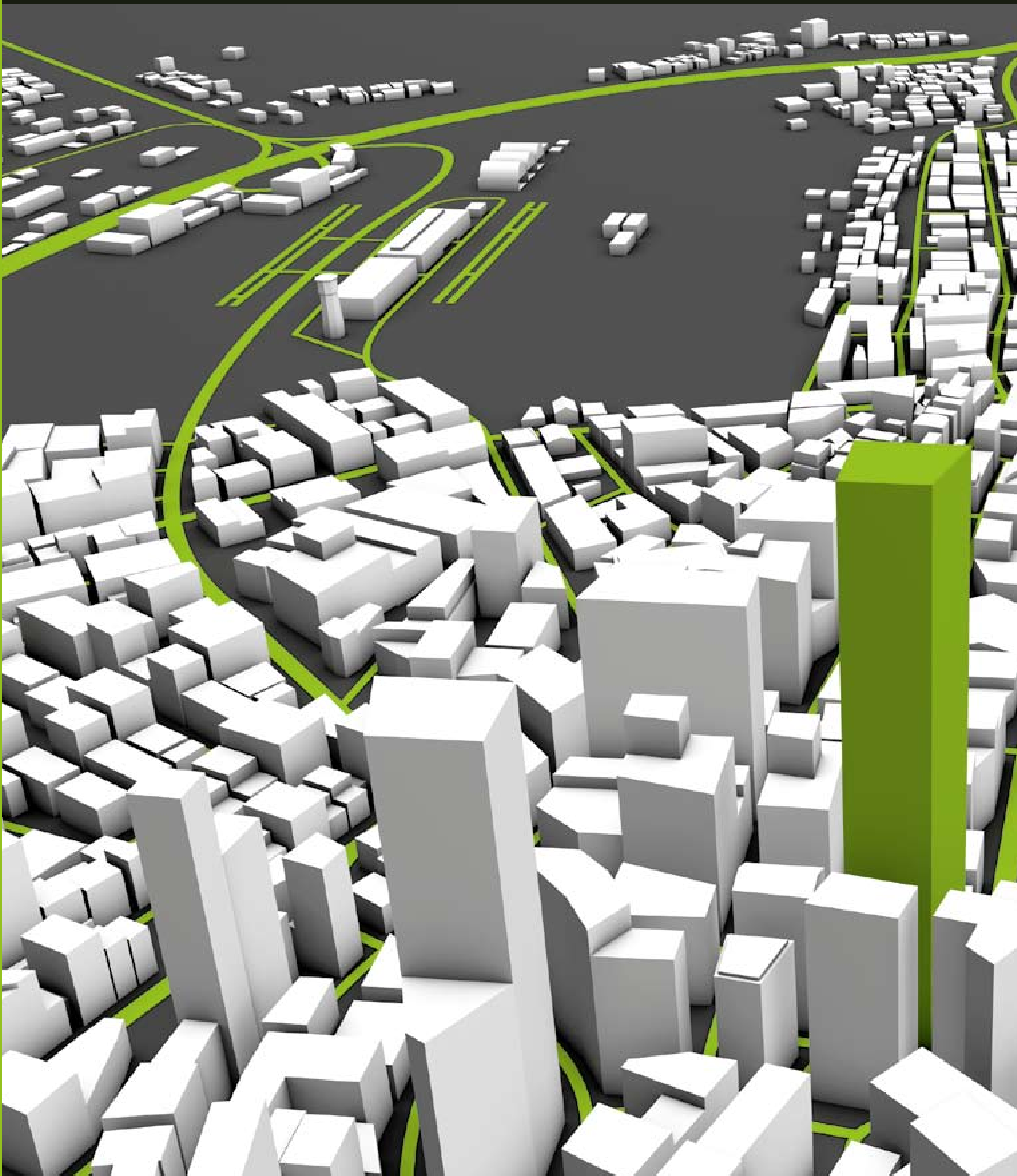
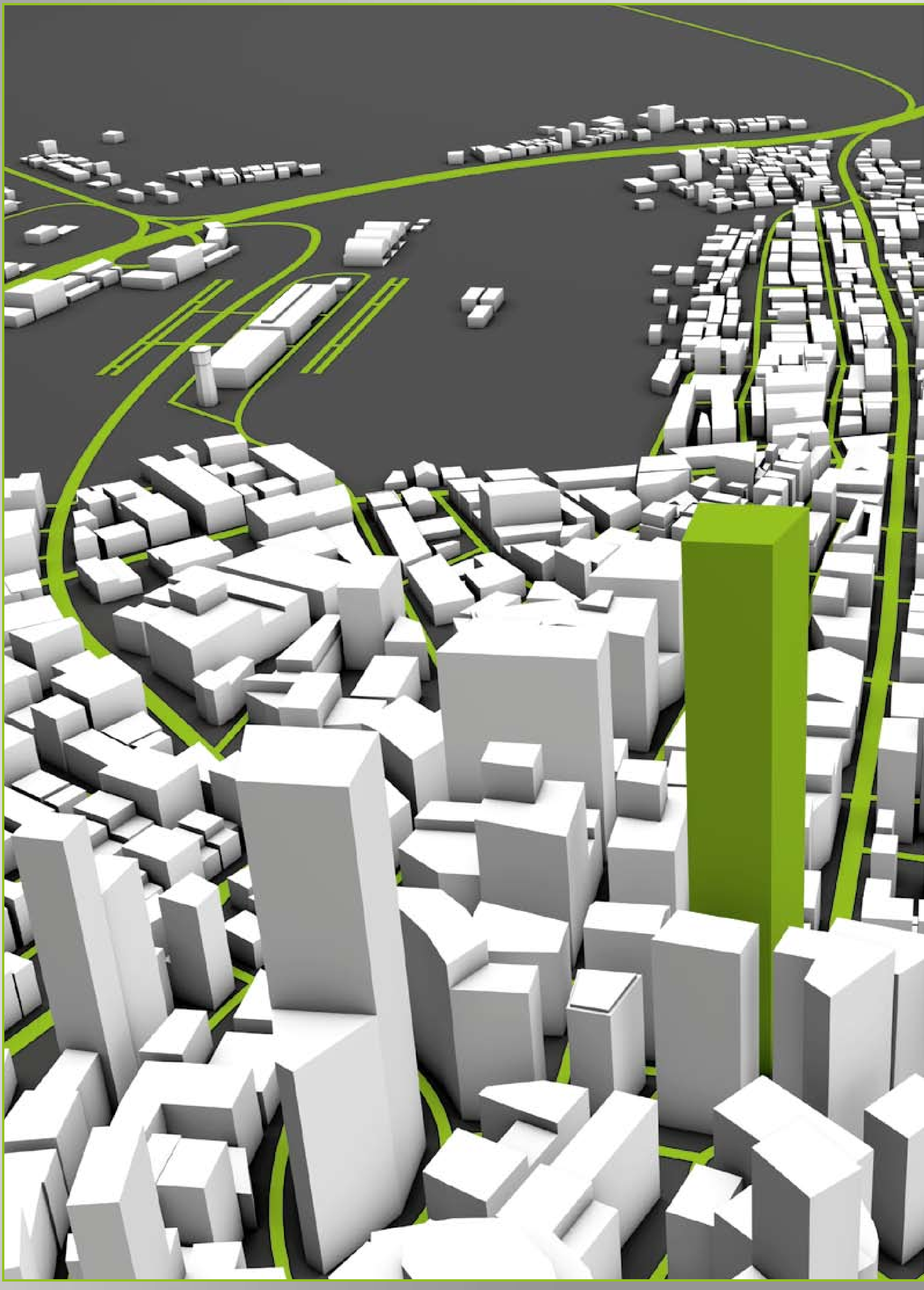
