write-downs of €–14 million (2013: €0 million) were undertaken on real estate taken over. An expense of €–5 million (2013: €0 million) resulted from the scrapping of IT assets and an expense of €–1 million (2013: €–11 million) from the bank levy.

Loan Loss Provisions The net addition of loan loss provisions (€–21 million; 2013: €–8 million) comprises net additions to specific allowances (€–32 million; 2013: €–8 million), net reversals of portfolio-based allowances (€5 million; 2013: net additions of €–9 million) and recovery payments on previously written-off loans and advances of €6 million (2013: €8 million) recognised in profit and loss.

Specific allowances only related to a few commitments in the REF segment and a borrower's note loan to Heta in the VP segment shown under loans and advances to customers. As in the previous year, no specific allowances were created on PIF funding. Portfolio-based allowances are only established for loans and advances for which no indication of an individual impairment has been determined. The net reversals were undertaken inter-alia due to rating improvements of counterparties.

General and Administrative Expenses General and administrative expenses decreased considerably to €−251 million in 2014 (2013: €−312 million). On the one hand, personnel expenses (€−110 million; 2013: €−121 million) decreased due to pbb Group's size adjustment to a specialised European bank and, on the other hand, due to the transfer of employees to FMS Wertmanagement Service GmbH in September 2013. The decrease in non-personnel expenses from €−191 million in 2013 to €−141 million in financial year 2014, was particularly due to lower IT and consultancy costs, following to fewer projects. The cost-income ratio deteriorated to 77.0% (2013: 64.7%) due to the charges from the Heta exposure. Without the burden from the Heta exposure the cost-income ratio would have amounted to 57.3%.

Net Miscellaneous Income/Expenses There were no net miscellaneous income/expenses in the reporting year (2013: € 3 million).

Profit or Loss before Tax Profit or loss before tax amounted to € 54 million (2013: € 165 million). Return on equity before tax amounted to 1.6% (2013: 5.0%). Without the burden from the Heta exposure profit or loss before tax would have amounted to € 174 million and return on equity before tax would have amounted to 5.0%.

Income Taxes Expenses of €−44 million from current taxes (2013: income of € 2 million), and expenses of €−6 million from deferred taxes (2013: €−7 million) resulted in total income taxes of €−50 million (2013: €−5 million). Current taxes include a tax expense for prior years of €−18 million (2013: tax income of € 6 million). In the prior year, current tax income amounted to € 2 million mainly due to the tax-free disposal of a participation as well as realisation of tax losses following the disposal of derivatives.

Net Income/Loss pbb Group's net income/loss was € 4 million (2013: € 160 million). Return on equity after tax amounted to 0.1% (2013: 4.9%). Without the burden from the Heta exposure net income/loss would have amounted to € 116 million and return on equity after tax would have amounted to 3.4%.

Operating Segments

With effect from 1 January 2014, pbb Group reorganised the reporting structure of the internal reporting system. The segment report to be prepared and set up for internal control in compliance with the regulations set out in IFRS 8 now includes the three business segments of REF, PIF and VP. The key change compared to the previous year is the dissolution of the former Public Sector Finance (PSF) segment and the creation of the new PIF segment. The non-strategic existing business portfolio in non-earmarked financing to the public sector (budget financing) formerly allocated to the PSF segment is now allocated to the VP segment. The new PIF segment includes the strategic public sector investment financing of pbb Group. The REF and PIF segments thus comprise the strategic activities, and the VP segment the non-strategic activities of pbb Group's customer business. In order to increase transparency and significance, the accrued fees for net interest income were segmented for the first-time since the beginning of financial year 2014 according to the principle of causation. The previous year's figures thus also had to be adjusted in accordance with IFRS 8.29, which favoured the REF segment but was to the detriment of the PIF and VP segments. The classification of income/expenses according to business segments is presented in the Note «Income Statement by Operating Segment».

Operating Segment Real Estate Finance (REF)

Real Estate Finance		2014	2013[1]	Change
Operating performance				
Operating income	in € million	292	355	−63
Net interest and similar income	in € million	304	261	43
Net fee and commission income	in € million	2	10	−8
Net trading income	in € million	−13	−21	8
Net income from financial investments	in € million	14	96	−82
Net income from hedging relationships	in € million	−2	4	−6
Net other operating income/expenses	in € million	−13	5	−18
Loan loss provisions	in € million	−14	−1	−13
General and administrative expenses	in € million	−160	−147	−13
Net miscellaneous income/expenses	in € million	–	2	−2
Profit or loss before tax	in € million	118	209	−91
Key ratio				
Cost-income ratio	in %	54.8	41.4	
Balance-sheet-related measures		**31.12.2014**	**31.12.2013**	
Financing volumes	in € billion	21.8	20.4	
Risk-weighted assets[2]	in € billion	7.2	7.4	

[1] Adjusted in accordance with IFRS 8.29
[2] Including risk-weighted credit risk positions as well as the capital requirements for market risk positions and operational risks scaled with the factor 12.5; consolidated in accordance with CRR; 31 December 2013 pro forma Basel III figure

The REF business segment comprises financing for professional real estate investors with a medium- to long-term orientation. As forecast, the larger share of income is attributed to the REF segment. The segment's profit or loss before tax of € 118 million fell below the prior-year figure (2013: € 209 million), which benefited from the non-recurring income of € 92 million from the sale of Little Britain Holdings (Jersey) Ltd.

At € 9.0 billion, the volume of new business including prolongations with maturities of more than one year surpassed the prior-year figure (2013: € 7.0 billion), as expected. The new business margins in 2014 exceeded the average margins of the existing business portfolio. Overall, this trend highlights the attractiveness of the real estate financing market and the excellent competitive position of pbb Group.

Operating Income Operating income dropped to € 292 million (2013: € 355 million), which was attributable to the non-recurring income in the prior year. Adjusted by the deconsolidation effects of subsidiaries, operating income increased by 8%. Net interest income amounted to € 304 million (2013: € 261 million) and benefited from the high new business margins, allocated pre-payment penalties due to early repayments as well as allocated revenue from the redemption of liabilities prior to maturity. Net fee and commission income amounted to € 2 million (2013: € 10 million). Compared to the previous year, non-accruable fees from the credit and other service business decreased. Net trading income amounted to €–13 million (2013: €–21 million) primarily due to the subsequent valuation of derivatives, taking account of the bilateral credit value adjustment, the pull to par effect of derivatives and the lower interest rates in the long-term ranges. Net income from financial investments in the amount of € 14 million (2013: € 96 million) in the past financial year in particular benefited from allocated revenues in the amount of € 9 million from the one-off fair value measurement of pbb's liability to DEPFA Finance N.V. as a result of the deconsolidation of this company as well as the sale of securities from the liquidity portfolio. In the previous year, the main item included in net income from financial investments of € 92 million was the income from the sale of Little Britain Holdings (Jersey) Ltd. Net income from hedging relationships of €–2 million (2013: € 4 million) was due to hedging inefficiencies to the extent admissible according to IAS 39. Net other operating income/expenses was negative at €–13 million (2013: € 5 million). Revenue from rental income could only partially compensate for the expenses from write-downs on real estate and the scrapping of IT assets.

Loan Loss Provisions A net amount of €–14 million was added to the loan loss provisions (2013: €–1 million). Net additions of €–24 million were made to specific allowances (2013: €–8 million), resulting from a small number of individual cases. € 4 million (net) was reversed in relation to portfolio-based allowances (2013: additions of €–2 million). Recovery payments on loans and advances previously written off of € 6 million (2013: € 8 million) were recognised in profit or loss.

General and Administrative Expenses At €–160 million, general and administrative expenses increased compared with the previous year (2013: €–147 million). This reflected additional personnel expenses to strengthen pbb Group's sales units. The cost-income ratio was 54.8% (2013: 41.4%).

Operating Segment Public Investment Finance (PIF)

Public Sector Finance		2014	2013[1]	Change
Operating performance				
Operating income	in € million	39	18	21
Net interest and similar income	in € million	45	29	16
Net fee and commission income	in € million	–	1	−1
Net trading income	in € million	−5	−8	3
Net income from financial investments	in € million	4	−2	6
Net income from hedging relationships	in € million	–	–	–
Net other operating income/expenses	in € million	−5	−2	−3
Loan loss provisions	in € million	–	–	–
General and administrative expenses	in € million	−33	−31	−2
Net miscellaneous income/expenses	in € million	–	–	–
Profit or loss before tax	in € million	6	−13	19
Key ratio				
Cost-income ratio	in %	84.6	>100.0	
Balance-sheet-related measures		**31.12.2014**	**31.12.2013**	
Financing volumes	in € billion	8.0	7.2	
Risk-weighted assets[2]	in € billion	2.4	3.1	

[1] Adjusted in accordance with IFRS 8.29
[2] Including risk-weighted credit risk positions as well as the capital requirements for market risk positions and operational risks scaled with the factor 12.5; consolidated in accordance with CRR; 31 December 2013 pro forma Basel III figure

The PIF business segment comprises financing eligible for covered bonds for the provision of public infrastructure. The segment's profit or loss before tax amounted to € 6 million (2013: €−13 million) and was thus slightly positive, as expected.

The new business in public investment finance reached the prior year's figures with €1.2 billion and thus fell below expectations, which provided for a significant increase compared to the previous year. The failure to reach the forecast figures is due to the more intense competitive situation. As pbb Group did not want to enter into transactions with weak margins or incur higher risk, only selective new business was concluded. As in the previous year, the new business margins were higher than the average margins in the existing portfolio, allowing pbb Group to increase the profitability of the portfolio.

Operating Income Operating income of €39 million were above the previous year's figure (2013: €18 million). The growth in net interest income from €29 million to €45 million was, inter-alia, due to the margins of the new business being above the existing business, which, in turn, increased the profitability of the public investment finance portfolio. In addition, higher revenues from pre-payment penalties favourably influenced net interest income. As in the other segments, the commission business played a minor part in the PIF segment (€0 million; 2013: €1 million). The main reasons for the negative net trading income of €–5 million (2013: €–8 million) were negative market changes in derivatives as a result of the lower interest rates in the long-term ranges as well as the subsequent valuation of derivatives taking into account the bilateral credit value adjustment. Net income from financial investments amounted to €4 million (2013: €–2 million). Of this amount, an allocated non-recurring income of €3 million is attributed to the first-time measurement of pbb's liability to DEPFA Finance N.V. at fair value due to the deconsolidation of the company. Additional income was a result of sales of securities in the liquidity portfolio. In net income from hedging relationships, hedge inefficiencies of micro fair value hedge relationships were balancing. Net other operating income/expenses amounted to €–5 million (2013: €–2 million).

Loan Loss Provisions In financial years 2014 and 2013, no additions or reversals were required.

General and Administrative Expenses At €–33 million, general and administrative expenses were slightly above the prior-year level (2013: €–31 million). The segment cost-income ratio was 84.6% (2013: >100.0%).

Operating Segment Value Portfolio (VP)

Value Portfolio		2014	2013[1]	Change
Operating performance				
Operating income	in € million	–21	91	–112
Net interest and similar income	in € million	56	12	44
Net fee and commission income	in € million	–1	–1	–
Net trading income	in € million	–12	–22	10
Net income from financial investments	in € million	–95	2	–97
Net income from hedging relationships	in € million	–1	5	–6
Net other operating income/expenses	in € million	32	95	–63
Loan loss provisions	in € million	–7	–7	–
General and administrative expenses	in € million	–58	–134	76
Net miscellaneous income/expenses	in € million	–	1	–1
Profit or loss before tax	in € million	–86	–49	–37
Key ratio				
Cost-income ratio	in %	>100.0	>100.0	
Balance-sheet-related measures		**31.12.2014**	**31.12.2013**	
Financing volumes	in € billion	21.3	23.6	
Risk-weighted assets[2]	in € billion	4.4	6.0	

[1] Adjusted in accordance with IFRS 8.29
[2] Including risk-weighted credit risk positions as well as the capital requirements for market risk positions and operational risks scaled with the factor 12.5; consolidated in accordance with CRR; 31 December 2013 pro forma Basel III figure

The VP business segment includes all the non-strategic portfolios and activities of pbb Group. These also include the budget financing formerly reflected in the PSF segment as well as the IT services provided to DEPFA. Due to the charges from the Heta exposure the segment's profit or loss before tax with €–86 million was below the forecast, which had assumed a slightly positive result. Not taking into account the Heta exposure, the result would have amounted to € 32 million and thus above the forecast.

Operating Income Operating income were negative with €–21 million due to the charges from the exposure to Heta (2013: € 91 million). Net interest income increased to € 56 million (2013: € 12 million) in particular due to higher allocated income from pre-payment penalties (approx. 40 % of net interest income) in connection with early repayments and redemptions of liabilities. Net fee and commission income amounted to €–1 million as in the prior year. Net trading income amounted to €–12 million (2013: €–22 million) primarily due to the pull to par effect of derivatives and the lower market interest rates in the long-term ranges. Net income from financial investments amounted to €–95 million (2013: € 2 million), which was mainly due to the Heta value adjustments. Net income from hedging relationships was due to hedging inefficiencies and amounted to €–1 million (2013: € 5 million). Net other operating income/expenses declined to € 32 million (2013: € 95 million). A significant factor was the IT services provided to DEPFA, which generated income of € 30 million (2013: € 36 million). Net income from services for the FMS Wertmanagement portfolio only amounted to € 1 million (2013: € 60 million).

Loan Loss Provisions Loan loss provisions (€–7 million; 2013: €–7 million) resulted from the valuation allowance on a borrower's note loan of Heta in the amount of €–8 million.

General and Administrative Expenses General and administrative expenses were considerably lower than in the previous year, at €–58 million (2013: €–134 million). The reason for this was the far-reaching termination of the services for the FMS Wertmanagement portfolio at the end of September 2013, which was also associated with a transfer of pbb Group employees to FMS Wertmanagement Service GmbH. The cost-income ratio continued to be higher than 100.0%.

Consolidation & Adjustments

Consolidation & Adjustments in € million	2014	2013	Change
Operating performance			
Operating income	16	18	–2
Net interest and similar income	16	17	–1
Net fee and commission income	–	–1	1
Net trading income	–	–	–
Net income from financial investments	–	–	–
Net income from hedging relationships	–	–	–
Net other operating income/expenses	–	2	–2
Loan loss provisions	–	–	–
General and administrative expenses	–	–	–
Net miscellaneous income/expenses	–	–	–
Profit or loss before tax	16	18	–2

Consolidation & Adjustments reconciles the aggregated segment results to the consolidated result. Alongside consolidation adjustments, this item contains certain expenses and income that do not fall within the operating segments' areas of responsibility.

Pre-tax profit in the Consolidation & Adjustments segment was positive, at €16 million (2013: €18 million). Net interest income arose predominantly from the investment of equity not allocated to the segments.

Development in Assets

Assets in € million	31.12.2014	31.12.2013[1)2)]	Change
Cash reserve	57	3,532	−3,475
Trading assets	2,016	1,642	374
Loans and advances to other banks	6,800	6,685	115
Loans and advances to customers	38,964	36,242	2,722
Allowances for losses on loans and advances	−138	−148	10
Financial investments	20,475	20,725	−250
Property and equipment	8	1	7
Intangible assets	23	31	−8
Other assets	6,659	4,769	1,890
Income tax assets	654	1,162	−508
Current tax assets	29	44	−15
Deferred tax assets	625	1,118	−493
Total assets	**75,518**	**74,641**	877

[1)] Adjustment due to retrospective IFRS 10 first time adoption. Details are disclosed in Note «Principles».
[2)] Adjusted due to IAS 8.42. Details are disclosed in Note «Consistency».

General Development in Assets

Total assets of pbb Group amounted to € 75.5 billion as of the balance sheet date, and was thus € 0.9 billion higher than at the end of the previous year (31 December 2013: € 74.6 billion).

The high level of the cash reserve resulting from the maturity of a security before the end of 2013 was largely re-invested during the reporting year and led to a shift to loans and advances to customers. The nominal volume of the REF portfolio increased by € 1.4 billion and the nominal volume of the PIF portfolio by € 0.8 billion. In addition, loans and advances to customers increased as a result of higher valuation adjustments of the underlyings as part of a hedge package following the lower level of market interest rates.

The lower market interest rates also resulted in an increase in the fair value hedge derivatives shown under other assets as well as in the positive derivative market values of trading assets.

The reduction in income tax assets was mainly attributed to deferred tax assets. These decreased by € 0.5 billion mainly due to fewer differences in balance sheet recognition with respect to derivative items between IFRS and HGB accounting.

Total Assets Covenants

As at 31 December 2014, pbb Group complied with all covenants relating to the total assets which had been imposed by the European Commission in connection with the approval of state aid. Because certain offsetting effects attributable to the transfer of selected positions to FMS Wertmanagement no longer exist, the adjusted total assets as at 31 December 2014 of € 75.5 billion (31 December 2013: € 74.6 billion) corresponded to total assets in accordance with IFRSs and were thus lower than the prescribed upper limit of €103.0 billion (31 December 2013: €105.0 billion). At € 54.5 billion (31 December 2013: € 51.6 billion), strategic total assets – which have been additionally adjusted by the non-strategic public sector financing portfolio – also fell below the prescribed upper limit of € 79.0 billion (31 December 2013: € 75.0 billion).

Investments

The purpose of pbb Group is to conduct banking business, particularly lending business. Capital expenditures on property and equipment and intangible assets are of minor significance. Nevertheless, pbb Group did invest in these areas in 2014. Additions of purchased and internally developed software amounted to € 4 million in the reporting period (2013: € 5 million). In addition, all pbb's workplaces were equipped with new hardware in financial year 2014. In the context of a project, the IT systems were separated from DEPFA. The investments affected all segments of pbb Group.

Development in Financial Position

Equity and liabilities in € million	31.12.2014	31.12.2013[1][2]	Change
Liabilities to other banks	3,187	3,522	−335
Liabilities to customers	10,593	10,848	−255
Securitised liabilities	47,827	46,858	969
Trading liabilities	1,960	1,453	507
Provisions	272	209	63
Other liabilities	6,182	4,722	1,460
Income tax liabilities	712	1,187	−475
Current tax liabilities	82	64	18
Deferred tax liabilities	630	1,123	−493
Subordinated capital	1,279	2,357	−1,078
Financial liabilities	**72,012**	**71,156**	856
Financial equity	**3,506**	**3,485**	21
Total equity and liabilities	**75,518**	**74,641**	877

[1] Adjustment due to retrospective IFRS 10 first time adoption. Details are disclosed in Note «Principles».
[2] Adjusted due to IAS 8.42. Details are disclosed in Note «Consistency».

Liabilities

Total Group liabilities amounted to € 72.0 billion, after € 71.2 billion at the prior-year reporting date.

As on the assets side, the continued low market interest rates resulted in higher valuations of the transactions presented in hedge accounting as well as of the negative derivative market values recognised in trading assets. Fair value adjustments were therefore made to the underlying transactions included in the securitised liabilities. The fair value hedge derivatives of other liabilities increased by € 1.7 billion.

The reduction in income tax liabilities was mainly attributed to deferred tax liabilities. As on the asset side, these decreased by € 0.5 billion mainly due to fewer differences in balance sheet recognition with respect to derivative items between IFRS and HGB accounting.

The subordinated capital decreased by € 0.9 billion due to the deconsolidation of DEPFA Finance N.V. A further decrease of € 0.2 billion was attributable to the partial redemption of liabilities to DEPFA Finance N.V. prior to maturity.

The ratio of securitised liabilities to total liabilities was 64.9 % (31 December 2013: 63.6 %); it represents the ratio of the carrying amounts of the Pfandbriefe to the carrying values of the liabilities to other banks/customers, securitised liabilities and the subordinated capital.

Capital

Development of Financial Equity The equity attributable to shareholders changed as follows:

Financial position equity in accordance with IFRS in € million	31.12.2014	31.12.2013[1)2)]	Change
Equity attributable to shareholders	**3,506**	**3,485**	21
Subscribed capital	380	380	–
Silent partnership contribution	999	999	–
Additional paid-in capital	3,265	5,036	–1,771
Retained earnings	–1,154	–3,115	1,961
Profits/losses from pension commitments	–79	–41	–38
Foreign currency reserve	2	1	1
Revaluation reserve	89	65	24
AfS reserve	–100	–220	120
Cash flow hedge reserve	189	285	–96
Consolidated profit/loss 1.1.–31.12.	4	160	–156
Total financial position equity	**3,506**	**3,485**	21

1) Adjustment due to retrospective IFRS 10 first time adoption. Details are disclosed in Note «Principles».
2) Adjusted due to IAS 8.42. Details are disclosed in Note «Consistency».

Capital Measures pbb's subscribed capital amounted unchanged to € 380,376,059.67 at 31 December 2014, and is composed of 134,475,308 registered ordinary bearer shares in the form of no-par-value shares with a notional interest in the subscribed capital of € 2.83 per share. Hypo Real Estate Holding was the sole shareholder of pbb. As in previous years there was no authorised or contingent capital as at 31 December 2014. The silent partnership contribution was paid in by Finanzmarktstabilisierungsfonds-FMS.

Financial position equity amounted to € 3.5 billion as at the balance sheet date (31 December 2013: € 3.5 billion). A withdrawal from the capital reserves of € 1,771 million was carried out to partially offset the accumulated balance sheet loss in the HGB financial statements of pbb in accordance with Par. 272 (2) No. 1–3 HGB. This lead to a transfer in equity from additional paid-in capital to retained earnings in the IFRS financial statements of pbb Group of € 1,771 million. Furthermore, retained earnings increased by € 30 million due to a payment by HRE Holding to compensate for payment obligations in connection with the transfer of positions to FMS Wertmanagement in 2010 as well as the consolidated profit in 2013 of € 160 million. The item profits/losses from pension commitments decreased equity by € 38 million as the discount rate used to measure the defined benefit pension obligations, in accordance with the market interest rate of 3.5% as of 31 December 2013, dropped to 2.0% as of 31 December 2014. The increase in the AfS reserve is a result of the spread improvements in southern European bonds, which are assigned to the IFRS valuation category AfS. The cash flow hedge reserve decreased mainly due to the shrinking of the derivatives.

Gains are used for strengthening equity or to repay capital not attributable to HRE Holding.

As part of the approval procedure granting state funds, the European Commission specified that pbb must be privatised by the end of 2015.

Key Regulatory Capital Ratios In accordance with the waiver rule set out in section 7 of the Capital Requirements Regulation (CRR), pbb is exempted from the requirement to establish the equity and core capital ratios. pbb Group voluntarily discloses these figures. The CET1 ratio amounted to 21.7% as at 31 December 2014 (31 December 2013: 18.5% pro forma Basel III figure), the own funds ratio amounted to 26.1% (31 December 2013: 23.2% pro forma Basel III figure). Please refer to the Risk and Opportunity Report for further information regarding the key regulatory capital ratios.

Liquidity

Principles and Objectives of the Liquidity and Financial Management The primary objective of pbb Group's financial management is to secure and manage the liquidity of pbb and its subsidiaries in such a way that their financing and funding capabilities are assured at all times. Central liquidity management is done by raising and investing liquidity on the money and capital markets and on the interbank money market, as well as with central banks. By contrast, the liquidity risk strategy, like the waiver rule, is part of HRE's risk strategy.

Maturities Asset/liability management for pbb Group is performed by HRE's Group Asset and Liability Committee (ALCO), which also acts on behalf of pbb Group. The following table compares the remaining terms of the assets and liabilities:

Maturity structure of financial position	31.12.2014		31.12.2013[1]	
in € million	Assets	Equity and liabilities	Assets	Equity and liabilities
Total	**75,518**	**75,518**	**74,641**	**74,641**
up to 3 months	8,320	6,953	10,145	6,778
3 months to 1 year	5,548	6,760	4,885	5,355
1 year to 5 years	23,013	26,637	23,439	26,598
5 years and over	29,415	22,536	28,715	24,854
Other assets[2]/equity and liabilities[3]	9,222	12,632	7,457	11,056

[1] Adjustment due to retrospective IFRS 10 first time adoption. Details are disclosed in Note «Principles».
[2] Trading assets, allowances for losses on loans and advances, property and equipment, intangible assets, other assets, income tax assets
[3] Trading liabilities, provisions, other liabilities, income tax liabilities, equity

Liquidity Management Liquidity management within pbb Group is performed centrally by pbb's Treasury division. The sales units are refinanced internally on a one-to-one basis when they enter into new business. This means that risks are bundled and centrally managed. The liquidity ratio is calculated at the level of the individual institution at pbb in accordance with the Liquiditätsverordnung (LiqV – German Liquidity Regulation), and amounted to 4.4 at the balance sheet date (31 December 2013: 3.0). This was significantly higher than the statutory minimum of 1.0. The Monitoring of complying with liquidity ratios within foreign regulations of permanent establishments is also ensured, if this is demanded by local regulatory authorities.

Funding In 2014, a new long-term funding volume of €6.0 billion (2013: €7.7 billion) was realised. Early repayments on the assets side and adequate liquidity allowed to reduce the capital market activities. €2.6 billion (2013: €4.5 billion) was attributable to benchmark new issues as well as increase in funds of existing public transactions. Approximately two thirds of the long-term funding is carried out via Pfandbrief issues, whilst unsecured issues accounted for one third. Fixed-income issues predominated. Open interest rate positions are usually hedged by swapping fixed interest rates for floating rates. Overall, securitised liabilities amounted to €47.8 billion (31 December 2013: €46.9 billion).

In addition to capital market funding, overnight and time deposit investments for private investors are offered to expand the unsecured funding base; the deposit volume of «pbb direkt» amounted to more than €1.5 billion at the balance sheet date (31 December 2013: €0.6 billion). In this segment, Festgeld-PLUS was added to the product range. Investors receive a fixed interest rate but have access to 20% of their original amount invested at any time.

Benchmark issues

ISIN	Announce-ment	Settlement	Maturity	Coupon in %	Volume in million	Issue price in %	Currency
DE000A1X3LT7 (mortgage Pfandbrief)	14.1.2014	21.1.2014	21.1.2022	1.875	500	99.362	EUR
DDE000A1MLUW0 (2nd tap)[1]	13.2.2014	20.2.2014	3.6.2019	2.125	50	104.988	EUR
DE000A11QAP6 (mortgage Pfandbrief)	18.3.2014	25.3.2014	25.3.2019	1.000	500	99.400	EUR
DE000A1X26E7 (1st tap)[2]	3.6.2014	10.6.2014	11.9.2017	2.250	150	103.278	EUR
DE000A1RFBY7 (2nd tap)[3]	23.6.2014	30.6.2014	30.1.2017	0.875	150	101.466	EUR
DE000A11QAP6 (1st tap)[4]	18.8.2014	25.8.2014	25.3.2019	1.000	175	102.090	EUR
DE000A11QA31 (mortgage Pfandbrief)	2.9.2014	9.9.2014	8.9.2017	0.250	500	99.827	EUR
DE000A11QAP6 (2nd tap)[4]	5.9.2014	12.9.2014	25.3.2019	1.000	75	102.534	EUR
DE000A12UAW2 (mortgage Pfandbrief)	23.9.2014	30.9.2014	29.9.2017	variable[5]	300	99.941	GBP
DE000A1X26E7 (2nd tap)[2]	6.11.2014	13.11.2014	11.9.2017	2.250	100	103.836	EUR

[1] Tap of a mortgage Pfandbrief in the original amount of €500 million on 24 May 2012
[2] Tap of a unsecured benchmark issue in the original amount of €500 million on 2 September 2013
[3] Tap of a mortgage Pfandbrief in the original amount of €500 million on 23 January 2013
[4] Tap of a mortgage Pfandbrief in the original amount of €500 million on 18 March 2014
[5] Three-month LIBOR plus 40 basis points

Ratings The following table shows the senior unsecured ratings and ratings for pbb's Pfandbriefe:

Senior unsecured ratings and ratings for Pfandbriefe of pbb[1]			31.12.2014			31.12.2013
	Fitch Ratings	Moody's	Standard & Poor's	Fitch Ratings	Moody's	Standard & Poor's
Long-term rating	A–	Baa2	BBB	A–	Baa2	BBB
Outlook	negative	negative	negative	stable	negative	stable
Short-term rating	F1	P–2	A–2	F1	P–2	A–2
Public sector Pfandbriefe	–	Aa1	AA+[2]	–	Aa1	AA+[3]
Mortgage Pfandbriefe	–	Aa2	AA+[2]	–	Aa2	AA+[3]

[1] Ratings from mandated rating agencies
[2] Negative outlook
[3] Stable outlook

The rating agencies may alter or withdraw their ratings at any time. For the evaluation and usage of ratings, please refer to the rating agencies' pertinent criteria and explanations and the relevant terms of use which are to be considered. Ratings should not serve as a substitute for personal analysis. They do not constitute a recommendation to purchase, sell or hold securities issued by pbb.

The development of ratings continues to be heavily influenced by external factors, such as legislative changes and, in this context, changes to rating methodologies. For example, in April 2014, the European Parliament voted to adopt the European Bank Recovery and Resolution mechanism for banks. In light of these statutory changes, rating agencies have started reviewing assumptions with respect to support components incorporated in senior unsecured ratings, these were however not finalised as of year-end 2014. In particular, future restrictions on systemic support for banks and a potential bail-in of senior unsecured creditors in a crisis, generally have negative implications for banks' senior unsecured ratings within the EU. The negative rating outlooks assigned to the bank reflect these developments and the inherent rating pressure.

As covered bond ratings are linked to the senior unsecured rating of the issuer, the aforementioned factors may also have implications on covered bond ratings, for which changes or further adjustments to the methodology were also announced during the course of 2014.

During 2014, the following major rating events occurred:

> Following the confirmation of the senior unsecured ratings with a stable outlook by Fitch Ratings in February 2014, the agency changed the outlook on the long-term rating of pbb to negative in March 2014, within the context of the aforementioned background; this change in outlook affected 17 other banks within the EU. In December 2014, Fitch Ratings affirmed the Senior Unsecured Rating assigned to pbb with an unchanged negative outlook. Simultaneously, the agency acknowledged the bank's positive development by raising its «Viability Rating» from «bb» to «bb+». As a result, the support uplift of the «A–» senior unsecured ratings was reduced by 1 notch to 4 notches.

> In August 2014, Moody's confirmed the senior unsecured rating maintaining a negative outlook. The progress made by pbb was recognised and the «Baseline Credit Assessment» was raised by one notch from «b3» to «b2». The support uplift of the «Baa2» senior unsecured rating was reduced by 1 notch to 6 notches. At the same time, pbb's «Bank Financial Strength Rating» was confirmed at E+ with a stable outlook.

> After the Public Sector Pfandbriefe ratings were confirmed with a stable outlook in February 2014, Standard & Poor's followed by confirming the Senior Unsecured Ratings in April 2014 but assigned a negative outlook on the bank's long-term rating. As no changes arose with respect to the bank's «Standalone Credit Profile», the explicit support uplift remained unchanged at 1 notch at this time. In May 2014, the outlook on the ratings of the Pfandbrief programmes was lowered from stable to negative and, in September 2014, the ratings for the Mortgage Pfandbrief programme were, again, confirmed with an unchanged outlook.

The effects of possible ratings changes on the development in assets, financial position and earnings of pbb are disclosed in more detail in the report on expected developments.

Off-balance-sheet Obligations Irrevocable loan commitments account for the majority of off-balance-sheet obligations and amounted to €2.2 billion as of 31 December 2014 (31 December 2013: €2.6 billion). Contingent liabilities resulted from guarantees and warranty agreements and amounted to €0.1 billion as at the balance sheet date (31 December 2013: €0.0 billion).

Summary

Principally pbb Group continued with its success of the previous years in financial year 2014. Without taking into account the hit from the Heta exposure, pre-tax profits of €165 million in the prior year increased to €174 million. Including revaluation adjustments (€–120 million) for the non-strategic exposure to Heta, pre-tax profits amounted to €54 million. The new business volume reached its highest level in the last five years with a two-digit billion figure and thus set the foundation for a successful financial year 2014.

Total assets increased by €0.9 billion compared to the prior-year end.

The requirements regarding the regulatory capital ratios and the liquidity ratio were satisfied throughout the financial year 2014. These are voluntarily disclosed by pbb Group.

Report on Post-balance Sheet Date Events

Early in February 2015, Standard & Poor's changed the outlook assigned to the Issuer's unsecured ratings from negative to developing. This assessment reflects uncertainties with regards to the development of the bank rating resulting from the privatisation. Standard & Poor's now assigns a higher probability to the privatisation.

On 17 February 2015, with the public invitation to a tender process, HRE Holding took the next important step for privatising its subsidiary, pbb. HRE Holding intends to dispose 100% of its shares in pbb and thereby meet the requirement of the European Commission imposed in summer 2011. The preparations for an IPO are being made in parallel.

Against the background of the implementation of its new bank rating methodology, Moody's placed pbb's bank ratings on review on 17 March 2015. On the one hand, the review affects the «Baseline Credit Assessment» which reflects the creditworthiness excluding support elements: Moody's expects an increase of the current «b2» assessment. On the other hand, due to the Bank Recovery and Resolution Directive (BRRD) and the expected decreasing probability of external support of banks by the state, Moody's has placed the current long- and short-term ratings (Baa2/P–2) on «Review for Downgrade». The «Bank Financial Strength Rating» was withdrawn for methodological reasons. Moody's expects to close the rating review on the basis of the new methodology within the next few months. If, and to which extent, the future longterm ratings will include external support elements going forward, will essentially depend on the bank's future ownership structure.

There were no other significant events after 31 December 2014.

Risk and Opportunity Report

The risk and opportunity report shows the risks and also the opportunities identified for the individual risk types within the framework of the implemented risk management and risk controlling system. With regard to risks and opportunities relating to all areas of the Company and also general Company-specific risks and opportunities, please refer to the details in the report on expected developments.

Organisation and Principles of Risk and Capital Management

HRE Holding has set up a Group-wide risk management and risk controlling system which represents as well an important precondition for the application of the so-called waiver according to article 7 CRR respectively Section 2 a KWG. All tasks in accordance with Section 25 a KWG for uniform risk identification, measurement and limiting as well as risk management are defined centrally by HRE Holding. Operational implementation is the responsibility of the respective subsidiary. This risk and opportunity report also covers opportunities within the framework of a quality assessment.

As the higher-level institution of HRE, HRE Holding developed a Group recovery plan in accordance with the legal requirements (German Banking Act: KWG) and the Minimum Requirements for the Design of Recovery Plans (MaSan) and integrated it into the business organisation. The indicators defined for the recovery plan form part of HRE's management of the Bank as a whole, which are fully integrated in pbb Group. The objective of the recovery plan is to identify at an early stage any developments that may put the Bank as a going concern at risk and thereby give the Bank the opportunity to take appropriate (counter) measures to prevent going-concern risks from materialising.

Organisation and Committees

The principles, methods and processes of the risk management system of HRE Group are specified centrally by risk management and controlling of HRE Holding and are applied in pbb Group.

The Management Board of HRE Holding, which is identical with the Management Board of Deutsche Pfandbriefbank AG, is responsible for the risk management system, and is responsible for taking decisions relating to the strategies and the main issues of risk management and risk organisation of pbb Group. The risk management system comprises the plausible and systematic identification, analysis, valuation, management, documentation, monitoring and communication of all major risks.

The following are major components of the risk management system for which the Management Board is responsible:
> Defining, updating and communicating business and risk strategies as the basis of business activities and risk acceptance within pbb Group
> Defining and improving organisation structures within pbb Group and in particular for risk management, which ensures that all major risks of pbb Group are managed and monitored
> Adopting credit competences as a decision-making framework along the credit processes within pbb Group
> Taking decisions regarding (portfolio) management measures outside the delegated competences

The Management Board of pbb notifies the Supervisory Board of pbb with regard to significant changes in the business and risk strategies as well as the risk profile of pbb Group. The Risk Management and Liquidity Strategy Committee (RLA) of the Supervisory Board 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 pbb Group and resolves upon necessary credit approvals for credit decisions. The Management Board notifies this committee of all increases to specific allowances and the creation of new specific allowances in excess of €5 million and also notifies this committee at regular intervals of major exposures with higher levels of risk.

The committees detailed in the following have been set up at the HRE Group level with the involvement of the respective decision-makers of pbb Group.

The **Group Risk Committee (Group RC)** of HRE, acting simultaneously for pbb, consists of the Chief Risk Officer (CRO; Chairman) and the Co-CEOs of HRE Holding, acting as CRO and the Co-CEOs of pbb simultaneously, as well as the Head of Risk Management & Control. In general, the committee meets on a monthly basis and discusses the risk development, adopts guidelines/policies, methods for risk measurement, the related parameters as well as methods of monitoring for all risk types. The Group Risk Committee is responsible for the development of standard guidelines of risk management and risk controlling across the Group and also monitors the development of the risk-bearing capacity, economic capital, the risk cover funds as well as the credit portfolio and the compliance with limits. The Risk Committee discusses the portfolios of HRE and hence of pbb Group.

The **Group Asset and Liability Committee (ALCO),** which also serves pbb, meets monthly. It is chaired by the member of the Management Board responsible for Treasury and Asset Management and comprises the CRO, the Co-CEOs and the managers of the Treasury, Finance and Risk Management & Control divisions. Its tasks include liquidity management, asset/liability management for HRE and pbb Group, defining long-term financing strategies, capital management, management of regulatory capital ratios and market risk management. The ALCO does not make any credit decisions or set any limits for other risk categories. This committee is also responsible for preparing decision-making documents for liquidity and refinancing strategies which, following discussions in the Group Risk Committee, are decided in the same way as acquisitions and disinvestments in the Management Board of HRE Group respectively of Deutsche Pfandbriefbank AG.

The **Group Credit Committee** of HRE, acting simultaneously for pbb, comprises the CRO (Chairman), the Co-CEOs, the Chief Credit Officers REF/PIF (CCO), the Senior Credit Executives as well as representatives of the front office. The front office representatives have a voting right as part of front office responsibility. As a general rule, the committee meets at least once a week and takes credit decisions on new business, prolongations and material changes that fall within the scope of its authority. It also votes on all credit decisions which are in the responsibility of the Management Board of pbb and which have to be approved by the Risk Management and Liquidity Strategy Committee. The decision-makers ensure that the credit decisions are consistent with the prevailing business and risk strategy.

The **Group Watchlist Committee** of HRE, acting simultaneously for pbb, meets every month. All exposures of pbb Group identified by the early warning system are discussed and, if appropriate, individual measures are decided there; these measures have to be subsequently implemented by the relevant departments. Where necessary, the committee takes decisions regarding the need to transfer exposures to CRM Workout, which then takes the necessary steps for restructuring and workout on the basis of an exposure strategy. All necessary credit decisions are taken by the key personnel in line with the allocation of credit powers or in the Credit Committee.

If there are any indications of an objective impairment of an exposure, the extent of the impairment is first determined and the result is presented in the **Group Risk Provisioning Committee.** The committee takes decisions within the framework of a predefined set of allocated powers and in line with the IFRS/HGB regulations, and provides recommendations regarding the creation and reversal of provisions for losses on loans and advances as well as any necessary salvage acquisitions. The recommendations made by the committee have to be decided by the Management Board of pbb in line with the relevant set of rules governing powers.

The **Group New Product Process Committee** ensures that, before business commences with new products or in new markets, the resultant risks as well as the related impact on processes, controls and the infrastructure are systematically analysed and addressed. The recommendations made by the committee form the basis of decisions to be made by the pbb Management Board in line with the relevant set of rules governing powers.

The **Group Stress Test Committee,** which is a sub-committee of the Group Risk Committee, is responsible for the methodology, performance and monitoring of the internal stress tests. It is chaired by the CRO.

Organisation of Risk Management of HRE Holding/pbb

as of 31 December 2014

Decision-making body
Recommendation/proposal/information

[1] Due to existing waiver according to article 7 CRR respectively Section 2a of the German Banking Act

Chief Risk Officer (CRO) In addition to the above-mentioned committees, the following organisation units of the Group CRO, who is also CRO of pbb, form an integral part of the risk management system of HRE, in which pbb Group is included:

Organisation of Chief Risk Officer (CRO)

as of 31 December 2014

Chief Risk Officer (CRO)

- Risk Management & Control (RMC)
- Credit Risk Management (CRM) REF
- Credit Risk Management (CRM) PIF

The organisation of the CRO function comprises the following monitoring and back-office entities on pbb Group level:
> The unit Risk Management & Control, which is also responsible for monitoring and managing market, credit, operational and liquidity risks as well as the risk-bearing capacity of pbb Group and which is also responsible for Group-wide uniform risk measuring methods, risk reports and credit processes
> The units of the Chief Credit Officers REF/PIF of pbb Group, which are each responsible for the analysis of new business and portfolio management. In addition to the traditional loan departments, CRM REF also comprises the Workout (Real Estate) unit, which is responsible for the recovery and workout of all critical exposures in the Real Estate Finance segment, and the central unit Credit Processes, which is responsible in particular for the organisation of the Credit Committee and for updating credit processes.

In addition to the CRO function, the Corporate Office/Compliance entity and the Group Internal Audit entity (independent) complement the risk management system of pbb Group. The area of responsibility of Group Internal Audit comprises risk-oriented regular as well as event-driven audits of processes and systems. This also includes the revision of the risk management system. **Property Analysis & Valuation,** which is responsible for the analysis and uniform valuation of the collateral properties using market and loan-to-value methods, is under the control of a Co-CEO. Regarding legal issues Risk Management is also supported by the Legal department.

Risk Strategy and Policies

The risk strategy of pbb Group is based on the business strategy, risk inventory and the results of the Group-wide financial planning process. It is applicable for the operating segments and legal entities of pbb Group. The risk strategy was revised in Februar 2014, adopted by the Management Board of pbb and presented to the Risk Management and Liquidity Strategy Committee of the Supervisory Board of pbb and afterwards to the Supervisory Board plenum to be noted.

The risk strategy reflects the strategic focus of pbb Group as a specialist for real estate finance and public investment finance in Germany and selected countries in Europe with Pfandbrief-oriented refinancing. It is reviewed at least annually and updated if applicable.

The operationalisation of the risk strategy is carried out via risk policies for the individual operating segments as well as for all major risk types (credit risk, market risk, liquidity risk, business risk, property risk and operational risk); these risk policies describe risk measurement, risk monitoring, risk management, the limit process as well as the escalation process if a limit is exceeded. The policies are regularly reviewed and updated where necessary.