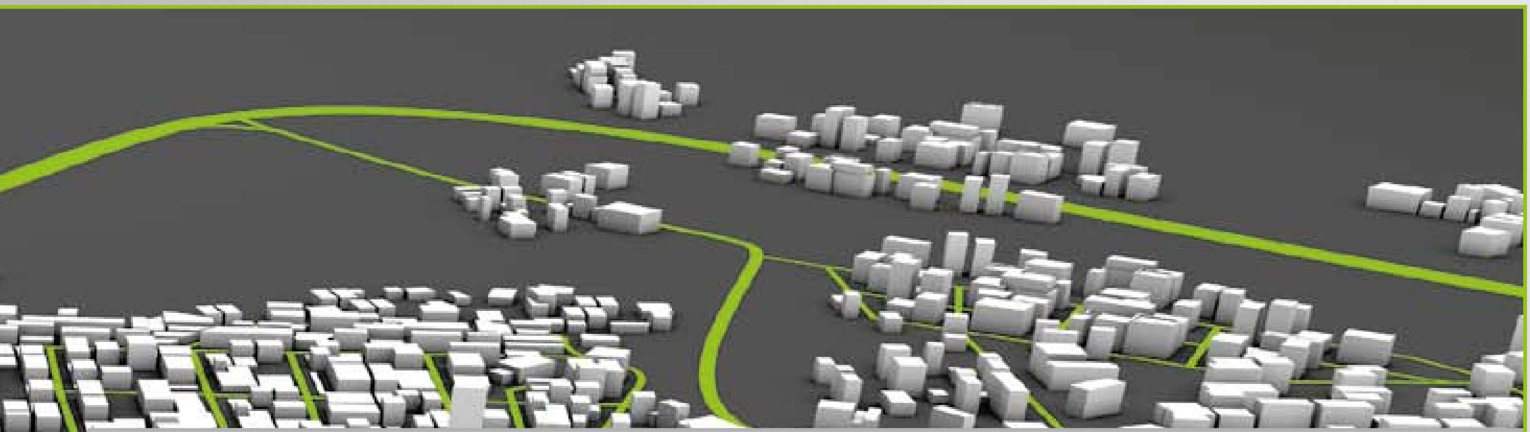
Annual Report
2010