Risk Reporting

Risk reporting reflects the structure of the operating segments. The Management Board of pbb receives regular risk reports which include an extensive overview as well as detailed information concerning the risk situation for each risk type and company as well as other management-relevant information. The supervisory bodies are also notified of risk-relevant issues at regular intervals. In addition, special reports are prepared on an ad hoc basis or at the request of the Management Board or Supervisory Board; such special reports consider specific and acute risk issues, for instance in relation to critical markets, products or counterparties.

Risk Quantification, Risk Controlling and Risk Management

The risk-bearing capacity analysis quantifies credit risk, market risk, business risk, real estate risk and operational risk, aggregates them to produce an overall risk figure and compares them with the risk cover amount under the risk-bearing capacity approach. The liquidity risk is quantified on the basis of the liquidity position. The individual calculation methods are described in detail in the risk report in the chapters «Result of Risk-bearing Capacity Analysis» respectively «Liquidity Risk».

Other risk types that are considered material by the regular internal risk inventory, such as regulatory risk and risks that are not considered material are not quantified using risk models. These risks are managed and limited using regular, detailed reports and clear instructions, such as compliance and corporate governance rules.

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

1. Monitoring the risk-bearing capacity of pbb Group by comparing economic capital and the risk cover amount under the risk-bearing capacity approach. In addition, the risk-bearing capacity is managed in detail by using a limit system for risk cover potential and economic capital for different risk types or segments.
2. Monitoring and analysis of the risk-weighted assets (RWA) of pbb Group at the portfolio level by means of stress tests which are intended to ensure that the CET1 ratio does not fall below 9%.
3. Operational risk management via
   - the use of regulatory risk parameters in lending business of pbb Group. This management approach shows the average expected loss at the borrower level, and is therefore a major component for the early recognition of risks and ongoing profitability monitoring. The parameters are reviewed and recalibrated annually.
   - A limit system for counterparty and issuer risks on the basis of a standard application which has been tested in the market with a risk measurement method that is uniform throughout the Group.
   - Intensive monitoring and management of individual exposures.
   - Monitoring the risk of losses by way of appropriate impairment triggers in accordance with IAS 39.
4. Daily monitoring of market risk.
5. Daily monitoring of liquidity risk.
6. Monitoring of operational risk.

Economic Capital and Monitoring the Risk-bearing Capacity

In accordance with Section 25 a (1) KWG, credit institutions are obliged to set up appropriate and effective procedures in order to ensure that their risk-bearing capacity can be determined and assured in the long term. These procedures complement the regulatory procedures defined in the CRR, CRD IV. The Bank's own risk-bearing capacity calculation is subject of regulatory reviews («Supervisory Review and Evaluation Process», SREP).

pbb Group has implemented a risk-bearing capacity analysis based on the Internal Capital Adequacy Assessment Process (ICAAP). The Internal Capital Adequacy Assessment rests upon the concept of economic capital.

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 (the confidence level) over a time horizon of one year. In the first half of 2014, the methodology for quantifying the credit default risk for transactions undertaken during the year was developed further. In the second half of 2014 there has been an adjustment in the market risk model to improve the reflection of credit spread risks.

Alongside the classic risk types – market, credit, business and operational risk – the risk inventory identified property risk as material and quantifiable. As a result, five separate risk types have been included in the ICAAP and are backed by capital. In particular in terms of the credit risk, additional risks from the unexpected losses of commitments already in default and extensions to existing business were included in the risk assessment in the second quarter and backed with capital via additional buffers.

To verify the risk bearing capacity, pbb Group is initially using a going-concern approach as a primary management approach. This management approach is explicitly based on the assumption that business will continue and that the regulatory minimum capital ratios will be complied with; it ensures that pbb Group will comply with the required minimum capital ratios even after adverse economic scenarios and associated losses have occurred. The level of severity of this scenario is reflected in the fact that the calculation of the economic capital is based on a confidence level of 95%. To ensure that the risk bearing capacity in the going-concern approach is complied with, pbb Group has implemented a comprehensive early warning system, which indicates relevant warning signals at an early stage before the minimum ratios are reached.

Besides the above mentioned going-concern approach, pbb Group also implemented a gone-concern approach as an additional management approach. The objective of the gone-concern approach is to ensure protection of the prior-ranking creditors in a hypothetical liquidation scenario after incurring extreme losses. In the structure of the gone-concern perspective, in agreement with the regulatory requirements for risk bearing capacity approaches and in addition to the above-mentioned major risks, the perspective also takes account of credit spread risks arising from securities in the investment book for calculating the economic capital and deducts the hidden losses attributable to these securities for determining the risk covering potential. A confidence level of 99.91% is used for the gone-concern approach when calculating the economic capital.

In 2013, pbb Group reported a second gone-concern approach, the so-called strategic gone-concern approach aimed at managing the strategic portfolio. With the allocation of all the wind-down commitments to the «Value Portfolio» segment in 2014, the strategic portfolio and the wind-down portfolio can now be managed in a focused way by managing each segment within the above-mentioned Bank-wide gone-concern approach. For this reason, the strategic gone-concern approach was not continued with as a management approach.

The methods of calculating the economic capital for the individual risk types as well as current parameters are described in greater detail in the chapter «Result of Risk-bearing Capacity Analysis». No economic capital is calculated for the liquidity risk. This risk type is addressed and limited by a separate management approach.

In order to assess the adequate capitalisation of the capital backing of pbb Group in the relevant steering approach, the amount of economic capital is compared with the respective available financial resources. Under the leading going-concern scenario, for example, the available risk cover amount largely comprises the CET1 capital available over a period of at least one year, less the capital required to meet the regulatory minimum capital ratios, after adjustment for negative RWA trends. The remaining CET1 capital is suitable for absorbing potential losses and for maintaining a corresponding risk buffer. Under the gone-concern approach, both equity in accordance with the IFRS and subordinate items with a term of more than one year are used to determine the risk cover amount, less hidden liabilities relating to securities in the investment book. In order to verify the risk-bearing capacity, the economic capital must be completely covered by the available financial resources.

The results of the risk-bearing capacity analysis and of the stress tests are regularly presented to the central Management Board and the Group Risk Committee. The results are discussed there and if necessary management measures are defined.

Risk Types

pbb Group distinguishes the following major risk types for its business activities:
> Credit risk (Counterparty risk)
> Market risk
> Liquidity risk
> Operational risk (including Legal risk)
> Business risk (partial consideration within the scope of the risk-bearing capacity analysis)
> Property risk

The following are major risk types of pbb Group which are not quantified but which are limited by means of suitable reports, guidelines and policies:
> Strategic risks
> Regulatory risks

Credit Risk (Counterparty Risk)

Definitions

The counterparty risk in general is defined as the risk of an unexpected default or decline in the fair value of a receivable or a derivative, resulting from a deterioration in the hedging situation or deterioration in the creditworthiness of a country or a counterparty.

The counterparty risk comprises the credit risk, counterparty default risk, issuer risk, country risk, concentration risk, fulfilment risk and tenant risk which in the risk strategy of pbb Group are defined as follows:

> Credit risk is defined as the risk which considers loans and traditional credit products. A major factor determining the credit risk is the ability of the borrower to fulfil his financial obligations as well as the value of collateral in the case of a borrowers' default. Declines in the fair value as a result of rating changes are taken into consideration for calculating the credit risk.

> Counterparty default risk is defined as the risk of a potential unexpected default or decline in the fair value of a claim or a derivative. This is due to a deterioration in the creditworthiness of a counterparty or a deterioration of the hedging situation. The counterparty default risk includes the replacement risk and the repayment risk.

> Issuer risk is defined as the risk in relation to bonds and other securities. In particular, it refers to the ability of the issuer to meet his financial obligations and also relates to the value of collateral in the event of the default of an issuer. Declines in the fair value as a result of rating changes are taken into consideration for calculating the issuer risk.

> Country risk arises from changes in the values of international exposures due to country-specific political and economic conditions. It essentially comprises the risk that arises in connection with business activities in certain countries. The country risk includes the conversion risk, transfer risk and sovereign default risk.

> Concentration risk is defined as the risk of cluster formation in relation to a risk factor or counterparties, or a strongly correlated group of risk factors or counterparties.

> Fulfilment risk is defined as the risk that the Bank makes a payment or delivers an asset which has been sold to a counterparty but does not receive a payment or the purchased asset.

> Tenant risk describes the risk that losses in rental income for properties will negatively influence the respective borrowers' debt service capacity. In addition, it includes the secondary concentration risk (tenant cluster risk), which arises when one and the same tenant is involved in multiple properties funded by the bank.

Credit Risk Strategy and Principles

pbb Group has broken down the overall credit portfolio into the segments Real Estate Finance (REF), Public Investment Finance (PIF), Value Portfolio (VP) and «Consolidation & Adjustments». The strategic business is attributable to Real Estate Finance (REF) and Public Investment Finance (PIF). The risk strategy of pbb Group also reflects this structure.

New business in the REF segment largely focuses on Pfandbrief-eligible financing of commercial real estate with sustainable cash flow in selected European countries. The main target customers of these operations are professional investors, institutional clients, real estate funds or selected developers.

In the PIF segment, new business of pbb Group focuses on Pfandbrief-eligible financing of public investment financings in selected European countries.

New business is to be refinanced with matching maturities where possible, mainly using Pfandbrief issues.

Credit Risk Reports

The credit risk reports provide information about the following main components:

> The **HRE Group Risk Report** contains the development in volumes as well as relevant credit risk management indicators such as the development of the expected loss as well as the unexpected loss via value at risk (VaR). The report shows the credit risk at HRE level and also at the level of pbb Group in the context of the overall bank risk and the risk-bearing capacity, it reports limit utilisations and violations of existing limits, and also identifies risk concentrations. Key indicators, such as the development of the exposure at default (EaD), the expected loss (EL), the credit value at risk (Credit VaR) as well as problem loans are integrated in this report and are discussed by the Management Board; the report is also submitted to the Risk Management and Liquidity Strategy Committee (RLA) of the Supervisory Board to be noted.

> For decisions relating to new business and adjustments of terms, major parameters, contents and analyses are presented to the Credit Committee and discussed.

> In the active business, 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 are reported to a wider group up to the CRO by way of so-called «Credit Issue Notes».

Credit Risk Quantification via Economic Capital and Risk-weighted Assets according to Capital Requirements Regulation (CRR)

Credit Portfolio Model For calculating the economic credit risk capital (credit risk VaR) pbb Group uses a credit portfolio model which is described in greater detail in the section «Result of Risk-bearing Capacity Analysis».

Stress Tests The stress tests for economic capital in credit risk are described in greater detail in the section «Result of Risk-bearing Capacity Analysis».

In addition to the stress tests for economic capital, there are also RWA reverse stress tests. They investigate the extent to which a certain risk parameter (e.g. rating, loss-given default (LGD), currency) can change before the minimum core equity (CET1) of 9% is no longer met. Tolerance change levels have been defined for all tested risk parameters; these levels must not be violated if the test of pbb Group is to be successfully completed.

Credit Risk Quantification according to CRR The Basel III Framework Agreement of the Basel Committee was implemented in the European context by means of the Capital Requirements Regulation (CRR). pbb Group has received the regulatory approval to apply the so-called Advanced Internal Rating-Based Approach (Advanced IRBA) for determining the regulatory capital backing.

Credit Risk Management and Monitoring

Credit Risk Management At the portfolio level, the intended portfolio structure is defined in the risk strategy by means of structure components. The limits are also based on the available financial resources, and include for pbb Group for example:
> Limiting of country risks
> Definition of strategic risk parameters (e.g. regions, financing duration)

The following reports and measures are key elements for monitoring compliance with the defined limits and the intended risk and return parameters at the portfolio level and also at the level of individual transactions:
> Analysis of portfolio developments of HRE Group and therefore as well for pbb Group in the Group Risk Committee
> Determining the credit risk VaR at the portfolio level by way of a credit portfolio model and partly limiting at the segment level; analysis of concentration risks and various stress tests
> Central Group-wide monitoring of risk concentrations by way of special, regular and ad hoc evaluations, such as regional or product-specific evaluations
> Continuous analysis of the portfolio and the relevant markets by the local Credit Risk Management units
> Regular evaluation of the collateral
> Special reports for exposures which are potentially at risk (e.g. «credit issue notes»)
> Calculation of a risk-adjusted margin using a defined RaRoC for new business

The credit competences also define the decision-making powers of the individual credit risk managers for prolongations in existing business, depending on the counterparty group and expected loss class.

Credit Risk Management and Monitoring At the level of individual transactions, the credit process guidelines define the necessary steps of assessing risk for new business, prolongations as well as the procedures for transferring exposures to the watchlist or workout.

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

The CRM entities carry out the initial risk analysis for new business and annual risk analysis for existing business. Probability of default (PD) and loss given default (LGD) rating tools, which are developed by Credit Risk as part of Risk Management and Control (RMC) and annually validated and calibrated, are used for valuation purposes and for preparing the credit decision in new and prolongation business. Property Analysis & Valuation (PAV) provides support for analysing and valuing the securities.

The Legal department, where appropriate together with external lawyers/lawyers' offices, is responsible for the contract and collateral organisation.

Defined early warning indicators are constantly monitored by CRM. If any problems are identified, an exceptional test is performed on the credit default risk (including a review of the value of collateral) and appropriate alternative actions are identified. Such cases are also included in a monthly monitoring cycle and presented in the Group Watchlist Committee.

If there are any objective indications of an impairment, the extent of such an impairment is determined. In the Group Risk Provisioning Committee (see also overview for organisation and committees), the results are discussed and, where necessary, decisions are taken with regard to creating or reversing impairments.

A restructuring plan or a workout plan for critical and impaired exposures is drawn up. The decision regarding restructuring or workout takes account of scenario analyses for the potential development of the borrower, the collateral or the relevant market. These are presented and approved in the Group Credit Committee, if necessary.

Critical exposures (watchlist) as well as restructuring and workout cases (non-performing loans) are reported on an aggregate basis monthly in the Group Risk Report and in the Group Risk Committee and also, upon request, in special analyses to the Management Board and Supervisory Board.

Hedging and Minimising Risk by Collateral

In the REF segment, financing arrangements are normally backed by property charges. On the occasion of the regular credit reports for existing financing arrangements or as part of the decision-making process in the case of new financing, the LTVs (loan-to-value) as well as the property (micro and macro location, rental situation, condition of property) and market circumstances are regularly discussed and are also taken into consideration as part of the assessment process for individual loans. On average, the loss-given default (LGD) is 13% for real estate financing arrangements which have not defaulted (31 December 2013: 15%). For the entire real estate finance portfolio, the LGD average is 15% (31 December 2013: 16%). These improvements in the average parameter values are attributable, inter-alia, to improvements at the level of individual transactions (ongoing repayments, larger partial repayments), as well as the decrease in the volume of a non-performing loan, which tends to have a higher LGD than the performing portfolio.

In addition to the property charge, the financing security also generally comprises rent assignation and the assignation of insurance claims (in the respective form of the various jurisdictions), accompanied by extensive notification and consultation obligations of the borrowers. Apart from the property charges, only a few more selected securities are considered to be of value in the credit assessment process, and in particular this is applicable for cash security, bank guarantees as well as guarantees of public-sector institutions. Corresponding knock-downs are recognised in relation to foreign currency security in order to take account of potential exchange rate risks.

In the Real Estate Finance segment, the real estate is valued under the following quality aspects:

a) When the loan is initially granted:

- For all real estate security, an internal report (property report) is prepared in the course of the loan decision-making process, and an external appraisal is generally obtained (this is always the case outside Germany) – before the loan is paid out. The procedures ensure that two views of the property are taken into consideration in the decision-making process. The first view is external and focuses solely on the property (as a complete market and lending value appraisal). The second view is internal within the framework of the financing arrangement; it compares the property risks with the financing structure.
- All internally prepared reports and appraisals are consistent with the principle of dual control. At least one senior property analyst who is an MRICS (certified member subject to the supervision of the Royal Institution of Chartered Surveyors) and/or who has passed the HypZert examination (certification by HypZert GmbH as a real estate valuer for financial purposes) is responsible for the report or the appraisal.
- In case of external appraisals all fair values and mortage lending values are calculated or at least reviewed by a senior property analyst who has passed the HypZert (F) examination (certification as a real estate valuer for financial purposes), or outside of Germany, the HypZert (MLV) examination (certification as a real estate valuer for mortgage lending valuation).

> When an order is placed for external appraisals, the MRICS and/or HypZert qualifications are also required as minimum standards. Other appraisals or comments are not recognised.
> In addition, the choice of external service providers in the field of real estate valuation is subject to strict selection criteria which are constantly monitored by the Bank and which are demonstrably checked every year.
> Every externally engaged appraisal, which has to be prepared in line with the principle of dual control, is again checked by an internal senior appraisal expert with the above qualifications before the data are entered into the Bank's internal system.

b) During on-going monitoring by the property analysis department:
> As part of the credit monitoring process, the economic value of the security is generally reviewed annually; this includes an assessment of the main factors which influence the real estate value (rental income, market changes, changes in the building condition). In Germany, the initial assessment is performed by CRM. A standardised catalogue of questions for capturing individual property changes, indexed market values based on time series, which are designed to identify changes in the market, and a market volatility model that provides additional information on changes in regional real estate markets are available for monitoring purposes. If this initial assessment indicates an expected change in the market value, a Property Analysis and Valuation (PAV) employee conducts a more detailed assessment in a second step. In all other European countries, on an annual basis the PAV division directly performs the monitoring applying the quality standards for the second-level monitoring. The property analyst reviews the individual property characteristics on the basis of up-to-date documentation and takes any market changes since the last market value appraisal into account in his or her assessment. If necessary, the property is also inspected. This second stage of the assessment is used to confirm the previous market value. If there are indications that the various factors point to a change in market value, a revaluation is arranged immediately. Standard procedure is for the market values of properties with a market value of over €5 million and loans over €3 million to be reappraised at least every three years. Differences in the values or the security are recognised in the bank systems for risk assessment purposes.
> In the market value calculation process which takes place every three years, the quality standards which are applied are the same as those applied in the new business process. Again, the MRICS and/or HypZert qualifications are the minimum qualifications required for preparing appraisals or comments.

c) General:
> The procedures for ensuring the personal quality standards for the property analysts or engaged external appraisal experts in line with the prevailing regulations (HypZert/MRICS) is carried out by the respective monitoring authorities independently of the Bank; these processes are internationally recognised. Corresponding evidence is checked by the Bank.
> The process of engaging external services is carried out independently of the actual valuation management process in order to ensure maximum independence. Externally prepared appraisals or comments in which there is a suspicion that the person preparing the appraisal or comment might not be neutral are not recognised in any way and are also not used for the Bank's own internal purposes for the further process of preparing an appraisal.
> External appraisals are internally checked and are subject to quality assurance measures.
> Development financing arrangements are constantly monitored by our specialists (control of building status and costs). In addition, well-known external specialist companies are also involved in construction controlling (technical control, cost control) on an ad-hoc basis in the case of complex development financing.

In the PIF segment guarantees in particular are accepted as collateral (e.g. contractual guarantees from public authorities, export guarantees, etc.). Additionally, in Public Sector Finance there exist legal framework requirements, such as the maintenance obligation, which allow recourse on a public sector entity for borrowers organised under public law.

In Treasury, deposits and securities are made available or accepted as collateral when trading with other banks. The collateralisation is based on standard agreements, which can be amended in individual cases if required or which can be subjected to individual review by the legal department.

Credit Portfolio

The entire credit portfolio of pbb Group is calculated by using the Exposure at Default (EaD).

The 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. period of arrears 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.

As of 31 December 2014 the Group-wide credit portfolio EaD amounted to €65.5 billion (31 December 2013: €69.2 billion)[a]. It included assets not regarded as core exposure of pbb Group with an EaD of €0.3 billion (31 December 2013: €0.6 billion)[b] which were selected to be transferred to FMS Wertmanagement but which were not able to be transferred via the originally envisaged method as a result of various considerations, including considerations of tax law. In 2010, the credit risk of these assets was transferred by means of guarantees provided by FMS Wertmanagement, so that pbb Group ultimately retains a counterparty risk with regard to FMS Wertmanagement and thus indirectly with regard to BRD in connection with these positions.

To properly reflect the actual economic risk in pbb Group, the above-mentioned positions guaranteed by FMS Wertmanagement have been detailed merely for information purposes in the following overviews of the portfolio development and structure by means of footnotes.

Considering the above-mentioned restrictions, the EaD for the total exposure of pbb Group amounted to €65.2 billion as of 31 December 2014 (31 December 2013: €68.6 billion)[c].

[a] The figure stated in the text is a pro forma Basel III figure based on IFRS carrying amounts.
The corresponding Basel II EaD as of 31 December 2013 amounted to €67.5 billion.
[b] The previous year's comparative figure shown in the text reflects the carrying amount calculated according to Basel II as well as the pro forma calculated IFRS-based Basel III figure.
[c] The figure stated in the text is a pro forma Basel III figure based on IFRS carrying amounts.
The corresponding Basel II EaD as of 31 December 2013 amounted to €66.9 billion.

Overview of the Total Exposure of pbb Group: € 65.2 billion EaD The credit portfolio is broken down into the following segments
> Real Estate Finance (REF),
> Public Investment Finance (PIF)
> as well as the non-strategic segment Value Portfolio (VP) which is earmarked for being wound down.

In addition to the internal reconciliation and consolidation positions, «Consolidation & Adjustments» shows the EaD for transactions which are not directly attributable to the operating segments. These are basically asset positions for asset and liability management.

The former segment of Public Sector Finance was re-segmented at the beginning of 2014. The strategic Public Investment Finance is now managed as an independent segment, whilst the non-strategic portfolio of existing business in primarily non-earmarked financing to the public sector (budget financing) allocated to the former Public Sector Finance segment was allocated to the Value Portfolio segment. The Real Estate Finance segment and also Consolidation & Adjustments remained largely unaffected by the re-segmentation. A detailed explanation of the re-segmentation process can be found in the individual segment descriptions.

An additional change to the figures in comparison with the Annual Report 2013 is due to the implementation of Basel III and the conversion of the regulatory reporting system to IFRS at the beginning of 2014. Due to the effects associated therewith, the EaD increased from € 66.9 billion to € 68.6 billion as of the reporting date 31 December 2013. To allow for comparison of the figures, the Basel II figures as of 31 December 2013 are therefore included, taking the new segment structure into account, in the last column of the tables for information purposes. The first two columns and the indicated change relate to Basel III figures respectively.

As of 31 December 2014, 54 % (69 %) of the EaD in «Consolidation & Adjustments» was attributed to the rating classes AAA to AA– and 24 % (20 %) of the EaD was attributed to the rating classes A+ to A–. 22 % (11 %) of the EaD was in the rating classes BBB+ to BBB-. The figure for the EaD in BB+ and positions rated lower was below 0,05 %.

Total portfolio: EaD according to business segments in € billion	31.12.2014[1]	31.12.2013[2)3)]	Change	31.12.2013[4]
Real Estate Finance	24.3	22.2	2.1	22.5
Public Investment Finance	9.2	8.4	0.8	8.3
Value Portfolio	24.8	25.0	−0.2	23.7
Consolidation & Adjustments	6.9	13.0	−6.1	12.4
Total	**65.2**	**68.6**	−3.4	**66.9**

[1] In addition € 0.3 billion EaD with regard to the counterparty FMS Wertmanagement including guaranteed positions of € 0.3 billion (VP: € 0.3 billion)
[2] In addition € 0.6 billion EaD with regard to the counterparty FMS Wertmanagement including guaranteed positions of € 0.6 billion (C & A: € 0.01 billion; VP: € 0.6 billion)
[3] Pro forma Basel III figure based on IFRS carrying amounts
[4] EaD according to Basel II after re-segmentation

As of 31 December 2014 the total exposure at default (EaD) of pbb Group decreased compared to year-end 2013 by €3.4 billion to €65.2 billion. On the whole, the share of EaDs in the strategic segments Real Estate Finance (37%; 31 December 2013: 32%) and Public Investment Finance (14%: 31 December 2013: 12%) increased. The percentage share in the non-strategic Value Portfolio likewise increased slightly (38%; 31 December 2013: 36%), however, decreasing by €0.1 billion in absolute terms. The percentage attributable to EaDs in «Consolidation & Adjustments» decreased from 19% as of 31 December 2013 to 11% as of 31 December 2014.

Risk Parameters **Expected Loss** The expected loss (EL) for a time period of one year is calculated for the entire exposure, with the exception of non-performing loans for which a specific allowance has already been recognised. This is calculated from the annual probability of default (PD), the loss-given default (LGD) and the exposure at default (EaD) using the parameters defined under Basel III.

The expected loss for pbb Group amounted to €146 million as of 31 December 2014 (31 December 2013: €171 million). The decrease in the expected loss was, in the first instance, due to the creation of an allowance and the recovery of larger financing in the Real Estate Finance segment. The rating improvements in Italy, Portugal and Spain also reduced the expected loss.

The figure was split to the segments as follows:

Total exposure: expected loss according to business segments in € million	**31.12.2014**	**31.12.2013**[1]	Change	**31.12.2013**[2]
Real Estate Finance	120	137	−17	136
Public Investment Finance	3	4	−1	4
Value Portfolio	22	29	−7	28
Consolidation & Adjustments	1	1	–	1
Total	**146**	**171**	−25	**169**

[1] Pro forma Basel III figure based on IFRS carrying amounts
[2] EL according to Basel II after re-segmentation

It has to be stated that future changes, for instance in the economy, may result in changes in the EL figures stated above. This is a further reason why realised losses can differ from the expected losses.

Economic Credit Risk Capital The economic capital for credit risk is calculated with the credit portfolio model. It amounted to €219 million as of 31 December 2014 (31 December 2013: €237 million) in the going-concern approach thus considering a confidence level of 95% and a period of one year, disregarding diversification effects to other risk types. Details regarding the calculation are set out in the section «Result of Risk-bearing Capacity Analysis».

Regional Breakdown of the Portfolio At the reporting date, the main focus of the exposure of pbb Group was unchanged on Western Europe. Germany continued to account for most of the overall exposure, with 42% (€27.3 billion). The significant decline in EaD of €6 billion year-over-year in Germany was mainly in connection with the decline in the exposure in «Consolidation & Adjustments» followed by items due in the Value Portfolio segment. In contrast, the new business in the strategic segments of REF and PIF resulted in an increase in the EaD attributable to Germany in the amount of €1 billion. The main items in the category «Other Europe», which accounted for approximately 17% (€11.3 billion) of the overall portfolio, were Austria (€7.2 billion; 31 December 2013: €6.5 billion) and Sweden (€1.2 billion; 31 December 2013: €1.2 billion) followed by Belgium and Finland with €0.5 billion each (Belgium 31 December 2013: €0.5 billion; Finland 31 December 2013: €0.4 billion).

The year-over-year increase to €6.1 billion (31 December 2013: €4.9 billion) in the exposure in France is mainly due to new business. New business in the UK exceeded the items due, resulting in a net increase of €0.5 billion. In Spain, the EaD in the existing business increased due to fair value-related changes in the IFRS carrying amounts in connection with hedging relationships. In the «Other» category, consisting almost exclusively of bonds of supranational organisations, new bond purchases of supranational organisations in particular ensured an increase of €0.3 billion to €2.0 billion in EaD.

Compared with the previous year the absolute figure of the category «Emerging Markets» in accordance with the IMF definition remained stable and mainly comprised Poland with €2.2 billion (31 December 2013: €2.0 billion) and Hungary with €0.8 billion (31 December 2013: €0.8 billion).

Total portfolio: EaD according to regions

in € billion	31.12.2014[1]	31.12.2013[2][3]	Change	31.12.2013[4]
Germany	27.3	33.3	−6.0	32.8
Other Europe[5]	11.3	10.4	0.9	9.9
France	6.1	4.9	1.2	5.3
Spain	5.2	5.1	0.1	4.9
Great Britain	4.9	4.4	0.5	4.2
Italy	3.4	3.4	–	3.1
Emerging Markets[6]	3.0	3.0	–	2.9
Other	2.0	1.7	0.3	1.6
Portugal	1.4	1.4	–	1.4
Japan	0.4	0.4	–	0.3
USA	0.2	0.5	−0.3	0.4
Ireland[7]	–	0.1	−0.1	0.1
Total	**65.2**	**68.6**	−3.4	**66.9**

[1] In addition €0.3 billion EaD with regard to the counterparty FMS Wertmanagement including guaranteed positions of €0.3 billion. The guaranteed positions related to Germany (42%, €0.1 billion) and Italy (58%, €0.2 billion).
[2] In addition €0.6 billion EaD with regard to the counterparty FMS Wertmanagement including guaranteed positions of €0.6 billion. The figures without guaranteed positions were fully attributable to Germany (€0.01 billion), the guaranteed positions related to Germany (55%, €0.3 billion) and Italy (45%, €0.3 billion).
[3] Pro forma Basel III figure based on IFRS carrying amounts
[4] EaD according to Basel II after re-segmentation
[5] Comprises among others Austria, Belgium, Switzerland, Sweden, Denmark, Finland and the Netherlands
[6] Emerging Markets in accordance with the IMF definition
[7] As of 31 December 2014 the EaD in Ireland amounted to €0.002 billion.

Depending on the results of the internal rating process, maximum limits in certain rating ranges are defined for each individual country or groups of countries; these limit the business operations of pbb Group. All country ratings and country limits are reviewed at least once every year by Risk Management & Control.

Issuer Risk The bonds, borrowers' note loans and structured loans in the portfolio are broken down according to region for the purpose of classifying the EaD according to issuer risk. The EaD is attributed on the basis of the domicile of the issuer. The EaD according to issuer risk amounted to € 38.5 billion as of 31 December 2014, slightly above the comparative figure at year-end 2013 (€ 38 billion). Western Europe accounted for most of the exposure, whereby Germany accounted for the highest figure (€ 13.5 billion; 31 December 2013: € 14.8 billion).

The main country under «Other Europe» was Austria (€ 7.0 billion; 31 December 2013: € 6.4 billion), followed by Belgium with € 0.5 billion (31 December 2013: € 0.5 billion).

The largest decline in the portfolio in terms of the issuer risk broken down according to regions was seen in Germany, and is mainly due to the repayment of bonds which fell due or the repayment of borrowers' note loans (–€ 1.3 billion). The increase in the exposure in France to € 2.9 billion compared to year-end 2013 (31 December 2013: € 2.4 billion) is mainly due to new business in the PIF segment. In the «Other» category, consisting almost exclusively of bonds of supranational organisations, new bond purchases of supranational organisations in particular ensured an increase in EaD.

With regard to the breakdown of issuer risk according to segments, the Value Portfolio segment accounted for 64% of the EaD at the end of 2014 (December 2013: 65%), the Public Sector Finance segment accounted for 23% (December 2013: 21%) and Consolidation & Adjustments for 13% (December 2013: 14%).

Total portfolio: issuer risk according to regions

in € billion	31.12.2014[1]	31.12.2013[2)3)]	Change	31.12.2013[4]
Germany	13.5	14.8	– 1.3	14.2
Other Europe[5]	8.5	7.9	0.6	7.2
Spain	4.8	4.6	0.2	4.4
Italy	3.3	3.2	0.1	2.9
France	2.9	2.4	0.5	2.7
Other	2.0	1.6	0.4	1.6
Portugal	1.4	1.4	–	1.4
Emerging Markets[6]	1.2	1.2	–	1.1
Great Britain	0.6	0.6	–	0.3
Japan	0.3	0.3	–	0.2
Total	**38.5**	**38.0**	0.5	**36.0**

1) In addition € 0.3 billion EaD with regard to the counterparty FMS Wertmanagement representing guaranteed positions which related to Italy (58%) and Germany (42%).
2) In addition € 0.3 billion EaD with regard to the counterparty FMS Wertmanagement representing guaranteed positions which were fully attributable to Germany
3) Pro forma Basel III figure based on IFRS carrying amounts
4) EaD according to Basel II after re-segmentation
5) Comprises among others Austria, Belgium, Switzerland, Sweden, Denmark, Finland and the Netherlands
6) Emerging Markets in accordance with the IMF definition

Real Estate Finance: € 24.3 billion EaD Portfolio Development and Structure The EaD of the Real Estate Finance portfolio of pbb Group increased by a total of € 2.1 billion compared with 31 December 2013. The customer derivatives included in the portfolio reported an EaD of € 0.5 billion as of 31 December 2014 compared with an EaD of € 0.4 billion at the end of 2013.

Whereas the absolute figures for France, Germany, «Other Europe» (here in particular Sweden and Slovakia) and Great Britain increased compared with the previous year's reference date, there was a decline in the absolute figure for Japan, Italy and Spain. The exposure in Emerging Markets remained stable in terms of exposure amounts.

Real Estate Finance: EaD according to regions[1]

in € billion	31.12.2014[2]	31.12.2013[3][4]	Change	31.12.2013[5]
Germany	12.5	12.0	0.5	12.1
Great Britain	4.2	3.5	0.7	3.6
France	2.7	1.8	0.9	1.8
Other Europe[6]	2.7	2.4	0.3	2.4
Emerging Markets[7]	1.8	1.8	–	1.8
Spain	0.4	0.5	–0.1	0.5
Italy[8]	–	0.1	–0.1	0.2
Japan[9]	–	0.1	–0.1	0.1
Portugal[10]	–	–	–	–
Total	**24.3**	**22.2**	2.1	**22.5**

[1] In the Real Estate Finance segment, there was no exposure to the counterparty FMS Wertmanagement.
[2] Breakdown including custumer derivatives of approx. € 0.5 billion
[3] Pro forma Basel III figure based on IFRS carrying amounts
[4] Breakdown including customer derivatives of approx. € 0.4 billion
[5] EaD according to Basel II after re-segmentation
[6] Comprises among others Austria, Switzerland, Sweden, Finland and the Netherlands
[7] Emerging Markets in accordance with the IMF definition
[8] The EaD in Italy in the Real Estate Finance segment amounted to € 0.02 billion as of 31 December 2014
[9] The EaD in Japan in the Real Estate Finance segment amounted to € 0.03 billion as of 31 December 2014
[10] In Portugal, € 0.03 billion EaD in the Real Estate Finance segment as of 31 December 2014 and also as of 31 December 2013 according to Basel III and Basel II

The breakdown of the portfolio by property type as at 31 December 2014 changed only slightly as against year-end 2013. The main items were the property types «Office buildings» with € 7.2 billion EaD or 30 % of the overall REF portfolio (31 December 2013: € 6.9 billion or 31 %) and «Retail» with € 6.7 billion EaD or 28 % of the REF portfolio (31 December 2013: € 6.2 billion or 28 %). The percentage of the financing of properties with residential use was slightly below the percentage as at year-end 2013 (22 %). Worth mentioning is also the almost unchanged percentage of 9 % of the property type «Logistics/Storage» (31 December 2013: 8 %) in the REF portfolio as well as the increase in mixed-use properties in the «Mixed Use» category of 5 % as of 31 December 2013 to 7 % as of 31 December 2014.

Real Estate Finance: EaD according to property type[1] in € billion	**31.12.2014**	**31.12.2013**[2]	Change	**31.12.2013**[3]
Office buildings	7.2	6.9	0.3	7.0
Retail	6.7	6.2	0.5	6.2
Housing construction	4.7	4.9	−0.2	4.9
Logistics/storage	2.3	1.7	0.6	1.8
Mixed use	1.6	1.0	0.6	1.0
Other	1.2	1.2	–	1.2
Hotel/leisure	0.6	0.3	0.3	0.4
Total	**24.3**	**22.2**	2.1	**22.5**

[1] In the Real Estate Finance segment, there was no exposure to the counterparty FMS Wertmanagement.
[2] Pro forma Basel III figure based on IFRS carrying amounts
[3] EaD according to Basel II after re-segmentation

At the end of the year 2014 the portfolio was still dominated by investment financing (89%; 31 December 2013: 92%). Higher risk construction projects in the building phase (construction financing) only accounted for 8% of the EaD (31 December 2013: 5%). Real Estate Finance for which the capital is serviced mainly out of the current property cash flow is shown under investment financing.

Real Estate Finance: EaD according to loan type[1] in € billion	**31.12.2014**	**31.12.2013**[2]	Change	**31.12.2013**[3][4]
Investment financing	21.7	20.4	1.2	20.6
Construction financing	2.0	1.2	0.8	1.2
Customer derivatives	0.5	0.4	0.1	0.4
Other	0.1	0.2	–	0.2
Total	**24.3**	**22.2**	2.1	**22.5**

[1] In the Real Estate Finance segment, there was no exposure to the counterparty FMS Wertmanagement.
[2] Pro forma Basel III figure based on IFRS carrying amounts
[3] EaD according to Basel II after re-segmentation
[4] Rounding difference

Risk Parameters Using the parameters defined under Basel III, the expected loss for the Real Estate Finance portfolio was € 120 million as of 31 December 2014 (31 December 2013: € 137 million). Seen in isolation, default in larger financing initially increased the expected loss. However, the expected loss decreased when looking at the Real Estate portfolio as a whole. The reasons for this were a newly created allowance and the recovery in larger financing.

Public Investment Finance: € 9.2 billion EaD Portfolio Development and Structure The portfolio of the former Public Sector Finance (PSF) operating segment was reorganised in the context of the re-segmentation process. The strategic part of the former PSF segment is now recognised in the Public Investment Finance (PIF) segment and amounted to € 9.2 billion as of 31 December 2014 (31 December 2013: € 8.4 billion). The non-strategic and wind-down portfolio in the context of budget financing was transferred to the Value Portfolio segment. The Basel II figures as of 31 December 2013 are included in the last column of the tables for information purposes taking into account the new segment structure.

The EaD in the Public Investment Finance segment increased by € 0.8 billion year-over year in particular due to new business in Germany and France.

Most of the exposure was reported for Western Europe with an emphasis on Germany, France and Italy. The percentage of the countries in this segment portfolio remained largely stable. As in the previous year, the major part of «Other Europe» was constituted by Austria and Belgium with € 0.3 billion (31 December 2013: € 0.3 billion) respectively. The increase in Germany and France is due to new business. The «Other» category includes almost exclusively exposures in respect of supranational organisations.

Public Investment Finance: EaD according to regions[1] in € billion	**31.12.2014**	**31.12.2013**[2]	Change	**31.12.2013**[3]
Germany	2.5	2.0	0.5	2.2
France	2.2	1.7	0.5	1.7
Spain	2.1	2.1	–	2.0
Italy	1.4	1.6	−0.2	1.5
Other Europe[4]	0.8	0.8	–	0.8
Other	0.1	0.1	–	0.1
Great Britain	0.1	0.1	–	–
Total	**9.2**	**8.4**	0.8	**8.3**

[1] In the Public Investment Finance segment, there was no exposure to the counterparty FMS Wertmanagement.
[2] Pro forma Basel III figure based on IFRS carrying amounts
[3] EaD according to Basel II after re-segmentation
[4] Comprises among others Austria, Belgium, Finland and Sweden

The position «Public Sector Borrowers» included receivables due from sovereigns (14 %), public sector enterprises (28 %) and municipalities (58 %).

Public Investment Finance: EaD according to counterparty structure[1] in € billion	**31.12.2014**	**31.12.2013**[2]	Change	**31.12.2013**[3]
Public sector borrowers	7.5	6.7	0.8	6.6
State-regulated companies[4]	1.7	1.7	–	1.7
Financial institutions[5]/insurance companies	–	–	–	–
Total	**9.2**	**8.4**	0.8	**8.3**

[1] In the Public Sector Finance segment, there was no exposure to the counterparty FMS Wertmanagement.
[2] Pro forma Basel III figure based on IFRS carrying amounts
[3] EaD according to Basel II after re-segmentation
[4] Water utilities, power supply utilities, etc.
[5] Financial institutions with a state background or state guarantee

The portfolio comprises the following financing:

(I) Financing concluded directly with a public sector debtor, eligible according to the German Pfandbrief Act, on the basis of a specific earmarking according to a defined product catalogue;

(II) Financing of companies, which have a public sector or private legal structure and funding, which are collateralised with a public sector guarantee within the meaning of the German Pfandbrief Act (transport and utility companies, municipal utilities, special-purpose associations, management companies, non-profits, associations); and

(III) Financing of special-purpose vehicles, which are collateralised with a public sector guarantee within the meaning of the German Pfandbrief Act.

The percentage of the EaD in the PIF segment attributed to the AAA to AA– rating classes increased by 12 percentage points to 43% compared with the previous year, inter alia due to new business concluded. The rating classes A+ to A– accounted for 31% of the EaD (31 December 2013: 23%). The relative percentage of the EaD in BBB+ and positions rated lower decreased commensurately by 19 percentage points to 26% year-over-year.

Public Investment Finance: EaD according to internal ratings[1] in € billion	**31.12.2014**	**31.12.2013**[2]	Change	**31.12.2013**[3]
AAA to AA–	3.9	2.6	1.3	2.7
A+ to A–	2.9	2.0	0.9	2.0
BBB+ to BBB–	2.1	3.5	–1.4	3.3
BB+ and worse	0.3	0.3	–	0.3
Total	**9.2**	**8.4**	0.8	**8.3**

[1] In the Public Sector Finance segment, there was no exposure to the counterparty FMS Wertmanagement.
[2] Pro forma Basel III figure based on IFRS carrying amounts
[3] EaD according to Basel II after re-segmentation

Risk Parameters The expected loss for the portfolio of the Public Investment Finance segment was €3 million (31 December 2013: €4 million). The decline was due to improvements in the ratings of Italy and Spain.

Value Portfolio: € 24.8 billion EaD Portfolio Development and Structure The Value Portfolio comprises non-strategic portfolios of pbb Group. At the beginning of 2014, the portfolio was re-segmented, in the context of which the non-strategic part of the former Public Sector Finance segment was transferred to the Value Portfolio in order to clearly separate the segments existing at the time into strategic and non-strategic segments. The Basel II figures as of 31 December 2013 are included in the last column of the tables for information purposes taking into account the new segment structure.

In conformity with this strategy, the further decrease in the exposure as of 31 December 2014 compared with 31 December 2013 was mainly due to reductions in Germany, with Germany remaining the focus in the portfolio. The exposure increases observed, particularly in «Other Europe» and Italy, are due to fair value-related changes in the IFRS carrying amounts that the EaD is based on due to hedging relationships. Austria accounted for the largest item in the «Other Europe» category with € 6.7 billion.