PUBLIC SECTOR FINANCE
REAL ESTATE FINANCE

DEUTSCHE
PFANDBRIEFBANK







pbb Deutsche Pfandbriefbank is a leading specialist bank for public sector finance and for real estate finance in Europe.

We operate exclusively in selected European countries and sectors, and are one of the largest lenders in this particular market segment. Our key refinancing instrument is the German Pfandbrief.

Public Sector Finance

Public sector finance focuses on central, regional and local authorities below the highest state level with only limited direct access to the capital market.

The regional focus is on European countries with good ratings in which lending operations can be refinanced by way of issuing Pfandbriefe: at present, the Bank concentrates on Germany, France, Italy and Spain.

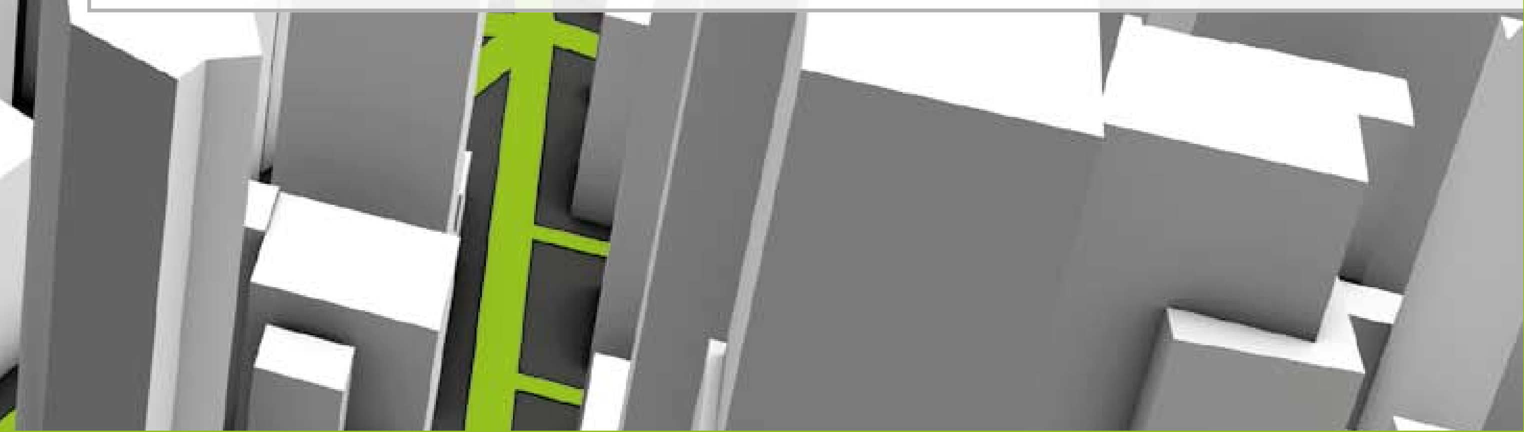
pbb Deutsche Pfandbriefbank aims primarily to operate primary customer business. The Bank will only be active on the secondary market if this is necessary for extending or improving the portfolio structure. In addition to traditional or customised financing solutions, pbb Deutsche Pfandbriefbank offers its customers derivative products for risk hedging purposes as well as consultancy services.

Real Estate Finance

In the field of real estate finance, the range of products and services of pbb Deutsche Pfandbriefbank is targeted primarily at professional real estate investors such as property companies, institutional investors and property funds; in Germany, the Bank also targets SME customers and customers with a regional focus.

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

We primarily finance office buildings, retail and logistics properties as well as residential properties. pbb Deutsche Pfandbriefbank focuses on financing with volumes of less than € 100 million. The Bank is also available for larger financing by way of syndicate loans or by way of syndication.



Financial Highlights
Ratings

Financial Highlights		2010	Combined 2009[1]
Operating performance according to IFRS			
Pre-tax profit/loss	in € million	– 135	– 1,525
Net income/loss	in € million	– 185	– 1,515
Key ratio			
Cost-income ratio[2]	in %	54.0	46.7
Balance sheet figures		**31.12.2010**	**31.12.2009**
Total assets	in € billion	186.8	215.2
Equity (excluding revaluation reserve)	in € billion	3.1	3.6
Equity	in € billion	3.4	2.7
Personnel			
Employees		919	915

[1] The combined figures have been prepared under the assumption that the merger between the former DEPFA Deutsche Pfandbriefbank AG and the Hypo Real Estate Bank AG to Deutsche Pfandbriefbank AG as well as the purchase of pbb Services GmbH (former Hypo Real Estate Systems GmbH) acquired by Deutsche Pfandbriefbank AG from Hypo Real Estate Holding AG did not take place during the financial year 2009 but as of 1 January 2009

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

Ratings of Deutsche Pfandbriefbank AG and its covered bonds as of 23 March 2011		Fitch Ratings	Moody's	Standard & Poor's
Deutsche Pfandbriefbank AG	Long-term	A–	A3	BBB
	Outlook	Stable	Stable	Stable
	Short-term	F1	P–1	A–2
Public sector Pfandbrief		AAA	Aaa	AA+
Mortgage Pfandbrief		AA+[1]	Aa1	AA+