Value Portfolio: EaD according to regions

in € billion	31.12.2014[1]	31.12.2013[2)3)]	Change	31.12.2013[4]
Germany	8.8	10.1	−1.3	9.5
Other Europe[5]	7.4	6.8	0.6	6.2
Spain	1.9	1.8	0.1	1.7
Italy	1.8	1.5	0.3	1.4
Portugal	1.4	1.4	–	1.4
Emerging Markets	1.2	1.2	–	1.1
Other	1.1	1.1	–	1.0
France	0.9	0.8	0.1	1.1
Japan	0.3	0.3	–	0.3
Great Britain[6]	–	–	–	–
Ireland[7]	–	–	–	–
USA[8]	–	–	–	–
Total	**24.8**	**25.0**	−0.2	**23.7**

1) In addition € 0.3 billion EaD with regard to the counterparty FMS Wertmanagement, which were fully guaranteed; the guaranteed positions related to Germany (42%) and Italy (58%)
2) In addition € 0.6 billion EaD with regard to the counterparty FMS Wertmanagement, which were fully guaranteed; the guaranteed positions related to Germany (55%) and Italy (45%)
3) Pro forma Basel III figure based on IFRS carrying amounts
4) EaD according to Basel II after re-segmentation
5) Comprises among others Austria, Slovenia, Belgium, Switzerland and the Netherlands
6) As of 31 December 2013 the EaD in Great Britain amounted to € 0.0004 billion EaD according to Basel III
7) As of 31 December 2013 the EaD in Ireland amounted to € 0.004 billion EaD according to Basel III
8) As of 31 December 2013 the EaD in the USA amounted to € 0.002 billion EaD according to Basel III and € 0.003 billion EaD according to Basel II

Value Portfolio: EaD according to counterparty structure in € billion	31.12.2014[1]	31.12.2013[2)3)]	Change	31.12.2013[4]
Public sector borrowers	19.2	17.7	1.5	16.8
Financial institutions/insurance companies	4.8	6.0	–1.2	5.7
Companies/Project Financing	0.8	1.3	–0.5	1.2
Total	**24.8**	**25.0**	–0.2	**23.7**

[1] In addition € 0.3 billion EaD with regard to the counterparty FMS Wertmanagement, which were fully guaranteed; the guaranteed positions related to Germany (42%) and Italy (58%)
[2] In addition € 0.6 billion EaD with regard to the counterparty FMS Wertmanagement, which were fully guaranteed; the guaranteed positions related to Germany (55%) and Italy (45%)
[3] Pro forma Basel III figure based on IFRS carrying amounts
[4] EaD according to Basel II after re-segmentation

Risk Parameters The expected loss for the value portfolio amounted to € 22 million as of 31 December 2014 using the parameters defined under Basel III (31 December 2013: € 29 million). The decline of the expected loss was due to improvements in the ratings of Italy and Portugal.

Structured Products

pbb Group's residual holdings in fully state-guaranteed collateralised debt obligations had a notional value of € 0.7 billion as of 31 December 2014 (31 December 2013: € 0.7 billion) and an actual fair value of € 0.7 billion (31 December 2013: € 0.7 billion).

The residual holdings of pbb Group of non-state-guaranteed structured securities, namely credit-linked investments in the form of collateralised debt obligations (CDOs in the narrower sense of the term), remained stable in comparison with the end of the year 2013 with a notional value of € 0.1 billion. The fair value of these securities which were almost completely written down and securitise credit risks amounted to € 3 million as of 31 December 2014 (31 December 2013: € 4 million).

The valuation of assets was essentially based on market values.

Consolidated Special-purpose Vehicle without Capital Share in pbb Group

As of the reporting date 31 December 2014, there were no consolidated special-purpose vehicles without capital share which require consolidation in accordance with IFRS 10 (31 December 2013: none).

Watchlist and Non-performing Loans

Early Warning System The early warning system of pbb Group has defined triggers (=criteria) for including loans in the watchlist and for being classified as workout loans (e.g. past due payments, failure to meet covenants – e.g. loan-to-value (LTV), interest service coverage [ISC]). The system constantly monitors whether a trigger has been set off. In the event of any problems being identified, the counterparty is analysed and, where appropriate, promptly transferred to restructuring or workout loans. Watchlist and non-performing loans (restructuring and workout loans) are defined as follows:

> Watchlist Loans Payments past due by more than 60 days or another defined early warning signal is triggered.
> Restructuring Loans Payments past due by more than 90 days or another defined early warning signal is triggered.
> Workout Loans There are no indications that the loan can be restructured. Enforcement measures have been/will be introduced, respectively specific allowances have been created or are planned.

Non-performing loan processing is also responsible for carrying out an impairment test in line with the relevant accounting regulations.

Development of Watchlist and Non-performing Loans of pbb Group

Watchlist and non-performing loans of pbb Group				31.12.2014[1]				31.12.2013[2)3)] (Pro forma Basel III figure)		31.12.2013[2)4)] (Basel II)
EaD in € million	REF	PIF	VP	Total	REF	PIF	VP	Total	Change	Total
Workout loans	9	–	–	9	6	–	–	6	3	6
Restructuring loans	818	–	316	1,134	933	–	2	935	199	934
Non-performing loans	**827**	**–**	**316**	**1,143**	**939**	**–**	**2**	**941**	202	**940**
Watchlist loans	**116**	**–**	**244**	**360**	**141**	**–**	**475**	**616**	−256	**596**
Total	**943**	**–**	**560**	**1,503**	**1,080**	**–**	**477**	**1,557**	−54	**1,536**

1) In addition €1 million EaD as of 31 December 2014 in «Consolidations & Adjustments»
2) In addition €6 million EaD as of 31 December 2013 in «Consolidations & Adjustments»
3) Pro forma Basel III figure based on IFRS carrying amounts
4) EaD according to Basel II after re-segmentation

The watchlist and non-performing loans decreased by a total of €54 million net.

In 2014, the watchlist loans decreased by €260 million (gross)[a)] or €256 million (net). The decrease was almost exclusively due to an improvement in the risk situation for these loans and the associated returns to standard processing. The sharp decline in the Value Portfolio segment amounting to €231 million was wholly due to the upgrade of a Spanish bank in the first quarter of 2014. In addition, two cases from the REF segment amounting to a total of €29 million were transferred back to standard processing. The total volume of new additions remained comparatively low at €4 million.

a) Excluding opposite effects

The non-performing loans decreased by € 315 million (gross)[a] and increased by € 202 million (net). In the Real Estate Finance segment, loans totalling € 249 million were successfully restructured or repaid. Two property-financings with an attributable financing volume of € 66 million were taken over to the Bank's own holdings. In non-performing loans support, commitments with a volume totalling € 507 million had to be transferred; the main driver for the increase was the Heta exposure in the Value Portfolio amounting to an effective € 314 million, which was transferred to restructuring in the course of the revaluations. A further € 193 million came from the REF segment with approximately 72% of the balances being due to two larger cases. The balance increases in portfolios, inter alia also due to fluctuations in the exchange rate, amounted to € 11 million.

Impairments and Provisions

Specific Allowances and Portfolio-based Allowances All financial assets which are not evaluated at fair value through profit or loss are subject to a regular impairment test. An assessment is first made to determine whether there is an objective indication of an impairment. The extent of any such impairment is then calculated as the difference between the carrying amount, at AfS assets (AfS = available for sale) plus AfS reserve, and the present value of the cash flows expected in future.

Portfolio-based allowances are calculated using risk parameters which are compliant with Basel III, 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 in the pbb.

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.

The specific allowances are approved in the Group Risk Provisioning Committee.

Risk Provisioning of pbb Group An overview of the development in provisions for losses on loans and advances and provisions is set out in the notes.

Coverage for Non-performing Loans[b]

The coverage ratio is defined as the ratio between the provisions created in relation to the non-performing exposures (including the residual volume of structured products as part of the Value Portfolio) and the EaD or, with regard to structured products and securities, the nominal amount.

As of 31 December 2014, the non-performing loans of pbb Group were covered at 30% (31 December 2013: 32%). The deterioration is primarily due to the relatively large increase in the volume of non-performing loans compared to allowances.

[a] Excluding opposite effects
[b] The amounts are recognised based on the prudential scope of consolidation. Included in the amount is a loan to a subsidiary to be consolidated in accordance with IFRS, which is not included in the consolidation for banking supervisory purposes. Not included are synthetically securitised parts of a loan. The previous year shown was adjusted to the new computational logic.

The non-performing loans in the REF segment were covered at 24% (31 December 2013: 25%). As of 31 December 2014, the PIF segment had no non-performing loans, as in the previous year. The coverage ratio in Value Portfolio amounted to 37% (31 December 2013: 96%). The year-over-year decline related to revaluations for the non-strategic exposure to Heta Asset Resolution AG (Heta).

Taking into account collateral provided, the coverage ratios amounted to approximately 100%.

Opportunities

The parameters for the risk dimensions for the credit risk are defined using statistical methods on the basis of numerous historical observations. The risk measures also depend on assumptions relating to future developments of macro-economic factors as well as developments on the credit markets. It is in the nature of things and is also in line with historical experience that there is a certain probability that such economic conditions perform more positively than originally assumed and that the potential losses arising from the credit risk therefore tend to be less than originally quantified by the risk measures. Such potentially positive developments then represent opportunities for pbb Group which can be utilised for reducing risk.

In specific terms, there are opportunities if fewer loans in future are affected by a default in performance than had originally been assumed as part of the risk quantification process.

There are also opportunities if there are in future fewer migrations to less positive rating categories than originally assumed.

There are also opportunities if the loss ratios of non-performing loans in future are lower than was originally assumed as part of the risk quantification process. Lower loss ratios may be triggered by various positive developments. Firstly, it is possible that the process of disposing of securities might generate higher proceeds than was originally assumed in the risk quantification process. Secondly, it is possible that a higher percentage of non-performing loans subsequently become performing loans again without any losses than had been the case in the past.

In addition to positive developments in terms of default rates and loss ratios, there are also opportunities in the context of the credit risk if the exposure values decline in the portfolio. This can for instance be the case if borrowers redeem or repay their loans more quickly than would have been expected on the basis of contractual agreements or on the basis of past experience. Exposure values can decline in the derivative portfolio if changes in certain market parameters, such as interest rates or exchange rates, mean that there is a decline in the market values of those positions which are associated with a replacement risk.

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 pbb Group are mainly exposed to the following risk types:
> Credit spread risk (risk from changes in credit spreads)
> General interest rate risk (risk from changes in general market interest rates)
> Inflation risk (risk from changes in inflation indices)
> Foreign currency risk (risk from changes in foreign exchange rates)
> Basis risk (risk from changes in basis spreads)
> Concentration risk (risk of additional losses due to one-sided portfolio mix; accounted for by using correlations between risk factors when determining value at risk)

Market Risk Strategy

pbb Group follows the following fundamental principles in relation to market risks:
> Transactions may be conducted only in financial instruments which must have successfully passed through the new product process and which are measured independently via a model or for which market prices are observable.
> All entered transactions are subject to daily income statement and risk monitoring by Risk Management & Control

Organisation of Market Risk Management

The transactions are monitored by Risk Management & Control which is separated from trading in the structure organisation right through to the level of the management.

Market Risk Reports

Risk Management & Control daily prepares extensive market risk reports for various recipients:
> The daily market risk report is addressed particularly to the Management Board of pbb. It shows market risk value at risks (VaR), limit utilisations and economic performance figures on all levels of the portfolio structure
> Daily sensitivity reports comprise analyses for the main risk factors at various levels. They are also made available to the Management Board.

Measurement and Limiting of Market Risk

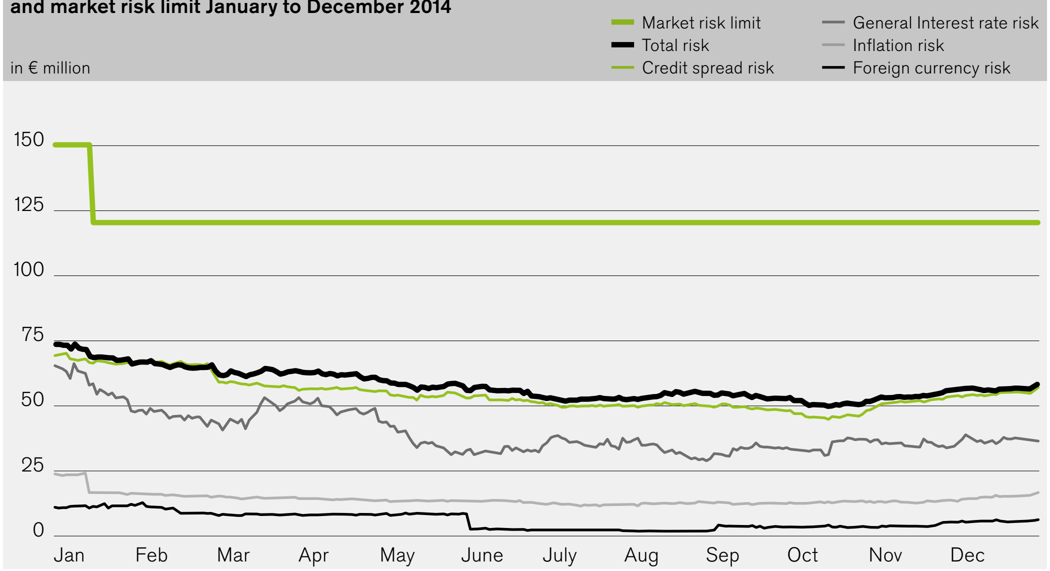
Market Risk Value at Risk Risk Management & Control uses a variance-covariance approach to calculate the market risk VaR at the overall and sub-portfolio level on a daily basis. All positions are taken into account, whereby the credit spread VaR from positions which are included in the IFRS category Loans & Receivables is not taken into consideration within market risk, but in credit risk.
> The correlations and volatilities which are used are based on historical time series of the previous 250 trading days, that are included in the calculation on an equally weighted basis.
> The historically observed correlations are used when the individual market risk components are aggregated to an overall VaR, which constitutes the basis for the limit monitoring.

> For the daily operational risk management, the VaR relates to a holding period of ten days and a one-sided 99% confidence interval.

On 31 December 2014 the market risk VaR amounted to € 57 million taking into consideration diversification effects between the individual types of market risk. The comparison figure as of 31 December 2013 was € 74 million. In the period under review there were no market risk VaR limit violations at pbb Group level. The pbb market risk limit was reduced from €150 million to €120 million on 15 January 2014.

In 2014 the development in the market risk VaR was mainly affected by the change in credit spread volatilities. 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 January to December 2014



The VaR assessment is complemented by further instruments such as sensitivity analyses, back testing as well as stress testing.

Sensitivity Analyses Overnight yield curves were used in the measurement relevant to the sensitivity analysis. 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 cannot be used as a measure for a potentially maximum loss, stress scenarios show the market risk under extreme conditions. At pbb Group hypothetical stress scenarios are calculated on a monthly basis for major key risk drivers. Here, the effects of extreme fluctuations in yield curves, foreign exchange rates, credit spreads, inflation rates and volatilities on the economic present value of ppb Group's portfolio as a whole are determined. In addition historical stress scenarios are simulated. A parallel shift required by supervisory authorities of 200 basis points upwards in the interest rate curve for all positions of pbb Group would have resulted in a loss of approximately € 509 million as of 31 December 2014 (year-end 2013: € 452 million). An opposite parallel shift of 200 basis points downwards in the interest rate curve would have resulted in a market value gain of € 245 million (year-end 2013: € 307 million). The asymmetrical relationship between the potential gain or loss primarily reflects the fact that the shift of 200 basis points described above is only performed at a maximum up to an interest rate of 0%. An extreme rise in the relevant credit spreads as of 31 December 2014 would result in a loss in market value of € 455 million. The Management Board and the corresponding executive bodies are regularly notified of the results of the stess test scenarios.

Back Testing The quality of the methods used to measure risk is continually reviewed and, where necessary, optimised on the basis of the daily comparison between the VaR figures and the subsequent actual changes in the present value of the portfolio. pbb Group has adopted the Basel Capital Accord's traffic light system for the quantitative analysis of its risk model. This counts the number of statistical (negative) outliers detected in backtesting within a period of 250 trading days. Overall, four outlier were observed in 2014, which were mainly attributable to unusually strong credit spread and exchange rate movements. pbb's risk model therefore achieved a traffic light rating of «green» under the Basel Capital Accord's traffic light system.

Economic Market Risk Capital For calculating the economic market risk capital, the market risk VaR for the going-concern approach is calculated for a period of one year and for a confidence level of 95%. The economic capital for market risks of pbb Group, disregarding diversification effects for other risk types, amounted to € 256 million as of 31 December 2014 (31 December 2013: € 185 million).

Reflection and Recognition of Economic Hedges as On-balance-sheet Hedges

Hedge accounting is defined as the special accounting regulations for hedges of IAS 39, the aim of which is to ensure that the changes in value of the hedged underlyings and hedging instruments cancel each other out to a large extent. The criteria of IAS 39 must be satisfied for the on-balance-sheet recognition of hedges. These criteria, such as the requirements relating to the effectiveness of a hedge, are to a certain extent not consistent with the methods used in bank management. There may therefore be differences between the economic hedges and the on-balance-sheet hedges.

Market Risk Management, Monitoring and Reduction

pbb Group uses a three-pillar approach for managing and monitoring the market risk:
> Management of the position in Treasury
> 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 positions market risk is monitored by a combination of value-at-risk (VaR) limits and monitoring of sensitivities by trade-independent Risk Management & Control.

General Interest Rate Risk The general interest rate risk amounted to € 36 million as at 31 December 2014 and was therefore significantly below the figure as at 31 December 2013 (€ 65 million). The average interest rate risk in 2014 was € 39 million (maximum € 66 million, minimum € 28 million). In the previous year, the interest rate risk averaged € 25 million (maximum € 68 million, minimum € 2 million). Excluding the capital investment book, the general interest rate risk remained low throughout 2014.

As in the previous year, non-linear interest rate risks from capital market transactions were negligible (year-end 2014: €0.049 million; year-end 2013: €0.4 million).

Credit Spread Risk The credit spread risk shows the potential change in the present value of exposures as a result of changes to the corresponding credit spread. Most of the credit spread risk was attributable to assets eligible as cover for Pfandbriefe. The Bank has risk measurement systems for calculating credit spread risk for all relevant exposures. Subject to VaR limitation are only the credit spread risks of AfS and dFVTPL stocks but not the LaR positions.

The credit spread VaR for the AfS and dFVTPL portfolios at the end of December 2014 declined year-on-year to €56 million, mainly as a result of lower credit spread volatility (year-end 2013: €69 million).

Other Market Risks The present value of the foreign currency risk was €5 million as at 31 December 2014, while inflation risks were €16 million as at 31 December 2014. OIS, tenor, cross-currency spread and Libor-Euribor basis risks were quantified and recognised as basis risks in the context of the VaR model. All the basis risks are included in the total VaR and are therefore subject to market risk limitation. The Bank is not exposed to share price or commodity risk. Financial derivatives are mainly used for hedging purposes.

Opportunities

As detailed above, the sensitivities result in a VaR, i.e. a possible future (economic) loss in the event of an unfavourable market development. It has to be mentioned that these sensitivities may also result in economic gains in the event of a positive market development. Accordingly, as described above high negative credit spread sensitivities arise which pose a risk. In the event of a reduction of the relevant credit spreads, these credit spread sensitivities result in economic profits, which again constitute an opportunity. Within the framework of the stress scenarios of pbb Group required by the supervisory authorities, e.g. a parallel shift of 200 basis points downwards in the interest rate curve (with a floor of 0%) would comprise the opportunity for a market value gain of €245 million.

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.

Liquidity Risk Strategy

The liquidity risk strategy is a key component of the risk strategy of pbb Group and is broken down into various modules. This ensures that the short- as well as the mid-term funding of pbb Group is monitored and controlled by means of a limit system. The limits are defined as part of the annual business planning process.

Organisation of Liquidity Risk Management

Risk Management & Control identifies, measures, reports and monitors the liquidity risk of pbb Group. Management of liquidity risk is the responsibility of the Treasury department of pbb Group which is independent of Risk Management & Control. The processes and methods which are used are regularly reviewed by the Group Risk Committee and the Group Asset and Liability Committee of HRE, both of which also act on behalf of pbb Group. Liquidity Risk cannot be calculated and reported by business segments.

Liquidity Risk Report

The liquidity management reports are prepared daily and reported to the entire Management Board as well as to the Deutsche Bundesbank and to the Bundesanstalt für Finanzdienstleistungsaufsicht. 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 liquidity risks. Contractual cash flows as well as optional cash flows are recognised. These data are regularly subject to back testing.

The liquidity position resulting from the liquidity reserve as well as contractual and optional cash flows is measured in different scenarios. In this context different liquidity positions are calculated on a daily basis. The three liquidity positions assume:
> Constant market and refinancing conditions (base scenario)
> Risk scenario (modified [historic] stress scenario)
> Liquidity stress ([historic] stress scenario).

In the risk and (historic) stress scenario, possible customer behaviour is for instance simulated in «stress situations». Historical time series are used to calculate 95% and 99% quantiles.

For the liquidity risk, a limit for a period of 12 months respectively 24 months has been defined for the base scenario. The limits in the risk and [historic] stress scenarios apply for a period of six months.

The limit system consists of:
> Limit relating to the liquidity stress profile for pbb Group (risk scenario and (historic) stress scenario) and trigger for the base scenario

In addition to reporting, pbb Group uses stress tests for investigating the effect of additional stress events on the liquidity position; these stress tests are conducted at regular intervals.

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

The scenarios are reported to the Management Board of Deutsche Pfandbriefbank AG as well as to external bodies, e.g. Deutsche Bundesbank.

Liquidity Risk Monitoring and Management

Monitoring of the liquidity risks is assured by the daily reporting of the liquidity situation and a defined escalation process. A liquidity emergency plan has also been adopted in this context; this plan forms the specialist and organisational framework for the treatment of liquidity shortages.

Liquidity risk management is based on various interconnected components which are based on a «liquidity risk tolerance» defined by the Management Board. This ensures that pbb Group has adequate liquidity reserves.

Hedging and Reduction of Liquidity Risk

A risk tolerance system 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» for pbb Group in stress conditions.

The limits applicable for risk tolerance are determined in line with stress scenarios and are adjusted at regular intervals.

Development of pbb Group's Risk Position

The development of the liquidity position in the first half of 2014 was in line with expectations.

The cumulative liquidity position (liquid assets as well as expected net cash flows) calculated as part of the liquidity risk measurement as of 31 December 2014 amounted to €4.3 billion for a 12-month horizon in the base scenario. Compared to the previous year, there was an (expected) decrease of €1.3 billion. As of 31 December 2014, the cumulative liquidity position in the risk scenario in the six-month forecast amounted to €1.8 billion.

The liquidity ratio in accordance with the Liquidity Ordinance amounted to 4.4 at Deutsche Pfandbriefbank AG as of 31 December 2014; it was thus higher than the statutory minimum of 1.0.

Funding markets

Driven by the monetary policy measures introduced by the central banks, in 2014 the capital markets continued to be caught between the poles of excessive liquidity in the search for investment options and low returns. From investors' point of view, the situation with the decline in the 10-year yield of approx. 100 basis points was significantly exacerbated resulting in the focus shifting towards longer terms and increased credit risk.

Geopolitical risks, such as the distortions in the emerging markets followed by the conflict in the Ukraine and the fight against IS terrorism, only affected the markets in the short term. In an environment that continues to be strongly influenced by the regulator (CRD IV, MREL, BRRD, SREP, AQR and stress tests) banks had to face new challenges.

Since the beginning of the fourth quarter, market players in the euro area faced the challenge of a new purchase program for covered bonds and ABSs (CBPP3). The central bank demand fueled by the purchase program resulted in a further narrowing of spreads on the Pfandbrief market and showed tendencies of crowding out the investors known so far.

Pbb Group can take advantage of both secured and unsecured issues for funding purposes. Pfandbriefe are the Bank's main funding instrument. Because of their high quality and acceptance on the international capital markets, Pfandbriefe are comparatively less affected by market fluctuations than many other funding sources.

In 2014, pbb Group realised a long-term funding volume of €6.0 billion (financial year 2013: €7.7 billion). Early repayments on the asset side and sufficient liquidity allowed for a reduction in capital market activities and thus €2.6 billion (2013: €4.5 billion) were attributed to new benchmark issues as well as increases in existing public sector transactions. Approximately two thirds of the long-term funding is carried out via Pfandbrief issues, whilst unsecured issues accounted for one third. Most issues are carried out on a fixed-income basis.

In the funding at matching maturities, pbb Group issued the first unsecured issues in Swedish krona, thus successfully expanding its investor base. In contrast, issues in British pound sterling were well placed.

As the first German issuer, Deutsche Pfandbriefbank AG instituted a program for unsecured issues on the Pro-Bond market of the Tokyo Stock Exchange in June 2014 to diversify unsecured funding. In addition to capital market funding, pbb Group offers overnight investments and time deposit investments for private investors to expand the unsecured funding base; the deposit volume amounted to more than €1.5 billion as of year-end (2013: €0.6 billion).

Forecast Liquidity Requirement

Due to the balanced asset and liability structure for the entire period there are no significant liquidity mismatches.

In addition to the forecast liquidity requirement for new business activities, the extent of the future liquidity requirement further depends on numerous external factors:
> Further development of the European financial crisis and possible effects on the real economy
> The future development of haircuts for securities for repo refinancing on the market and with the central banks
> Possible additional collateral demands as a result of changing market parameters (such as interest rates and foreign currency rates)
> The development in collateral demands for hedges
> Changed requirements of the rating agencies regarding the necessary overcollateralisation in the cover pools

Funding Risk

With regard to the funding risk, please refer to the presentation of the business risk in the section «Result of Risk-bearing Capacity Analysis».

Market Liquidity Risk

With regard to financial instruments which are measured at fair value, quantitative details for a better assessment of the market liquidity risk can be obtained from the presentation of the three levels of the fair value hierarchy in the notes. Generally there is no intention to sell LaR holdings for liquidity management purposes, as liquidity for these holdings can mainly be generated by way of including them in the cover pool, refinancing opportunities of the central bank or repo transactions. In the internal management the market liquidity risk is taken into account in the context of market risk.

Risks

The adjustments of the ECB's interest rate policy in the light of the European financial crisis and the resulting decline in overall interest rates entail the risk that investors underweight the bond market when allocating funds. This could lead to a general increase in funding spreads. The renewed debates regarding the continuation of the euro zone in its current composition could also influence the development of the funding spread.

Opportunities

The cumulative liquidity position of €4.3 billion in the base scenario over a horizon of 12 months which is detailed in the section «Development of the Risk Position of the pbb Group» as of 31 December 2014 opens up the opportunity of being able to provide a flexible response particularly with regard to possible new business.

If there was an overall positive development for pbb Group in the external factors specified in the section «Forecast Liquidity Requirement», this would per se result in a lower future liquidity requirement.

Operational Risk (including Legal Risks)

Definition

pbb Group defines operational risk as «the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events». The definition includes legal, model, conduct, reputational and outsourcing risks.

Since the financial year of 2014, operational risk at pbb Group also includes reputational risks. These are defined as the risk of losses due to events that may damage customers', shareholders', investors' or supervisory authorities' trust in pbb Group or its products and services on offer. This also includes a negative perception of the Bank by the public due to «bad press», which may fundamentally affect the business activities of pbb Group. pbb's definition also includes a negative perception of the Bank by its employees. The reputational risk is monitored by pbb Group and fully integrated in the operational risk management.

Strategy for Operational Risks

In the context of operational risk management, the top priority of pbb Group is to minimise financial losses from potential operational risk events. The overriding aims of this strategy are the early recognition, recording, assessment as well as monitoring, prevention and limiting of operational risks as well as early and meaningful management reporting.

Organisation of Operational Risk Management

Within Risk Management & Control, the operational risk division is responsible for the coordination of consistent policy, tools and practices throughout the HRE Group for the management, measurement, monitoring and reporting of relevant operational risks. This also comprises pbb Group.

Special Developments in the Organisation of Legal Risk Management

In accordance with MaRisk, significant risks in financial institutions must be evaluated by a unit independent to the front office and trading areas.

As the legal risk is regarded as significant, the Legal department is responsible for managing legal risks and is therefore a fixed component of risk management of pbb Group.

The primary objective of the Legal department in managing legal risks is to structure transactions so that they are legally enforceable and certain. This includes protecting the integrity and reputation of pbb Group. Accordingly, the Legal department supports the transactions of pbb Group by providing proactive and business-oriented consulting services.

The Legal department also monitors developments in the relevant legislation and case law and reviews its effects on new and existing business. The «Legal Policy» describes the roles and responsibilities of the Legal department within pbb Group and serves as a guideline for employees.

The legal risk is included and monitored in the context of the existing OpRisk Framework. This includes the Key Risk Indicator Report, the Operational Risk Self Assessment and an analysis of risk events.

The legal risk is also taken into account and described in all the important risk documents. It is regarded as significant for the Group and partially included in the ICAAP and backed by capital (by means of the general OpRisk).

In addition to the management, follow-up and capitalisation of legal risks, the Legal and Finance departments meet quarterly to discuss open legal cases.

The Legal department indicates the probability of successful conclusion per legal case.

Provisions for legal risks are created in accordance with IAS 37. A provision is a liability whose payment date or amount is uncertain. Provisions must be created if a present obligation has arisen for a company from an event from which an outflow of resources with economic benefit for meeting this obligation is probable and the amount of the obligation can be reliably estimated. In accordance with IAS 37.15 there are isolated cases for which it is unclear whether a present obligation exists. In these cases, a past event leads to a present obligation if, taking into account all the available substantial indications for the existence of a present obligation as of the balance sheet date, there are more indications for than against the obligation. For exceptions, such as a legal dispute, the issue of whether certain events have occurred or whether these have led to a present obligation can be debated. In this case, pbb determines whether a present obligation exists as of the closing date taking into account all the available material indications, including the opinion of, for instance, experts. Please refer to the report on expected developments and the Note «Provisions» for a presentation of the legal 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 pbb Group, each individual business area and management level takes on responsibility for its own operational risks, and provides appropriate resources and processes for limiting such risks. The focus of the operational risk department is the proactive identification, management and mitigation of risks rather than on just risk monitoring, measurement and reaction to risk.

Consolidated information is used in order to determine the operational risk profile of pbb Group and any required measures in relation to mitigation of identified risks. Operational risk scenario analyses, which are conducted annually, are also used in this context.

Regular reports are prepared for the Chief Risk Officer (CRO) and the Group Risk Committee. The monthly Group risk report includes details concerning operational risk events and losses and key risk issues affecting pbb Group. In addition, a quarterly risk report regarding key risk indicators notifies the Management Board of potential risk sources. On an annual basis an annual operational risk report is produced which includes a summary of important events during the year and also the results of the operational risk self-assessment process. This report is circulated to the board of pbb and presented to the Group Risk Committee.

Risk Measurement

The economic capital for operational risk in the going-concern perspective amounted to € 39 million as of 31 December 2014 (31 December 2013: € 37 million). Details of the calculation are set out in the chapter «Result of Risk-bearing Capacity Analysis».

In line with the standard approach, the regulatory capital backing for operational risks, which is calculated at the end of each year, was 81 million as of 31 December 2014 (31 December 2013: € 74 million).

Operational Risks Profile of pbb Group

pbb suffered financial losses of € 10.9 million in relation to operational risk during 2014 (2013: € 1.2 million). In terms of operational loss, 37 % is accounted for by the Real Estate Finance segment and 32 % is accounted for by the Public Sector Finance segment and the Value Portfolio segment each.

The Basel II event type «Execution, Delivery & Process Management» was the category with the highest number both of events (86%) and of the category to which almost all related financial effects are attributed (99.7 %) in 2014. This event was also reflected in the operational risk self-assessment process, which is a bottom-up risk assessment performed by all of the Bank's segments.

pbb Group's operational risk profile has improved continually over the past few years, inter alia thanks to the successful implementation of various IT projects and the consolidation of its core systems.

Opportunities

The annual reports published in recent years note that pbb Group has an increased reliance on employees in key positions. This was attributed to the special situation at the time during the financial market crisis and the resulting uncertainty surrounding pbb's future. We expect this key person risk to decrease as the privatisation of pbb is getting closer.

Property Risk

Property risks are defined as potential negative changes in the value of a company's own property portfolio due to a deterioration of the general property situation or a negative change of the specific characteristics of the individual property caused by the property being vacant, changed usage options, building damages, investment requirements, etc.

The company's own property portfolio (almost exclusively salvage acquisitions) of pbb Group is limited to a few isolated cases. Salvage acquisitions are not regarded as a part of the company's objective within the meaning of a business strategy but are subject to assessment in the individual case. The fundamental objective is to develop these properties using holistic, real estate criteria, e.g. cost/earning situation, increase of occupancy rates, optimisation of usage options as well as further development of the location and to work out solutions in individual cases or sell the property subsequently with the best possible impact on value.

By calculating the economic capital at the level of individual transactions, property risks are recognised as a whole and regularly monitored.

The administration and active risk management of salvage acquisitions is carried out by the rescue deal management of the Bank that specialises in this business field.

Result of Risk-bearing Capacity Analysis

Going-Concern

Going-concern in € million	31.12.2014	31.12.2013	Change
Credit risk	219	237	−18
Market risk	256	185	71
Operational risk	39	37	2
Business risk	3	0	3
Property risk	10	9	1
Total before diversification effects	**527**	**468**	59
Total after diversification effects	**488**	**421**	67
Available financial resources (free capital)	1,464	1,946	−482
Excess capital (+)/capital shortfall (–)	976	1,525	−549

The going-concern perspective explicitly focuses on the protection of regulatory minimum capitalisation, and thus focuses on the continuation of business activities of pbb Group in periods of difficult economic downturns. In order to prove the risk-bearing capacity the first step is to calculate the economic capital at a confidence level of 95%. This includes the risk types which we define to be of a material nature, namely credit risk, market risk, operational risk, funding risk as part of the business risk and property risk.

Excluding the diversification effects between the individual risk types, the economic capital of pbb Group in the going-concern perspective amounted to € 527 million (31 December 2013: € 468 million). If these effects are taken into account, it was € 488 million (31 December 2013: € 421 million). The most significant risk type on the basis of the ICAAP (measured in terms of the economic capital) in December 2014 was the market risk, which accounted for approximately 49% of the undiversified economic capital, followed by the credit risk at 42%. The increase in economic capital in the market risk of € 71 million is primarily driven by the significant decrease in credit spreads and interest rates in European countries, which resulted in higher values during the year and thereby also higher credit spread sensitivity of securities in the IFRS category AfS. In addition, a methodological adjustment in the market risk in the second half of the year contributed to the increase in the market risk.

The decline in the credit risk of € 18 million is mainly a result of ratings improvements of public sector debtors as well as revaluations for the exposure to Heta Asset Resolution AG (Heta). Operational risks increased slightly due to the recognition of internal data from 2014 in the operational risks modelling methods. The property risk also increased slightly due to the additional recognition of a property in the Netherlands since December 2014.

The rise in the business risk is due to stressed funding costs for a higher liquidity requirement in the going-concern stress scenario.

This is opposed by the so-called free capital as risk covering potential, comprising available CET1 capital less the CET1 capital necessary for covering the regulatory minimum ratios and less a buffer for immaterial risks and risks, which are either not or only partially quantifiable. In accordance with the principle of prudence, an additional charge in relation to the risk-weighted assets is taken into account in order to determine the CET1 capital necessary for covering the regulatory minimum ratios. The free capital is calculated both on the current figures, as well as on the planned values over a time horizon of one year. The lower free capital arising from these calculations is used as risk covering potential in the going-concern approach. The amount of free capital as of the reporting date was €1.5 billion (31 December 2013: €1.9 billion) and was based on the budgeted figures as the repayment of the silent partnership contribution as of the end of 2015 of €1 billion has already been taken into account here and the planned CET1 is thus lower. The decline in free capital of €0.4 billion was, however, significantly lower than the recognition of the silent participation of a notional €1 billion as, in the Annual Report 2013, CET1 was still accounted for according to HGB [German Commercial Code] accounting, which meant that the loss allocation for the silent participation had to be accounted for. A smaller part of the decrease is due to taking into account an additional buffer. It now also covers the credit risk from potential extensions and unexpected changes in value from transactions in default.

Accordingly, the resulting excess capital as of 31 December 2014 amounted to €1.0 billion for the given period of one year (31 December 2013: €1.5 billion); it is further proof of the risk-bearing capacity of pbb Group in the leading going-concern perspective.

The distribution of the economic capital according to segments is as follows:

Economic capital according to segments in € million	**31.12.2014**	**31.12.2013**	Change
Real Estate Finance	136	137	−1
Public Investment Finance[1]	22	268	−246
Value Portfolio	325	12	313
Consolidation & Adjustments	139	56	83
Total	**488**	**421**	67

[1] Comparison with the Public Sector Finance figures as of 31 December 2013. As a pro forma presentation of the figures would entail a disproportionately high cost for determining the figures, given the re-segmentation undertaken in 2014, a presentation of the pro forma figures for the Public Investment Finance and Value Portfolio segments as of 31 December 2013 was waived.

The decline in economic capital in the Public Investment Finance segment (€−246 million) is mainly due to the re-segmentation of the budget financing business (from Public Investment Finance to the Value Portfolio). An increase in economic capital is therefore reported for the Value Portfolio segment. In addition, in particular in the Value Portfolio, a cyclical updating of model parameters in the credit portfolio model resulted in a further increase in economic capital as well as due to higher concentration in public sector debtors due to the implementation of the Basel III regulations.

The €83 million increase in economic capital in the Consolidation & Adjustment segment was mainly driven by the transfer of netting positions from OTC transactions as well as the equity book in the context of re-segmentation after Consolidation & Adjustments.

Gone-Concern

In supplement to the going-concern approach, pbb Group uses a gone-concern approach (liquidation perspective) as an additional, parallel management approach. The objective of the so-called gone-concern approach is to guarantee protection of the senior lender in a hypothetical liquidation scenario with a very high probability. pbb Group has selected a confidence level of 99.91% that integrates homogenously into the generally conservative parametrisation of the models. However, this liquidation scenario does not assume an opportunistic winding up of portfolios as postulated by the German Pfandbrief Act, and instead assumes an immediate sale at fair values of assets and securities in the investment book. According to this assumption, besides the already mentioned major risks from the going-concern approach, it also takes account of credit spread risks arising from securities in the investment book for calculating the economic capital, and deducts simultaneously the net hidden losses attributable to these securities for determining the risk covering potential.

Gone-concern in € million	**31.12.2014**	**31.12.2013**	Change
Credit risk	1,437	1,447	–10
Market risk	1,356	1,083	273
Operational risk	84	78	6
Business risk	65	53	12
Property risk	23	20	3
Total before diversification effects	**2,965**	**2,681**	284
Total after diversification effects	**2,647**	**2,436**	211
Available financial resources before hidden losses	4,147	4,285	–138
Hidden losses	–	546	–546
Available financial resources	**4,147**	**3,739**	408
Excess capital (+)/capital shortfall (–)	1,500	1,303	197

In the gone-concern approach, the economic capital excluding diversification effects amounted to €3.0 billion as of 31 December 2014 (31 December 2013: €2.7 billion) and with the diversification effects €2.6 billion (31 December 2013: €2.4 billion). The main drivers are also in this respect the credit risk (€1.4 billion) and the market risk (€1.4 billion). Most of the market risk is attributed to credit spread risks, which are primarily driven by continued volatility in credit spreads in parts of the European Economic Area mainly in the securities in the Value Portfolio of pbb Group. The €273 million increase in the market risk was due to higher credit spread sensitivities as a result of higher valuations of financial investments and, in addition, a methodological adjustment in the market risk in the second half-year. The credit risk decreased by €10 million mainly as a result of improved ratings of public sector debtors as well as a revaluation for the exposure to Heta Asset Resolution AG (Heta). Operational risks increased due to the rise in the regulatory capital backing. The property risk also increased slightly due to the additional recognition of a property in the Netherlands since December 2014. The increase in the business risk is due to stressed funding costs for a higher liquidity requirement in the gone-concern stress scenario.

The risk covering potential in the gone-concern approach, before the deduction of hidden losses, initially amounted to € 4.1 billion (31 December 2013: € 4.3 billion); the figure remained at € 4.1 billion (31 December 2013: € 3.7 billion) after the net hidden losses attributable to the securities in the investment portfolio were deducted. As in the going-concern approach, a smaller impact was felt as a result of taking into account an additional buffer to cover unexpected losses from the default commitments portfolio and to cover the credit risk from potential extensions. The decrease in the credit spreads of many European public sector debtors in 2014 resulted in a significant recovery of the net hidden losses in securities in the investment book of pbb Group; no net hidden losses were therefore deducted as of the balance sheet date 31 December 2014. The decrease in net hidden losses is therefore also the main reason for the increase in the risk covering potential of € 0.4 billion.

If the European sovereign debt crisis should worsen and the credit spreads of many European debtors increase again as a result thereof, a corresponding increase in both credit spread risks as well as hidden losses can be expected, irrespective of any counter-measures taken.

The distribution of the economic capital by segments in the gone-concern approach is as follows:

Economic capital according to segments

in € million	31.12.2014	31.12.2013	Change
Real Estate Finance	417	515	−98
Public Investment Finance[1]	548	1,869	−1,321
Value Portfolio	1,600	27	1,573
Consolidation & Adjustments	388	188	200
Total	**2,647**	**2,436**	211

[1] Comparison with the Public Sector Finance figures as of 31 December 2013. As a pro forma presentation of the figures would entail a disproportionately high cost for determining the figures, given the re-segmentation undertaken in 2014, a presentation of the pro forma figures for the Public Investment Finance and Value Portfolio segments as of 31 December 2013 was waived.

As in the going-concern approach, in the gone-concern approach the decline in economic capital in the Public Investment Finance segment (€ −1.3 billion) is mainly due to the re-segmentation of the budget financing business from the Public Investment Finance to the Value Portfolio segment in January 2014. An increase in economic capital is therefore reported for the Value Portfolio segment. In addition, the cycling updating of model parameters as well as the implementation of the Basel III regulations, which resulted in higher concentrations in the Value Portfolio, resulted in a further increase in economic capital. The increase in economic capital in Consolidation & Adjustments was mainly driven by the transfer of netting positions from OTC transactions as well as the allocation of the equity book to Consolidation & Adjustments. The decrease in economic capital in the Real Estate Finance segment is due to an improvement, on average, in the credit quality of the REF portfolio. In addition, the REF segment benefited from the higher concentration in the Value Portfolio as a result of portfolio effects. The economic capital therefore decreased further.