[1] Credit watch for possible downgrade

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

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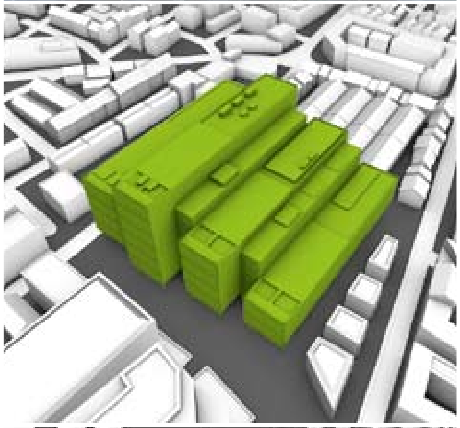
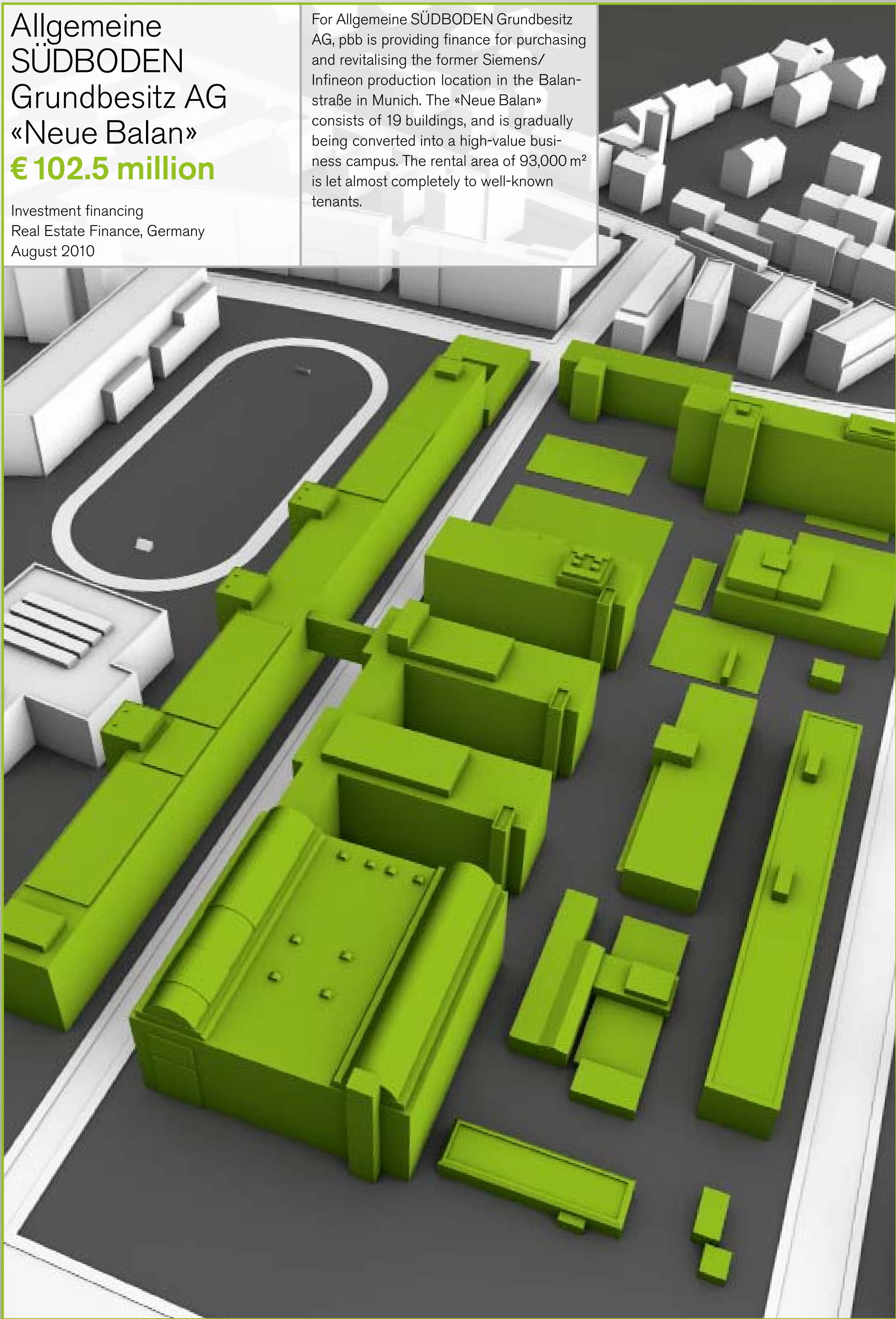


Allgemeine SÜDBODEN Grundbesitz AG «Neue Balan»

€ 102.5 million

Investment financing
Real Estate Finance, Germany
August 2010

For Allgemeine SÜDBODEN Grundbesitz AG, pbb is providing finance for purchasing and revitalising the former Siemens/ Infineon production location in the Balanstraße in Munich. The «Neue Balan» consists of 19 buildings, and is gradually being converted into a high-value business campus. The rental area of 93,000 m² is let almost completely to well-known tenants.



Preface of the CEO

Preface of the CEO

The financial year 2010 has marked the transition from the process of stabilising and realigning Deutsche Pfandbriefbank to a restructured special bank for real estate finance and public sector finance. The process of restructuring the Group has, to a large extent, been completed. The final step is the positive completion of the EU state aid proceedings, which we expect in the first half of 2011. Our focus is now on the market and on our customers.

The process of restructuring the Group has to a large extent been completed

The key aspect of restructuring was to break down the existing portfolio into two parts: A strategic portfolio which we are continuing in pbb Deutsche Pfandbriefbank, and a portfolio which we have placed on run-off. In terms of products, regions, risk profile and refinancing opportunities, the latter portfolio has a value but is not consistent with pbb Deutsche Pfandbriefbank's new strategy. Since being transferred in October 2010 to FMS-Wertmanagement, this portfolio is being reduced in a value-preserving manner. As the portfolio manager, we are supporting FMS-Wertmanagement in this task.

Independence from any external liquidity support

The remaining portfolio of pbb Deutsche Pfandbriefbank is profitable and constitutes the basis for the further growth of the bank. In addition, the portfolio is essentially refinanced with matching maturities and via the German Pfandbrief. As a result, pbb Deutsche Pfandbriefbank is independent from any external liquidity support being provided by the Financial Markt Stabilisation Fund, SoFFin. Together with the assets, we were, therefore, also able to transfer those issues of pbb Deutsche Pfandbriefbank which were guaranteed by SoFFin and which served to assure liquidity to FMS Wertmanagement.

With profit in the second half of the year, the pre-tax loss for the whole of 2010 was thus reduced by more than 90 percent

The transition to a restructured bank is also reflected in the quarterly results of the Deutsche Pfandbriefbank sub-group in the financial year 2010. All quarterly results in 2010 were better than the corresponding quarters in the previous year. In the third quarter of 2010, we generated a positive quarterly result for the first time since the autumn of 2008, and continued this positive trend in the fourth quarter. Following a loss in the first half of the year and a profit in the second half of the year, the pre-tax loss for the whole of 2010 amounted to € 135 million, and was thus reduced by more than 90 percent compared with the previous year. Assuming a normal market development, we intend to be profitable in the current financial year 2011.

Concentration on the core business and returning to the markets

For this purpose, we are now concentrating completely on our core business and are returning with full force to the market. We want to again make a major contribution to supplying credit to our customers in the public sector and in the real estate industry, and we also intend to step up our activities as an issuer on the Pfandbrief markets.

We consider that we have established an excellent position in this respect. We continue to consistently focus our range of products and services on the needs of our customers, and also enjoy an established network of clients. Clients appreciate our competence for individual financing: we have sector know how, have experience with syndication and syndicate loans and are also able to offer a local as well as a European approach. We are convinced that demand for such solutions will continue to increase, whereas the number of competitors will decline. We are operating in a market with great potential.

Reprivatisation is a medium- to long-term objective

Our medium- to long-term objective continues to be the reprivatisation of Deutsche Pfandbriefbank AG, as envisaged by the Federal Republic of Germany as the owner of Hypo Real Estate Holding AG. We have stabilised, restructured and refocused the Bank with the support of the Federal Republic of Germany. For the Federal Republic of Germany and the

The Management Board of Deutsche Pfandbriefbank AG (from left): Wolfgang Groth, Manuela Better (CEO), Dr. Bernhard Scholz, Alexander Freiherr von Uslar-Gleichen

taxpayer, the bank's success on the market and the subsequent reprivatisation represents the option which will maximise value for the exit from the investment. In this way, we intend to repay as much as possible of the support provided out of taxpayers' funds.

All employees of the Bank are committed to working towards these objectives. I should like again to thank all colleagues for their major commitment and the success which has been attained.