Opportunities

Although it is still clearly too soon to speak of a turnaround in the European sovereign debt crisis in 2014, pbb Group has observed a stabilisation of the European bond markets as a result of the crisis management of the ECB. If there is a complete recovery of trust in the European public finances, systematic rating improvements of public sector issuers could lead to a reduction in risk and thus also to a further increase in excess capital in the ICAAP.

Method Used for the Individual Risk Types

The economic capital for each risk type is determined using a quantitative approach and is aggregated to form an overall bank risk with due consideration being given to specific correlations. In line with the common market standard, the risk types are calculated for a period of one year and in relation to a defined confidence level (99.91% in the gone concern, 95% in the going concern).

The method of calculating the economic capital for the individual material risk types for 2014 is explained in the following.

Credit Risk For calculating the credit risk at the portfolio level, pbb Group uses a credit portfolio model which follows the approach of a so-called asset value model. The fundamental idea of this approach is that the repeated simulation of correlated rating migrations, borrower defaults as well as a calculation of resultant value changes via a corresponding revaluation of the portfolio mean that probability statements can be made with regard to potential losses from lending business. The loss distribution calculated in this way can then be used to calculate the economic credit risk capital as an unexpected loss. This defines the maximum unexpected loss calculated for a defined confidence level which will result within one year due to rating migrations and defaults in lending business. In addition to the loss distribution of the credit portfolio, a significant result is the risk-commensurate allocation of the credit risk capital to the individual borrower units using the so-called expected shortfall principle. This ensures fair causation-based allocation to the borrowers, and thus constitutes a major module in the risk-oriented management of the credit portfolio.

In the second quarter of 2014, the credit risk from extension assumptions was included in the calculation for the credit risk and taken into account in the risk covering potential in the form of a risk buffer. In addition, the risk of changes to valuation adjustments for commitments already in default was modelled in the second quarter of 2014 and also taken into account in the form of an additional risk buffer for determining the risk covering potential.

Market Risk The purpose of calculating the economic capital for the market risk is to identify potential financial losses resulting from changes in the prices of items in the investment book and trading book. In this process, the potential non-systematic losses are derived from an analysis of historical time series of specific factors of influence (risk factors), e.g. interest rates, exchange rates and credit spreads over the previous seven years. The relatively long period of seven years ensures that economic phases which are not favourable for the Bank are also taken into account in the model. The annual loss distribution of the portfolio market value is then determined by means of a simulation procedure and using the linear sensitivities of the financial instruments; this can then be used to determine the economic capital in relation to a confidence level of 95% and 99.91%. In the second half of 2014, the model was adjusted, which resulted in a slight increase in the market risk capital. The main change is due to improved modelling of the credit spread risks.

Operational Risk The calculation of economic capital for operational risk takes into account both the results of the calculation in accordance with the Standard Approach under Basel II/Basel III and the results generated by a mathematical model used to calculate losses from operational risks, which uses internal data as inputs. This past-related approach is enhanced by the recognition of forward-looking budget figures for three years. For the purposes of the capital adequacy procedure, the regulatory capital requirement is scaled to the corresponding lower confidence level (from 99.9% to 95%). In the gone-concern approach it is scaled to the higher confidence level of 99.91%.

Business Risk In pbb Group, the business risk is generally defined as the risk of reductions in profit due to changes in the external business environment which affect the economic conditions of the Bank. Alongside non-quantifiable risks such as regulatory risk, reputational risk and strategic risk, these include risks arising from increased funding costs and higher funding requirements, as well as earnings risk. Economic capital for business risk is calculated using a scenario-based increase in financing costs due to higher funding requirements and a simultaneous increase in the unsecured funding rate. Earnings risk is taken into account amongst others by not including planned income from new business in the risk cover amount.

Property Risk pbb Group's real estate risk is calculated using a mathematical-statistical model that enables the Bank to make statements on the probability of potential declines in the value of properties in its portfolio. The inputs for the model are mainly based on time series of representative real estate indices for the portfolio.

Liquidity Risk Capitalising for liquidity risk in the narrower sense is not possible. Liquidity risks in the broader sense of higher funding costs for potential funding gaps are recognised in the economic capital for the business risk.

Stress Tests

Stress tests have become increasingly important in the recent past, both from a supervisory perspective and for internal bank management, not least as a result of the European sovereign debt crisis. All activities, developments and decisions relating to stress tests are bundled within the Stress Test Committee, which reports directly to the Risk Committee. As part of an integrated approach, the impact of macroeconomic stress scenarios on all material risks and on risk-taking potential under stressed market parameters was calculated for a multi-year time horizon in the period under review. These scenarios focus on the continuation and/or intensification of the current sovereign debt crisis.

Furthermore, stress tests relating to economic risk capital and risk cover funds are used to obtain a deeper understanding of the sensitivity of risk-bearing capacity to adverse changes in economic factors. In addition, inverse stress tests are conducted regularly. These describe specific constellations of parameters under which the risk-bearing capacity would be at risk. Alongside institutionalised stress tests, ad hoc requests by the Management Board played an important role in the period under review.

SREP

On 19 December 2014, the EBA published the final guideline on the regulatory review and evaluation process (SREP – Supervisory Review and Evaluation Process) after a consultation process lasting several months. The guideline, consisting of some 200 pages (EBA/GL/2014/13), is aligned to the supervisory authorities of the member states of the European Union and should be implemented in the institutions in 2015 and applied from 2016. In the guideline, the EBA takes a holistic SREP approach that comprises assessing selected key indicators, the business model, governance as well as capital and liquidity risks.

The SREP is thus based on a holistic evaluation of an institution culminating in an overall creditworthiness grading of an institution. It is therefore a bridge between the former pillar II in accordance with Articles 76–87, 97 of CRD IV and the BRRD (Bank Recovery and Resolution Directive – Directive 2014/59/EU), which focuses on winding up and reorganisation.

Based on the consultations taking place in 2014, pbb Group has already initiated a project that aims to fully implement SREP.

As part of the ECB's implementation of the EBA Guidelines, minimum ratios including the CET1 ratio and the own funds ratio were prescribed for HRE on 12 March 2015. These ratios were met as of 31 December 2014. It remains to be seen how the ECB will handle the SREP topic further in the transition year 2015.

Key Regulatory Capital Ratios

In accordance with the waiver regulation set out in section 7 of the Capital Requirements Regulation (CRR, from 1 January 2014), pbb is exempted from the requirement to establish the equity and core capital ratios. pbb Group voluntarily discloses these figures.

(EU) Directive no. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms applies with effect from 1 January 2014.

These regulations (CRR/CRD IV) form the basis for determining the regulatory capitalisation.

Besides the minimum capital ratios, the changes also affect the requirements for the eligibility of capital instruments as well as the mandatory determination of the regulatory capital similarly to the accounting standard used. For this reason, the regulatory key figures have been determined based on IFRS since 1 January 2014 (up until the end of 2013 they were based on the German Commercial Code [HGB]). In addition, the abolition of the former preference for certain risk items pursuant to section 64 (h) of the German Banking Act (Kreditwesengesetz [KWG]) and the CRR-based introduction of an additional CVA charge results in a significant increase in risk-weighted assets in relation to the figures as at the end of 2013.

The Management Board manages the capital based on the CRR. According to the CRR, the CET1 ratio (Common Equity Tier 1/risk-weighted assets) may not fall below 4.0 %, the Tier 1 ratio (Tier 1/risk-weighted assets) may not fall below 5.5 % and the own funds ratio (own funds/risk-weighted assets) may not fall below 8.0 % in 2014.

These requirements with respect to the regulatory capital ratios were satisfied throughout the whole of 2014.

For ease of comparison, the figures are additionally stated as of 31 December 2013, calculated according to the regulations applicable from 1 January 2014.

Own Funds in € million	31.12.2014	31.12.2014 Basel III fully phased-in[1]	31.12.2013 Pro forma Basel III figure[2)3)]	31.12.2013 Pro forma Basel III figure fully phased-in[1)2)]	31.12.2013[4]
CET1	3,364	2,090	3,336	1,993	2,475
Additional Tier 1	195	999	216	999	350
Tier 1	3,559	3,089	3,552	2,992	2,825
Tier 2	483	334	632	454	835
Own Funds	**4,042**	**3,423**	**4,184**	**3,446**	**3,660**

1) After expiry of all Basel III transitional regulations
2) Consolidated in accordance with CRR (following the appropriation of net profit 2013)
3) Adjusted due to IAS 8.42. Details are disclosed in Note «Consistency».
4) Consolidated in accordance with section 10 a of German Banking Act (KWG) (following the appropriation of net profit 2013)

Risk-weighted assets (RWA)[1] in € million	31.12.2014	31.12.2014 Basel III fully phased-in[2]	31.12.2013 Pro forma Basel III figure[3]	31.12.2013 Pro forma Basel III figure fully phased-in[2)3)]	31.12.2013[4]
Market risks	217	217	158	158	75
thereof interest rate risks	–	–	–	–	–
thereof foreign exchange risks	217	217	158	158	75
Operational risks	1,010	1,010	923	923	923
Credit risks	14,261	14,261	16,979	16,979	13,087
thereof CVA charge	445	445	531	531	–
Other RWA	1	1	3	3	–
RWA total	**15,489**	**15,489**	**18,063**	**18,063**	**14,085**

1) Including weighted credit risk positions and capital charges for market risk positions and operational risk, using a scaling factor of 12.5
2) After expiry of all Basel III transitional regulations
3) Consolidated in accordance with CRR
4) Consolidated in accordance with section 10 a of the German Banking Act (KWG)

Capital ratios in %	31.12.2014	31.12.2014 Basel III fully phased-in[1]	31.12.2013 Pro forma Basel III figure[2)3)]	31.12.2013 Pro forma Basel III figure fully phased-in[1)2)]	31.12.2013[4]
CET1 ratio	21.7	13.5	18.5	11.0	17.6
Tier 1 ratio	23.0	19.9	19.7	16.6	20.1
Own funds ratio	26.1	22.1	23.2	19.1	26.0

1) After expiry of all Basel III transitional regulations
2) Consolidated in accordance with CRR (following the appropriation of net profit 2013)
3) Adjusted due to IAS 8.42. Details are disclosed in Note «Consistency».
4) Consolidated in accordance with section 10 a of German Banking Act (KWG) (following the appropriation of net profit 2013)

Result of the «Comprehensive Assessment» of the ECB

According to the methodology applied by the ECB, the Comprehensive Assessment had to be carried out at the highest consolidated level. pbb Group was therefore included in the Comprehensive Assessment of the ECB through Hypo Real Estate Group (HRE). In view thereof, the following results thus also do not relate to pbb Group but to Hypo Real Estate Group.

The EU-wide comprehensive assessment was conducted by the ECB in cooperation with the National Competent Authorities in 2014. 130 banks were subject to this exercise. The comprehensive assessment comprised basically of two main pillars: an asset quality review (AQR) – to enhance the transparency of bank balance sheets by reviewing the quality of banks' assets, including the adequacy of asset and collateral valuation and related provisions, and a stress test – performed in close cooperation with the European Banking Authority (EBA).

HRE performed well in the Asset Quality Review («AQR») and stress test conducted by the European Central Bank (ECB). The AQR yielded valuation adjustments according to ECB audit guidelines in an aggregate amount of € 37 million for the Group's aggregate exposure. Since the review was based on a reporting date of 31 December 2013, it incorporated the full financial statements of HRE Group subsidiaries Deutsche Pfandbriefbank AG and DEPFA BANK plc. The adjustments lowered the Common Equity Tier 1 (CET1) ratio by 0.15 percentage points.

Taking the AQR results into account, the HRE shows a Common Equity Tier 1 (CET1) ratio of 10.78% at the end of the stress period (in the year 2016) in the adverse scenario, which implies certain stress assumptions. The Group's stressed CET1 ratio thus clearly exceeds the ECB's minimum requirement of 5.5%. In the baseline scenario, the HRE shows a CET1 ratio of 18.16%, compared with a minimum ratio of 8%.

In line with the approach taken by the ECB, DEPFA BANK plc was not included in the stress test results, due to the impending sale (by the end of 2014). This reduced consolidated assets, but also consolidated equity. Stress test results also exclude the € 1 billion silent participation contributed by SoFFin, which – from a regulatory perspective – is only taken into consideration at Deutsche Pfandbriefbank AG, on a single-entity level.

As a consequence, both HRE and pbb Group have engaged intensively with the results of the Comprehensive Assessment. In particular, the valuation adjustments based on the ECB review specifications arising from the AQR, were reviewed again in individual cases in the context of the accounting rules material to financial reporting. Taking into account the discretionary leeway in the financial reporting, adjustments were made to the accounting records where necessary.

Internal Control System and Risk Management System Relevant for the Consolidated Financial Reporting Process

Concept

The internal control system and risk management system relevant for the consolidated financial reporting process comprise the principles, processes and measures used to ensure the effectiveness and efficiency of financial reporting, as well as to ensure compliance with statutory provisions. The objective of the internal control system and risk management system relevant for the consolidated financial reporting process system is to ensure that the consolidated financial statements comply with the relevant rules in respect of the consolidated financial statement. Risks that may prevent this overall objective from being achieved are identified and assessed in the process; any risks identified are limited and their effect on the financial statements and their appropriate presentation are reviewed. The internal control system relevant for the consolidated financial reporting process is an integral part of the risk management system. It aims to implement controls so as to provide sufficient assurance that, despite the risks identified, the financial statements are prepared in accordance with the relevant rules. However, an internal control and risk management system relevant for the consolidated financial reporting process cannot provide an absolute guarantee that these goals will be met.

pbb Group's internal control system and risk management system relevant for the consolidated financial reporting process is reflected in its organisational structure and workflows. With respect to the organisational structure, it primarily comprises the Management Board, the Supervisory Board as the supervisory body, the Audit Committee established by the Supervisory Board, the Finance division and the Group Finance Committee (GFC) at HRE level. The duties of the CFO are carried out by one of the two Co-CEO's.

As the company's legal representative, pbb's Management Board is required to prepare consolidated financial statements and a Group management report. In connection with the requirement to establish a Group-wide internal control and risk management system, the whole Management Board of pbb is also responsible for the form – i.e. the concept, implementation, maintenance and monitoring – of an appropriate and effective internal control and risk management system relevant for the consolidated financial reporting process. All strategies are decided on by the whole Management Board on the basis of recommendations made by the Co-CEO, who carries out the duties of the CFO, or the GFC.

The Supervisory Board is tasked with advising and monitoring the Management Board. It also has audit and reporting-related obligations. pbb's Supervisory Board established an Audit Committee to support its activities in this area. In accordance with section 100 (5) of the Aktiengesetz (AktG – German Stock Corporation Act), at least one member of the Supervisory Board must have expertise in accounting or auditing.

Group Internal Audit supports the Management Board and the Supervisory Board in its control function by performing independent audits.

At 31 December 2014, the Co-CEO who carries out the duties of the CFO was responsible for Communications, Corporate Office/Compliance, Finance and Legal. The Finance division comprises the Accounting, Financial Reporting, Regulatory Reporting, Procurement Services & Corporate Controlling and Tax departments. The Finance division prepares the consolidated financial statements in accordance with IFRS and provides the capital market information relevant to accounting. pbb Group companies prepare their financial statements in accordance with the relevant local legal requirements. These financial statements are standardised around uniform Group accounting policies in accordance with IFRS for the purposes of Group financial reporting. Each entity included in the consolidated financial statements reports its statement of financial position, income statement, and notes to a central department in Group Accounting via the consolidation software. Group Accounting translates the foreign currency positions into euros using the consolidation software. The data are validated, analysed and consolidated.

The GFC at HRE level, who also works for pbb Group, issues recommendations to the Management Board. These include, among other things, establishing and monitoring the accounting and reporting policies as well as workflows for all units and segments. The GFC is composed of the members of the Management Board and the managers of the Finance, Risk Management & Control and Treasury divisions.

With respect to workflows, the internal control system and risk management system relevant for the consolidated financial reporting process is based on the objective of largely standardised the processes and software. Core activities and processes are governed by policies and a code of conduct, according to which the four eye principle must be applied in all material transactions. Data and IT systems are protected against unauthorised access. In addition, certain relevant information is only made available to those employees who need it for their work. Where necessary, results are agreed at Group level.

Implementation

pbb Group implemented the concept for the internal control system and risk management system relevant for the consolidated financial reporting process to identify, assess and limit risks. The governing bodies of HRE Holding and pbb largely comprise the same people, enabling a uniform management of these companies. For example, the members of pbb's Management Board also form the Management Board of HRE Holding.

pbb Group has introduced a control attestation process to strengthen the internal control system. After adjusting for risk, all the significant controls of divisions of pbb Group are recorded and controlled in this process. These key controls are reviewed and confirmed by the divisions in a regular reporting process. Corporate Office/Compliance and Group Internal Audit review these in a downstream process.

There is a clear separation of functions within the Finance division; for example, the Accounting and Financial Reporting departments are separated. The GFC and other committees, as well as divisional meetings serve as overarching links between the different tasks. In addition, executing, accounting and administrative activities such as payment transfers and payment entries are clearly separated or subject to the four eye principle. Furthermore, the units included in the consolidated financial statements report their data to a central Group department, ensuring the subsequent processing in a uniform manner.

Systems-based and non-systems-based risk management measures and internal controls are used within the workflows. At the systems level, standard software is used as far as possible to post, reconcile, check and report data so as to avoid errors. The same applies to consolidation, which is performed using standard market software. The consolidation software supports the reconciliation of intragroup transactions at a technical level in a clearly defined process, ensuring that these transactions are eliminated correctly and in full. Data from the entities included in the consolidated financial statements are reported using a uniform, standardised chart of accounts. Automated plausibility checks are performed on the data reported by subsidiaries for consolidation purposes, for example. The largest part of assets and liabilities is held by the parent company pbb. The balances carried forward are checked by the system. To prevent data loss, the data in the consolidation software are backed up on a daily basis and the backup is stored on tape. As a general rule, pbb Group's software is protected against unauthorised access by a clearly defined administration concept and authorisation rules.

Alongside the systems-based measures, pbb Group has implemented manual and non-systems-based processes. For example, the correctness and completeness of the data reported are checked using a standardised process involving variance analyses based on plan/actual comparisons, among other things. In addition, the consolidated statement of financial position and the consolidated income statement are determined on a monthly basis. Projections and forecasts are also drawn up. Mandatory Group-wide accounting guidelines are defined and communicated in a manual, among other ways. These guidelines cover the analysis and interpretation of new and existing IFRS standards and interpretations so as to ensure the application of uniform accounting policies across the Group. Generally applicable valuation methods are used. The procedures used and the underlying parameters are reviewed at regular intervals and modified as necessary.

In order to improve the quality of controls, various divisions are integrated in certain processes and are required to reconcile. For example, the interdepartmental new product process and the review of existing products (with a right of veto by the Finance division) are designed to ensure that products are recognised in the financial reporting in a uniform and systematic manner. In addition, the processes of the market valuations undertaken by Risk Management & Control are coordinated in the GFC. Annual and interim financial report preparation is another example of interdepartmental coordination. All of the areas involved must sign off on these reports before they are officially prepared by the Management Board (subcertification process), creating an additional level of control for the products to be disclosed. All of the divisions affected agree in advance on the content of material sections of the annual report in editorial meetings.

As part of the risk management system relevant for the consolidated financial reporting process, pbb Group takes measures to combat fraud and intentional violations that negatively impact the Group. Fraud against pbb Group includes theft, embezzlement, or breach of fiduciary duty, as well as intentional accounting errors in connection with the consolidated financial reporting process. pbb Group identifies and evaluates risks and takes measures to prevent such fraudulent activities and intentional violations. In addition, a systems-based concept is used to train employees in compliance regulations.

Maintenance

pbb Group reviews and improves its internal control system and risk management system relevant for the consolidated financial reporting process on an ongoing basis, amongs others, as part of Management Board and GFC meetings, to ensure that risks are identified, assessed and limited as accurately and as comprehensively as possible. Consequently, the internal control and risk management system relevant for the consolidated financial reporting process is adapted to new circumstances such as changes to pbb Group's structure and business model or new statutory requirements.

The risk of fraud and intentional violations is regularly analysed in order to take defensive measures. Factors taken into account include suspicious events and changes in pbb Group's situation and that of individual employees.

Any changes to processes and IT systems required as a result of legislative amendments are implemented as separate interdepartmental projects with a clear allocation of functions. At the same time, the risk management system relevant for the consolidated financial reporting process is also adapted to the changes in the provisions.

pbb Group's IT landscape is continually enhanced. In the reporting year the IT systems of pbb and DEPFA were seperated. In addition, the number of company codes were reduced and the general ledger was improved in 2014. In 2013 subledgers were merged.

Monitoring

The Group Internal Audit division reports to the Co-CEO who is not carrying out the duties of the CFO. This division is responsible for checking that processes and procedures are carried out in a due and proper manner and identifying inefficiencies, irregularities or manipulation. The Group Internal Audit division also reviews the effectiveness and appropriateness of risk management and the internal control system in an independent and risk-oriented manner in line with the rules set out in the Minimum Requirements for Risk Management (MaRisk), and identifies any weaknesses in risk identification, assessment and mitigation. This also includes reviewing the IT systems and the processes and controls of the Finance functions. Concrete action plans with specific deadlines are drawn up and their implementation monitored to remedy the identified shortcomings. Group Internal Audit is not integrated into the workflow, nor is it responsible for the results of the audited process. In order to be able to carry out its duties, Group Internal Audit has a full and unrestricted right to information on activities, processes and the IT systems.

As the body responsible for supervising and advising the Management Board, the Supervisory Board may inspect and examine the Company's books and assets in accordance with section 111 (2) of the AktG. In addition, the Management Board reports regularly to the Supervisory Board. Group Internal Audit reports to the whole Management Board and the Audit Committee at appropriate intervals, however, at least quarterly. The Chairman of the Audit Committee can directly obtain information from the heads of Finance, Group Internal Audit and Risk Management & Control. The Supervisory Board discusses the internal control and risk management system relevant for the consolidated financial reporting process. The Supervisory Board appoints the auditors of the consolidated financial statements and the Group management report. The Supervisory Board approves the consolidated financial statements and the Group management report prepared by the Management Board and audited by the independent auditors.

The auditors of the financial statements attend the Supervisory Board meetings relating to the financial statements and all of the meetings of pbb Group's Audit Committee to report on the material findings of their audit including material weaknesses in the internal control and risk management system relevant for the consolidated financial reporting process. Where relevant, the auditors immediately report findings and issues that emerge during the audit and that are material for Supervisory Board to carry out their duties. The Supervisory Board discusses the focus of the audit with the auditors in advance.

Report on Expected Developments

Macroeconomic Forecast

The macroeconomic environment is expected to continue to develop positively in 2015. Despite the current geopolitical hotspots, the global economy is likely to gain momentum in the absence of further financial, economic or political shocks. However, the economic recovery in the eurozone will remain slow and differ from country to country. In general continuing fiscal policy consolidation is expected to keep burdening the short-term growth potential of the member states. Conversely, the consolidation process of the government budgets is, however, likely to have a positive effect on the sustainability of public finances. In the eurozone, GDP growth is likely to accelerate in 2015 in particular due to stabilisation in investment demand as well as net exports and in view of the currently weaker euro. Growth rates of Spain and Germany are expected to be higher than for France and Italy, both of which however are likely to finally be able to overcome their economic stagnation. The US economy will play a decisive part as its expected growth should have a positive effect on net exports of the eurozone. After a strong expansion in the prior year the economy of the United Kingdom is expected to slow down at a comparably high level. In Scandinavia and in Central and Eastern Europe growth rates are likely to remain at reassuringly high levels. The inflation rates are expected to develop at a leisurely pace in the global economy and particularly in the eurozone in 2015. Persistently weak energy prices are supposed to lead to even lower inflation rates fuelling fears of deflation. In view of the ongoing disinflationary trend, the ECB is likely to maintain its purchase program of financial assets – in particular eurozone government bonds prioritising the liquidity allocation for the banking sector.

Due to the expansive monetary policy still pursued by the ECB, there is likely to be a further decoupling of short- and long-term interest rates between the euro and dollar regions. Whilst interest rates in the eurozone are likely to remain close to their historic lows, a noticeable rise in the short- and long-term interest rates in the US should be expected.

Sources: Bloomberg, ECB, IMF

Sector-specific Environment

Overall Situation in the Banking Sector

Despite the comprehensive supply of liquidity, the international banking sector is still facing a difficult operating environment in 2015.

In the eurozone, the banks in the crisis states in particular are suffering under the burden of non-performing loans. The negative rating pressure on the banking sector is, however, not only limited to these countries but affects the European banking sector as a whole. The weak dynamic of the current economic recovery limits profitability. Plans that have already been initiated to involve investors of subordinated debts in bank resolutions negatively effect the capital costs of banks. In general the increasingly stricter regulation continues to have a negative influence the sector's profitability.

Despite this the credit risk assessment of the largest European banks is more optimistic than it has been one year ago which is also due to the improved capitalisation. Whilst banks' operating environment remains challenging, the major expansion of the balance sheet of the European Central Bank is likely to keep the sector's credit risk implied by the markets at an extremely low level.

The number of geopolitical conflicts increased globally in 2014. Any future intensification or expansion of these conflicts could have a negative effect on the markets and thus the earning power of pbb Group.
Sources: Bloomberg, ECB

Real Estate Finance

The dynamic on the commercial property markets will remain high in 2015. Due to the generally low interest rates, investors continue to plan high levels of inflows into real estate as an investment class. Against this background, a further increase in the investment volume of commercial real estate can be expected for 2015.

Investors' primary focus is likely to remain on the highly liquid markets in Germany, France and the United Kingdom, followed by the Scandinavian and Eastern European markets. With the increasing interest shown by more opportunistic investors, the markets in countries such as Spain or the Netherlands are also likely to develop favourably.

Taking into account the extremely low interest rates and the high investment pressure of many institutional market players, returns are likely to decline slightly in 2015 overall. The trend of investing in more decentralised regions and locations is likely to gain momentum also with respect to the types of real estate.

The financing institutions will be able to benefit from this positive development on the equity side. Continued pressure on credit margins can, however, be expected due to the increasing willingness of non-banks to offer credit financing.
Source: CBRE research

Public Investment Finance

Banks providing public investment finance will continue to apply stringent transparency requirements to public sector borrowers in the foreseeable future. In particular, lenders will probably again begin to very selectively assess countries in focus, such as Spain and Italy, for new business opportunities under certain conditions. In addition to a clear disclosure of their financial situation and an analysis of the precise purpose of the requested funds, the borrowers' economic situation and outlook will be crucial factors in financing decisions.

This market environment will continue to see significant shifts in the competition. As a result, previously cautious banks will again start to increase their financing activity in some countries or in specific cases financing will be offered by other market participants, such as insurance companies and credit funds.

The situation on the German and French markets is likely to remain largely unchanged compared with 2014. The German market continues to be dominated by public sector banks and development banks, with margins at a low level. In France, fierce competition has led to shrinking margins. This trend could also continue next year. However, France will again offer good opportunities for transactions with attractive risk-earnings profiles.

There will also be sufficient opportunities In the area of export financing for new business in the future partly due to the modified strategic orientation of previously very active banks.

Public Budget Finance

Speculations regarding possible quantitative easing by the ECB resulted in broad yield lows on government bonds at the end of 2014. Depending on the structure and scope of the purchase program, it remains to be seen how strongly affected countries such as Italy will be which already have very low returns.

Funding Markets

The central banks continue to provide the impetus for the capital markets. In Europe, the third covered bond purchase program will keep the funding costs for covered bonds at a low level. At the same time, however, established groups of investors will be driven towards more risky products.

A continuing historically low-interest rate environment, in parts with negative interest rates on savings deposits, is likely to favour demand by investors for unsecured bonds and drive investors further along the credit curve to more risky assets.

In recent years, the regulatory environment has changed significantly and issuers and investors will continue to be faced with major challenges. However, the regulatory and legal changes could make it difficult for some issuers to place unsecured bonds.

Company Forecasts

The forecasts for pbb Group's future development represent estimates that were made on the basis of the information currently available. If the assumptions on which the forecasts are based on do not materialise or if risks and opportunities do not occur to the extent calculated, the actual results may differ significantly from the results currently expected.

Privatisation Project

In summer 2014, pbb's parent company, HRE Holding, started the privatisation process for pbb. pbb's Management Board set up a project and drove the privatisation forward with the highest priority. The Management Board works closely with the parent company's committees as well as the Bundesanstalt für Finanzmarktstabilisierung (Federal Financial Market Stabilisation Authority) and the Federal Ministry of Finance. Citigroup Global Markets Deutschland AG and Deutsche Bank AG were mandated as joint global coordinators and financial advisers.

In the first formal step HRE Holding started a tender process for up to 100% of the shares in pbb on 17 February 2015, which has not been completed yet. The preparations for a stock exchange listing for pbb, which represents an alternative privatisation pathway to the tender process, were also initiated.

In recent years, pbb met the requirements for privatisation with its successful restructuring, realignment and re-entry into the credit and capital markets as well as by sustainably increasing its earning power.

pbb's privatisation is a condition imposed by the European Commission from the state aid decision in summer 2011. This condition affects the Federal Republic of Germany as the ultimate owner of HRE Holding. The privatisation of pbb by the Federal Republic of Germany must be concluded by the end of 2015 in accordance with the decision of the European Commission.

The privatisation project ensures that the legal and organisational requirements for unbundling HRE Holding and pbb Group are being prepared for and met.

Future Developments in Assets, Financial Position and Earnings

pbb Group regards itself as well equipped to be in a position to privatise in 2015. For 2015, the period of the forecast, pbb Group is aiming for growth. The Group aims for a slight increase of the profit or loss before tax compared to 2014 (€174 million) adjusted by the revaluation loss for the Heta exposure (€–120 million). A significant increase is aimed for the profit or loss before tax in comparison with the result of €54 million recognised in 2014. pbb Group also aims for a slight increase in the new business volume (2014: €10.2 billion). The effect from the increase in new business could more than compensate for the higher expenses from the bank levy and for meeting regulatory requirements. Due to the development in new business, a slight increase in the notional amounts of REF and PIF financing is aimed for (31 December 2014: €29.8 billion). A significant improvement in return on equity after tax compared with the value recognised in 2014 (0.1%) and the figure for 2014 adjusted by the revaluation for the Heta exposure (3.4%) is aimed for.

However in the event of a harmful change in ownership as provided for in section 8c Körperschaftssteuergesetz (German Corporate Tax Act), pbb Group's current tax losses carried forward could no longer be usable. As a result, the current deferred tax assets on tax losses carried forward would have to be written off. This would result in a negative net income/loss and a negative return on equity after tax.

For the cost-income ratio – a financial key performance indicator for efficiency – a slight year-on-year improvement compared to the 2014 figure adjusted by the revaluation for the Heta exposure (2014: 57.3%) is aimed for. A significant improvement is aimed for in comparison with the cost-income ratio of 77.0% recognised in 2014.

Profits will be retained until the privatisation under the burden sharing required by the European Commission in order to redeem the silent participation made by the Financial Market Stabilisation Fund (Finanzmarktstabilisierungsfonds-FMS). This condition will be lifted after the privatisation has been completed.

Again it is aimed for that profit or loss before tax remains to be primarily attributable to the Real Estate Finance segment (REF) in financial year 2015. Slightly positive profit or loss before tax is aimed for in the Public Investment Finance (PIF) and Value Portfolio (VP) segments.

An important secondary condition for pbb Group besides meeting its earnings and profitability targets is to ensure its risk bearing capacity. With respect to the going-concern perspective, it is aimed for that the risk covering potential available after complying with regulatory minimum capital ratios will exceed the required economic capital. From a gone-concern perspective, pbb Group aims for the available capital to exceed the required economic capital as long as spreads in the European countries in focus do not widen significantly increasing the hidden liabilities.

In 2015, the CET1 capital ratio is aimed to be significantly below the level of 2014 (21.7%) due to the planned repayment of the silent participation. Nevertheless, the aim is to ensure that the CET1 capital ratio is significantly above the limit required by the regulatory authority as well as significantly above the CET1 capital ratio aimed for by pbb Group (core equity tier 1 ratio in accordance with Basel III) of 12.5%.

Total assets as at 31 December 2014 amounted to €75.5 billion. In 2015 the increase in assets in the REF and PIF segments is aimed to compensate for the strategic decline of the budget finance in the VP segment. As a consequence of the higher REF and PIF finance volumes, a slight rise of funding requirement is aimed for, increasing the liabilities side.

Opportunities The following opportunities may affect the future development in assets, financial position and earnings:

- In recent years, pbb Group has developed an excellent market position, which has also been evident in the increase in the new business volume in 2014 compared with the prior year. This successful reorientation has made it possible for pbb Group to continue its healthy development and increase the profitability of its core business areas of commercial real estate finance and public investment finance with the aim of achieving growth.
- The discontinuation of the operating services provided to FMS Wertmanagement in September 2013 and the IT services to DEPFA at the end of 2014 has created another opportunity to further increase the focus on the relevant customer markets in the areas of commercial real estate finance and public investment finance. This should have a positive impact on new business volumes and hence also on the development in assets and earnings.

> There is strong demand for financing on the markets which are relevant for pbb Group. In this context, pbb Group considers that the market climate in commercial real estate finance will be attractive in the long term; this would have a positive impact on the volume of new business and would thus have a positive impact on the development in assets and earnings.
> Likewise, pbb Group sees an attractive market environment in the second strategic segment public investment finance. A high demand for financing of the public infrastructure continues to be expected, which would have a positive effect on the volume of new business and consequently on the development in assets and earnings.
> The development on the real estate markets offer the opportunity for an increase in value of pbb Group's restructured properties and thus the possibility of profitably selling them.
> The non-strategic Value Portfolio has decreased significantly in recent years. The volume is also expected to decline further in the future. Potential for growth in the strategic segments is therefore created with the associated release of risk-weighted assets, which will have a positive effect on the development in earnings.
> The conditions imposed by the European Commission on pbb Group in respect of the limitations on new business activities will be lifted after the privatisation. pbb Group could expand its business activities in new markets and thereby increase its profitability, however, it does not intend to change its conservative risk profile at this time.
> Pfandbriefe are a sound investment with a tried-and-tested market infrastructure; this is also reflected by the strong demand from investors. pbb Group has extensive experience in the Pfandbrief market and is able to build on its existing customer relationships. As a result, it was able to successfully place several mortgage and public sector Pfandbrief issues on the market in recent years. A mortgage Pfandbrief with a term of three years at the valid reference rate was thus issued on the swap market without premium for the first time in the reporting year. pbb Group therefore utilises a capital market instrument that is still in demand – something that has a positive effect on its development in financial position.
> pbb Group also placed unsecured issues, a clear reflection of investors' confidence. This important means of raising funds has a positive impact on pbb Group's liquidity and the development in financial position.
> pbb Group issues overnight deposits and term deposits with terms of up to ten years via pbb direkt. The latter's deposit volumes have increased continuously in 2014, allowing pbb Group to access a new source of funding and react flexibly to market opportunities. This has a positive impact on pbb Group's liquidity and the development in financial position.
> pbb Group's strict focus on costs represents a further opportunity. The reduced general and administrative expenses in financial years 2014 and 2013 demonstrate the success already achieved. The status of processes will be continuously monitored in order to identify appropriate improvement measures. pbb Group aims to maintain a stable cost base to increase the profitability supported by an active growth. This would positively influence liquidity and the development in earnings.
> Additional efficiency gains will result from the further harmonisation of the IT systems. This is supported by a new framework agreement with an external service provider which is contributing to a further reduction in the IT expenses.
> pbb Group is an attractive employer. Capable and highly qualified employees and executives can be retained and recruited who support pbb Group achieve its ambitious targets.

Risks However, the possibility of future negative effects on pbb Group's development in assets, financial position and earnings cannot be ruled out. The level of exposure is influenced through the occurrence or non-occurrence of the following risks, or the extent to which the following risks might materialise:

- Several European countries were only able to obtain funding with the support of international aid programmes in recent years. If the debt crisis in certain countries worsened further and it became necessary for creditors to take a haircut on other countries' bonds or if public sector debtors became insolvent pbb Group could also suffer substantial allowances for losses on loans and advances and securities. These allowances might increase if, due to market turbolences, the crisis of individual countries spreads to debtors currently considered to be solvent. In addition, the legal underlying conditions for guarantees and warranties may change.
- Allowances on losses for loans and advances were only required for a small number of individual exposures in recent years thanks, among other things, to pbb Group's successful portfolio management. Nevertheless, it is still possible that significant allowances on losses for loans and advances will have to be recognised in the future. The need to recognise allowances on losses for loans and advances primarily depends on the economic situation of the financed objects, although it could also be the result of a general crisis in individual markets, such as the real estate markets of various countries. In addition, the legal underlying conditions for guarantees and warranties may change.
- The number of geopolitical conflicts increased globally in 2014. Any future intensification or expansion of these conflicts could have a negative effect on the markets and thus the earning power of pbb Group.
- The situation on the funding markets improved further in 2014; in addition the ECB has further measures at its disposal. However the ECB interventions show that the funding markets continue to be prone to disturbances. If the European economy dipped again into recession, the recovery from the debt crisis in some states would be put at risk resulting in a new loss of confidence and sharp sales reductions on the issuing markets or the interbank market. Interest rate movements could also affect market liquidity. If the funding markets were to be disrupted by such events, pbb Group's liquidity situation could be negatively impacted despite the existence of an appropriate cushion. A further consequence might be a conscious reduction in the volume of new business.
- Rating agencies continue to adapt their methodologies and models in order to assess, amongst other factors, the changing macro-economic environment and the potential impact of the European sovereign debt crisis. These include the new European legislative initiatives to centralise supervision of large banks and to support bank resolution and bail-in of senior unsecured creditors. At the beginning of 2015, the methodological changes that have been announced in this context were not fully finalised, implementation is however expected to take place later in the year. The possible extent of rating downgrades depends on the respective degree of systemic support uplift taken into account in the senior unsecured ratings and the rating agencies' ultimate dealings with this topic. Against the aforementioned background and beyond, methodological amendments with regard to covered bond ratings were also announced or implemented, which may have an impact on the ratings upon their application. Furthermore, changes to specific rating drivers with regards to the bank or its Pfandbriefe, as well as the privatisation of pbb which is planned by year-end 2015, may result in rating changes. In general, privatisation can – depending on, amongst other things, the future ownership structure, the new owners' creditworthiness and strategy – have a neutral, positive or negative rating effect. Due to the existing linkages, changes to issuer ratings can correspondingly affect the Pfandbrief ratings. Downgrades of the bank and/or Pfandbrief ratings could have a negative impact, particularly on the bank's funding conditions, on triggers and termination rights within derivatives and other contracts and on access to suitable hedge counterparties and hence may compromise pbb's liquidity as well as its development in assets, financial position and earnings.

- pbb Group's planned profitability is based on adequate growth and high portfolio profitability. Should the development of the size and margins of the portfolio aimed for, for example by increased competition on the market, not be achieved, pbb Group will not be able to reach the required cost-income ratio.
- The market interest rate level is currently at an extremely low level. If market interest rates remained at this low in the long run or dropped even further, it could have negative effects on some of pbb Group's portfolios, such as the investment of the liquidity reserve and the investment of own funds. This may compromise the development in earnings. Negative effects may also impact other market participants, which may have a positive or negative effect on the competition. In extreme cases, turbulences may arise on the market due to the interconnected nature of the markets.
- Pursuant to the waiver regulation in accordance with Art. 7 of the Capital Requirements Regulation (CRR), pbb is, amongst others, exempted from determining its own funds and Tier 1 capital ratios as well as determining respectively monitoring its limits on large loans. During the course of the targeted privatisation, pbb Group will be separated from HRE Holding. In this context, the exemption offered by the waiver is expected to be lifted. This could result in an additional capital requirement or a limitation of business activities (for instance, due to lower limits on large loans), which could have a negative effect on pbb Group's development in assets, financial position and earnings.
- The ongoing development of national and international regulatory requirements may have an impact on the structure of assets and liabilities affecting the development in earnings. For instance the further development of the obligations presented by the Basel Committee on Banking Supervision («Basel III» regulation), introduced in the EU via the CRR, regarding more stringent liquidity and capital requirements might have a negative impact on profitability. In addition it is possible that additional requirements for the capital structure (Minimum Requirement for Own Funds and Eligible Liabilities – MREL) and the level of indebtedness (Leverage Ratio) currently under discussion may have a negative effect on the funding and business activity of pbb Group. Existing regulatory and economic parameters could be impacted, too resulting for example in a change in the capitalisation.
- With its «Guidelines for common procedures and methodologies for the supervisory review and evaluation process» (SREP Guidelines) from December 2014 the EBA proposed a uniform procedure to be used by the ECB in reviewing and assessing credit institutions. The key areas of focus are credit, market price and operational risks, interest rate fluctuation risks in the investment book, risks of excessive indebtedness, liquidity risks and their management. Minimum ratios have been provided for monitoring purposes. pbb Group does not rule out that the ECB may demand a higher capitalisation and even higher equity ratios in the future. This could impact the development in assets, financial position and earnings of pbb Group.
- As part of its approval decision in the state aid proceedings, the European Commission specified the privatisation of pbb as soon as possible, by no later than 31 December 2015. If privatisation fails to be carried out by 31 December 2015, a divestiture trustee will sell pbb to a purchaser without a minimum price being specified, provided that the Commission has approved the purchaser and the final binding purchase agreement. The sale or alternative shareholder concepts agreed with the European Commission could have a positive or negative impact on the development in assets, financial position and earnings of pbb Group.