Kind regards

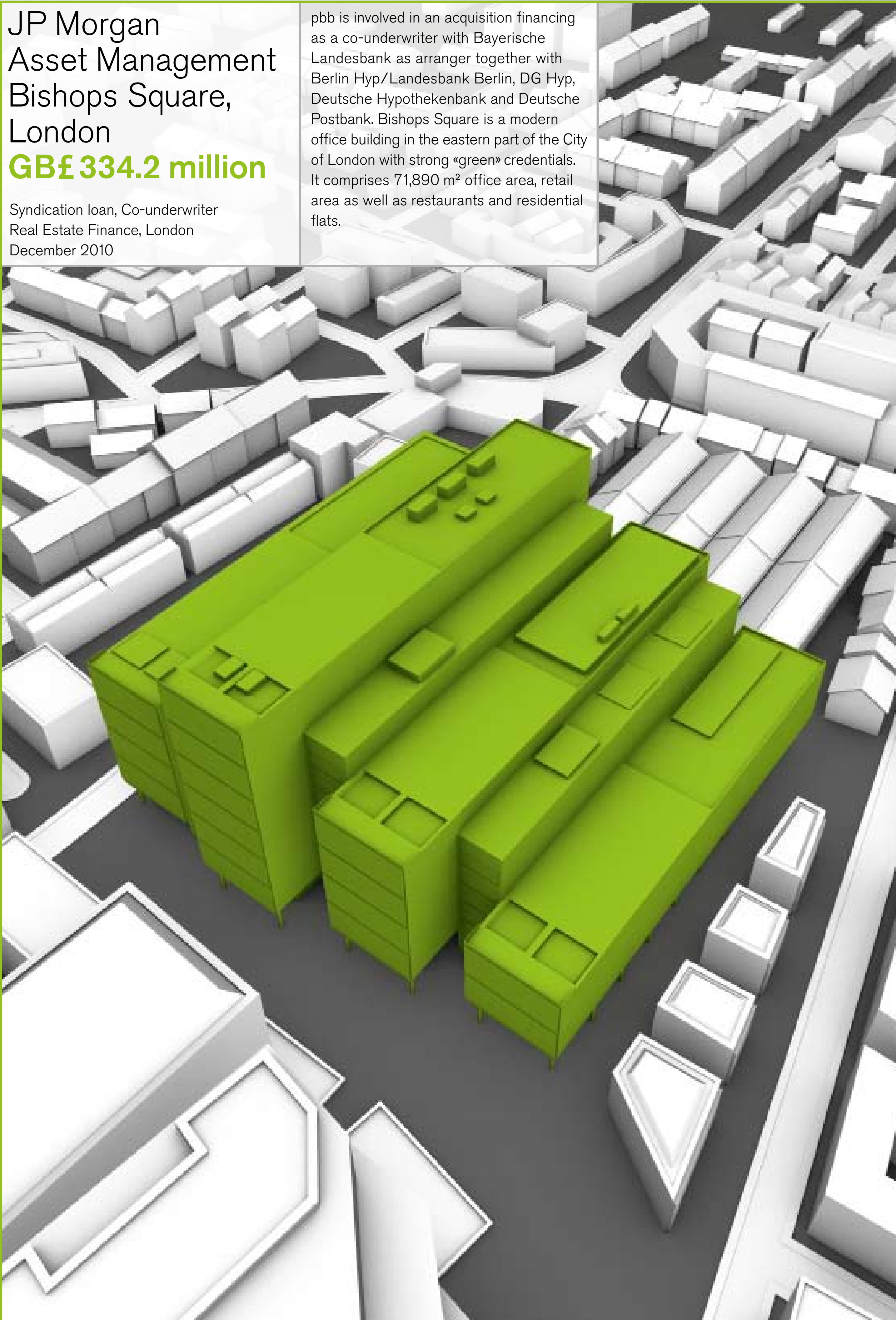
Manuela Better
CEO

JP Morgan Asset Management Bishops Square, London

GB£ 334.2 million

Syndication loan, Co-underwriter
Real Estate Finance, London
December 2010

pbb is involved in an acquisition financing as a co-underwriter with Bayerische Landesbank as arranger together with Berlin Hyp/Landesbank Berlin, DG Hyp, Deutsche Hypothekenbank and Deutsche Postbank. Bishops Square is a modern office building in the eastern part of the City of London with strong «green» credentials. It comprises 71,890 m² office area, retail area as well as restaurants and residential flats.



Financial Review

Financial Review
Business and Conditions

Macro-economic Situation

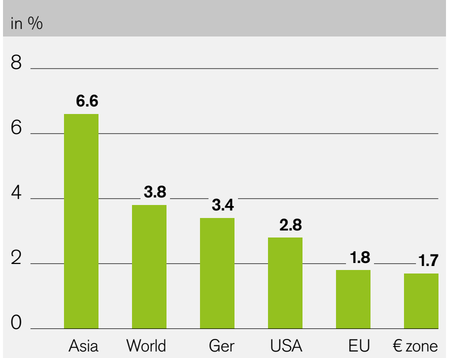
Following the downturn in the economy in 2009, the economic situation throughout the world stabilised appreciably in the year under review. There are, however, major differences between individual countries. With growth of 3.6 %, Germany has to a large extent been able to approach the level of economic activity seen before the crisis. However, it has to be borne in mind that the decline in Germany in 2009 was also particularly severe. Due to the high levels of national debt, the countries which were the focus of particular attention were Portugal, Italy, Ireland, Greece and Spain, the last three of which posted a decrease in the gross domestic product for two consecutive years. In addition, other countries and regions outside the euro zone and Europe were also the focus of particular attention of the financial markets and rating agencies as a result of their levels of debt. There are, however, various reasons for this situation. Ireland is having to cope mainly with a banking sector which is relatively oversized compared with the remainder of the real economy and which has been experiencing problems, whereas Greece is having to contend mainly with fiscal problems. In Spain, the main problems are the effects of a bursting property bubble and the difficult labour market.

The Asian economies have managed to survive the crisis quite well, headed by China, which again reported double-digit growth (10.3 %) in 2010. The USA has reported growth of 2.9 % for economic activity, thus returning to the level seen before the crisis; however, the unemployment rate in the USA continued to be just below 10 % in 2010.

The most important political measure in the year under review at the macro-economic level was the combination of a continuation of expansionary monetary policy throughout the world and a «rescue package» for countries with fiscal problems at the European level. The rescue package, which involves national governments, the EU and also the International Monetary Fund, became necessary in order to maintain the fiscal viability of individual countries – in particular Greece and Ireland – in view of constantly widening risk spreads. Despite the total volume of the rescue package (around € 750 billion), it has so far not been able to prevent considerable downgradings of the ratings of some countries and thus also corresponding risk premiums in interest rates. Nevertheless, the rate differences for instance between Greece and Germany are much more moderate than was the case before the introduction of the euro.

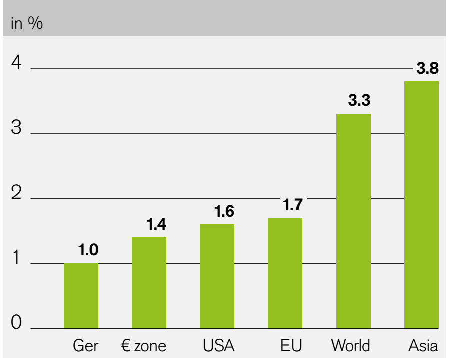
In the field of monetary policy, the policy of quantitative easing which commenced in 2009 was continued in the year under review. In May 2010, the European Central Bank (ECB) announced that it would for the first time also accept Greek government bonds with a low rating as collateral for the normal measures applicable for providing liquidity. At the same time, the ECB for the first time intervened in order to stabilise these markets by way of purchasing government bonds. In the USA, the policy of quantitative easing was pursued to an even greater extent than in Europe. In November 2010, the Federal Reserve System announced that it would buy government bonds worth approx. US-Dollar 600 billion by mid-2011, and would thus permit the money supply to rise further. Despite these measures, inflation in Europe and also in the USA remained below the level of 2 % in 2010.