- > The methods used to value financial instruments are constantly evolving on the market. For example, the market conventions for valuing derivatives have changed, the effect of which can, inter alia, be seen in the increasing use of funding value adjustments for taking into account funding costs of unsecured transactions when pricing derivatives. Such or similar changes could have a negative impact on pbb Group's development in earnings in the future.
- > The risk bearing capacity concept is enhanced on a continuous basis. These enhancements and new regulatory requirements could have an impact on the risk bearing capacity assessment using both the going concern approach and the gone concern approach. The development of the market values of assets and liabilities is an influencing factor affecting the risk bearing capacity in the gone-concern approach. If hidden liabilities increased due to changes in fair value, the cover capital could fall below the economic capital requirement.
- > pbb Group's image has been stressed by its affiliation to HRE Group in recent years. Negative consequences for the achievement of pbb Group's objectives cannot be ruled out.
- > Due to the nature of its business and the international expansion as well as the high number of relevant laws and regulations, pbb Group is involved in litigation, arbitration and regulatory proceedings in some countries. Legal disputes which are currently pending (especially relating to participation certificates issued, described under the Note «Provisions»), or could become pending in the future, could have a material adverse effect on pbb Group's total other comprehensive income for the period and equity base.
- > New developments in legislation and case law could have a negative effect on the business and thus the development in assets, financial position and earnings of pbb Group.
- > pbb Group is exposed to operational risks, resulting, for example, from technology risks. Although pbb Group has already successfully completed a number of projects to optimise processes and IT infrastructure, it is exposed to operational risks that could result in significant losses.
- > A further operational risk results from reliance on employees who hold risk-taking positions. Resignations of employees in key positions cannot be ruled out. This could impact the development in assets, financial position and earnings.
- > Additional bank levies are planned or under discussion in most EU countries. Examples include the introduction of a European restructuring fund or a financial market transaction tax. Such taxes could have a negative impact on pbb Group's total other comprehensive income for the period and render certain transactions unprofitable.

Summary

pbb Group's positive development in recent years will result in numerous opportunities to increase profitability in future. However, this assessment is based on the assumption that risks arising, for instance, from factors beyond pbb's control, such as the sovereign debt crisis, do not materialise. Overall, giving due consideration to the opportunities and risks, pbb Group expects a profit or loss before tax for 2015 slightly above the result for 2014 (€174 million), which was adjusted for the Heta exposure (€–120 million). A significant increase is aimed for in comparison with the profit or loss before tax recognised in 2014 of €54 million.

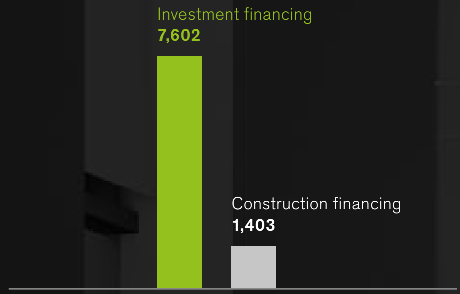
Areim Fastigheter 2 AB Stockholm

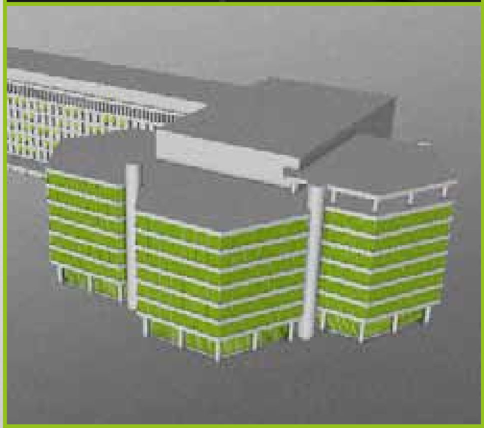
€ 155 million

Investment finance
Sweden
March 2014

pbb provided SEK 1,385 billion (approx. € 155 million) in acquisition financing to Areim Fastigheter 2 AB («Areim») for the purchase of a 38,000 m² office building in Stockholm, Sweden. The landmark property is situated on the edge of Stockholm's Central Business District and is the headquarters of the insurance company Trygg-Hansa. The transaction is a further demonstration of pbb's strong commitment to the nordic markets, which is one of pbb's core markets. pbb has been servicing the nordic region from its Stockholm office since September 2012.

New business 2014 according to loan type
in € million (commitments, including extensions > 1 year)





Consolidated Financial Statements

Consolidated Financial Statements
Consolidated Income Statement

Consolidated income statement in € million	Notes	**2014**	**2013**[1]	Change
Operating income		326	482	−156
Net interest and similar income	32	421	319	102
Interest and similar income		2,333	2,487	−154
Interest and similar expenses		−1,912	−2,168	256
Net fee and commission income	33	1	9	−8
Fee and commission income		13	15	−2
Fee and commission expenses		−12	−6	−6
Net trading income	34	−30	−51	21
Net income from financial investments	35	−77	96	−173
Net income from hedging relationships	36	−3	9	−12
Net other operating income/expenses	37	14	100	−86
Loan loss provisions	38	−21	−8	−13
General and administrative expenses	39	−251	−312	61
Net miscellaneous income/expenses	40	–	3	−3
Profit or loss before tax		**54**	**165**	**−111**
Income taxes	41	−50	−5	−45
Net income/loss		**4**	**160**	**−156**
attributable to: Equity holders		4	160	−156

[1] Adjusted due to retrospective IFRS 10 first time adoption. Details are disclosed in Note «Principles».

Consolidated Statement of Comprehensive Income

Consolidated statement of comprehensive income			2014			2013
in € million	Before tax	Tax	Net of tax	Before tax	Tax	Net of tax
Profit or loss	**54**	**−50**	**4**	**165**	**−5**	**160**
Items that will not be reclassified to income statement	−53	15	−38	7	−2	5
Profits/losses from pension commitments	−53	15	−38	7	−2	5
Items that may be reclassified to income statement	34	−9	25	45	−13	32
Foreign currency reserve	1	–	1	−1	–	−1
AfS reserve	166	−46	120	196	−56	140
Cash flow hedge reserve	−133	37	−96	−150	43	−107
Total other comprehensive income	**−19**	**6**	**−13**	**52**	**−15**	**37**
Total comprehensive income of the period	**35**	**−44**	**−9**	**217**	**−20**	**197**
attributable to:						
Equity holders	35	−44	−9	217	−20	197

Components of consolidated statement of comprehensive income		
in € million	2014	2013
Net income/loss	**4**	**160**
Profits/losses from pension commitments	−38	5
Unrealised gains/losses	−38	5
Foreign currency reserve	1	−1
Unrealised gains/losses	1	−1
AfS reserve	120	140
Unrealised gains/losses	120	137
Reclassification adjustments for gains/losses included in profit or loss	–	3
Cash flow hedge reserve	−96	−107
Unrealised gains/losses	60	−175
Reclassification adjustments for gains/losses included in profit or loss	−156	68
Total other comprehensive income	−13	37
Total unrealised gains/losses	143	−34
Total reclassification adjustments for gains/losses included in profit or loss	−156	71
Total comprehensive income of the period	**−9**	**197**

Consolidated Statement of Financial Position

Assets in € million	Notes	31.12.2014	31.12.2013[1)2)]	Change	1.1.2013[1)2)]
Cash reserve	9, 43	57	3,532	−3,475	1,929
Trading assets	10, 44	2,016	1,642	374	3,325
Loans and advances to other banks	11, 45	6,800	6,685	115	8,917
Loans and advances to customers	11, 46	38,964	36,242	2,722	49,590
Allowances for losses on loans and advances	12, 47	−138	−148	10	−325
Financial investments	13, 48	20,475	20,725	−250	25,326
Property and equipment	14, 49	8	1	7	2
Intangible assets	15, 50	23	31	−8	39
Other assets	16, 51	6,659	4,769	1,890	7,242
Income tax assets	25, 52	654	1,162	−508	1,701
Current tax assets		29	44	−15	53
Deferred tax assets		625	1,118	−493	1,648
Total assets		**75,518**	**74,641**	**877**	**97,746**

Equity and liabilities in € million	Notes	31.12.2014	31.12.2013[1)2)]	Change	1.1.2013[1)2)]
Liabilities to other banks	17, 56	3,187	3,522	−335	7,797
Liabilities to customers	17, 57	10,593	10,848	−255	11,895
Securitised liabilities	17, 58	47,827	46,858	969	52,296
Trading liabilities	18, 59	1,960	1,453	507	3,192
Provisions	19, 60	272	209	63	235
Other liabilities	20, 61	6,182	4,722	1,460	14,438
Income tax liabilities	25, 62	712	1,187	−475	1,695
Current tax liabilities		82	64	18	64
Deferred tax liabilities		630	1,123	−493	1,631
Subordinated capital	21, 63	1,279	2,357	−1,078	2,910
Liabilities		**72,012**	**71,156**	**856**	**94,458**
Equity attributable to equity holders		**3,506**	**3,485**	**21**	**3,288**
Subscribed capital	64	380	380	–	380
Silent partnership contribution	22, 64	999	999	–	999
Additional paid-in capital	64	3,265	5,036	−1,771	5,036
Retained earnings	64	−1,154	−3,115	1,961	−3,184
Profits/losses from pension commitments	19	−79	−41	−38	−46
Foreign currency reserve	24	2	1	1	2
Revaluation reserve	8	89	65	24	32
AfS reserve		−100	−220	120	−360
Cash flow hedge reserve		189	285	−96	392
Consolidated profit/loss 1.1.–31.12.		4	160	−156	69
Equity		**3,506**	**3,485**	**21**	**3,288**
Total equity and liabilities		**75,518**	**74,641**	**877**	**97,746**

[1)] Adjusted due to retrospective IFRS 10 first time adoption. Details are disclosed in Note «Principles».
[2)] Adjusted due to IAS 8.42. Details are disclosed in Note «Consistency».

Consolidated Statement of Changes in Equity

Consolidated statement of changes in equity	Equity attributable to equity holders									
							Revaluation reserve			
in € million	Subscribed capital	Silent participation	Additional paid-in capital	Retained earnings	Profits/losses from pension commit-ments	Foreign currency reserve	AfS reserve	Cash flow hedge reserve	Consoli-dated profit/loss	**Equity**
Equity at 31.12.2012[1]	**380**	**999**	**5,036**	**−3,166**	**–**	**−29**	**−360**	**400**	**69**	**3,329**
Changes due to retrospective first time adoption of IFRS 10 and IAS 19 (revised 2011)	–	–	–	5	−46	–	–	–	–	−41
Adjustments due to IAS 8.42[2]	–	–	–	−23	–	31	–	−8	–	–
Equity at 1.1.2013	**380**	**999**	**5,036**	**−3,184**	**−46**	**2**	**−360**	**392**	**69**	**3,288**
Capital increase	–	–	–	–	–	–	–	–	–	–
Transaction costs of capital measures	–	–	–	–	–	–	–	–	–	–
Treasury shares	–	–	–	–	–	–	–	–	–	–
Distribution	–	–	–	–	–	–	–	–	–	–
Total comprehensive income for the year	–	–	–	–	5	−1	140	−107	160	197
Transfer to retained earnings	–	–	–	69	–	–	–	–	−69	–
Changes in the group of consolidated companies	–	–	–	–	–	–	–	–	–	–
Equity at 31.12.2013	**380**	**999**	**5,036**	**−3,115**	**−41**	**1**	**−220**	**285**	**160**	**3,485**
Equity at 1.1.2014	**380**	**999**	**5,036**	**−3,115**	**−41**	**1**	**−220**	**285**	**160**	**3,485**
Capital increase	–	–	–	–	–	–	–	–	–	–
Transaction costs of capital measures	–	–	–	–	–	–	–	–	–	–
Equity transfer	–	–	−1,771	1,771	–	–	–	–	–	–
Treasury shares	–	–	–	–	–	–	–	–	–	–
Distribution	–	–	–	–	–	–	–	–	–	–
Total comprehensive income for the year	–	–	–	–	−38	1	120	−96	4	−9
Transfer to retained earnings	–	–	–	160	–	–	–	–	−160	–
Changes in the group of consolidated companies	–	–	–	–	–	–	–	–	–	–
Contribution from equity holder	–	–	–	30	–	–	–	–	–	30
Equity at 31.12.2014	**380**	**999**	**3,265**	**−1,154**	**−79**	**2**	**−100**	**189**	**4**	**3,506**

[1] As disclosed in consolidated financial statements 2012. Retrospective IAS 19 (revised 2011) first time adoption took effect in 2013.
[2] Details are disclosed in Note «Principles».

Consolidated Statement of Cash Flows

Consolidated statement of cash flows[1] in € million	2014	2013[2]
Net income/loss	**4**	**160**
Write-downs, provisions for losses on, and write-ups of, loans and advances and additions to provisions in lending business	27	13
Write-downs and depreciation less write-ups on non-current assets	98	15
Change in other non-cash positions	157	185
Result from the sale of non-current assets	−23	−97
Other adjustments	−371	−320
Subtotal	**−108**	**−44**
Change in assets and liabilities from operating activities after correction for non-cash components		
Increase in assets/decrease in liabilities (–)		
Decrease in assets/increase in liabilities (+)		
Trading portfolio	−8	−57
Loans and advances to other banks	−1,132	2,162
Loans and advances to customers	−1,331	4,892
Other assets from operating activities	4	119
Liabilities to other banks	−490	−3,992
Liabilities to customers	−251	−927
Liabilities evidenced by certificates	−1,229	−3,595
Other liabilities from operating activities	−290	−561
Interest income received	2,186	2,226
Interest expense paid	−1,661	−1,987
Taxes on income paid/refund	−10	11
Cash flow from operating activities	**−4,320**	**−1,753**
Proceeds from the sale of non-current assets	3,081	4,765
Payments for the acquisition of non-current assets	−2,134	−944
Proceeds from the sale of investments	6	81
Cash flow from investing activities	**953**	**3,902**
Contribution from equity holder	30	–
Payments of subordinated capital	−138	−546
Cash flow from financing activities	**−108**	**−546**
Cash and cash equivalents at the end of the previous period	3,532	1,929
+/– Cash flow from operating activities	−4,320	−1,753
+/– Cash flow from investing activities	953	3,902
+/– Cash flow from financing activities	−108	−546
+/– Effects of exchange rate changes and non-cash valuation changes	–	–
Cash and cash equivalents at the end of the period	**57**	**3,532**

[1] Explanations in Note «Notes to the Items in the Consolidated Statement of Cash Flows»
[2] Adjusted due to retrospective IFRS 10 first time adoption. Details are disclosed in Note «Principles».

Notes

1 General Information

The Group is headed by pbb which is registered in the commercial register of the Amtsgericht (local court) Munich (HRB 41054) and is a 100% subsidiary of Hypo Real Estate Holding AG (HRE Holding). HRE Holding is a 100% subsidiary of Finanzmarktstabilisierungsfonds-FMS. pbb Group combines the strategic assets and new business of Hypo Real Estate Group (HRE). New business is generated in real estate finance and public investment finance.

Accounting Policies

2 Principles

pbb has prepared its consolidated financial statements for the period ended 31 December 2014 in line with EC ordinance No. 1606/2002 of the European Parliament and Council of 19 July 2002 in accordance with International Financial Reporting Standards (IFRS). These financial statements are based on the IFRS rules, which have been adopted in European Law by the European Commission as part of the endorsement process; they are also based on the regulations of commercial law which are applicable in accordance with Section 315 a (1) HGB (German Commercial Code). With the exception of certain regulations on fair value hedge accounting for a portfolio hedge of interest rate risks in IAS 39 Financial Instruments: Recognition and Measurement, all the IFRS rules requiring to be applied in terms of the regulations specified by IFRS were fully recognised by the European Union (EU). Pbb Group does not use fair value hedge accounting for a portfolio hedge of interest rate risks. The consolidated financial statements therefore comply with IFRS as a whole as well as the IFRS as applicable in the EU.

The IFRS are standards and interpretations adopted by the International Accounting Standards Board (IASB). These are, in particular, 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). In addition, the German Accounting Standards (Deutsche Rechnungslegungs Standards – DRS) published by the Deutsche Rechnungslegungs Standards Committee (DRSC) have been taken into account provided they are not inconsistent with the IFRS.

The Management Board of pbb prepared these consolidated financial statements on 18 March 2015 under the going-concern assumption.

Initially Adopted Standards, Interpretations and Amendments Applied for the First Time The following standards, interpretations and amendments were applied for the first time in financial year 2014:
> IFRS 10 Consolidated Financial Statements and IAS 27 Separate Financial Statements (revised 2011)
> IFRS 11 Joint Arrangements and IAS 28 Investments in Associates and Joint Ventures (revised 2011)
> IFRS 12 Disclosure of Interests in Other Entities
> Amendments to IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interests in Other Entities: Transition Guidance
> Amendments to IFRS 10 Consolidated Financial Statements, IFRS 12 Disclosure of Interests in Other Entities and IAS 27 Separate Financial Statements: Investment Entities
> Amendments to IAS 32: Offsetting Financial Assets and Financial Liabilities
> Amendments to IAS 36: Recoverable Amount Disclosures for Non Financial Assets
> Amendments to IAS 39: Novation of Derivatives and Continuation of Hedge Accounting

IFRS 10 and IAS 27 (revised 2011) IFRS 10 replaces the guidance on control and consolidation previously contained in IAS 27 and SIC-12. IFRS 10 introduces the concept of control as the basis for consolidation. Under this model, parent-subsidiary relationships can arise not only from voting power, but from other contractual arrangements as well. IAS 27 was renamed Separate Financial Statements and now deals only with separate financial statements; SIC-12 was withdrawn.

Due to the retrospective first-time application of IFRS 10, the formerly consolidated company House of Europe Funding I Ltd., George Town, no longer requires consolidation. The deconsolidation resulted in a reduction in the balance sheet total of €202 million as of 31 December 2013 (2012: €254 million), which affected the cash reserve (€0 million, 2012: €8 million), financial investments (€167 million; 2012: €246 million) and loans and advances to other banks (€35 million; 2012: €0 million) on the assets side, and securitised liabilities (€202 million; 2012: € 254 million) on the liabilities side. The deconsolidation did not affect the consolidated income statement.

In addition, based on IFRS 10, the first-time consolidation of DEPFA Finance N.V., Amsterdam, resulted in an increase in retained earnings as a sub item of equity of €5 million as of 1 January 2014/31 December 2013 (2012: €5 million). In addition, the subordinated liabilities in the subordinated capital increased by €917 million as of 1 January 2014/31 December 2013 (2012: €917 million). On the assets side, other receivables as a sub item of loans and advances to banks increased by €922 million (2012: €922 million) as of 1 January 2014/31 December 2013. The initial consolidation did not affect the consolidated income statement. DEPFA Finance. N.V., was sold to DEPFA BANK plc, Dublin, on 18 July 2014 as part of the unbundling of pbb Group and its sister group DEPFA. Details are disclosed in the Note «Consolidation».

IFRS 11 and IAS 28 (revised 2011) IFRS 11 supersedes IAS 31 and removes the option to proportionately consolidate joint ventures. From now on, joint ventures will be accounted for using the equity method in accordance with IAS 28. As pbb Group has no shares in joint ventures, the first-time application of IFRS 11 and IAS 28 (revised 2011) had no impact.

IFRS 12 IFRS 12 combines the disclosure requirements for interests in subsidiaries, joint ventures, associates and unconsolidated special-purpose vehicles in a single standard. The new standard was initially effective for financial years beginning on or after 1 January 2013. However, it was endorsed by the European Union with an effective date of 1 January 2014. pbb Group has provided the information requiring to be disclosed in accordance with IFRS 12 in the Notes «Disclosures of interests in subsidiaries», «Disclosures of interests in associates» and «Holdings of pbb».

Amendments to IFRS 10, IFRS 11 and IFRS 12 The amendments clarify that decisions about whether or not investments are required to be consolidated in accordance with IFRS 10 should be made at the beginning of the period in which the standard is applied for the first time. pbb Group has adjusted its accounting processes to ensure that the decision about whether to consolidate is made on 1 January 2014.

Amendments to IFRS 10, IFRS 12 and IAS 27 The amendments pertain to specifically defined investment entities. As pbb Group is not classified as an investment entitiy due to its business model the first-time application had no impact.

Amendments to IAS 32 The amendments clarify the requirements for offsetting financial instruments. The first-time application had no significant impact on pbb Group.

Amendments to IAS 36 These relate to cash-generating units to which significant goodwill or significant intangible assets with an indefinite useful life have been allocated. The amendment had no effect on these consolidated statements as pbb Group has no intangible assets of this kind in its portfolio.

Amendments to IAS 39 By means of the amendments to IAS 39, the IASB has therefore added a exemption to the previous IAS 39, which provides relief from the requirement to cease hedge accounting if the novation of a hedging instrument with a central counterparty is the consequence of a regulatory or statutory directive. pbb Group made use of the exemption in order to structure its hedging relationships effectively.

Standards, Interpretations and Amendments Endorsed by the EU but Not Yet Effective

The following standards, interpretations and amendments were endorsed by the EU as of the balance sheet date but are not yet applicable and were not voluntarily applied early:

> IFRIC Interpretation 21 Levies
> Amendments to IAS 19 (revised 2011) Employee Benefits: Defined Benefit Plans – Employee Contributions
> Annual Improvements to IFRSs 2010–2012 Cycle
> Annual Improvements to IFRSs 2011–2013 Cycle

IFRIC Interpretation 21 IFRIC 21, an interpretation of IAS 37, clarifies when a present obligation exists and a provision or liability has to be recognised for levies imposed by governments. In particular, levies resulting from IAS 12 as well as fines and penalties are not within the scope of IFRIC 21. In the European Union, IFRIC 21 is effective for financial years beginning on or after 17 June 2014. For pbb Group, IFRIC 21 is not at present expected to have a significant impact on the levies currently payable.

Amendments to IAS 19 (revised 2011) The amendments to IAS 19 clarify the requirements regarding the attribution of employee contributions or contributions from third parties to periods of service when the contributions are linked to service. They also provide relief when contributions are independent of the number of years of service. The amendments are effective for financial years beginning on or after 1 July 2014. They are not expected to have a significant impact on pbb Group.

Annual Improvements Project Annual Improvements to IFRSs 2010–2012 relates to IFRS 2, IFRS 3, IFRS 8, IFRS 13, IAS 16, IAS 38 and IAS 24, and Improvements to IFRSs 2011–2013 to IFRS 1, IFRS 3, IFRS 13 and IAS 40. The amendments are to be applied for the first time to reporting periods beginning on or after 1 July 2014. All the amendments and adjustments are either not relevant or of minor importance for pbb Group. No significant effects are expected.

Standards, Interpretations and Amendments Issued but Not Yet Endorsed by the EU In addition, standards, interpretations and amendments were issued, but had not yet been endorsed by the European Union and not applied early by pbb Group as at the reporting date. The dates of the first application for the following standards are subject to endorsement by the European Union:
> IFRS 9 – Financial Instruments
> IFRS 14 Regulatory Deferral Account
> IFRS 15 Revenue from Contracts with Customers
> Amendments to IFRS 10, IFRS 12 and IFRS 28: Investment Entities – Applying the Consolidation Exception
> Amendments to IFRS 10 and IAS 28: Sale or Contribution of Assets Between an Investor and its Associate or Joint Venture
> Amendments to IFRS 11: Accounting for Acquisitions of Interests in Joint Operations
> Amendments to IAS 1: Disclosure Initiative
> Amendments to IAS 16 and IAS 41: Bearer Plants
> Amendments to IAS 16 and IAS 38: Clarification of Acceptable Methods of Depreciation and Amortisation
> Amendments to IAS 27: Equity Method in Separate Financial Statements
> Annual Improvements to IFRSs 2012–2014 Cycle

IFRS 9 The IASB has a project to replace IAS 39 Financial Instruments: Recognition and Measurement was concluded with the publication of IFRS 9 in July 2014. In its final version, the standard contains fundamental revisions of Classification and Measurement, Impairment Methodology and Hedge Accounting. The latter, however, without regulations on macro hedging.

The Classification and Measurement phase provides the following measurement categories for the classification of financial instruments:
> at fair value through profit or loss
> at fair value through other comprehensive income
> at amortised cost

The classification of financial debt instruments on the assets side depends on the entity's business model for managing financial assets and the characteristics of the contractual cash flows of the financial asset. Equity instruments and assets at FVTPL, on the other hand, are generally required to be measured at fair value. On the liabilities side, non-derivative liabilities that are not held for trading or that the entity does not voluntarily measure at fair value must be measured at amortised cost. Changes in the value of liabilities at FVTPL that are attributable to changes in the entity's own credit risk are required to be recognised directly in equity.

With the Impairment Methodology phase, accounting for impairment losses was primarily changed so that expected losses are to be recognised in addition to only losses incurred (expected lost model).

With the new regulations in hedge accounting, accounting for hedging relationships will be more closely tied to the economic risk management of a company. In addition, the mandatory quantitative effectiveness tests for hedging relationships will no longer be required but the test can also be qualitative. As long as regulations on accounting for macro hedges have not yet been adopted, the IASB grants an accounting option according to which the former rules of IAS 39 can be applied.

IFRS 9 is to be applied for the first time to reporting periods beginning on or after 1 January 2018. The standard must be initially applied retrospectively, however, various simplification options are available. The standard may be applied earlier voluntarily. The initial application of IFRS 9 is expected to have an extensive impact on pbb's consolidated financial statements. It is likely that some assets and liabilities previously measured at amortised cost will have to be measured at fair value in future. In addition, the accounting processes relating to impairment losses will have to be substantially adjusted in accordance with the new rules, which may result in higher allowances. The exact quantitative effects on pbb Group cannot yet be reliably estimated at this point.

IFRS 14 With the new standard, companies applying IFRS for the first time will be able to retain certain regulatory provision items for price-regulated activities in the IFRS financial statements. IFRS 14 is to be applied for the first time to reporting periods beginning on or after 1 January 2016. As pbb Group is not applying IFRS for the first time, IFRS 14 will have no impact.

IFRS 15 The new standard replaces the previous standards on revenue realisation IAS 18 and IAS 11. Revenues are now realised when customers gain control over the agreed goods and services and are able to derive benefits therefrom. IFRS 15 is to be applied for the first time to reporting periods beginning on or after 1 January 2017. Due to its business model, pbb Group does not expect any significant impacts.

Amendments to IFRS 10, IFRS 12 and IAS 28 The amendments clarify exemptions from the duty to prepare consolidated financial statements pursuant to IFRS 10.4 (a) and now also prescribes that investment entities that measure their subsidiaries at fair value are included in the scope of IFRS 12. The amendments must be applied to financial years beginning on or after 1 January 2016. As pbb Group is not classified as an investment entity due to its business model, and is also not expected to qualify in the future, no impacts are expected from the amendments to IFRS 10, IFRS 12 and IAS 28.

Amendments to IFRS 10 and IAS 28 This amendment removes an inconsistency between IFRS 10 and IAS 28 and clarifies the recognition of unrealised gains from a disposal or addition of assets between an investor and an associate or a joint venture. The amendments are to be applied for the first time to reporting periods beginning on or after 1 January 2016. The effects on pbb Group will depend on whether such transactions will be conducted in the future. This was not the case in the financial year of 2014.

Amendments to IFRS 11 The amendments to IFRS 11 relate to a clarification that acquisitions of shares in joint ventures that represent a business within the meaning of IFRS 3 must also be accounted for in accordance with the principles of IFRS 3. The amendments are to be applied for the first time to reporting periods beginning on or after 1 January 2016. The effects on pbb Group will depend on whether shares in joint ventures within the meaning of IFRS 11 will be held in the future. This was not the case in the financial year of 2014.

Amendments to IAS 1 With the amendment to IAS 1, the concept of materiality is highlighted further with the aim of relieving IFRS financial statements of unimportant information thus promoting the provision of relevant information. For this purpose it is clarified that the concept of materiality must be applied to all components of the IFRS financial statements, which should prevent the shifting of irrelevant information from other parts of the financial statements to the Notes. Corresponding to this, it is clarified that unimportant information is also not separately recognised if its presentation in an IFRS standard is explicitly required. This also applies if certain minimum items are required. In addition, the following items continue to be regulated, clarified or suggested by the amendments to IAS 1:
> Presentation of subtotals
> Structure of the Notes, for instance depending on the relevance of the information for an understanding of the net assets, financial position and results of operations
> Disclosures regarding accounting methods
> Presentation of results of companies measured according to the equity method in the statement of comprehensive income as an independent item

The amendments must be applied to financial years beginning on or after 1 January 2016. pbb Group does not expect any material impacts on the consolidated financial statements.

Amendments to IAS 16 and IAS 41 The amendments govern the accounting for so-called producing plants and are to be applied for the first time to reporting periods beginning on or after 1 January 2016. The amendments had no effect on these consolidated statements as pbb Group has no assets within the meaning of IAS 41 in its portfolio.

Amendments to IAS 16 and IAS 38 The amendments to IAS 16 and IAS 38 clarify that depreciation of tangible and intangible assets with a limited useful life on the basis of revenues of goods produced by same is, in principle, not appropriate. The amendments are to be applied for the first time to reporting periods beginning on or after 1 January 2016. As pbb Group undertakes the depreciation on tangible and intangible assets on a straight-line basis using assumed useful lives, and will also continue to do so in the future, no impacts on its financial statements are expected.

Amendments to IAS 27 Interests in subsidiaries, joint ventures and associated companies can, in future, also be accounted for according to the equity method in the IFRS separate financial statements. The amendments are to be applied for the first time to reporting periods beginning on or after 1 January 2016. As the regulations relate exclusively to IFRS separate financial statements, no effects are expected to impact pbb's IFRS consolidated financial statements.

Annual Improvements Project Annual Improvements to IFRSs 2012–2014 amends the IFRS 5, IFRS 7, IAS 19 and IAS 34 standards. The amendments are to be applied for the first time to reporting periods beginning on or after 1 January 2016. All the amendments and adjustments are either not relevant or of minor importance for pbb Group. No significant effects are expected.

Statement of Compliance for the Public Corporate Governance Code of the Federation The Management Board of the Company, that is wholly owned indirectly by the Federal Republic of Germany, has resolved to use the Public Corporate Governance Code of the federation, which is based on the «comply or explain» principle, subject to identical resolution by the Supervisory Board. The Management Board and the Supervisory Board published a statement of compliance for the Public Corporate Governance Code of the federation on pbb's website (www.pfandbriefbank.com) after the respective resolution is adopted by the Supervisory Board.

Group Management Report The Group management report meets the requirements of section 315 (1) and (2) HGB (German Civil Code) and DRS 20. It comprises fundamental information about the Group, a report on the economic position, a report on post-balance sheet date events, a risk and opportunity report and a report on expected developments. The risk and opportunity report contains information which, under IFRS 7, is required to be disclosed. Events after the balance sheet date are described in the report on post-balance sheet date events.

3 Consistency

pbb Group applies accounting policies consistently in accordance with the IFRS framework concept as well as IAS 1 and IAS 8.

pbb Group determined the hedge adjustments to the derivatives incorrectly when re-designating a derivative portfolio from cash flow hedge accounting to micro fair value hedge accounting and the stand-alone portfolio prior to the earliest period shown in these consolidated financial statements. This resulted in an overstatement of the cash flow hedge reserve. In these consolidated financial statements, pbb Group corrected the cash flow hedge reserve as of 31 December 2013 and as of 1 January 2013 pursuant to IAS 8.42 with retrospective effect with no effect on profit and loss (decrease of €−8 million respectively). Retained earnings were corrected commensurately as of 31 December 2013 and 1 January 2013 (increase of € 8 million respectively). The pro forma Basel III figures of the regulatory capital, CET1, were adjusted by € 8 million as of 31 December 2013 at the same time.

In the context of the de-consolidation of units accounted for in foreign currency prior to the period recognised as the earliest in these consolidated financial statements, pbb Group carried forward the foreign currency reserve attributable to the de-consolidated units in equity. In these consolidated financial statements, pbb Group adjusted these foreign currency reserves in the statement of financial position as of 31 December 2013 and as of 1 January 2013 as well as in the consolidated statement of changes in equity for 2013 against retained earnings pursuant to IAS 8.42 with retrospective effect with no effect on profit and loss. The foreign currency reserve was adjusted commensurately as of 31 December 2013 and 1 January 2013 by € 31 million respectively, and retained earnings were adjusted commensurately as of 31 December 2013 and 1 January 2013 by €−31 million respectively.

After adjustments, the cash flow hedge reserve amounted to € 285 million as of 31 December 2013 and € 392 million as of 1 January 2013. After the two adjustments, retained earnings amounted to €−3,115 million as of 31 December 2013 and €−3,184 million as of 1 January 2013. After the adjustment, the foreign currency reserve amounted to € 1 million as of 31 December 2013 and € 2 million as of 1 January 2013. These adjustments did not impact the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of cash flows, the total assets and the total equity.

A corporate tax rate of 27.67% was used during the reporting year compared with 15.83% in the previous year. Due to the absence of DEPFA, the corporate tax rate used in the higher level HRE was the actual domestic income tax rate of pbb, which was a significant component of the two consolidated financial statements. This rate was applied uniformly to both the consolidated financial statements of pbb as well as HRE Holding. The corporate tax rate of the previous year was adjusted to 27.78% in accordance with the reporting year.

Beyond as of 31 December 2014 pbb Group applied the same accounting and measurement principles as in the consolidated financial statements as of 31 December 2013.

4 Uniform Consolidated Accounting

The separate financial statements of the consolidated domestic and foreign companies are incorporated in the consolidated financial statements of pbb Group using uniform accounting and measurement principles.

5 Consolidation

Number of subsidiaries/ entities[1]	Fully consolidated subsidiaries		Not fully consolidated subsidiaries[2]		Associated entities and other investments		
	Total	Thereof special-purpose entities	Total	Thereof special-purpose entities	Associated entities	Other investments	**Total**
1.1.2013[3]	**10**	**5**	**4**	–	**3**	**4**	**21**
Additions	1	1	–	–	–	–	1
Disposals	–1	–1	–	–	–	–	–1
Mergers	–	–	–1	–	–	–	–1
31.12.2013	**10**	**5**	**3**	–	**3**	**4**	**20**
1.1.2014	**10**	**5**	**3**	–	**3**	**4**	**20**
Additions	1	–	–	–	–	–	1
Disposals	–1	–1	–1	–	–	–1	–3
Mergers	–	–	–	–	–	–	–
31.12.2014	**10**	**4**	**2**	**–**	**3**	**3**	**18**

[1] pbb, subsidiaries, associated companies and other investments
[2] Not fully consolidated due to immateriality
[3] Adjusted due to retrospective IFRS 10 first time adoption. Details are disclosed in Note «Principles».

A subsidiary is a entity that is controlled by another entity. Control is deemed to exist if pbb has decision-making powers to manage relevant activities, has a right to significant returns from the subsidiary and can use its decision-making powers to influence the amount of the significant variable returns. Structured entities are entities in which voting rights or similar rights are not the dominant factors in determining control, such as if the voting rights relate merely to administrative duties and the relevant activities are governed by contractual agreements. As for subsidiaries, structured entities must be consolidated if the structured entity is controlled.

In the financial year of 2014, pbb Group applied the new IFRS 10 standard for the first time. The effects from the retrospective application are disclosed in the Note «Principles». The following changes arose in the scope of consolidation of pbb Group between 1 January and 31 December 2014:

> The company Immo Invest Real Estate GmbH in Munich was initially consolidated as of 1 January 2014. On 25 February 2014, the company took over all the shares in the company RPPSE Espacio Oviedo S.L.U., Madrid, which had already been consolidated in pbb Group in 2013. There were no significant impacts on the development in net assets, financial position and results of operations of pbb Group from the initial consolidation.

- DEPFA Finance. N.V., was sold to DEPFA BANK plc, Dublin, for € 6 million on 18 July 2014 as part of the unbundling of pbb Group and DEPFA. The de-consolidation resulted in a gain of € 21 million, which was recognised in pbb's consolidated financial statements under net income from financial investments. With the de-consolidation of the company, pbb's liabilities to DEPFA Finance N.V. became external relationships in respect of the Group. These liabilities no longer have to be eliminated. The first time measurement of liabilities at fair value resulted in earnings of € 21 million. The € 1 million loss generated by the company between 1 January and 18 July 2014, is included in pbb's consolidated financial statements. In accordance with the accounting regulations applicable to pbb Group, the balance sheet total amounted to € 1,233 million and, on the asset side, was almost exclusively attributed to loans and advances to banks. The equity and liabilities side comprised € 1,227 million in subordinated capital and € 6 million in equity.
- A property financed in the Netherlands was consolidated for the first time on 12 November 2014. Based on contractual agreements with the owners, pbb obtained control within the meaning of IFRS 10 over the property on the same date. The rented office building was refinanced by pbb to an amount of € 30 million. The individual valuation allowance on the receivable amounted to € 13 million. The initial consolidation resulted in an asset change. The pbb Group recognises the property with a book value of € 17 million under the item other assets instead of the loan impaired to this amount. The income from renting the property amounting to less than € 1 million is recognised in the income statement under other operating income/expenses. The interest accrued on the loan receivable from the financing of the building to date has been eliminated on the basis of contractual agreements.

Consolidation Principles At the acquisition date the costs of a business combination are allocated by recognising the acquiree's identifiable assets, liabilities and contingent liabilities that satisfy the recognition criteria according to IFRS 3.10 at their fair values at that date. Any difference between the cost of the business combination and the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities so recognised are accounted as goodwill or as an excess of acquirer's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities in accordance with IFRS 3.32–36. If the interest in net fair value of the identifiable assets, liabilities and contingent liabilities exceeds the costs of business combination the acquirer shall reassess the identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination, and recognise immediately in profit or loss any excess remaining after reassessment.

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

There are no material interests in associated companies or joint ventures. The holdings are accounted as AfS financial instruments.

6 Disclosures of Interests in Subsidiaries

These consolidated financial statements set out a list of shareholdings in the Note «Holdings of pbb». In this list, the subsidiaries are classified on the basis of whether or not they are consolidated. Other shareholdings are also listed. All fully consolidated companies have prepared their individual financial statements for the period ended 31 December 2014.

The effects of the contractual relations between the Group companies and the subsidiaries which are not consolidated are set out in the consolidated financial statements. Pbb Group was unable to reliably determine a fair value for two interests in subsidiaries (2013: three) that are not included as they are of minor importance to the Group. Interests in these companies in the legal form of a limited company (GmbH) are not traded in an active market and are therefore measured at cost and accounted for in the AfS financial investments.

The total amount of the book values of the company's interests in subsidiaries individually regarded as minor amounted to € 0 million (2013: € 0 million). The summarised balance sheet totals of the subsidiaries not included in the scope of consolidation comprised less than 0.1% of the consolidated balance sheet total, as in the previous year. The total of the Group's interests in the profit or loss of the interests in subsidiaries regarded as minor amounted to € 0 million (2013: less than € 1 million). In the financial year 2014, no financial investments whose fair value could not be reliably determined were derecognised (2013: € 1 million).

One consolidated subsidiary and one subsidiary that was not consolidated due to it being of subordinate importance for pbb Group were in liquidation. The balance sheet totals of these companies amounted to € 0 million in total (2013: € 0 million). These liquidations are expected to be concluded in the financial year of 2015.

Significant restrictions with respect to the usability of assets within the Group Statutory, contractual or regulatory restrictions and protective rights of non-controlling interests may limit the Group in its ability to obtain access to the assets and to easily transfer same to another company or other companies and pay the Group's liabilities. As of the balance sheet date the Group had no significant interests over which it could exert control. 100% of the voting right is retained in all the companies controlled by pbb. Consequently, there are no significant restrictions due to third-party protective rights.

Due to the principle of burden sharing required by the EU Commission, a condition imposed by same in 2011 as a result of the state aid procedure, profits will be retained by pbb Group until privatisation, and used for repaying the silent participation of the Federal Republic of Germany. In particular, no repayments of other equity instruments (e.g. hybrid capital instruments, profit participation certificates) not required by law may be undertaken.

7 Disclosures of Interests in Associates

An associated company is of significance to the Group due to the book values of the company's interest and the share in the profits of the investment company. pbb Group has interests in three associated companies (2013: three). Pbb Group currently has no investments in associated companies to be included according to the at-equity method due to minor importance. Interests in these companies in the legal form of a partnership are measured at amortised cost and accounted for under the AfS financial investments.

The total amount of the book values of the company's interests in associated companies individually regarded as minor amounted to € 0 million (2013: € 0 million). In the financial years 2014 and 2013 the totals of the Group's interests in the profit or loss of the interests in associated companies individually regarded as minor amounted to less than € 1 million each.

8 Financial Instruments

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

Recognition and Derecognition pbb Group recognises a financial asset or a financial liability in its statement of financial position if a Group company becomes party to the contractual provisions of the financial instrument.

The purchases or sales of financial instruments are recognised on the trading date. Premiums and discounts are recognised in accordance with the accrual concept in the position net interest and similar income. In accordance with the primary derecognition concept of IAS 39, a financial asset has to be derecognised when all risks and rewards have substantially been transferred. If the main risks and rewards of ownership of the transferred financial asset are neither transferred nor retained, and if control over the transferred asset is retained, the Company has to recognise the asset to the extent of its continuing involvement. There are no transactions within pbb Group which result in partial derecognition due to a continuing involvement.

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

Collateral with the same counterparty and same conditions (e.g. ISDA master agreement) must be netted according to IAS 32. Accordingly, only the net amount is disclosed.

Categories According to IAS 39 When a financial asset or financial liability is recognised initially, it is measured at its fair value.

For subsequent measurement purposes IAS 39 requires that all financial instruments have to be classified according to this standard, to be disclosed in the statement of financial position and to be measured according to its categorisation:

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

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

If there is a difference between transaction price and market value at the trading date and the difference results from unobservable data that have a significant impact on the measurement of a financial instrument, the difference (so-called day one profit) is not recognised immediately in profit or loss but is recognised over the life of the transaction. The remaining difference is recognised directly in profit or loss when the inputs become observable, when the transaction matures or is closed out. In the financial years 2014 and 2013 there were no material day one profits.

Designated at Fair Value through Profit or Loss (dFVTPL) If certain conditions are satisfied, financial assets or liabilities can be classified as a financial asset respectively a financial liability at fair value through profit or loss when they are initially recognised. A designation can be made if the use of the measurement category means that a recognition and measurement inconsistency is either avoided or considerably reduced, and management and performance measurement of a portfolio of financial instruments are based on the fair values or if the instrument contains a separable embedded derivative. dFVTPL financial instruments are measured at fair value. Changes in fair value are recognised in profit or loss.

As of 31 December 2014 and 31 December 2013, pbb Group had no financial assets and no financial liabilities in the category dFVTPL.

Held-to-Maturity (HtM) Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity. HtM financial investments are measured at amortised cost. In financial years 2014 and 2013, no financial assets were classified as HtM at pbb Group.

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

Loans and receivables are recognised in the positions loans and advances to banks, loans and advances to customers and financial investments, and are measured at amortised cost. Interest income from loans and receivables is recognised in net interest and similar income. Market price related net gains and net losses attributable to prepayment penalties and disposal of loans and advances to customers and of loans and advances to other banks are disclosed in net interest and similar income. Such net gains and net losses from financial investments are recognised in net income from financial investments. Impairments due to credit standing factors and which affecting profit or loss are recognised in loan loss provisions respectively, in the case of financial investments, in net income from financial investments.

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

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

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

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

Financial liabilities at amortised cost are measured at amortised cost. Financial liabilities at amortised cost that are not securitised are recognised in liabilities to other banks and liabilities to customers. If these financial liabilities are securitised and not subordinated, they are recognised in securitised liabilities. Subordinated liabilities are recognised in subordinated capital. Interest expenses from financial liabilities at amortised cost are recognised in net interest and similar income. In addition, the position net interest and similar income includes net gains and net losses attributable to repurchases or withdrawals before maturity as well as impairments and impairment reversals of financial liabilities at amortised cost.

Derivatives Derivatives are measured at fair value. Changes in fair value are recognised in profit or loss if the derivatives are not part of cash flow hedge accounting. The measurement gains and losses from stand-alone derivatives are recognised in net trading income and from hedging derivatives in net income from hedging relationships. In the statement of financial position, stand-alone derivatives are disclosed as trading assets and trading liabilities. Hedging derivatives are disclosed as other assets and other liabilities.

Outside the held-for-trading and dFVTPL category, embedded derivative financial instruments within a structured product and which are required to be separated are separated from the host contract and recognised as stand-alone derivative financial instruments. Thereafter, the host contract is measured in accordance with its classification. The change in value arising from the separated derivatives that are measured at fair value is recognised in profit or loss.

Classes IFRS 7 and IFRS 13 required disclosures according to classes of financial instruments. pbb Group mainly defined the IAS 39 measurement categories, irrevocable loan commitments, financial guarantees, hedging derivatives and cash reserve as classes.

Measurement Methods Financial instruments at fair value are measured on the basis of stock market prices or other market prices, if existent. If a price is not available from an active market, observable market prices from comparable financial instruments are used. If prices from comparable financial instruments are not available, valuation models are used that base on observable market parameters. If these parameters are not observable at the markets, the measurement of the financial assets is based on models with non-market-observable parameters. The used measurement models are market standard models. A description of these models and the products is given in the Note «Fair Values of Financial Instruments».

Impairment According to IAS 39.58 a financial asset must be tested for impairment. At each balance sheet date pbb Group assesses on a case-by-case basis whether there is objective evidence for impairment. The criteria used to determine if there is such objective evidence included:
> significant financial difficulties of the borrower
> overdue contractual payments of either principal or interest or other breaches of contract
> increased probability that the borrower will enter bankruptcy or other financial reorganisation
> renegotiations due to economic problems
> a decline in the fair value of a financial asset below its (amortised) cost

Receivables at risk of default are restructured by pbb Group if the borrower's financial position has deteriorated but a positive going-concern forecast for the loan exposure can still be carried out. This is carried out by changing the underlying terms and conditions or side agreements by means of a unilateral or mutual declaration of intent. Restructuring agreements should maximise opportunities for pbb Group to realise its outstanding receivables or at least minimise the risk of default of the loan exposure. These generally include inter alia standstill agreements, changed interest payment/repayment terms, interest/repayment reductions or the suspension of contractual agreements (e.g. financial covenants) so that the borrower is again able to meet their payment obligations. The credit risk associated with restructured loans is managed by the Group's Credit Risk Management units. The methods used to measure and manage risk are presented in the section of the risk and opportunity report entitled «Credit Risk». Further information is provided in the Note «Restructured Loans and Advances».

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

pbb Group impairs loans and advances as well as financial investments whose terms have been renegotiated if there is objective evidence for impairment.

To measure the impairment loss, the following factors are especially considered:
> pbb Group's aggregate exposure to the customer
> the amount and timing of expected interest and redemption payments
> the realisable value of collateral and likelihood and time of successful repossession
> the likely deduction of any costs involved in recovering amounts outstanding
> the market price of the asset if available

For the purpose of calculating portfolio-based allowances, financial assets measured at amortised cost for which no impairment has been identified on an individual basis are grouped in portfolios according to their credit risk. The portfolio-based allowances cover impairments which have been incurred but not yet been identified. The parameters used to determine portfolio-based allowances are checked regularly and adjusted if necessary. The allowances are determined after taking into account the following factors:
> historical loss experience in portfolios of similar credit risk characteristics
> a judgement whether current economic conditions and credit conditions improved or deteriorated compared to the past
> the estimated period between impairment occurring and the impairment being identified
> state of the current economic cycle

Hedge Accounting Hedging relationships between financial instruments are classified as a fair value hedge, a cash flow hedge or hedge of a net investment in a foreign operation in accordance with IAS 39. Hedging instruments used to hedge interest rate risks are mainly interest rate derivatives, for example interest rate swaps and options.

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

If the hedge of the fair value in the course of the reporting period meets the criteria of IAS 39.88, the hedge is accounted as follows:
> The profit or loss arising when the hedging instrument is remeasured at fair value (for a derivative hedging instrument) or the currency component of its carrying amount measured in accordance with IAS 21 (for non-derivative hedging instruments) is recognised in profit or loss for the period and
> The carrying amount of a hedged item is adjusted by the profit or loss arising from the hedged item and attributable to the hedged risks, and is recognised in profit or loss for the period. This is applicable if the hedged item is otherwise measured at cost. The profit or loss attributable to the hedged risk is recognised in profit or loss for the period if the hedged item is an available-for-sale (AfS) financial asset. The amortisation of the hedge adjustment is started on the date of the revoking of the hedge relationship.

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

Cash Flow Hedge According to IAS 39, a cash flow hedge is a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with the recognised asset or liability (for instance some or all future interest payments on variable-interest debt) or a highly probable forecast transaction that could affect profit or loss. For instance, future variable interest payments on variable interest receivables and liabilities are swapped for fixed payments primarily by means of interest rate swaps.

Under cash flow hedge accounting, hedging instruments are measured at fair value. The measurement result has to be broken down into an effective and an ineffective portion of the hedge relationship.

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

A hedging relationship is deemed to be effective if, at the beginning and throughout the entire duration of the transactions, variability in cash flows of the hedged item are compensated almost completely (range of 80% to 125%) by variability in cash flows of the hedging instruments. For the purpose of establishing whether a specific portion of the hedging instrument is effective, the future variable interest payments on the receivables and liabilities to be hedged are compared quarterly with the variable interest payments from the interest derivatives in detailed maturity bands. The dollar offset method is used to assess effectiveness.

If a cash flow hedge for a forecast transaction is deemed to be no longer effective, or if the hedge relationship is revoked, the cumulative gains or losses on the hedging instrument initially recognised in equity remain in equity until the agreed or forecast transaction occurs. At this point, the gains or losses are recognised in profit or loss. pbb Group uses a macro approach for cash flow hedge accounting.

Hedge of a Net Investment in a Foreign Operation A net investment hedge is a hedge of the foreign currency exposure on a net investment in a foreign operation. Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. pbb Group did not hedge a net investment in a foreign operation in the financial years 2014 and 2013.

9 Cash Reserve

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

10 Trading Assets

Trading assets comprise positive market values of stand-alone derivatives of the bank book. pbb Group has no non-derivative trading instruments in its portfolio. Trading assets are measured at fair value. Gains and losses arising from the valuation and realisation of trading assets are recognised in net trading income in profit or loss.

11 Loans and Advances

Loans and advances to other banks and loans and advances to customers are measured in accordance with IAS 39 at amortised cost if they are not categorised dFVTPL or AfS or a hedged item of a fair value hedge. As of 31 December 2014, and as of 31 December 2013, pbb Group did not have loans and advances which are classified as AfS or dFVTPL.

Additions to allowances for losses on loans and advances are disclosed as a separate item provisions for losses in profit or loss. Value changes from hedge relationships are recognised under net income from hedging relationships. All other income and expenses from loans and advances, including net gains and net losses, are recognised in net interest and similar income.

12 Allowances for Losses on Loans and Advances and Provisions for Contingent Liabilities and Other Commitments (Risk Provisions)

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

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

Portfolio-based Allowances Under IAS 39.64, loans which were not specifically impaired are pooled in risk-inherent portfolios. Portfolio-based allowances are recognised for these portfolios; these allowances are measured in respect of current events and information with regard to significant changes with detrimental consequences which have occurred in the technology, market, economic or legal environment, as well as historical default rates.

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

13 Financial Investments

LaR and AfS securities are recognised and disclosed as financial investments. AfS financial assets are measured at fair value. Changes in fair value of AfS financial assets are disclosed as a separate item of equity (AfS reserve) not affecting profit or loss until the asset is sold, withdrawn, disposed of, or if impairment is established for the financial asset in accordance with IAS 39.58 et seq. Therefore, the cumulative profit or loss previously recognised in equity is now affecting profit or loss. Specific allowances on AfS financial assets are directly deducted from the carrying amount of the assets. Portfolio-based allowances on AfS financial assets shall not be created for AfS financial assets. AfS financial assets which are hedged effectively against market price risks are part of the hedge accounting. LaR financial investments are measured at amortised cost. Specific allowances and portfolio-based allowances on LaR financial investments are directly deducted from the carrying amount of the assets. In the financial years 2014 and 2013, pbb Group did not have any HtM and dFVTPL financial assets.

14 Property and Equipment

Property and equipment are generally measured at cost of purchase or cost of production. The carrying amounts of tangible assets (except land) are depreciated on a straight-line basis in accordance with the expected useful lives of the assets. In addition, property and equipment are tested at least annually for impairment. If the value of property and equipment has impaired, an impairment loss is recognised in profit or loss. If the reasons for the impairment no longer exist, an amount not exceeding amortised cost or cost of production is reversed through profit or loss. In the case of fittings in rented buildings, the contract duration taking account of extension options is used as the basis of this contract duration if it is shorter than the useful life.

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

Subsequent cost of purchase or costs of conversion are capitalised if an additional economic benefit flows to the Company. Maintenance expenses of property and equipment are recognised in profit or loss of the financial year in which they arose.

15 Intangible Assets

Purchased and internally generated software are the main items recognised as intangible assets. Goodwill, brand names and customer relations are not capitalised.

Software is an intangible asset with a finite useful life. Purchased software is measured at the amortised purchase cost. pbb Group capitalises internally generated software if it is highly probable that future economic benefits will flow to the Group and the expenses can be measured reliably. Expenses eligible for the capitalisation of internally generated software include external, directly attributable costs of materials and services as well as personnel expenses for employees directly associated with the creation of software used by the Company. Software is amortised on a straight-line basis over expected useful lives of three to five years. In addition, intangible assets with a finite useful life are tested for impairment annually or whenever there is an indication that the intangible asset may be impaired.

16 Other Assets

Other assets mainly comprise positive fair values from derivative financial instruments (hedging derivatives) and salvage acquisitions. Salvage acquisitions are measured as inventories at the lower of cost of purchase and net realisable value in accordance with IAS 2.

17 Liabilities

Liabilities other than hedged items of an effective fair value hedge and which are not classified as dFVTPL are measured at amortised cost. Premiums and discounts are recognised on a pro rata basis. Interest-free liabilities are recognised with their present value. pbb Group has not designated any liabilities into the category dFVTPL. Changes in value resulting from hedge relationships are disclosed under net income from hedging relationships. All income and expenses from liabilities including net gains and net losses resulting from redemption of liabilities are recognised in net interest and similar income.

18 Trading Liabilities

Trading liabilities include negative market values of trading derivatives and of stand-alone derivatives of the bank book. Trading liabilities are measured at fair value. Unrealised and realised profits and losses attributable to trading liabilities are recognised in net trading income in profit or loss.

19 Provisions

A provision is a liability of uncertain timing or amount. A provision shall be recognized when an entity has a present obligation as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. According to IAS 37.15 in rare cases it is not clear whether there is a present obligation. In these cases a present event is deemed to give rise to a present obligation if, taking into account of all available evidence, it is more likely that not that a present obligation exists at the end of the reporting period. In rare cases, for example in a law suit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation. In such a case, pbb determines whether a present obligation exists at the end of the reporting period by taking account of all available evidence, including, for example, the opinion of experts.

Under IAS 37.36 et seq., the best estimate is used for measuring provisions for contingent liabilities and contingent losses attributable to pending transactions. Long-term provisions are generally discounted with an interest rate that reflects the current assessments of the time value of money and the risks specific to the liability.

Provisions for defined benefit plan provisions are calculated on the basis of actuarial reports in accordance with IAS 19. They are measured using the projected unit credit method. The amount of the provision equals the so-called net defined benefit liability which is the difference between the present value of the defined benefit obligation and the fair value of plan assets. pbb closed plan assets in the form of a qualifying insurance policy to hedge parts of the risk from the defined benefit obligations. The reinsurance is pledged to the plan beneficiaries.

The determination of the net defined benefit liability is based on demographic and financial actuarial assumptions. A demographic assumption is for example the mortality for which pbb uses guidance tables. In financial actuarial assumptions the discount rate has the greatest effect on the amount of defined benefit liability. The rate used for the measurement is determined by reference to market yields at the end of the reporting period on high-quality, fixed-interest corporate bonds.

Net interest on the defined benefit liability is determined by multiplying the defined benefit liability by the discount rate. The determination is done at the beginning of the financial year taking account of any changes in the net defined benefit liability during the period as a result of contribution and benefit payments. Net interest on defined benefit liability are shown together with all other effects on income statement from the defined benefit obligations and the plan assets in the position pension expenses and related employee benefit costs in general and administrative expenses.

Remeasurements of the net defined benefit liability result from actuarial gains and losses and the return on plan assets excluding amounts included in net interest on the net defined benefit liability. Remeasurements of the net defined benefit liability are shown in equity in the position profit/losses from pension obligations. Changes of remeasurements of the net defined benefit liability within a period are shown as a component of the consolidated statement of comprehensive income. Actuarial gains and losses result from increases or decreases in the present value of the defined benefit obligation due to changes of actuarial assumptions and experience adjustments. Changes of the discount rate usually have the biggest effect on the actuarial gains and losses.

20 Other Liabilities

Besides negative fair values from derivatives recognised in hedge accounting, accrued liabilities are one of the items recognised in other liabilities. Accruals arise from liabilities for products or services which have been received or supplied and have not yet been paid for, invoiced by the supplier or formally agreed. This also includes short-term liabilities to employees, for instance flexitime credits and vacation entitlements. The accrued liabilities are recognised at the amount likely to be utilised.

If the obligations listed at this note cannot be quantified more precisely on the balance sheet date and if the criteria specified in IAS 37 for recognising provisions are satisfied, these items have to be disclosed as provisions.

21 Subordinated Capital

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

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

22 Silent Partnership Contribution

Finanzmarktstabilisierungsfonds-FMS provided pbb with a silent partnership contribution of €1.0 billion deducted by transaction costs in 2009. The silent partnership contribution has an indefinite life. The silent shareholder participates in a cumulative loss to the extent of its silent deposit expressed as a percentage of the total carrying amount of all liability capital shares of the Bank which participate in a cumulative loss. The extent to which the silent shareholder participates in the cumulative loss is limited to its silent deposit. The cumulative loss attributable to the year 2008 is not taken into consideration for calculating the participation in the loss. The silent partnership contribution is classified as an equity instrument on initial recognition in accordance with the substance of the contractual arrangement and the definitions in IAS 32. The silent partnership contribution is measured initially at cost, with such cost being equivalent to the fair value of the consideration received.

23 Share-based Compensation

As of 31 December 2014 and as of 31 December 2013 no company of pbb Group has provided a commitment for share-based compensation.

24 Currency Translation

Currency translation is carried out in accordance with the regulations of IAS 21. On the balance sheet date, monetary items in a foreign currency are translated into the functional currency. The reporting currency is the euro. Non-monetary items which were stated in a foreign currency using historical cost of purchase are measured using the exchange rate applicable at date of purchase.

Income and expenses attributable to currency translation of the affiliated companies' single financial statements into the functional currency are generally recognised in profit or loss in balance of other operating income/expenses.

In this consolidated financial statement, balance sheet items of the subsidiaries, if they do not prepare financial statements in euros, are translated using the closing rates at the balance sheet date. For translating the expenses and income of these subsidiaries, the average rates are used. Differences resulting from the translation of the financial statements of the subsidiaries do not affect profit or loss and are disclosed in the consolidated statement of changes in equity. The group of consolidated companies does not include any companies from hyperinflationary countries.

25 Income Taxes

Income taxes are accounted for and measured in accordance with IAS 12. Apart from the exceptions defined in the standard, deferred taxes are calculated for all temporary differences between the IFRS values and the tax values as well as for the differences resulting from uniform Group measurement principles and differences from the consolidation (balance sheet method). Deferred tax assets arising from non-utilised losses carried forward, interest assets carried forward and tax credits are recognised if required in accordance with IAS 12.34 et seq. and not opposed by a change in tax status in accordance with SIC-25.

Deferred taxes are calculated using the national tax rates which are expected at the time the differences are balanced, as the concept of deferred taxes is based on the presentation of future tax assets or tax liabilities (liability method). Changes in tax rates have been taken into account. The corporate income tax claim which was capitalised on 31 December 2006 has been paid out since 1 January 2008 over a period of ten years independently of a dividend payment. The interest-free claim is measured at the present value. An unchanged rate of 3.7% p.a. was used for discounting purposes.

26 Non-current Assets Held for Sale

In accordance with IFRS 5, a non-current asset or disposal group must be classified as held for sale if the related carrying amount is primarily realised by a disposal transaction and not by continued use. To reclassify an asset as held for sale, certain conditions must be met on a cumulative basis. Above all, there must be a specific intention to sell, the asset must be immediately available and the disposal must be highly probable.

In accordance with IFRS 5, non-current assets or disposal groups held for sale must be measured as at the balance sheet date at the lower of carrying amount and fair value less costs to sell. The assets must be disclosed separately in the statement of financial position. As at 31 December 2014 and at 31 December 2013 pbb Group did not own any assets held for sale.

27 Accounting Estimates and Assumptions

When the financial statements are being prepared, pbb Group makes future-related assumptions as well as estimations, resulting in a considerable risk of a major change to the disclosed assets and liabilities becoming necessary during the next financial year. The assumptions and parameters underlying the estimates to be made are based on the exercise of appropriate judgement.

Going Concern The consolidated financial statements of pbb are based on the assumption of going concern. The conditions of going concern are described in the report on expected developments.

Allowances The portfolio of pbb Group is reviewed for impairments at least annually. It is necessary to assess whether the estimated future cash flows of a loan portfolio are lower than the actually agreed cash flows. For this purpose, it is necessary to make judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers, or national or economic factors that correlate with defaults on assets in the portfolio. The methods and assumptions concerning the estimates of the extent and timing of the payment streams are reviewed regularly to keep any differences between estimated and actual defaults as low as possible. In addition, the determination of portfolio-based allowances is based on a loss identification period as well as the expected loss based on statistical data.

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

Embedded Derivatives In accordance with IAS 39.11, an embedded derivative must be separated from the host contract and measured separately if, in addition to other criteria, the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract. In order to evaluate the existence of an obligation to separate, the economic risks of the host contracts and embedded derivatives are assessed.

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

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

Intangible Assets and Property and Equipment pbb Group's accounting for intangible assets and property and equipment is subject to estimating uncertainty, particularly in the determination of the useful life of assets and the associated amount of depreciation/amortisation recognised per period.

Provisions Estimates are used in the measurement of provisions at pbb Group. Estimating uncertainty arises in particular during assessment of the amount of the future cash outflows, the time horizon and the discount rate.

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

With regard to the capitalisation of losses carried forward and other tax credits, the extent as well as the actual availability of such tax benefits are subject to estimation. Major losses carried forward are subject to national German tax law, and their availability also depends inter alia on the restrictions set out in Sections 10 d EStG, 8 c KStG as well as Section 10 a GewStG. Restrictions based on a change in the tax status (SIC-25) as a result of the planned privatisation did not occur as of the balance sheet date. Deferred tax assets arising from losses carried forward are therefore recognised to the extent as it is likely that future taxable income will be available to offset the non-utilised tax losses carried forward.

Consolidation Companies and structured entities must be consolidated if pbb has direct or indirect control over them. Control is deemed to exist if pbb has decision-making powers to manage relevant activities, has a right to significant returns from the subsidiary and can use its decision-making powers to influence the amount of the significant variable returns. The level of control is assessed on the basis of contractual and economic relationships to the company or the structured entity. In assessing whether pbb exerts control or substantial influence over the company, estimates or discretionary leeways are required.

Segment Reporting

28 Notes to Segment Reporting by Operating Segment

With effect from 1 January 2014, pbb Group reorganised the reporting structure of its internal reporting system in terms of two aspects:

> The segment report to be prepared and set up for internal control in compliance with the regulations set out in IFRS 8 now includes the three business segments of Real Estate Finance (REF), Public Investment Finance (PIF) and Value Portfolio (VP). The key change compared to the previous year is the dissolution of the former Public Sector Finance (PSF) segment and the creation of the new Public Investment Finance (PIF) segment. The non-strategic portfolio of existing business in non-earmarked financing to the public sector (budget financing) in the former PSF segment is now in principle allocated to the VP segment. The new PIF segment includes the strategic public sector investment financing of pbb Group. The REF and PIF segments thus comprise the strategic activities, and the VP segment the non-strategic activities of pbb Group's customer business. The previous year's figures were adjusted as required by IAS 8.29.

> In order to increase transparency and significance, the accrued fees for net interest income were segmented for the first time since the beginning of the financial year of 2014 according to the principle of causation. The previous year's figures thus had to also be adjusted, which favoured the REF segment but was to the detriment of the PIF and VP segments. The previous year's figures were adjusted as required by IAS 8.29.

Real Estate Finance (REF) The REF operating segment comprises financing for professional real estate investors with a medium- to long-term orientation. These include professional national and international real estate companies, institutional investors, property funds as well as, in Germany, customers with a regional focus. Adequate batch sizes and loan-to-values commensurate for the level of risk involved are essential. Strategic partnerships are agreed with other institutions with the aim of permitting higher loan-to-values and larger volumes for customers by means of syndications and syndicated financing arrangements.

Public Investment Finance (PIF) The PIF operating segment comprises financing eligible for covered bonds for the provision of public infrastructure. The focus here is on public institutions, municipal and social housing construction, buildings for the utilities and waste disposal market, transport infrastructure as well as healthcare and nursing institutions. In addition, pbb Group is active in publicly guaranteed export financing. Financing is given to public sector debtors, companies with a public or private legal structure as well as special-purpose vehicles with a public service guarantee.

Value Portfolio (VP) The VP operating segment includes all the non-strategic portfolios and activities of pbb Group. In particular, the segment comprises budget financing and selected structured products as well as income and expenses from IT services provided to DEPFA. The IT services provided to DEPFA came to an end as of 31 December 2014.

The service provided for FMS Wertmanagement was discontinued to a large extent on 30 September 2013, as mandated by the European Commission. The remaining income and expenses, in particular from the provision of information, the granting of powers of attorney, as well as the provision of services required by the regulatory authorities, are not material and shown in the VP operating segment.

Consolidation & Adjustments is used for reconciling the sum of operating segments results with the consolidated result. The column includes equity which is not allocated to the operating segments.

29 Income Statement by Operating Segment

Income/expenses

in € million		REF	PIF	VP	Consolidation & Adjustments	**pbb Group**
Operating income	2014	292	39	−21	16	326
	2013[1]	355	18	91	18	482
Net interest and similar income	2014	304	45	56	16	421
	2013[1]	261	29	12	17	319
Net fee and commission income	2014	2	–	−1	–	1
	2013[1]	10	1	−1	−1	9
Net trading income	2014	−13	−5	−12	–	−30
	2013[1]	−21	−8	−22	–	−51
Net income from financial investments	2014	14	4	−95	–	−77
	2013[1]	96	−2	2	–	96
Net income from hedging relationships	2014	−2	–	−1	–	−3
	2013[1]	4	–	5	–	9
Net other operating income/expenses	2014	−13	−5	32	–	14
	2013[1]	5	−2	95	2	100
Loan loss provisions	2014	−14	–	−7	–	−21
	2013[1]	−1	–	−7	–	−8
General and administrative expenses	2014	−160	−33	−58	–	−251
	2013[1]	−147	−31	−134	–	−312
Net miscellaneous income/expenses	2014	–	–	–	–	–
	2013[1]	2	–	1	–	3
Profit or loss before tax	2014	**118**	**6**	**−86**	**16**	**54**
	2013[1]	**209**	**−13**	**−49**	**18**	**165**

Cost-income ratio[2]

in %		REF	PIF	VP	**pbb Group**
Cost-income ratio (based on operating income)	2014	54.8	84.6	>100.0	77.0
	2013[1]	41.4	>100.0	>100.0	64.7

[1] Adjusted in accordance with IFRS 8.29
[2] The cost-income ratio is the ratio of general and administrative expenses and operating income.

30 Balance-sheet-related Measures by Operating Segment

The Management Board controls balance-sheet-related measures by operating segments based on equity, risk-weighted assets and on financing volumes. Financing volumes are the notional amounts of the drawn parts of granted loans and parts of the securities portfolio.

Balance-sheet-related measures by operating segment in € billion		REF	PIF	VP	Consolidation & Adjustments	**pbb Group**
Equity[1]	31.12.2014	0.8	0.5	1.4	0.7	3.4
	31.12.2013[2]	0.8	0.4	1.2	1.0	3.4
Risk-weighted assets[3]	31.12.2014[4]	7.2	2.4	4.4	1.5	15.5
	31.12.2013[2][5]	7.4	3.1	6.0	1.6	18.1
	31.12.2013[2][6]	8.1	2.1	3.2	0.7	14.1
Financing volumes	31.12.2014	21.8	8.0	21.3	–	51.1
	31.12.2013[2]	20.4	7.2	23.6	–	51.2

[1] Excluding revaluation reserve
[2] Adjusted in accordance with IFRS 8.29
[3] Including risk-weighted credit risk positions as well as the capital requirements for market risk positions and operational risks scaled with the factor 12.5
[4] Consolidated in accordance with CRR
[5] Pro forma Basel III figure; consolidated in accordance with CRR
[6] Consolidated in accordance with section 10 a of the German Banking Act (KWG)

31 Breakdown of Operating Income

Operating Income by Products

Operating income by products in € million		Real estate financing	Public investment financing	Other products	**pbb Group**
Operating income	2014	292	39	−5	**326**
	2013[1]	355	18	109	**482**

[1] Adjusted in accordance with IFRS 8.29

Operating Revenues by Regions pbb Group differentiates between the regions Germany, Rest of Europe and America/Asia. Allocation of values to regions is based on the location of the registered offices of the Group companies or their branches.

Operating revenues by regions in € million		Germany	Rest of Europe	America/Asia	**pbb Group**
Operating revenues	2014	286	35	5	**326**
	2013	326	53	103	**482**

Operating Revenues by Customers There were no significant customers within the meaning of IFRS 8.34 in the financial year of 2014. In the previous year a balance of net other operating income/expenses of €60 million recognised in the Value Portfolio segment resulted from services for the portfolio of FMS Wertmanagement. Because this item accounted for more than 10% of all operating income of pbb Group, FMS Wertmanagement was a major client within the meaning of IFRS 8.34. The service provided for FMS Wertmanagement was largely discontinued on 30 September 2013, as mandated by the European Commission.

Notes to the Consolidated Income Statement

32 Net Interest and Similar Income

Net interest and similar income by categories of income/expenses in € million	2014	2013[1]
Interest and similar income	**2,333**	**2,487**
Lending and money-market business	1,336	1,341
Fixed-income securities and long-term equity	637	785
Current gains/losses from swap transactions (net interest income and expense)	360	361
Interest and similar expenses	**−1,912**	**−2,168**
Liabilities to other banks and customers	−409	−487
Securitised liabilities	−1,403	−1,570
Subordinated capital	−100	−111
Total	**421**	**319**

[1] Adjusted due to retrospective IFRS 10 first time adoption. Details are disclosed in Note «Principles».

Total interest income for financial assets that are measured at amortised cost, amounted to € 2.0 billion (2013: € 2.1 billion). Total interest expenses for financial liabilities that are not measured at fair value through profit or loss amounted to €−1.9 billion (2013: €−2.2 billion).

33 Net Fee and Commission Income

Net fee and commission income in € million	2014	2013
Securities and custodial services	−2	−1
Lending operations and other service	3	10
Total	**1**	**9**

Net commission income is attributable exclusively to financial assets and financial liabilities which are not designated at fair value through profit or loss.

34 Net Trading Income

Net trading income in € million	2014	2013
From interest rate instruments and related derivatives	−31	−51
From credit risk instruments and related derivatives	1	–
Total	**−30**	**−51**

35 Net Income From Financial Investments

Net income from financial investments in € million	2014	2013
Income from financial investments	35	101
Expenses from financial investments	–112	–5
Total	**–77**	**96**

Net income from financial investments consists of income from the sale of securities of the measurement categories AfS and LaR together with changes in the value of such instruments that are to be recognised in profit or loss. HtM investments were not held in 2014 and 2013. Based on measurement categories, net income from financial investments is broken down as follows:

Net income from financial investments of financial instruments by IAS 39 categories in € million	2014	2013
AfS financial investments	7	4
LaR financial investments	–105	–2
No IAS 39 category attributable	21	94
Total	**–77**	**96**

Allowances on the securities issued by Heta reduced the net income from financial investments in the amount of €–109 million. In addition €21 million resulted from the sale of DEPFA Finance N.V. on 18 July 2014. With the de-consolidation of the subsidiary pbb's liabilities to DEPFA Finance N.V. transformed into Group external liabilities. These liabilities no longer have to be eliminated. The first time valuation of liabilities resulted in earnings of €21 million. In the prior year period an amount of €94 million could not be attributed to any measurement category in accordance with IAS 39. This related mainly to the income from the disposal of the subsidiary Little Britain Holdings (Jersey) Ltd.

36 Net Income from Hedging Relationships

Net income from hedging relationships in € million	2014	2013
Result from fair value hedge accounting	–4	8
Result from hedged items	–403	–344
Result from hedging instruments	399	352
Result from dFVTPL investments and related derivatives	–	–
Result from dFVTPL investments	–	–1
Result from derivatives related to dFVTPL investments	–	1
Ineffectiveness from cash flow hedge accounting recognised in net income	1	1
Total	**–3**	**9**

37 Net Other Operating Income/Expenses

Net other operating income/expenses in € million	2014	2013
Other operating income	87	245
Other operating expenses	–73	–145
net other operating income/expenses	**14**	**100**

The decrease in the balance of net other operating income/expenses is, among others, due to the far-reaching termination of the services for the FMS Wertmanagement portfolio in the third quarter of 2013. The net income arising from this amounted to only €1 million (2013: € 60 million). IT services provided to DEPFA resulted in net income of € 30 million (2013: € 36 million). These services were largely discontinued on 31 December 2014. Further income was attributable to rental income generated from taken over real estate of €10 million (2013: €11 million), reversals of provisions in connection with follow-up liabilities for services to third parties (€ 4 million, 2013: € 0 million) and income from currency translations (€ 4 million, 2013: less than € 1 million). Write-downs of €–14 million (2013: € 0 million) were undertaken on real estate taken over. An expense of €–5 million (2013: € 0 million) resulted from the scrapping of IT assets.

38 Loan Loss Provisions

Loan loss provisions in € million	2014	2013
Allowances for losses on loans and advances	–27	–17
Additions	–48	–66
Reversals	21	49
Allowances for contingent liabilities and other commitments	–	1
Additions	–	–
Reversals	–	1
Recoveries from written-off loans and advances	6	8
Total	**–21**	**–8**

The development of specific allowances on loans and advances as well as portfolio-based allowances is disclosed in the note «Allowances for Losses on Loans and Advances».

39 General and Administrative Expenses

General and administrative expenses in € million	**2014**	**2013**
Personnel expenses	–110	–121
Wages and salaries	–85	–94
Social security costs	–17	–18
Pension expenses and related employee benefit costs	–8	–9
Non-personnel expenses	–141	–191
Other general and administrative expenses	–130	–177
Consulting expenses	–18	–40
IT expenses	–77	–91
Office and operating expenses	–13	–14
Other non-personnel expenses	–22	–32
Depreciation, amortisation and impairment	–11	–14
of software and other intangible assets excluding goodwill	–11	–13
of property and equipment	–	–1
Total	**–251**	**–312**

Cost-income ratio in %	**2014**	**2013**
Cost-income ratio	77.0	64.7

40 Net Miscellaneous Income/Expenses

Net miscellaneous income/expenses in € million	**2014**	**2013**
Miscellaneous income	5	11
thereof: Reversals of restructuring provisions	4	11
Miscellaneous expenses	–5	–8
thereof: Additions to restructuring provisions	–4	–4
Other taxes	–	–4
Net miscellaneous income/expenses	**–**	**3**

41 Income Taxes

Breakdown in € million	2014	2013
Current taxes	–44	2
Deferred taxes	–6	–7
thereof: Deferred taxes on capitalised losses carried forward	–34	80
Total	**–50**	**–5**

Current taxes include a tax expense for prior years of €–18 million (2013: tax income of €6 million). In the prior year current tax income amounted to €2 million mainly due to the tax-free disposal of a participation as well as the realisation of tax losses due to the domestic disposal of derivatives.

The following overview shows the development of the deferred taxes recognised in the financial statements.

Development of deferred taxes in € million	2014	2013
Deferred taxes recognised in the statement of financial position	–5	–5
Difference to prior year	–	–22
thereof: Recognised in profit or loss	–6	–7
Recognised in profits/losses from pension commitments	15	–2
Recognised in AfS reserve	–46	–56
Recognised in cash flow hedge reserve	37	43

Reconciliation in € million	2014	2013[1]
Profit or loss before tax	54	165
Applicable (legal) tax rate in %	27.67	27.78
Expected (computed) tax expense	–15	–46
Tax effects		
arising from tax rate differences	–1	3
arising from tax-free income	–	21
arising from deductible and non-deductible items	–15	–26
arising from valuation adjustments and non-application of deferred taxes	–1	37
arising from prior years	–18	6
Reported income taxes	**–50**	**–5**
Group tax ratio in %	**92.59**	**3.03**

[1] Adjusted, details are disclosed in Note «Consistency»

The tax rate applicable for the financial year, including solidarity surcharge, is 27.67% (prior year: 27.78%) and is comprised of the 15.0% German corporate tax rate currently valid, the payable solidarity surcharge of 5.5% as well as the average trade tax rate of 11.843% (prior year: 11.954%).

The effect from tax rate differences is primarily a result of the different local tax rates for the foreign permanent establishments.

The effect attributable to tax deductible and non-deductible items primarily relate to expenses which are not deductible for tax purpose. Since these effects result in permanent differences they are excluded from the calculation of deferred taxes, yet reduce or increase the tax-base.

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

The effects arising from valuation adjustments and non-application of deferred taxes, on the one hand, comprise effects from the write down of deferred tax assets on losses carried forward and, on the other hand, opposing effects from the use of tax losses carried forward previously not accounted for.

The effects from previous years include current taxes for previous years which have been incurred as a result of tax audits or a reassessment of the tax liability.

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

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

Deferred tax liabilities/assets in € million	**2014**	**2013**[1]
Loans and advances to other banks/customers (including loan loss allowances)	52	22
Financial investments	150	11
Trading assets	130	384
Other assets/liabilities	297	693
Others	1	13
Deferred tax liabilities	**630**	**1.123**
Loans and advances to other banks/customers (including loan loss allowances)	7	9
Financial investments	135	88
Provisions	40	38
Other assets/liabilities	222	483
Trading liabilities	42	284
Securitised liabilities	2	5
Losses carried forward	177	211
Deferred tax assets	**625**	**1.118**

[1] Adjusted due to IAS 8.42. Details are disclosed in Note «Consistency».

For domestic companies, the deferred taxes are calculated using the future uniform rate of corporation tax of 15.0% plus the corresponding 5.5% solidarity surcharge and the trade tax depending on the locally applicable assessment rate (the current basic rate is 3.5%). For pbb, the tax rate for the calculation of deferred taxes is 27.67% (2013: 27.78%).

On the reporting date, there are unused tax losses carried forward totalling €3,670 million (2013: €3,781 million) at corporate tax level and €3,800 million (2013: €3,844 million) at trade tax level. Deferred tax assets have been recognised on a portion of €607 million (2013: €738 million) at corporate tax level and €681 million (2013: €810 million) at trade tax level, because the criteria for recognition in accordance with IAS 12.34 et seq. were satisfied. The losses carried forward can be utilised for an unlimited period of time. No allowances were undertaken on deferred taxes from temporary differences in the financial year (2013: €1 million).

From the origination and reversal of temporary differences, deferred tax income arose of €28 million (2013: tax expense of €−86 million).

Tax rate changes did not result in major deferred tax expenses or income in the current year nor in the previous year.

The use of tax losses previously not recognised resulted in a reduction in the current income tax expense of €3 million (2013: €0 million). A deferred tax expense of €−3 million (2013: income of €39 million) resulted from the devaluation of previously recognised losses carried forward.

On differences associated with investments in subsidiaries, deferred tax liabilities in the amount of €160 million (2013: €140 million) have not been recognised because the Group has the ability and the intention to invest profits permanently in these subsidiaries.

42 Net Gains/Net Losses

The income statement contains the following net gains/net losses recognised in profit or loss according to IFRS 7.20 (a):

Net gains/net losses in € million	**2014**	**2013**
Loans and receivables	−75	16
Available for sale	7	4
Held for trading	−30	−51
Designated at fair value through profit or loss	–	−1
Financial liabilities at amortised cost	−4	−14

Notes to the Consolidated Statement of Financial Position (Assets)

43 Cash Reserve

Cash reserve in € million	31.12.2014	31.12.2013
Balance with central banks	57	3,532
Total	**57**	**3,532**

Cash in hand as of 31 December 2014 amounts to less than € 1 million as was the case in the previous year.

44 Trading Assets

Trading assets in € million	31.12.2014	31.12.2013
Positive fair values of derivative financial instruments	2,016	1,642
Total	**2,016**	**1,642**

45 Loans and Advances to Other Banks

Loans and advances to other banks by type of business in € million	31.12.2014	31.12.2013[1]
Loans and advances	3,153	4,631
Public sector loans	1,136	1,978
Real estate loans	–	51
Other loans and advances	2,017	2,602
Investments	3,647	2,054
Total	**6,800**	**6,685**

Loans and advances to other banks by maturities in € million	31.12.2014	31.12.2013[1]
Repayable on demand	2,011	1,614
With agreed maturities	4,789	5,071
up to 3 months	3,689	2,143
3 months to 1 year	132	381
1 year to 5 years	404	646
5 years and over	564	1,901
Total	**6,800**	**6,685**

[1] Adjustment due to retrospective IFRS 10 first time adoption. Details are disclosed in Note «Principles».

46 Loans and Advances to Customers

Loans and advances to customers by type of business in € million	31.12.2014	31.12.2013
Loans and advances	38,964	36,042
Public sector loans	17,125	15,464
Real estate loans	21,822	20,557
Other loans and advances	17	21
Investments	–	200
Total	**38,964**	**36,242**

Loans and advances to customers by maturities in € million	31.12.2014	31.12.2013
Unspecified terms	591	–
With agreed maturities	38,373	36,242
up to 3 months	1,102	2,087
3 months to 1 year	2,349	2,937
1 year to 5 years	16,933	15,122
5 years and over	17,989	16,096
Total	**38,964**	**36,242**

47 Allowances for Losses on Loans and Advances

Breakdown in € million	31.12.2014	31.12.2013
Specific allowances for losses on loans and advances to customers	−93	−97
Portfolio-based allowances	−45	−51
Total	**−138**	**−148**

Development in € million	Specific allowances	Portfolio-based allowances	**Total**
Balance at 1.1.2013	**−283**	**−42**	**−325**
Changes affecting income	1	−9	−8
Gross additions	−50	−16	−66
Reversals	42	7	49
Increase of the present value due to passage of time (unwinding)	9	–	9
Changes not affecting income	185	–	185
Use of existing allowances	185	–	185
Balance at 31.12.2013	**−97**	**−51**	**−148**
Balance at 1.1.2014	**−97**	**−51**	**−148**
Changes affecting income	−24	5	−19
Gross additions	−43	−5	−48
Reversals	11	10	21
Increase of the present value due to passage of time (unwinding)	8	–	8
Changes not affecting income	28	1	29
Use of existing allowances	32	1	33
Effects of foreign currency translations and other changes	−4	–	−4
Balance at 31.12.2014	**−93**	**−45**	**−138**

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

48 Financial Investments

Breakdown in € million	**31.12.2014**	**31.12.2013**[1]
AfS financial investments	4,906	4,284
Debt securities and other fixed-income securities	4,903	4,282
Equity securities and other variable-yield securities	3	2
LaR financial investments	15,569	16,441
Debt securities and other fixed-income securities	15,569	16,441
Total	**20,475**	**20,725**

[1] Adjustment due to retrospective IFRS 10 first time adoption. Details are disclosed in Note «Principles».

The carrying amounts of the LaR financial investments were reduced by portfolio-based allowances amounting to €−9 million (2013: €−14 million).

Financial investments by maturities in € million	31.12.2014	31.12.2013[1]
Unspecified terms	3	2
With agreed maturities	20,472	20,723
Up to 3 months	867	767
From 3 months to 1 year	3,067	1,567
From 1 year to 5 years	5,676	7,671
From 5 years and over	10,862	10,718
Total	**20,475**	**20,725**

[1] Adjustment due to retrospective IFRS 10 first time adoption. Details are disclosed in Note «Principles».

pbb Group has made use of the IASB amendments to IAS 39 and IFRS 7, published on 13 October 2008, and reclassified retrospectively as of 1 July 2008 financial investments out of the measurement category AfS of € 30.2 billion. At the date of reclassification the effective interest rate for the AfS securities was between 0.25% and 34.4%.

The following tables summarise the carrying amounts and fair values as of 31 December 2014 and 31 December 2013 as well as fair value gains and losses that would have been recognised in 2014 and 2013 if the financial assets had not been reclassified.