Real GDP growth 2010



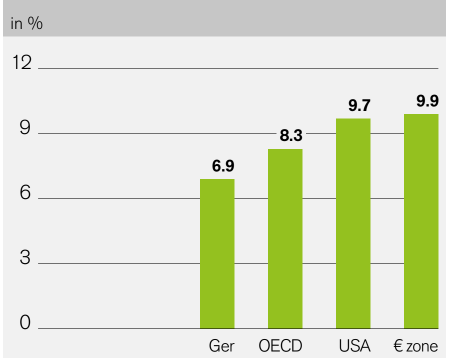
Source: EIU, obtained from Datastream

Consumer price inflation 2010



Source: EIU, obtained from Datastream

Unemployment rates 2010



Source: OECD, Economic Outlook No. 88, 11/2010

The development of the exchange rate between the euro and the US dollar was relatively mixed in the course of the year. Whereas in the first half of 2010 concern regarding the (fiscal) stability of some countries in the euro zone resulted in the euro falling from US-Dollar 1.44/Euro to approx. US-Dollar 1.20/Euro, the euro strengthened to more than US-Dollar 1.40/Euro by the beginning of November, and ended the reporting year at around US-Dollar 1.33/Euro. There were also similarly strong fluctuations between the euro and the other major currencies. In the course of 2010, the euro weakened by more than 15% against the Swiss franc.

As a result of the support measures adopted in the crisis of 2008/2009, fiscal policy in most countries was still very expansionary, with correspondingly high government deficits. However, the need for budget consolidation is compelling more and more countries to make much less aggressive use of this tool of economic policy. The evident increase in risk awareness on the (financial) markets and the associated differences between international risk premiums have been and still are factors contributing to this development.

Sector-specific Situation

Overall Situation of the Banking Sector

The lessons to be drawn from the financial crisis and the associated consequences for the banking sector were the predominant issues of 2010. The new Basel III regulations which are intended to ensure better capital backing in the sector have already resulted in intense considerations regarding possibilities of obtaining capital. Many countries have tightened up the regulations applicable for the financial sector in order to reduce the risk of future crises. Some countries for instance have introduced a separate bank tax in order to claw back the extensive state support from the banking sector or in order to create reserves for future crises. In Europe, the banks have so far repaid only part of the support which was received. Nor have any nationalised banks been reprivatised so far. In the USA, this has already been achieved at most institutions. In day-to-day operations, problems affected some banks which had to refinance loans for which the collateral was worth less than at the time at which the loan was originally extended. A further problem was posed by portfolios with government bonds from European countries which are at the focus of particular attention because additional collateral had to be provided for these portfolios as a result of the above-mentioned turmoil on the markets.

Public Sector Finance

The euro crisis increased the sensitivity of financial markets for financial policy risks in 2010. The financial markets evaluated the specific budget figures of the individual economies, and attention was focused on the financial policy risks of the countries. This increased level of attention particularly in Europe has meant that all economies – not only those of the countries which have become the focus of attention as a result of a high state deficit – have defined and communicated measures for budget consolidation. Particular attention is devoted to Spain as a result of the size of the country's economy. The Spanish government has announced additional consolidation measures and has initiated a labour market reform. France and Great Britain have also adopted budget consolidation measures. The British emergency budget was in general positively received. France has also imposed consolidation measures in order to put an end to the rising level of debt and thus not to pose a risk to its AAA rating. Many of the economies which have been hardest hit are only able to obtain funding at much higher interest rates and are reliant on multilateral financial aid (International Monetary Fund, financial commitments of the EU). It will be of crucial importance to meet the financial policy objectives in two respects: to assure liquidity and ratings. Unsettled markets have meant that customers from countries of strategic core markets, such as Spain, have tried to cover financing requirements for 2010 and have thus tapped the market more quickly and for larger amounts. The markets for covered bonds (compared with the development in margins of government bonds) have remained relatively stable. Even within the context of central bank purchases for supporting the markets, the total volumes of issues have reported a positive development (higher than in previous years) because public paper with a better rating and other conservative forms of investment (Pfandbriefe in particular) are becoming attractive for a wider range of investors in the current climate.

Real Estate Finance

The unexpectedly positive economic developments in 2010 have had a stabilising impact on the real estate markets which are relevant for the Bank. Major main and secondary real estate markets and sectors have again been boosted as a result of stronger investor interest, and this has been reflected in rising transaction volumes. On the other hand, commercial real estate markets are still suffering from lower rents, high vacancy levels and stagnating purchase prices. Investor interest has focused strongly on the premium and quality segment of the real estate market.