Reclassifications in 2008 Effects in 2014	into: Financial investments (LaR)		Effect in reporting period if no assets had been reclassified (1.1.–31.12.2014)	
	31.12.2014			
	Carrying amount in € billion	Fair value in € billion	Income statement in € million	AfS reserve (after taxes) in € million
out of: Financial investments (AfS)	8.9	9.3	–	303

Reclassifications in 2008 Effects in 2013	into: Financial investments (LaR)		Effect in reporting period if no assets had been reclassified (1.1.–31.12.2013)	
	31.12.2013			
	Carrying amount in € billion	Fair value in € billion	Income statement in € million	AfS reserve (after taxes) in € million
out of: Financial investments (AfS)	9.5	9.4	–	226

49 Property and Equipment

Breakdown in € million	31.12.2014	31.12.2013
Operating equipment	8	1
Total	**8**	**1**

Development of property and equipment in € million	2014	2013
Operating equipment		
Acquisition/production costs		
Balance at 1.1.	**15**	**18**
Additions	7	–
Disposals	–1	–3
Balance at 31.12.	**21**	**15**
Depreciation and write-ups		
Balance at 1.1.	**–14**	**–16**
Depreciation	–	–1
Disposals	1	3
Balance at 31.12.	**–13**	**–14**
Carrying amounts		
Balance at 31.12.	**8**	**1**

50 Intangible Assets

Breakdown in € million	31.12.2014	31.12.2013
Purchased software	1	2
Internally developed software	18	27
Other intangible assets	4	2
Total	**23**	**31**

Development of intangible assets in € million	Software acquired	Internally developed software	Other intangible assets	2014 Total	2013 Total
Acquisition/production costs					
Balance at 1.1.	**77**	**51**	**2**	**130**	**128**
Additions	–	4	2	6	7
Disposals	−1	−13	–	−14	−5
Balance at 31.12.	**76**	**42**	**4**	**122**	**130**
Amortisation and write-ups					
Balance at 1.1.	**−75**	**−24**	–	**−99**	**−89**
Depreciation	−2	−9	–	−11	−13
Disposals	2	9	–	11	3
Balance at 31.12.	**−75**	**−24**	**–**	**−99**	**−99**
Carrying amounts					
Balance at 31.12.	**1**	**18**	**4**	**23**	**31**

51 Other Assets

Other assets in € million	31.12.2014	31.12.2013
Positive fair values from derivative financial instruments	6,449	4,601
Hedging derivatives	6,449	4,601
Fair value hedge	5,975	4,115
Cash flow hedge	474	486
Salvage acquisitions	120	97
Other assets	81	59
Reimbursements under insurance policies	9	12
Total	**6,659**	**4,769**

The portfolio of salvage acquisitions increased due to objects taken over and consolidated in Hungary and the Netherlands.

52 Income Tax Assets

Income tax assets in € million	**31.12.2014**	**31.12.2013**[1]
Current tax assets	29	44
Deferred tax assets	625	1,118
Total	**654**	**1,162**

[1] Adjusted due to IAS 8.42. Details are disclosed in Note «Consistency».

The income tax assets contain both reimbursement claims from current taxes as well as a considerable element of deferred tax assets. The latter are attributable to capitalised temporary tax claims in connection with tax losses carried forward in the amount of €177 million (2013: € 211 million) as well as other temporary tax claims. Pursuant to IAS 12.61, a significant amount of tax assets as a result of temporary differences were credited to the cash flow hedge reserve in the amount of € 190 million (2013: € 332 million), to the AfS reserve in the amount of € 38 million (2013: € 84 million) as well as to the actuarial gains/losses benefit plan in the amount of € 30 million (2013: € 15 million) as the underlying assets were also posted to these items. The significant reduction in deferred tax assets in comparison to the previous year was mainly a result of lower recognition differences of derivatives between IFRS and HGB (German Commercial Code).

The current tax assets also include the capitalised claim for a credit following the reduction in corporate income tax in the amount of € 26 million (2013: € 34 million).

53 Subordinated Assets

The balance sheet items do not contain subordinated assets.

54 Repurchase Agreements

As a pledgor of genuine repurchase agreements, pbb Group has pledged assets with a book value of € 0.7 billion (31 December 2013: € 1.3 billion). The securities are still recognised as assets. The considerations which have been received amount to € 0.6 billion (31 December 2013: € 1.3 billion) and are recognised solely as liabilities to other banks. Assets in repurchase agreements are the only transferable assets the acquirer can sell or repledge in the absence of default according to IAS 39.37 (a).

55 Securitisation

As of 31 December 2014 pbb Group had the synthetic securitisation Estate UK-3 with a transaction period of 15 years (maturity 2022) and a total volume of lending of € 323 million (31 December 2013: € 384 million) in the portfolio. The collateral-taker of the transaction with commercial mortgage loans is pbb. The credit linked notes were completely sold to the investors. Therefore, no risks remained at pbb Group. Overall a reduction of expected loss according to Basel III of € 147 million (31 December 2013: € 138 million according to Basel II) was achieved.

Notes to the Consolidated Statement of Financial Position (Equity and Liabilities)

56 Liabilities to Other Banks

Liabilities to other banks by maturities in € million	31.12.2014	31.12.2013
Repayable on demand	1,693	1,269
With agreed maturities	1,494	2,253
Up to 3 months	529	1,015
3 months to 1 year	116	285
1 year to 5 years	305	478
5 years and over	544	475
Total	**3,187**	**3,522**

57 Liabilities to Customers

Liabilities to customers by maturities in € million	31.12.2014	31.12.2013
Repayable on demand	1,154	676
With agreed maturities	9,439	10,172
Up to 3 months	1,274	894
3 months to 1 year	1,328	1,821
1 year to 5 years	5,305	5,360
5 years and over	1,532	2,097
Total	**10,593**	**10,848**

58 Securitised Liabilities

Securitised liabilities by type of business in € million	31.12.2014	31.12.2013[1]
Debt securities issued	25,330	25,634
Mortgage bonds	10,135	8,719
Public sector bonds	10,026	12,103
Other debt securities	5,169	4,699
Money market securities	–	113
Registered notes issued	22,497	21,224
Mortgage bonds	5,912	5,907
Public sector bonds	14,715	13,719
Other debt securities	1,870	1,598
Total	**47,827**	**46,858**

[1] Adjustment due to retrospective IFRS 10 first time adoption. Details are disclosed in Note «Principles».

Securitised liabilities by maturities in € million	31.12.2014	31.12.2013[1]
With agreed maturities		
Up to 3 months	2,258	2,883
3 months to 1 year	5,166	3,239
1 year to 5 years	20,137	19,886
5 years and over	20,266	20,850
Total	**47,827**	**46,858**

[1] Adjustment due to retrospective IFRS 10 first time adoption. Details are disclosed in Note «Principles».

59 Trading Liabilities

Trading liabilities in € million	31.12.2014	31.12.2013
Negative fair values from derivative financial instruments	1,960	1,453
Total	**1,960**	**1,453**

60 Provisions

Breakdown in € million	31.12.2014	31.12.2013
Provisions for pensions and similar obligations	115	65
Restructuring provisions	42	48
Provisions for contingent liabilities and other commitments	11	13
Other provisions	104	83
thereof: Long-term liabilities to employees	2	2
Total	**272**	**209**

There are defined contribution and defined benefit plans for the employees of pbb Group. In the defined contribution plans pbb makes payments for commitments by industry-wide organisations, for instance the BVV in Germany. In almost all non-German entities, a defined percentage of fixed salary is paid into externally managed pension funds for employees as part of defined contribution pension schemes. Expenses in respect of defined contribution plans amounted to €–4 million (2013: €–5 million). The expense is expected to be similar in 2015. Expenses in respect of defined contribution plans for persons with a key function in the Group amounted to €–1 million (2013: €–1 million). The employer's contribution to the statutory pension insurance amounted to €–6 million in 2014 (2013: €–7 million).

There are defined benefit pension commitments for many employees in Germany. There are no defined benefit pension commitments in the non-German entities. For the defined benefit plans the employees receive a direct commitment from their respective company. The pension plan especially contains retirement pensions, disability pensions and surviving dependant's pensions. The receipt of retirement pensions or disability pensions starts after a vesting period is fulfilled, at the earliest after reaching a minimum age in the case of part or full incapacity for work, at the latest when going into retirement, usually after completion of the 65th year of life. In the case of active employees, there are predominantly modern modular pension plans. For the other eligible persons there are also final salary-based defined benefit plans. The annual pension module depends, among other things, on the gross annual salary paid and the member's length of service. The surviving dependant's pension usually amounts to 60% of the pension of the spouse respectively the entitlement on that. The pension plan is administered by pbb itself with the aid of an external service provider for the administration.

Pension provisions are recognised for obligations arising from direct commitments. The defined benefit plans have been principally closed for new entrants since 1 April 2004. There have been no plan amendments, curtailments and settlements in the years 2014 and 2013.

The risk of insolvency is covered within the framework of legal requirements by Pensionssicherungsverein a.G. in relation to the total amount of pension obligations.

The following actuarial assumptions were used to measure the defined benefit pension obligations:

Actuarial assumptions in %	**31.12.2014/ 1.1.2015**	**31.12.2013/ 1.1.2014**
Discount rate	2.00	3.50
Rate of increase in pension obligations	1.75	2.00
Rate of increase in future compensation and vested rights	2.50	2.50

The rate of increase in career for members of the Management Board amounts 0.0% (31 December 2013: 0.0%), for directors and non-pay-scale staff 1.5% (31 December 2013: 1.5%) and for pay-scale staff 0.5% (31 December 2013: 0.5%). The guidance tables 2005G from Klaus Heubeck were used as the biometric basis.

The defined benefit pension commitments of pbb do not contain any unusual or entity-specific risks. pbb is faced by the common demographic risks, for example from longevity or invalidity of the entitled employees, and common financial risks like for example a change of the discount rate. pbb took out reinsurance to protect itself against parts of these risks. The reinsurance is a qualifying insurance policy in accordance with IAS 19 and thus is a plan asset. The fair value of plan assets is a component of the net liability from defined benefit plans which is deducted from the present value of the defined benefit obligation. The reinsurance does not consist of any unusual or plan-specific risks.

Principally, the pension payments of the reinsured pension obligations are funded by the income from the plan assets. If the income does not cover the pension payments pbb has to pay the pensions out of its own funds. For the non-reinsured pension obligations the payments are also made out of own funds.

Balance sheet items (net defined benefit liability) in € million	2014	2013
Present value of defined benefit obligation	297	247
Fair value of plan assets	–182	–182
Total	**115**	**65**

Development of net defined benefit liability in € million	2014	2013
Balance at 1.1.	**65**	**71**
Transfer of staff	–	–
Pension expenses	3	4
Remeasurements	53	–7
Reclassifications in reimbursements	–	2
Direct payments to beneficiaries	–6	–5
Balance at 31.12.	**115**	**65**

Development of defined benefit obligation in € million	2014	2013
Balance at 1.1.	**247**	**261**
Transfer of staff	–	–4
Current service costs	1	2
Interest expenses	8	8
Remeasurements	55	–7
Actuarial gains/losses from demographic assumptions	–	–
Actuarial gains/losses from financial assumptions	51	–8
Actuarial gains/losses from experience assumptions	4	1
Settlements	–	–
Payments to beneficiaries	–14	–13
Balance at 31.12.	**297**	**247**

Plan assets consist exclusively of reinsurance pledged to plan beneficiaries. The plan assets accordingly do not contain any own financial instruments or any own used property and equipment. Additional contributions of € 10 million to the plan assets are expected in 2015 for retrospective insurance contributions. pbb does not use special asset-liability matching strategies to manage the pledged reinsurance.

Development of fair value of plan assets in € million	2014	2013
Balance at 1.1.	**182**	**190**
Transfer to staff	–	–4
Interest income	6	6
Remeasurements	2	–
Payments to beneficiaries	–8	–8
Reclassifications in/from reimbursements	–	–2
Balance at 31.12.	**182**	**182**

Development of pension expenses in € million	2014	2013
Service costs	**1**	**2**
Current service costs	1	2
Past service costs	–	–
Curtailments	–	–
Gains/losses on settlements	–	–
Net interest expenses	2	2
Interest expenses on defined benefit obligation	8	8
Interest income on plan assets	–6	–6
Total	**3**	**4**

Compared to 2014 a slight increase in the pension expense is expected for 2015 due to individual new commitments. Pension expenses are part of general and administrative expenses.

Remeasurements of the net defined benefit liability result from actuarial gains and losses and the return on plan assets excluding amounts included in net interest on the net defined benefit liability.

Remeasurement recognised in other comprehensive income (equity) in € million	2014	2013
Actuarial gains/losses from demographic assumptions	–	–
Actuarial gains/losses from financial assumptions	–51	8
Actuarial gains/losses from experience assumptions	–4	–1
Remeasurements from plan assets	2	–
Total	**–53**	**7**

Delevopment of reimbursement in € million	2014	2013
Balance at 1.1.	**9**	**7**
Additions	–	2
Balance at 31.12.	**9**	**9**

As at 31 December 2014, the quantitative sensitivity analysis – which uses the same measurement methods as the obligation recognised in the statement of financial position – for the material actuarial assumptions is as follows:

Actuarial assumptions

in € million		Change of sensitivity level (+ increase / – decrease)		Gross obligation
Discount rate	in percentage points	+0.5	in € million	276
	in percentage points	–0.5	in € million	321
Rate of increase in pension obligations	in percentage points	+0.5	in € million	315
	in percentage points	–0.5	in € million	281
Rate of increase in future compensation and vested rights	in percentage points	+0.5	in € million	298
	in percentage points	–0.5	in € million	297

The assumption of mortality only has an immaterial effect because the risk of longevity is mainly covered by the plan assets.

The weighted average duration of the defined benefit obligations amounted to 15 years at 31 December 2014 (31 December 2013: 14 years).

Development of provisions (without provisions for pension and similar obligations)

in € million	Restructuring provisions	Provisions for contingent liabilities and other commitments	Other provisions
Balance at 1.1.2013	**71**	**17**	**76**
Additions	4	–	74
Reversals	–11	–4	–18
Increase of the present value due to passage of time (unwinding)	1	–	–
Amounts used	–17	–	–49
Reclassifications	–	–	–
Balance at 31.12.2013	**48**	**13**	**83**
Balance at 1.1.2014	**48**	**13**	**83**
Additions	4	–	81
Reversals	–4	–	–11
Increase of the present value due to passage of time (unwinding)	1	–	–
Amounts used	–7	–	–44
Reclassifications	–	–2	–5
Balance at 31.12.2014	**42**	**11**	**104**

On 19 December 2008 the Management Board and Supervisory Board of pbb Group decided upon the strategic realignment and restructuring of the Group. A restructuring provision amounting to € 120 million was created for obligations relating to the strategic realignment and restructuring in the fourth quarter 2008. In the financial year 2014 €–7 million (2013: €–17 million) were used of this provision. The restructuring provision will probably be completely utilised by the year 2024.

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

The other provisions comprise provisions for legal risks of €77 million (31 December 2013: €29 million). They also include among others provisions for other taxes and long-term liabilities with regard to employees.

Legal risk (litigation risk) pbb Group is obliged, in all jurisdictions in which it conducts its business, to comply with a large number of statutory and supervisory requirements and regulations such as certain rules of conduct to avoid conflicts of interest, to combat money laundering, to prevent terrorist financing, to prevent criminal offences to the detriment of the financial sector, to regulate foreign trade and to safeguard bank, business and data secrecy. Given the nature of business and international expansion of activities and the large number of relevant requirements and regulations, pbb Group is involved in litigation, arbitration and regulatory proceedings in some countries. These also include criminal and administrative proceedings as well as the assertion of claims in an amount not specified by the party asserting the claim. pbb Group recognises provisions for the uncertain obligations arising from these proceedings if the potential outflow of resources is sufficiently likely and the amount of the obligation can be estimated. The probability of the outflow of resources, which often cannot be estimated with certainty, is highly dependent on the outcome of the proceedings. The assessment of this probability and the quantification of the obligation are largely based on estimates. The actual liability can vary considerably from this estimate. Accounting for the individual legal procedure, pbb Group analyses developments of the individual cases and comparable cases, drawing on its own expertise or opinions by external consultants, and in particular by legal advisors, depending on the significance and complexity of the respective case. The provisions recognised for the proceedings are not reported separately as pbb Group believes that the outcome of the proceedings would be seriously compromised by their disclosure.

pbb received contractually agreed compensation of €6 million for a former French financing arrangement, which has since been repaid in full. The customer has brought an action before the Paris commercial court for repayment of the fee, which it believes to be unreasonable. The court dismissed the action in full on 7 October 2014. The plaintiff appealed against this dismissal.

In appraisal proceedings relating to the merger of three predecessor mortgage banks to form pbb in 2001, the new appraisal ordered by the court has resulted in an additional payment averaging €1.00 per share. The potential subsequent payment claims amount up to €9.4 million plus interest as from 2001.

The profit participation certificates issued by the predecessor institutions participated in significant losses due to the net losses for the period incurred since 2008, and to pbb's net accumulated losses since this time. The redemption amounts have reduced and interest paymant has been suspended. Individual investors therefore initiated legal proceedings, contesting in particular various individual clauses relating to loss participation and replenishment following loss participation. The key questions in this connection are which balance sheet items must be taken into account to calculate loss participation and whether replenishment is required if pbb records a net income, unappropriate retained earnings or a other income. Courts have decided against the legal view of pbb especially in view of the individual decisions regarding profit participation certificates. The bank has lodged appeals in these cases. The contested profit participation certificates had a notional amount of €221 million (of which proceedings involving a principal amount of €15.4 million were pending in which the plaintiff is demanding a repayment of €6.3 million). These claims may ultimately result in a full or partial increase in the repayment claims and, if applicable, result in interest claims by the plaintiff.

Since the decisions of the Federal Court of Justice in 2014 on the inadmissibility of a credit processing fee in credit agreements with private customers, the Bank sees itself facing queries from previous private customers for the repayment of alleged credit processing fees. These demands have not yet proven to be justified. Since the end of last year, individual commercial customers have requested the repayment of the credit processing fees.

In February 2014, pbb applied to the Federal Central Tax Office (Bundeszentralamt für Steuern) for the initiation of a mutual agreement procedure in accordance with the regulations set out in the EU Arbitration Convention for the years 2006 to 2012. The subject matter of this mutual agreement procedure will be the attribution of tax income to the branch in Paris, France. This application was made as an agreement regarding the allocation of taxable profit could not be reached between the German and French fiscal authorities in the context of negotiations regarding an «Advanced Pricing Agreement» and, therefore, double taxation of income may be possible. Depending on the outcome of the mutual agreement procedure, this could result in a tax expense or a tax income for pbb Group.

Otherwise, no proceedings for which the Management Board believes the probability of an outflow of resources to be not unlikely, or which are of material significance to pbb Group for other reasons, exist with an amount in dispute in excess of more than €5 million.

61 Other Liabilities

Other liabilities in € million	**31.12.2014**	**31.12.2013**
Negative fair values from derivative financial instruments	6,083	4,441
Hedging derivatives	6,083	4,441
Fair value hedge	5,649	3,969
Cash flow hedge	434	472
Other liabilities	99	281
Total	**6,182**	**4,722**

Other liabilities include, amongst others, accruals pursuant to IAS 37 including accounts payable in respect of invoices still outstanding, short-term liabilities to employees and other accruals in respect of commission, interest, non-personnel expenses and similar expenses.

62 Income Tax Liabilities

Income tax liabilities in € million	31.12.2014	31.12.2013[1]
Current tax liabilities	82	64
Deferred tax liabilities	630	1,123
Total	**712**	**1,187**

[1] Adjusted due to IAS 8.42. Details are disclosed in Note «Consistency».

Income tax liabilities include both provisions and liabilities from current taxes as well as deferred tax liabilities. A significant proportion of deferred tax liabilities were netted against the cash flow hedge reserve of € 263 million (2013: € 442 million). Additional deferred tax liabilities of € 367 million (2013: € 681 million) are a result of temporary differences recognised in profit or loss. The significant reduction in deferred tax assets in comparison to the previous year was mainly a result of lower recognition differences of derivatives between IFRS and HGB (German Commercial Code).

63 Subordinated Capital

Breakdown in € million	31.12.2014	31.12.2013[1]
Subordinated liabilities	939	2,036
Hybrid capital instruments	340	321
Total	**1,279**	**2,357**

Early repayment obligation on the part of the issuer cannot occur for any subordinated liabilities. In the event of bankruptcy or liquidation, such liabilities may only be repaid after all non-subordinated creditors have been satisfied.

Subordinated capital by maturities in € million	31.12.2014	31.12.2013[1]
With agreed maturities		
Up to 3 months	45	41
3 months to 1 year	150	10
1 year to 5 years	890	874
5 years and over	194	1,432
Total	**1,279**	**2,357**

[1] Adjustment due to retrospective IFRS 10 first time adoption. Details are disclosed in Note «Principles».

The unwinding of value adjusted instruments of subordinated capital led to an expense of €–19 million (2013: €–18 million).

Participating Certificates Outstanding As at 31 December 2014 no participating certificates outstanding were issued (31 December 2013: one issue with a carrying amount of € 0 million).

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

64 Equity

Subscribed capital equals the maximum liability of the shareholder for the liabilities of the corporation to its creditors. The subscribed capital as of 31 December 2014 and during the entire financial year 2014 amounted to € 380,376,059.67 which is divided into 134,475,308 ordinary bearer shares in the form of no-par-value shares representing a theoretical interest in the share capital of € 2.83 per share. HRE Holding holds 100 % of the share capital of pbb. Finanzmarktstabilisierungsfonds-FMS is the only shareholder of HRE Holding. At 31 December 2014 and 31 December 2013 there was neither authorised capital nor conditional capital.

Additional paid-in capital includes premiums from the issue of shares and the contribution to the reserves of Finanzmarktstabilisierungsfonds-FMS. Retained earnings were generally created only from net income of the current financial year or previous periods. This includes legal reserves to be created from net income and other retained earnings. In addition, retained earnings increased by € 30 million due to a payment by HRE Holding to compensate for payment obligations already accrued for in prior years in connection with the transfer of positions to FMS Wertmanagement in 2010. A withdrawal was made from the additional paid-in capital pursuant to section 272 (2) nos. 1–3 HGB of € 1,771 million to partially balance out the balance sheet loss in accordance with the German Commercial Code. In the IFRS consolidated financial statements, there was a reduction of € –1,771 million in additional paid-in capital with an increase of the same amount in retained earnings.

In the year 2009 Finanzmarktstabilisierungsfonds-FMS provided pbb with a silent partnership contribution of € 1.0 billion. The silent partnership contribution participates in the cumulative loss calculated in accordance with the regulations of commercial law to the same extent that the silent partnership contribution is related to the total carrying amount of all liable capital shares which participate in the cumulative loss. The total loss of the silent partner in relation to the cumulative loss under commercial law is limited to its silent partnership contribution. The cumulative loss which is attributable to the year 2008 is not used for calculating the loss participation. At € 92 million the silent partnership contribution was unchanged to the prior-year balance sheet date in pbb's separate financial statements pursuant to HGB as of 31 December 2014. pbb has a replenishment obligation.

65 Trust Business

The following tables show the volume of fiduciary business not shown in the consolidated balance sheet.

Trust assets in € million	31.12.2014	31.12.2013
Loans and advances to customers	–	3
Total	**–**	**3**

Trust liabilities in € million	31.12.2014	31.12.2013
Liabilities to customers	–	3
Total	**–**	**3**

Notes to the Consolidated Statement of Cash Flows

66 Notes to the Items in the Consolidated Statement of Cash Flows

The consolidated statement of cash flows shows the cash flows of the financial year broken down by operating activities, investing activities and financing activities. Cash and cash equivalents correspond to the balance sheet item cash reserve, and include cash in hand and credit balances at central banks.

Operating activities are defined broadly, and correspond to operating result. Cash flow from operating activities includes payments (inflows and outflows) attributable to loans and advances to other banks and customers as well as securities attributable to trading assets and other assets. Inflows and outflows attributable to liabilities to other banks and customers, securitised liabilities and other liabilities are also included under operating activities. The interest and dividend payments resulting from operating activities are shown under cash flow from operating activities.

Cash flow from investing activities comprises payments for investment and security holdings as well as for property and equipment.

Cash flow from financing activities comprises inflows from capital increases, payments into reserves and silent participations as well as inflows and outflows for subordinated capital.

DEPFA Finance N.V. was sold in the financial year 2014. The selling price of €6 million was recognised in the cash flow from investing activities.

Notes to the Financial Instruments

67 Derivative Transactions

In order to minimise (reduce) both the economic and the regulatory credit risk, bilateral netting agreements have been concluded. By means of such netting agreements, the positive and negative fair values of the derivatives contracts included under the master agreement can be offset against one another, and the future regulatory risk add-ons for these products can be reduced. Through this netting process, the credit risk is limited to a single net claim on the party to the contract.

For both regulatory reports and the internal measurement and monitoring of the credit commitments, such risk-reducing techniques are utilised only if they are considered to be enforceable under the respective legal system in the event that the business associate becomes insolvent. Legal advice is taken in order to check enforceability.

Similar to the master agreements, pbb Group concludes collateral agreements with its business associates to collateralise the net claim or liability remaining after netting (obtained or pledged collateral). Usually, this collateral management reduces credit risk by means of prompt measurement and adjustment of the exposure to customers.

Volume of derivatives at 31 December 2014	Notional amount				Fair value	
	Remaining maturities					
in € million	Less than 1 year	1 to 5 years	More than 5 years	**Total**	positive	negative
Interest-based transactions						
OTC products	11,880	42,817	37,248	91,945	8,411	7,939
Interest rate swaps	10,464	38,001	37,190	85,655	8,407	7,934
Interest rate options	1,416	4,816	58	6,290	4	5
Call options	677	2,408	29	3,114	4	–
Put options	739	2,408	29	3,176	–	5
Total	**11,880**	**42,817**	**37,248**	**91,945**	**8,411**	**7,939**
Foreign-currency-based transactions						
OTC products	4,355	1,284	344	5,983	54	104
Spot and forward currency transactions	4,194	–	–	4,194	19	55
Interest rate/currency swaps	161	1,284	344	1,789	35	49
Total	**4,355**	**1,284**	**344**	**5,983**	**54**	**104**
Total	**16,235**	**44,101**	**37,592**	**97,928**	**8,465**	**8,043**

Use made of derivative transactions at 31 December 2014 in € million	Notional amount	Fair value positive	Fair value negative
Interest-based transactions			
Fair value hedge accounting	52,880	5,975	5,649
Cash flow hedge accounting	4,462	450	401
Stand-alone derivatives	34,603	1,986	1,889
Total	**91,945**	**8,411**	**7,939**
Foreign-currency-based transactions			
Cash flow hedge accounting	391	24	33
Stand-alone derivatives	5,592	30	71
Total	**5,983**	**54**	**104**
Total	**97,928**	**8,465**	**8,043**

Volume of derivatives at 31 December 2013 in € million	Notional amount Remaining maturities Less than 1 year	1 to 5 years	More than 5 years	Total	Fair value positive	negative
Interest-based transactions						
OTC products	13,027	41,587	41,893	96,507	6,176	5,830
Interest rate swaps	11,931	38,223	41,871	92,025	6,165	5,815
Interest rate options	1,096	3,364	22	4,482	11	15
Call options	543	1,634	16	2,193	11	–
Put options	553	1,730	6	2,289	–	15
Total	**13,027**	**41,587**	**41,893**	**96,507**	**6,176**	**5,830**
Foreign-currency-based transactions						
OTC products	3,971	835	336	5,142	67	64
Spot and forward currency transactions	3,818	37	–	3,855	17	38
Interest rate/currency swaps	153	798	336	1,287	50	26
Total	**3,971**	**835**	**336**	**5,142**	**67**	**64**
Total	**16,998**	**42,422**	**42,229**	**101,649**	**6,243**	**5,894**

Use made of derivative transactions at 31 December 2013 in € million	Notional amount	Fair value positive	Fair value negative
Interest-based transactions			
Fair value hedge accounting	56,749	4,115	3,969
Cash flow hedge accounting	6,332	443	455
Derivatives hedging dFVTPL financial instruments	–	–	–
Stand-alone derivatives	33,426	1,618	1,406
Total	**96,507**	**6,176**	**5,830**
Foreign-currency-based transactions			
Cash flow hedge accounting	452	43	17
Stand-alone derivatives	4,690	24	47
Total	**5,142**	**67**	**64**
Total	**101,649**	**6,243**	**5,894**

Counterparties	**31.12.2014**		**31.12.2013**	
	Fair value		Fair value	
in € million	positive	negative	positive	negative
OECD banks	7,516	7,967	5,474	5,788
OECD financial institutions	209	25	205	42
Other companies and private individuals	740	51	564	64
Total	**8,465**	**8,043**	**6,243**	**5,894**

68 Cash Flow Hedge Accounting

The cash flows of the hedging items shown in cash flow hedge accounting are expected to occur in the following periods:

Cash flow hedge: periods of hedging items when cash flows are expected to occur in € million	**31.12.2014**	**31.12.2013**
Up to 1 month	–1	–1
1 month to 3 months	–3	–3
3 months to 1 year	–2	–3
1 year to 2 years	–1	–10
2 years to 5 years	–8	–15
5 years and over	–53	–74
Total	**–68**	**–106**

It is expected that the cash flows will affect the income statement in the period of occurrence.

The development of the cash flow hedge reserve is shown in the consolidated statement of changes in equity.

69 Undiscounted Cash Flows of Financial Liabilities

Contractually agreed undiscounted cash flows of the financial liabilities according to IFRS 7.39 in € billion	31.12.2014	31.12.2013
Up to 3 months	4	3
From derivative financial instruments	–	1
From non-derivative financial instruments	4	2
3 months to 1 year	9	7
From derivative financial instruments	1	–
From non-derivative financial instruments	8	7
1 year to 5 years	32	33
From derivative financial instruments	2	2
From non-derivative financial instruments	30	31
5 years and over	31	35
From derivative financial instruments	3	2
From non-derivative financial instruments	28	33

In conformity with the requirements, the contractually agreed undiscounted cash flow maturities are presented in accordance with the worst-case scenario, meaning that if there are options or terminations rights involved the most unfavourable case from a liquidity perspective will be assumed. This presentation does not reflect the economic management which is based on expected cash flows. The liquidity risk strategy and management of pbb Group is described in the risk and opportunity report.

70 Assets Assigned or Pledged as Collateral

Assets have been pledged as collateral for the following assets and received collaterals:

Liabilities in € million	31.12.2014	31.12.2013
Liabilities to other banks	845	1,479
Total	**845**	**1,479**

The following assets were pledged as collateral for the above liabilities:

Assets pledged in € million	31.12.2014	31.12.2013
Loans and advances to customers	278	200
Financial investments	695	1,294
Total	**973**	**1,494**

The assets pledged mainly resulted from repurchase agreements. The transactions were carried out at the normal standard terms for repurchase transactions and concluded on an arm's-length basis.

In financial year 2014, two properties in Hungary and one property in the Netherlands were taken over with a total carrying amount of € 32 million. In the prior year, a Spanish property was taken over in the amount of € 27 million.

71 Collaterals Permitted to Resell or Repledge

As of 31 December 2014 and as of 31 December 2013 there were no collaterals that may be resold or repledged in the absence of default.

72 Transfer of Financial Assets

Transferred financial assets shall be derecognised if the derecognition criteria of IAS 39 are met. The derecognition concept of IAS 39 requires to derecognise financial assets, if risks and rewards are almost completely transferred.

However, the transferring party could retain a continuing involvement in derecognised assets. Normal confirmations and warranties in connection with the transfer, e.g. relating to fraud, good faith and fair dealings, do not represent a continuing involvement. pbb Group has no continuing involvement in transferred and derecognised financial assets.

73 Fair Values of Financial Instruments

The fair value of financial instruments, in the opinion of pbb Group, is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e. an exit price). The fair values were determined as of the balance sheet date based on the market information available and on valuation methods described here.

All financial assets and liabilities that are measured at fair value are grouped into the three fair value hierarchies by pbb Group. Reclassifications within the fair value hierarchy are made at the end of the reporting period. 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).

Fair values and fair value hierarchy of financial instruments					31.12.2014
in € million	Carrying amounts	Fair value	Level 1	Level 2	Level 3
Financial assets	**74,623**	**76,959**	**13,345**	**31,390**	**32,224**
at fair value through profit or loss	7,991	7,991	–	7,916	75
at fair value not affecting profit or loss	5,380	5,380	4,906	474	–
in balance sheet not measured at fair value	61,252	63,588	8,439	23,000	32,149
Cash reserve	57	57	57	–	–
Trading assets (HfT)	2,016	2,016	–	2,016	–
Loans and advances to other banks	6,800	6,846	1,955	3,907	984
Category LaR	6,800	6,846	1,955	3,907	984
Loans and advances to customers[1]	38,826	41,063	–	13,193	27,870
Category LaR	38,826	41,063	–	13,193	27,870
Real Estate Finance	21,664	22,858	–	–	22,858
Public Investment Finance	5,367	5,731	–	3,560	2,171
Value Portfolio	10,024	10,550	–	7,694	2,856
Consolidation & Adjustments	1,816	1,969	–	1,939	30
Portfolio-based allowances	−45	−45	–	–	−45
Financial investments	20,475	20,528	11,333	5,900	3,295
Category AfS	4,906	4,906	4,906	–	–
Category LaR	15,569	15,622	6,427	5,900	3,295
Other assets	6,449	6,449	–	6,374	75
Fair value hedge derivatives	5,975	5,975	–	5,900	75
Cash flow hedge derivatives	474	474	–	474	–
Financial liabilities	**70,954**	**73,105**	**17,778**	**13,715**	**41,612**
thereof: at fair value through profit or loss	7,609	7,609	–	7,601	8
thereof: at fair value not affecting profit or loss	434	434	–	434	–
in balance sheet not measured at fair value	62,911	65,062	17,778	5,680	41,604
Liabilities to other banks	3,187	3,322	1,690	317	1,315
Liabilities to customers	10,593	11,035	1,192	–	9,843
Securitised liabilities	47,827	49,388	14,884	5,363	29,141
Covered	40,967	42,541	12,194	5,168	25,179
Uncovered	6,860	6,847	2,690	195	3,962
Trading liabilities (HfT)	1,960	1,960	–	1,958	2
Other liabilities	6,108	6,108	12	6,077	19
Fair value hedge derivatives	5,649	5,649	–	5,643	6
Cash flow hedge derivatives	434	434	–	434	–
Other financial liabilities	25	25	12	–	13
Subordinated capital	1,279	1,292	–	–	1,292
Other items	**2,322**	**2,342**	–	–	2,342
Contingent liabilities	84	84	–	–	84
Irrevocable loan commitments	2,238	2,258	–	–	2,258

[1] Reduced by allowances for losses on loans and advances

Fair values and fair value hierarchy of financial instruments					**31.12.2013**
in € million	Carrying amounts	Fair value	Level 1	Level 2	Level 3
Financial assets	**73,279**	**74,219**	**16,801**	**25,900**	**31,518**
at fair value through profit or loss	5,757	5,757	–	5,678	79
at fair value not affecting profit or loss	4,770	4,770	4,284	482	4
in balance sheet not measured at fair value	62,752	63,692	12,517	19,740	31,435
Cash reserve	3,532	3,532	3,532	–	–
Trading assets (HfT)	1,642	1,642	–	1,642	–
Loans and advances to other banks	6,685	6,589	1,693	1,222	3,674
Category LaR[1]	6,685	6,589	1,693	1,222	3,674
Loans and advances to customers[2]	36,094	37,758	2	14,090	23,666
Category LaR	36,094	37,758	2	14,090	23,666
Real Estate Finance	20,084	21,069	–	–	21,069
Public Investment Finance	4,189	4,413	–	3,229	1,184
Value Portfolio	9,513	9,848	–	8,591	1,257
Consolidation & Adjustments	2,359	2,479	2	2,270	207
Portfolio-based allowances	–51	–51	–	–	–51
Financial investments	20,725	20,097	11,574	4,428	4,095
Category AfS	4,284	4,284	4,284	–	–
Category LaR[1]	16,441	15,813	7,290	4,428	4,095
Other assets	4,601	4,601	–	4,518	83
Fair value hedge derivatives	4,115	4,115	–	4,036	79
Cash flow hedge derivatives	486	486	–	482	4
Financial liabilities	**69,669**	**71,227**	**20,762**	**8,341**	**42,124**
at fair value through profit or loss	5,422	5,422	–	5,410	12
at fair value not affecting profit or loss	472	472	–	472	–
in balance sheet not measured at fair value	63,775	65,333	20,762	2,459	42,112
Liabilities to other banks	3,522	3,551	1,330	906	1,315
Liabilities to customers	10,848	11,277	1,329	–	9,948
Securitised liabilities	46,858	48,254	18,059	1,553	28,642
Covered	40,810	42,169	15,798	1,499	24,872
Uncovered[1]	6,048	6,085	2,261	54	3,770
Trading liabilities (HfT)	1,453	1,453	–	1,451	2
Other liabilities	4,631	4,631	44	4,431	156
Fair value hedge derivatives	3,969	3,969	–	3,959	10
Cash flow hedge derivatives	472	472	–	472	–
Other financial liabilities	190	190	44	–	146
Subordinated capital[1]	2,357	2,061	–	–	2,061
Other items	**2,594**	**2,675**	–	–	2,675
Contingent liabilities	25	25	–	–	25
Irrevocable loan commitments	2,569	2,650	–	–	2,650

[1] Adjusted due to retrospective IFRS 10 first time adoption. Details are disclosed in Note «Principles».
[2] Reduced by allowances for losses on loans and advances

As in the previous year, no financial instruments measured at fair value were reclassified from Level 1 to Level 2 and vice versa. Not all inputs for certain assets that were previously allocated to Level 2 and measured at fair value were observable on the market in 2014. As a result, assets recognised at fair value in the amount of € 8 million (2013: € 18 million) and financial liabilities in the amount of € 0 million (2013: € 3 million) were reclassified from Level 2 to Level 3. From 3 to level 2 assets recognised at fair value in the amount € 17 million (2013: € 0 million) and financial liabilities in the amount of € 3 million (2013: € 0 million) were reclassified because inputs were observable on the market again.

Disclosures to the Measurement Methods and Input Parameters

Measurement Process Both the Finance and the Risk Management & Control divisions play a role in the measurement process. The Finance division supplies accounting data. This includes:

> identification data, such as business identification numbers or International Securities Identification Numbers (ISINs)
> static data such as notional amounts, name and country of the counterparty and (remaining) terms
> accounting data such as carrying amounts, accruals and the effects of hedge accounting

Risk Management & Control calculates additional data used to measure fair value such as interest rates, credit spreads and market prices, as well as internal ratings and LGDs for certain financial instruments.

Finance compiles the data and checks it for completeness. The division then calculates the fair values of the financial instruments using measurement methods determined by Risk Management & Control. Once measurement is complete, Finance performs quality checks on the data and then approves it for further use.

Level 2 instruments measured at fair value as of 31 December 2014	Measurement methods	Observable parameters
Trading assets/liabilities	DCF methods	Cap volatilities
		Euro zone inflations rates
		Reference interest rates
		Saisonalities of Euro zone inflations rates
		Swaption volatilities
		Volatilities of Euro zone inflation caps
		Spot market exchange rates
		Yield curves
	Option pricing models	Cap volatilities
		Reference interest rates
		Swaption volatilities
		Spot market exchange rates
		Exchange rates volatilities
		Yield curves
Fair value hedge derivatives	DCF methods	Cap volatilities
		Reference interest rates
		Swaption volatilities
		Yield curves
	Option pricing models	Cap volatilities
		CMS Spread Options (strike price)
		CMS Spread Options (option price)
		Euro zone inflations rates
		Reference interest rates
		Saisonalities of Euro zone inflations rates
		Swaption volatilities
		Volatilities of Euro zone inflation caps
		Spot market exchange rates
		Exchange rates volatilities
		Yield curves
Cash flow hedge derivatives	DCF methods	Reference interest rates
		Yield curves
	Option pricing models	Cap volatilities
		CMS Spread Options (strike price)
		CMS Spread Options (option price)
		Reference interest rates
		Swaption volatilities
		Spot market exchange rates
		Exchange rates volatilities
		Yield curves

Level 3 instruments measured at fair value as of 31 December 2014	Measurement methods	Non-observable parameters	Parameter range (weighted average)
Trading assets/liabilities	Option pricing models	Forward/exchange rate correlations	0.00% (0.00%)
		Asset swap spreads (volatilities)	+0.34% (+0.34%)
Fair value hedge derivatives	Option pricing models	EUR-EONIA beyond 2.10.2064	+1.41% (+1.41%)
		EUR-EO6M beyond 2.10.2064	+1.53% (+1.53%)
		Historical index/index correlations	−0.94 to +71.19% (+30.97%)
		Historical index/exchange rate correlations	−10.82% to +20.49% (+4.11%)

Financial instruments not measured at fair value as of 31 December 2014	Level 2		Level 3		
	Measurement methods	Observable parameters	Measurement methods	Observable parameters	Non-observable parameters
Financial assets					
Loans and receivables (LaR)	DCF models	Credit spreads	DCF models	Credit spreads	Internal rating classes
		Reference interest rates		Reference interest rates	Recovery rates
		Risk-free interest rate		Risk-free interest rate	Expected maturities
		Observable future cash flows		Observable future cash flows	Estimated future cash flows
	Quoted prices in non-active markets	Quoted prices for proxy trades	–	–	–
Financial liabilities					
Financial liabilities at amortised cost	DCF models	Observable future cash flows	DCF models	Observable future cash flows	Estimated future cash flows
		(Own) credit spreads		(Own) credit spreads	(Own) credit spreads (secondary market grid)
		Benchmark interest rates		Benchmark interest rates	–
	Quoted prices in non-active markets	Quoted prices for proxy trades	–	–	–

Sensitivities Although pbb Group believes that its estimates of fair values are appropriate, using reasonably possible alternative input factors will significantly impact the fair value. The following table shows the fair value sensitivity of level 3 instruments as of 31 December 2014 and as of 31 December 2013 which have been quantified on the basis of the specified valuation parameters taking account usual market scenarios:

Sensitivities of level 3 instruments measured at fair value in € million	31.12.2014 Positive changes	31.12.2014 Negative changes	31.12.2013 Positive changes	31.12.2013 Negative changes
Assets				
Financial assets at fair value through profit or loss				
Fair value hedge derivatives	–	–	0.7	–0.7
Total	**–**	**–**	**0.7**	**–0.7**
Liabilities				
Financial liabilities at fair value through profit or loss				
Trading liabilities	0.7	–0.7	–	–
Fair value hedge derivatives	0.5	–0.5	–	–
Total	**1.2**	**–1.2**	**–**	**–**

The disclosed favourable and unfavourable changes are calculated independently from each other. Offsetting effects due to compensating derivatives and hedge relationships attenuate both favourable and unfavourable changes.

Changes in Level 3 Financial Instruments measured at Fair Value

Changes in level 3 financial assets in € million	Trading assets	Financial assets at fair value through profit or loss: Fair value hedge derivatives	Financial assets at fair value not affecting profit or loss: Cash flow hedge derivatives	**Total**
Balance at 1.1.2013	**1**	**78**	**4**	**83**
Comprehensive income				
Income statement	–1	–17	–	–18
Revaluation reserve	–	–	–	–
Purchases	–	8	–	8
Sales	–	–8	–	–8
Issues	–	–	–	–
Settlements	–	–	–	–
Transfers into Level 3	–	18	–	18
Transfers out of Level 3	–	–	–	–
Balance at 31.12.2013	**–**	**79**	**4**	**83**
Balance at 1.1.2014	**–**	**79**	**4**	**83**
Comprehensive income				
Income statement	–	2	–1	1
Revaluation reserve	–	–	–	–
Purchases	–	19	–	19
Sales	–	–19	–	–19
Issues	–	–	–	–
Settlements	–	–	–	–
Reclassification into Level 3	–	8	–	8
Reclassification out of Level 3	–	–14	–3	–17
Balance at 31.12.2014	**–**	**75**	**–**	**75**

Changes in level 3 financial liabilities in € million	Financial liabilities at fair value through profit or loss Trading liabilities	 Fair value hedge derivatives	Financial liabilities at fair value not affecting profit or loss Cash flow hedge derivatives	Total
Balance at 1.1.2013	**2**	**2**	**–**	**4**
Comprehensive income	–	–	–	–
Income statement	–	−2	–	−2
Revaluation reserve	–	–	–	–
Purchases	–	9	–	9
Sales	–	−2	–	−2
Issues	–	–	–	–
Settlements	–	–	–	–
Transfers into Level 3	–	3	–	3
Transfers out of Level 3	–	–	–	–
Balance at 31.12.2013	**2**	**10**	**–**	**12**
Balance at 1.1.2014	**2**	**10**	**–**	**12**
Comprehensive income				
Income statement	–	−1	–	−1
Revaluation reserve	–	–	–	–
Purchases	–	–	–	–
Sales	–	–	–	–
Issues	–	–	–	–
Settlements	–	–	–	–
Reclassification into Level 3	–	–	–	–
Reclassification out of Level 3	–	−3	–	−3
Balance at 31.12.2014	**2**	**6**	**–**	**8**

The earnings contributions made by trading assets and trading liabilities are presented under net trading income, whereas the effects of hedge relationships recognised in profit or loss are reported under net income from hedging relationships.

Assets and Liabilities According to Measurement Categories and Classes

The carrying amounts reflect the maximum on balance sheet exposure to credit default risk of the assets respectively the maximum exposure of the other items according to IFRS 7.

Asset and liabilities according to measurement categories and classes in accordance with IAS 39 in € million	**31.12.2014**	**31.12.2013**[1]
Assets	**74,623**	**73,279**
Loans and receivables (LaR)	61,195	59,220
Available for sale (AfS)	4,906	4,284
Held for trading (HfT)	2,016	1,642
Cash reserve	57	3,532
Positive fair values from hedging derivatives	6,449	4,601
Liabilities	**70,954**	**69,669**
Held for trading (HfT)	1,960	1,453
Financial liabilities at amortised cost	62,911	63,775
Negative fair values from hedging derivatives	6,083	4,441

[1] Adjustment due to retrospective IFRS 10 first time adoption. Details are disclosed in Note «Principles».

74 Exposure to Selected European Countries

Exposure to selected European countries as of 31 December 2014 in € million	Counterparty	IAS 39 measurement category	Up to 3 months	3 months to 1 year	year to 5 years	5 years and over	**Total**	Notional amount	Fair value
Italy	Sovereign	LaR	85	–	293	373	751	675	714
		AfS	–	41	–	1,565	1,606	1,100	1,606
	Sub-sovereign	LaR	–	–	19	951	970	927	837
Portugal	Sovereign	LaR	–	–	43	–	43	39	43
		AfS	–	–	49	136	185	165	185
	Sub-sovereign	LaR	–	–	130	200	330	330	271
	State-guaranteed	LaR	–	–	100	329	429	405	367
Spain	Sovereign	LaR	–	–	–	10	10	10	10
		AfS	103	792	–	–	895	865	895
	Sub-sovereign	LaR	11	308	889	677	1,885	1,710	1,853
		HfT	–	–	–	5	5	35	5
	State-guaranteed	LaR	–	–	63	149	212	193	214

Exposure to selected European countries as of 31 December 2013 in € million	Counterparty	IAS 39 measurement category	Up to 3 months	3 months to 1 year	1 year to 5 years	5 years and over	**Total**	Notional amount	Fair value
Italy	Sovereign	LaR	–	–	107	149	256	253	227
		AfS	–	–	–	1,300	1,300	1,060	1,300
	Sub-sovereign	LaR	–	–	8	1,028	1,036	1,002	863
	State-guaranteed	LaR	–	–	176	404	580	505	521
Portugal	Sovereign	LaR	–	–	43	–	43	36	41
		AfS	–	–	46	109	155	165	155
	Sub-sovereign	LaR	–	–	130	200	330	330	254
	State-guaranteed	LaR	–	62	100	323	485	465	364
Spain	Sovereign	AfS	–	667	–	–	667	650	667
	Sub-sovereign	LaR	–	29	1,116	785	1,930	1,783	1,803
		HfT	–	–	–	3	3	35	3
	State-guaranteed	LaR	21	–	74	155	250	237	259

As of 31 December 2014 and as of 31 December 2013 pbb Group did not have any exposure to sovereign counterparties of Greece, Cyprus and Ireland. The same applies for sub-sovereign or state-guaranteed counterparties of those states.

The exposure to selected countries shown in the table contains loans and advances and securities. In addition, it shows interest rate derivatives to sovereign and sub-sovereign counterparties. The interest rate derivatives are netted with collaterals. Time lags in providing the collaterals and haircuts are not taken into account. State-guaranteed exposure contains for example loans and advances to banks and corporations which are guaranteed by sovereigns or sub-sovereigns. As of 31 December 2014 and as of 31 December 2013 pbb Group did not have any credit default swaps whose underlyings are linked to sovereigns, sub-sovereigns and state-guaranteed exposures of the countries shown above.

For the total exposure as of 31 December 2014 and as of 31 December 2013 the exposure at default according to regions is disclosed in the risk and opportunity report.

For financial assets which are measured at fair value through profit or loss changes in value are directly included in the book value. pbb Group tests financial assets which are not measured at fair value through profit or loss for impairments. Allowances for loans and advance or impairments for securities are created if there is objective evidence that it is not possible to recover the entire amount which is due according with the original contractual conditions. As per 31 December 2014 and as of 31 December 2013 there was no such objective evidence.

The fair values of the exposure to selected European countries were determined by applying the measurement methods disclosed in the Note «Fair Values of Financial Instruments».

75 Past Due but Not Impaired Assets

The following table shows the total portfolio of the partly or completely past due but not impaired loans and advances as of 31 December 2014 and as of 31 December 2013. However, no specific allowances were made for these assets respectively the underlying collaterals as pbb Group does not consider that there is any issue regarding their recoverability. Such timing issues in receipts of payments due occur regularly (up to three months) in the normal course of business and are not considered to be an evidence for impairment.

LaR Assets

Carrying amounts of past due but not impaired LaR assets in € million	31.12.2014	31.12.2013
Up to 3 months	32	274
From 3 months to 6 months	10	40
From 6 months to 1 year	7	81
From 1 year and over	10	47
Total	**59**	**442**

Carrying amounts LaR assets in € billion	31.12.2014	31.12.2013[1]
Carrying amount of LaR assets that are neither impaired nor past due	60.5	58.3
Carrying amount of LaR assets that are past due but not impaired (total investment)	0.1	0.4
Carrying amount of individually assessed impaired LaR assets (net)	0.6	0.4
Balance of specific allowances	0.1	0.1
Balance of portfolio-based allowances	0.1	0.1
Total	**61.4**	**59.3**
thereof: Loans and advances to other banks (including investments)	6.8	6.7
Loans and advances to customers (including investments)	39.0	36.2
Financial investments (gross)	15.6	16.4

[1] Adjustment due to retrospective IFRS 10 first time adoption. Details are disclosed in Note «Principles».

The carrying amount of assets that would otherwise be past due or impaired and whose terms have been renegotiated amounted to € 88 million (2013: € 91 million).

The fair value of collaterals for the impaired financial assets amounted to approximately € 0.6 billion (2013: € 0.4 billion). The collaterals mainly consist of land charges.

AfS Assets As of 31 December 2014 and as of 31 December 2013 pbb Group had neither past due and not impaired nor impaired AfS financial investments in the portfolio.

76 Restructured Loans and Advances

In the financial years 2014 and 2013, restructuring agreements mainly related to standstill agreements and to the discontinuation of contractual arrangements.

Restructured loans and advances in € million	31.12.2014	31.12.2013
Carrying amount of loans and advances that are neither impaired nor past due	1,048	1,128
Carrying amount of loans that are past due but not impaired (gross)	12	28
Carrying amount of individually assessed impaired loans and advances (gross)	241	352
Total	**1,301**	**1,508**

Development of restructured loans and advances in € million	2014	2013
Balance at 1.1.	**1,508**	**1,818**
Additions	592	213
Disposals	−633	−462
Reclassifications after expiry of good conduct period	−135	–
Changes in the basis of consolidation	−31	−61
Balance at 31.12.	**1,301**	**1,508**

Proportion of restructured loans and advances in the total portfolio in %	31.12.2014	31.12.2013[1]
Proportion of restructured loans and advances in the total portfolio	2.8	3.5

[1] Adjustment due to retrospective IFRS 10 first time adoption. Details are disclosed in Note «Principles».

Allowances for losses on restructured loans and advances in € million	31.12.2014	31.12.2013
Specific allowances	73	62
Portfolio-based allowances	4	7
Total	**77**	**69**

Proportion of allowances for losses in the restructured loans and advances portfolio in %	31.12.2014	31.12.2013
Proportion of allowances for losses in the restructured loans and advances portfolio	6.0	4.6

77 Netting of Financial Instruments

The following tables show the gross carrying amounts of recognised financial assets respectively liabilities, the gross carrying amounts of the items offset in the statement of financial position and the net amounts of the financial assets and liabilities recognised in the statement of financial position. They also show the rights of set-off that did not lead to an offsetting in the statement of financial position, the collateral received for financial assets, the collateral pledged for financial liabilities and the net amounts of financial assets and liabilities remaining following the application of the netting agreements and deduction of the collateral.

Netting agreements pbb Group routinely enters into standardised bilateral netting agreements in the derivatives business to minimise the legal risk as well as the economic and regulatory counterparty default risk. The national respectively international agreements used are the German Master Agreement for Financial Futures and the ISDA Master Agreement issued by the International Swaps and Derivatives Association. The derivatives cannot be offset in the statement of financial position since their conditions are not identical (e.g. different terms or currency underlyings).

Collateral In addition, pbb Group also enters into collateral agreements to hedge the net receivables and net liabilities arising following offsetting according to the netting agreements (collateral received or pledged). The collateral used is primarily cash collateral; however, securities are sometimes also used by way of title transfer. The collateral agreements likewise cannot be offset against the derivatives.

Netting of financial instruments as of 31 December 2014 in € billion	Gross carrying amounts of recognised financial assets/liabilities	Gross carrying amounts of the items offset in the statement of financial position	Net amounts presented in the statement of financial position	Rights of set-off that did not lead to an offsetting in the statement of financial position	Received respectively pledged collaterals	Remaining net amount
Financial assets	**8.5**	**–**	**8.5**	**6.0**	**1.8**	**0.7**
Positive fair values of derivatives	8.5	–	8.5	6.0	1.8	0.7
Financial liabilities	**8.0**	**–**	**8.0**	**6.0**	**1.9**	**0.1**
Negative fair values of derivatives	8.0	–	8.0	6.0	1.9	0.1

Netting of financial instruments as of 31 December 2013 in € billion	Gross carrying amounts of recognised financial assets/liabilities	Gross carrying amounts of the items offset in the statement of financial position	Net amounts presented in the statement of financial position	Rights of set-off that did not lead to an offsetting in the statement of financial position	Received respectively pledged collaterals	Remaining net amount
Financial assets	**6.2**	**–**	**6.2**	**4.4**	**1.4**	**0.4**
Positive fair values of derivatives	6.2	–	6.2	4.4	1.4	0.4
Financial liabilities	**5.9**	**–**	**5.9**	**4.4**	**1.4**	**0.1**
Negative fair values of derivatives	5.9	–	5.9	4.4	1.4	0.1

Other Notes

78 Contingent Liabilities and Other Commitments

Contingent liabilities and other commitments in € million	31.12.2014	31.12.2013
Contingent liabilities	**84**	**25**
Guarantees and warranties	84	25
Loan guarantees	–	4
Performance guarantees and warranties	84	21
Other commitments	**2,238**	**2,569**
Irrevocable loan commitments	2,238	2,569
Guarantees	6	30
Mortgage and public sector loans	2,232	2,539
Total	**2,322**	**2,594**

pbb, Munich, as a legal successor of Hypo Real Estate Bank International AG, has taken over with the announcement as of 2 January 2006 irrevocable and unconditional guarantees to fulfil all liabilities of Hypo Public Finance Bank puc, Dublin. By the fact that all shares of Hypo Public Finance Bank puc, Dublin, were sold, the commitment was limited according to the guarantee contract to all liabilities, which existed until the date of sale. Due to the current development in earnings, assets and financial position as well as the expected future development, pbb does not rule out the default of Hypo Public Finance Bank puc, Dublin, but a default should be rather unlikely.

In accordance with the framework agreement for transferring risk positions and non-strategic operations to a deconsolidated environment constituted under federal law in accordance with Section 8a of Finanzmarktstabilisierungsfondsgesetz pbb assumes joint and several liability for all payment obligations of its subsidiaries resulting from the transaction agreements which have been transferred as part of the process of transferring assets to FMS Wertmanagement.

The Restructuring Fund Ordinance specifies an additional charge for the so-called bank levy. The difference between the actually determined bank levy and the calculated standard amount for the years 2011 to 2019 can be subsequently charged in the following two years in each case. However, the obligation to pay the additional amount arises only if corresponding profits are generated in subsequent financial years; the amount of this payment is capped by the feasibility or charge specified in the ordinance. Whether the additional payment becomes due, and also the extent of such an additional payment, accordingly depend on profits being generated in subsequent years.The additional payment which pbb can be charged in 2015 and 2016 is € 13 million.

Due to a requirement in line with the principle of burden sharing required by the EU Commission, profits will be retained at pbb Group until privatisation, and will be used for repaying the silent partnership contribution of Finanzmarktstabilisierungsfonds-FMS.

pbb Group is a lessee in the context of operating lease agreements. Non-terminable operating lease agreements for land and buildings as well as for operating and business equipment existed as of 31 December 2014. The minimum obligations arising from non-terminable leasing arrangements will result in expenses of €–12 million in 2015, €–37 million in total in the years 2016 to 2019 and €–27 million in total for 2020 and beyond. In the previous year the minimum obligations from non-terminable operating lease agreements were as follows: for the financial year 2014: €–11 million, in financial years 2015 to 2018 €–36 million in total and for 2019 and beyond €–31 million in total. Operating lease agreements concluded by pbb Group were made on an arm's-length basis and are mainly related to the rental of land and buildings. The agreements include partial renewal options that the lease can be extended for several periods, and price escalation clauses in the form of stepped rents or indexation clauses as well as release clauses.

For pbb Group irrevocable loan commitments form the largest part of other commitments. Irrevocable loan commitments comprise all commitments of a creditor which can grant a loan and advance at a later date and which can cause a credit risk. These are mainly credit commitments which are not fully drawn.

79 Key Regulatory Capital Ratios

In accordance with the waiver regulation set out in Section 7 of the Capital Requirements Regulation (CRR, from 1 January 2014), pbb is exempted from the requirement to establish the equity and core capital ratios. pbb Group voluntarily discloses these figures.

(EU) Directive no. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms applies with effect from 1 January 2014.

These regulations (CRR/CRD IV) form the basis for determining the regulatory capitalisation.

Besides the minimum capital ratios, the changes also affect the requirements for the eligibility of capital instruments as well as the mandatory determination of the regulatory capital similarly to the accounting standard used. For this reason, the regulatory key figures have been determined based on IFRS since 1 January 2014 (up until the end of 2013 they were based on the German Commercial Code [HGB]). In addition, the abolition of the former preference for certain risk items pursuant to section 64 (h) of the German Banking Act (Kreditwesengesetz [KWG]) and the CRR-based introduction of an additional CVA charge results in a significant increase in risk-weighted assets in relation to the figures as at the end of 2013.

The Management Board manages the capital based on the CRR. According to the CRR, the CET1 ratio (Common Equity Tier 1/risk-weighted assets) may not fall below 4.0%, the Tier 1 ratio (Tier 1/risk-weighted assets) may not fall below 5.5% and the own funds ratio (own funds/risk-weighted assets) may not fall below 8.0% in 2014.

These requirements with respect to the regulatory capital ratios were satisfied throughout the whole of 2014.

With its «Guidelines for common procedures and methodologies for the supervisory review and evaluation process» (SREP Guidelines) in December 2014, the EBA proposed a uniform procedure to be used by the ECB in reviewing and assessing institutions. The primary areas of focus are credit, market price and operational risks, interest rate fluctuation risks in the investment book, risks of excessive indebtedness, liquidity risks and their management. As part of the monitoring, minimum ratios including the CET1 ratio and the own funds ratio were prescribed for HRE on 12 March 2015. These ratios were met as of 31 December 2014.

For ease of comparison, the figures are additionally stated as of 31 December 2013, calculated according to the regulations applicable from 1 January 2014.

Own Funds in € million	31.12.2014	31.12.2014 Basel III fully phased-in[1]	31.12.2013 Pro forma Basel III figure[2][3]	31.12.2013 Pro forma Basel III figure fully phased-in[1][2]	31.12.2013[4]
CET1	3,364	2,090	3,336	1,993	2,475
Additional Tier 1	195	999	216	999	350
Tier 1	3,559	3,089	3,552	2,992	2,825
Tier 2	483	334	632	454	835
Own Funds	**4,042**	**3,423**	**4,184**	**3,446**	**3,660**

[1] After expiry of all Basel III transitional regulations
[2] Consolidated in accordance with CRR (following the appropriation of net profit 2013)
[3] Adjusted due to IAS 8.42. Details are disclosed in Note «Consistency».
[4] Consolidated in accordance with section 10 a of German Banking Act (KWG) (following the appropriation of net profit 2013)

Risk-weighted assets (RWA)[1] in € million	31.12.2014	31.12.2014 Basel III fully phased-in[2]	31.12.2013 Pro forma Basel III figure[3]	31.12.2013 Pro forma Basel III figure fully phased-in[2][3]	31.12.2013[4]
Market risks	217	217	158	158	75
thereof interest rate risks	–	–	–	–	–
thereof foreign exchange risks	217	217	158	158	75
Operational risks	1,010	1,010	923	923	923
Credit risks	14,261	14,261	16,979	16,979	13,087
thereof CVA charge	445	445	531	531	–
Other RWA	1	1	3	3	–
RWA total	**15,489**	**15,489**	**18,063**	**18,063**	**14,085**

[1] Including weighted credit risk positions and capital charges for market risk positions and operational risk, using a scaling factor of 12.5
[2] After expiry of all Basel III transitional regulations
[3] Consolidated in accordance with CRR
[4] Consolidated in accordance with section 10 a of the German Banking Act (KWG)

Capital ratios in %	31.12.2014	31.12.2014 Basel III fully phased-in[1]	31.12.2013 Pro forma Basel III figure[2][3]	31.12.2013 Pro forma Basel III figure fully phased-in[1][2]	31.12.2013[4]
CET1 ratio	21.7	13.5	18.5	11.0	17.6
Tier 1 ratio	23.0	19.9	19.7	16.6	20.1
Own funds ratio	26.1	22.1	23.2	19.1	26.0

[1] After expiry of all Basel III transitional regulations
[2] Consolidated in accordance with CRR (following the appropriation of net profit 2013)
[3] Adjusted due to IAS 8.42. Details are disclosed in Note «Consistency».
[4] Consolidated in accordance with section 10 a of German Banking Act (KWG) (following the appropriation of net profit 2013)

80 Group Auditors' Fee

Group auditors' fee in €thousand	**2014**	**2013**
Audit	2,280	2,584
Other assurance services	486	632
Tax advisory services	–	2
Other non-audit services	1,164	3,193
Total	**3,930**	**6,411**

The table shows fees to the group auditor KPMG AG Wirtschaftsprüfungsgesellschaft.

81 Relationship with Related Parties

According to IAS 24 (Related-Party Disclosures), a party is related to an entity if, directly or indirectly through one or more intermediaries, the party controls or is controlled by the reporting entity, has an interest in the entity that gives it significant influence over the entity or has joint control over the entity as well as associates and joint ventures. In addition, retirement benefit schemes for post-employment benefits for employees are also included under related parties.

Transactions with related entities or persons were performed on an arm's-length basis under consideration of the characteristics of section 311 et seq. AktG (German Stock Corporation Act). In accordance with Section 7d FMStBG, the regulations of the Aktiengesetz (Stock Corporation Act) regarding controlling entities are not applicable to Finanzmarktstabilisierungsfonds-FMS, central government and the corporations, institutions and special funds established by central government as well as related persons or other companies which are directly or indirectly dependent on them. This is not applicable for the application of regulations regarding the representation of employees in the supervisory board of a company controlled by Finanzmarktstabilisierungsfonds-FMS. According to IAS 24.25, pbb Group is exempted from the requirement of reporting on events, receivables and liabilities including obligations with related parties in accordance with IAS 24.18 if these parties are also controlled by the Federal Republic of Germany or if the Federal Republic of Germany is involved in the joint management of such related parties or if it has a material influence over such parties.

Related Entities Finanzmarktstabilisierungsfonds-FMS, a special fund of the federal government in accordance with Section 2 (2) FMStFG, represents the ultimate parent entity of HRE Holding and thus also of pbb. Accordingly, pbb is a government-related entity and a related party to other companies which are controlled, jointly controlled or significantly influenced by the Federal Republic of Germany. In addition to the parent entity HRE Holding FMS Wertmanagement and its affiliated company DEPFA are also controlled by the Federal Republic of Germany and is thus a related party of pbb Group. In the year 2014, pbb Group reimbursed Finanzmarktstabilisierungsfonds-FMS no expenses (excluding bank levy) (2013: €0 million).

pbb Group had a net liability of €0.3 billion (31 December 2013: €0.0 billion) to its parent company HRE Holding as of 31 December 2014. As of 31 December 2014, HRE Holding held financial investments of pbb Group amounting to €0.8 billion (2013: €0.8 billion). Net interest income of pbb Group to HRE Holding amounted to €–12 million (2013: €–12 million). Net other operating income/expenses of €4 million (2013: €5 million) resulted from the transfer of employees to HRE Holding, the passing on of Management Board salaries to HRE Holding resulted in the amount of €2 million (2013: €0 million) and €1 million (2013: €1 million) is attributable to IT services rendered to HRE Holding. Retained earnings increased by €30 million due to a payment by HRE Holding to compensate for payment obligations in connection with the transfer of positions to FMS Wertmanagement in 2010.

Net income from services for the FMS Wertmanagement portfolio amounted to only €1 million (2013: €60 million). As at 31 December 2014 and as 31 December 2013 there were no material transactions which would have affected the development of assets, financial position or earnings of pbb Group.

pbb Group had loans and advances (netted by liabilities) to DEPFA which was sold to FMS Wertmanagement on 19 December 2014 of €0.1 billion as of 31 December 2014 (2013: €0.2 billion) and subordinated liabilities of €0.2 billion (2013: €0.3 billion). In the financial year 2014 pbb Group realised a net interest income of €–16 million (2013: €–38 million) and a net fee and commission income of €0 million (2013: €0 million) to DEPFA. The net income from IT services provided to DEPFA was €30 million (2013: €36 million). These services were largely discontinued on 31 December 2014.

DEPFA Finance. N.V., was sold to DEPFA Bank plc, Dublin, for €6 million on 18 July 2014 as part of the unbundling of pbb Group and DEPFA. With the de-consolidation of the company, pbb's liabilities to DEPFA Finance N.V. became external relationships in respect of the Group. These liabilities no longer have to be eliminated. The first time measurement of liabilities resulted in earnings of €21 million, which is recognised in net income from financial investments.

There were no business relationships with the fellow subsidiary Hypo Real Estate Finance B.V. i.L., Amsterdam in the years 2014 and 2013. Besides, assets and liabilities did not exist.

As at 31 December 2014, loans and advances to non-consolidated companies amounted to €0 million (2013: €0 million); the liabilties amounted to €0 million (2013: €0 million). Loans and advances to associated companies which were not measured with the equity method amounted to €39 million (2013: €41 million), whereas the liabilities were at €0 million (2013: €0 million).

All further transactions carried out in the current financial year and in the previous period with companies, which were controlled, jointly controlled or significantly influenced by the Federal Republic of Germany, related to operational business, and overall were immaterial for pbb Group.

On 31 December 2014 liabilities to defined contribution plans amounted to €2 million (2013: €2 million).

Related Persons pbb Group defines related persons as the Management Board, the Supervisory Board, employees in the second tier of management at pbb as well as members of management of the subsidiaries of pbb as well as their respective close relatives. pbb paid neither fixed remuneration nor severance payments to the Management Board during the financial years 2014 and 2013. Although employment contracts between the members of the Management Board and pbb have been closed in preparation of the privatization in 2014, the renumeration, however, has been charged in full to HRE Holding. For 2014, the total remuneration paid to former members of the Management Board and their surviving dependants amounted to €5,136 thousand (2013: €5,173 thousand). The Supervisory Board remuneration for the reporting period amounted to €96 thousand (2013: €100 thousand). This figure was composed exclusively of fixed remuneration. There were no receivables to related persons from loans or advanves at balance sheet date.

Vested remuneration paid to persons with key function in the Group (Senior Management)[1]			**2014**	**2013**
in € thousand	Remuneration[2]	Severance payments	**Total**	**Total**
Total	6,579	–	**6,579**	**6,858**

[1] Members of the second tier of management of pbb and managing directors of subsidiaries of pbb
[2] Reporting follows the so-called vested principle. The components of compensation which were vested in the relevant period 2014 are reported.

Pension obligations to persons with key function in pbb Group (Senior Management) in € thousand	**31.12.2014**	**31.12.2013**
Total[1]	85,650	73,963

[1] Thereof €71,154 thousand (2013: €63,404 thousand) for pensioners and surviving dependants

Statement according to section 15a WpHG During the complete financial years 2014 and 2013 HRE Holding held all shares of pbb. Hence, members of the Management Board and the Supervisory Board did not hold shares of the Company as at 31 December 2014 and as at 31 December 2013. In the years 2014 and 2013 no shares or share derivatives of pbb were purchased or sold by members of the Management Board and the Supervisory Board.

82 Employees

Average number of employees	2014	2013
Employees (excluding apprentices)	838	960
thereof: senior staff in Germany	17	17
Total	**838**	**960**

83 Members of the Supervisory Board and of the Management Board

Supervisory Board of pbb
in financial year 2014

Name, place of residence Function in the Supervisory Board	**Principal activity** Function in the Committees of the Supervisory Board
Dr. Günther Bräunig, Frankfurt am Main, Germany Chairman (from 26.8.2014)	**Member of the Management Board of KfW** Chairman of the Presidential- and Nominations Committee and of the Remuneration Control Committee, Member of the Audit Committee and of the Risk Management and Liquidity Strategy Committee
Dr. Bernd Thiemann, Münster, Germany Chairman (until 26.8.2014)	**Former Chairman of the Management Board of DG Bank AG** Chairman of the Presidential- and Nominations Committee and of the Remuneration Control Committee, Member of the Audit Committee and of the Risk Management and Liquidity Strategy Committee
Dagmar Kollmann, Vienna, Austria Deputy Chairperson	**Entrepreneur** Chairperson of the Audit Committee and Member of the Presidential- and Nominations Committee, of the Risk Management and Liquidity Strategy Committee and of the Remuneration Control Committee
Dr. Christian Gebauer-Rochholz, Hochheim, Germany Workers' Council Representative	**Bank employee**
Dr. Alexander Groß, Teltow, Germany Member (until 25.2.2014)	**Head of the Economic Policy department in the Bundesministerium für Wirtschaft und Energie**
Georg Kordick, Poing, Germany Workers' Council Representative	**Bank employee**
Joachim Plesser, Ratingen, Germany Member (from 26.8.2014)	**Former member of the Management Board of Eurohypo AG** Chairman of the Risk Management and Liquidity Strategy Committee, Member of the Presidential- and Nominations Committee, of the Audit Committee and of the Remuneration Control Committee
Dr. Ludger Schuknecht, Frankfurt am Main, Germany Member	**Director General for economic and fiscal policy strategy; international economy and finance in the Bundesministerium der Finanzen**
Heike Theißing, Munich, Germany Workers' Council Representative	**Bank employee** Member of the Remuneration Control Committee
Dr. Hedda von Wedel, Andernach, Germany Member	**President of the Bundesrechnungshof, retired** Member of the Audit Committee
Dr. Jeromin Zettelmeyer, Berlin, Germany Member (from 15.4.2014)	**Head of the Economic Policy department in the Bundesministerium für Wirtschaft und Energie**

Management Board of pbb
in financial year 2014

Name and place of residence	Function in the Management Board	Mandates held in Supervisory Bodies under the Respective Law for Major Corporations
Andreas Arndt Munich, Germany	Co-CEO (from 1.10.2014) CFO (from 15.4.2014 until 30.9.2014)	
Manuela Better Munich, Germany	CEO (until 3.6.2014)/CRO (until 1.3.2014)	> Non-executive Director of DEPFA BANK plc (until 5.6.2014) > Non-executive Director of DEPFA ACS Bank (until 5.6.2014) > Non-executive Director of Hypo Public Finance Bank (until 5.6.2014) > AXA Konzern AG (from 27.5.2014)
Thomes Köntgen Frankfurt am Main, Germany	Co-CEO (from 1.10.2014)	
Wolfgang Groth Tawern, Germany	Treasury/Asset Management	> Non-executive Director of DEPFA BANK plc > Chairman and Non-executive Director of DEPFA ACS Bank (from 24.7.2014) > Chairman und Non-executive Director of Hypo Public Finance Bank
Andreas Schenk Dreieich, Germany	CRO (from 1.3.2014)	
Dr. Bernhard Scholz Regensburg, Germany	Real Estate Finance/Public Investment Finance	
Alexander von Uslar Grünwald, Germany	CFO/COO (until 16.5.2014)	> Non-executive Director of DEPFA BANK plc (until 16.5.2014) > Non-executive Director of DEPFA ACS Bank (until 16.5.2014)

84 Holdings of pbb

Holdings of pbb as of 31 December 2014
Additional statement according to HGB

Name, place of business and country	Purpose of business	Interest in % Total Sec 16 (4) Aktiengesetz	of which held indirectly	Differing voting rights in %	Currency	Equity in thousands	Net income/ loss in thousands
Consolidated companies							
Hayabusa Godo Kaisha, Tokyo, Japan	Salvage acquisition	100.00	100.00	–	JPY	−252,896	−9,050
Hypo Real Estate Capital India Corp. Private Ltd. i. L., Mumbai, India	in liquidation	100.00	–	–	INR	18,652	−980
Hypo Real Estate Capital Japan Corp., Tokyo, Japan	Credit intermediary	100.00	–	–	JPY	30,486,256	−117,223
Hypo Real Estate International LLC I[1], Wilmington, USA	Refinancing	100.00	–	–	EUR	114,182	346,936
Hypo Real Estate International Trust I[1], Wilmington, USA	Refinancing	100.00	–	–	EUR	−113,700	119,000
IMMO Immobilien Management GmbH & Co. KG, Munich, Germany	Real estate company	100.00	–	–	EUR	1,223	−11
IMMO Invest Real Estate GmbH[2], Munich, Germany	Salvage acquisition	100.00	–	–	EUR	3,028	–
Ragnarök Vermögensverwaltung AG & Co. KG[3], Munich, Germany	Real estate company	100.00	–	–	EUR	1,158	−65
RPPSE Espacio Oviedo S.L.U., Madrid, Spain	Salvage acquisition	100.00	100.00	–	EUR	−2,543	−13,693
Non-consolidated companies due to minor significance							
GfI-Gesellschaft für Immobilienentwicklung und -verwaltung mbH i. L., Stuttgart, Germany	in liquidation	100.00	–	–	EUR	10	–
Immo Immobilien Management Beteiligungsgesellschaft mbH, Munich, Germany	Real estate company	100.00	–	–	EUR	20	−8
Associated companies due to minor significance not measured at equity							
SANO Grundstücks-Vermietungsgesellschaft mbH & Co. Objekt Dresden KG[1], Düsseldorf, Germany	Model of bank holding	33.33	–	25.00	EUR	−3,331	546
SOMA Grundstücks-Vermietungsgesellschaft mbH & Co. Objekt Darmstadt KG[1], Düsseldorf, Germany	Model of bank holding	33.33	–	25.00	EUR	−10,170	60
WISUS Beteiligungs GmbH & Co. Zweite Vermietungs-KG[1][4], Munich, Germany	Model of bank holding	33.00	–	24.44	EUR	−1,959	308

[1] Financial figures from the financial year 2013
[2] Profit transfer by shareholders on the basis of profit and loss transfer agreement
[3] General partner liability (Komplementärhaftung) of pbb
[4] In accordance with section 264 b HGB the annual financial statement was not published

Exchange rates €1 corresponds to		**31.12.2014**
India	INR	76.7190
Japan	JPY	145.2300

Munich, 18 March 2015

Deutsche Pfandbriefbank Aktiengesellschaft
The Management Board

Andreas Arndt

Thomas Köntgen

Wolfgang Groth

Andreas Schenk

Dr. Bernhard Scholz

Responsibility Statement

To the best of our knowledge, and in accordance with the applicable reporting principles, the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group, and the Group management report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the material opportunities and risks associated with the expected development of the Group.

Munich, 18 March 2015

Deutsche Pfandbriefbank Aktiengesellschaft
The Management Board

Andreas Arndt **Thomas Köntgen**

Wolfgang Groth **Andreas Schenk** **Dr. Bernhard Scholz**

Review Report

We have audited the consolidated financial statements prepared by the Deutsche Pfandbriefbank AG, Munich, comprising consolidated statement of financial position, consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity, consolidated statement of cash flows and notes, together with the group management report for the business year from 1 January to 31 December 2014. The preparation of the consolidated financial statements and the group management report in accordance with IFRSs, as adopted by the EU, and the additional requirements of German commercial law pursuant to § 315 a Abs. 1 HGB [Handelsgesetzbuch «German Commercial Code»] are the responsibility of the parent company's management. Our responsibility is to express an opinion on the consolidated financial statements and on the group management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with § 317 HGB [Handelsgesetzbuch «German Commercial Code»] and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements in accordance with the applicable financial reporting framework and in the group management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the consolidated financial statements and the group management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of those entities included in consolidation, the determination of entities to be included in consolidation, the accounting and consolidation principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements and group management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the consolidated financial statements comply with IFRSs, as adopted by the EU, the additional requirements of German commercial law pursuant to § 315 a Abs. 1 HGB and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. The group management report is consistent with the consolidated financial statements and as a whole provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development.

Munich, 18 March 2015

KPMG AG
Wirtschaftsprüfungsgesellschaft
[original German version signed by:]

Wiechens
Wirtschaftsprüfer
[German Public Auditor]

Schmidt
Wirtschaftsprüferin
[German Public Auditor]

Summary of Quarterly Financial Data

pbb Group	2013				2014
in € million	4th quarter	1st quarter	2nd quarter	3rd quarter	4th quarter
Operating performance					
Operating income	113	89	114	112	11
Net interest and similar income	87	89	106	108	118
Net fee and commission income	4	–	–	–	1
Net trading income	2	–9	–9	–3	–9
Net income from financial investments	–2	–1	2	22	–100
Net income from hedging relationships	2	–3	–3	1	2
Net other operating income/expenses	20	13	18	–16	–1
Loan loss provisions	–	5	–7	1	–20
General and administrative expenses	–72	–62	–62	–64	–63
Net miscellaneous income/expenses	2	6	–	–5	–1
Profit or loss before tax	43	38	45	44	–73

Real Estate Finance	2013[1]				2014
in € million	4th quarter	1st quarter	2nd quarter	3rd quarter	4th quarter
Operating performance					
Operating income	77	72	78	76	66
Net interest and similar income	69	72	79	81	72
Net fee and commission income	4	–	–	–	2
Net trading income	–1	–4	–4	–1	–4
Net income from financial investments	2	1	1	9	3
Net income from hedging relationships	1	–1	–1	–	–
Net other operating income/expenses	2	4	3	–13	–7
Loan loss provisions	8	5	–7	–	–12
General and administrative expenses	–42	–39	–38	–41	–42
Net miscellaneous income/expenses	1	4	–	–2	–2
Profit or loss before tax	44	42	33	33	10

[1] Adjusted in accordance with IFRS 8.29

Public Investment Finance	2013[1]				2014
in € million	4th quarter	1st quarter	2nd quarter	3rd quarter	4th quarter
Operating performance					
Operating income	5	8	10	10	11
Net interest and similar income	8	9	11	12	13
Net fee and commission income	1	–	–	–	–
Net trading income	–	–1	–1	–1	–2
Net income from financial investments	–4	–	–	4	–
Net income from hedging relationships	–	–1	–1	–	2
Net other operating income/expenses	–	1	1	–5	–2
Loan loss provisions	–	–	–	1	–1
General and administrative expenses	–9	–8	–7	–9	–9
Net miscellaneous income/expenses	–	1	–	–1	–
Profit or loss before tax	–4	1	3	1	1

[1] Adjusted in accordance with IFRS 8.29

Value Portfolio	2013[1]				2014
in € million	4th quarter	1st quarter	2nd quarter	3rd quarter	4th quarter
Operating performance					
Operating income	27	6	24	20	−71
Net interest and similar income	5	4	14	9	29
Net fee and commission income	−1	–	–	–	−1
Net trading income	3	−4	−4	−1	−3
Net income from financial investments	–	−2	1	9	−103
Net income from hedging relationships	1	−1	−1	1	–
Net other operating income/expenses	19	9	14	2	7
Loan loss provisions	−8	–	–	–	−7
General and administrative expenses	−21	−15	−17	−14	−12
Net miscellaneous income/expenses	1	1	–	−2	1
Profit or loss before tax	−1	−8	7	4	−89

[1] Adjusted in accordance with IFRS 8.29

Consolidation & Adjustments	2013[1]				2014
in € million	4th quarter	1st quarter	2nd quarter	3rd quarter	4th quarter
Operating performance					
Operating income	4	3	2	6	5
Net interest and similar income	5	4	2	6	4
Net fee and commission income	–	–	–	–	–
Net trading income	–	–	–	–	–
Net income from financial investments	–	–	–	–	–
Net income from hedging relationships	–	–	–	–	–
Net other operating income/expenses	−1	−1	–	–	1
Loan loss provisions	–	–	–	–	–
General and administrative expenses	–	–	–	–	–
Net miscellaneous income/expenses	–	–	–	–	–
Profit or loss before tax	4	3	2	6	5

[1] Adjusted in accordance with IFRS 8.29

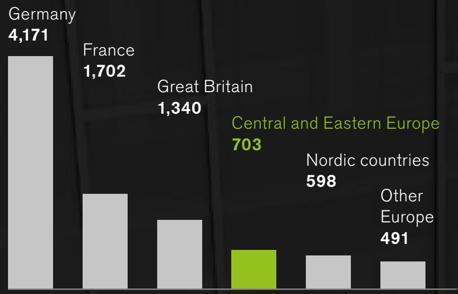
Lipowy Office Park Warsaw

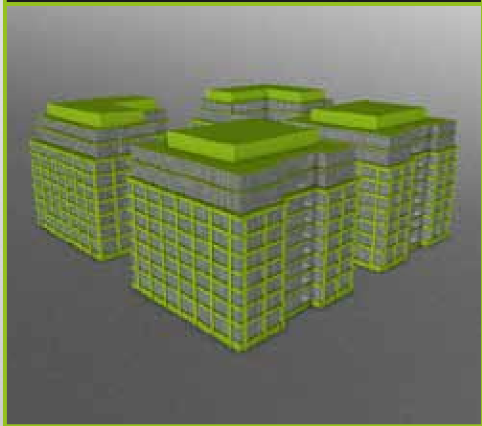
€ 55 million

Investment finance
Poland
May 2014

pbb provided a € 55 million medium-term refinancing facility for two of W.P. Carey's publicly held, non-traded REIT affiliates. The proceeds are being used to partially refinance the purchase price paid for the acquisition of Lipowy Office Park, Bank Pekao's headquarters. The 34,900 m² office complex was completed in 2009 by Hochtief Development Poland. It consists of four nine-storey modern office buildings, located in the Ochota district, at the major road connecting Warsaw's central business district with the international airport «Fryderyk Chopin». This transaction emphasises the value that pbb's knowledge of eastern and western european markets can bring to its clients.

New business 2014 according to regions
in € million (commitments, including extensions > 1 year)





Additional Information

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Financial calendar	
9 March 2015	Preliminary annual results 2014
27 March 2015	Annual Report 2014
19 May 2015	Results for the first quarter 2015
17 August 2015	Results for the second quarter 2015/Interim Report 2015
23 November 2015	Results for the third quarter 2015

Future-oriented Statements

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Publisher
Deutsche Pfandbriefbank AG, Munich, Germany
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