The German commercial real estate market has reported a positive development in 2010 compared with the previous year. Particularly as a result of the return of international investors, a transaction volume of around €18 billion was achieved in Germany in 2010, even if this figure was boosted by major individual transactions. The low level of interest rates and the economic upswing have meant that German properties are now attractive for institutional investors, such as open and closed funds, financial investors, pension funds and foundations. Buyer interest has focused significantly on properties in good to very good locations, with solvent tenants and long-term rental agreements. The office and retail segment has been particularly preferred in Germany. Demand for commercial property has also strengthened in 2010 in the remainder of Europe. Great Britain has led the recovery of European commercial real estate markets and reported a recovery in 2010 particularly as a result of the demand of international investors, although the recovery slowed down appreciably in the second half of 2010. In France, the commercial investment market expanded particularly strongly in 2010, whereas Spain is still waiting to see a recovery in the commercial real estate markets.

German residential housing construction reported growth again in 2010. Following a lengthy period in the doldrums, the number of building approvals has again risen strongly. Thanks to stronger demand for housing in the metropolitan areas, new residential districts are currently being built in the major cities and catchment areas. In the field of new housing construction, completion figures lag behind the overall development to a certain extent. This demand overhang is likely to result in higher rental prices particularly in the main metropolitan areas. Although the interest of institutional investors has become stronger, the creation of private residential property accounted for most of new housing construction in 2010.

The uncertainty in the property rental sector following the economic crisis gave way to cautious optimism in 2010. The level of rents for the main types of commercial property in Germany weakened only moderately, or even stabilised in 2010. Although the decline appears to have been arrested, it is still too soon to speak of a complete all-clear. Although more offices are again being let in Germany, some of these activities merely involved relocations, and the vacancy levels at some locations are still high. The British economy continues to stabilise despite the budget consolidation. The property markets have benefited to varying degrees from this development. Rents on the office property market in London in particular have recovered appreciably from their lows, and prime rents have again reported the strongest growth in a European comparison. Rents for preferred locations in the metropolitan region of Paris have also continued to stabilise. On the other hand, even prime rents in Madrid and Barcelona have continued to decline. This trend will probably continue.

As expected, vacancy levels in Germany increased slightly in 2010. The existing reserve of supply, particularly in terms of office premises, depressed the markets and resulted in a more than adequate supply of premises. The overall supply of premises available in the short term will not decline significantly – despite the fact that completion volumes have declined. However, as a result of the positive economic development, there has been an improvement in the marketing opportunities for modern and well-appointed buildings in good locations. The vacancy rates in Great Britain continued to decline in 2010, particularly in the office markets close to the centre of London. In France, vacancy rates have increased slightly, with the exception of the region of Greater Paris, where in particular there has not been a further increase in the vacancy rates in the office premises market. In Spain, vacancy rates have increased further in all segments.

In Germany, the market for commercial real estate financing is currently dominated by regional/national providers. International real estate financiers have stepped up their competitive activities in the other European countries. At the same time, there is evidence that German real estate financiers are withdrawing from the international markets and are focusing on their domestic market.

Competition is extremely fierce for small and mid-size financing arrangements, particularly with regard to the financing of real estate with long-term leases. In the case of financing arrangements in excess of €50 million, investors are in certain cases experiencing difficulties in finding a bank to provide the necessary finance. Market players who are able to make an offer to investors with Pfandbrief-eligible financing will occupy this segment.

The securitisation market has not yet recovered in 2010. Investor confidence has not yet returned. By changing the capital regulations regarding the securitisation of loans and regarding investment in securitisations, the legislative authorities have created a European framework of regulations. It remains to be seen how far these new regulations will restore confidence on the capital markets.

Refinancing Markets

The refinancing markets were very volatile in 2010. At the beginning of the year, the market stabilised, and it was possible for some successful benchmark transactions to be carried out. Issuing activities declined sharply due to the situation in Greece and Ireland and it was only possible for a small number of issues to be carried out in narrow windows. The markets calmed down to some extent following the ECB's announcement of a further buying programme; the ECB purchased covered bonds as well as government bonds. The remaining uncertainty had an impact on public transactions as well as private placings. The establishment of the European Stabilisation Fund and further stabilisation measures calmed down the markets further, and revived the refinancing markets. The consequence of the high levels of volatility in 2010 was an increase in refinancing margins at most issuers.

The Pfandbrief will thus continue to be an important refinancing instrument of banks in 2011. However, covered financing will continue to be very important.

Major Legal Conditions

In December 2010, with the Restructuring Fund Act (RStruktFG), the legislative authorities created further possibilities for stabilising the financial market by overcoming portfolio and system problems. In this connection, the legislative authorities also extended the Financial Market Stabilisation Fund Act (FMStFG) and defined precisely the possibilities of the Financial Market Stabilisation Fund (SoFFin) in connection with the stabilisation measures granted by SoFFin following the financial crisis (injections of capital, guarantees, etc.), in order in particular to enable existing investments of SoFFin to be reprivatised subject to optimum terms. Since 31 December 2010, the regulatory requirements applicable to the banks have been tightened with the amendment to the KWG resulting from the changes to the Banking Guideline and the Capital Adequacy Guideline (CRD II). The changes mainly relate to the regulations applicable for large loans (the netting options for interbank receivables are no longer applicable and the definition of borrower units has been extended), recognition of hybrid core capital components and the securitisation rules. The associated limitation of lending is intended to further restrict the risk of banks.

Company-specific Conditions

Organisational and Legal Structure of Deutsche Pfandbriefbank AG

Deutsche Pfandbriefbank AG is the strategic core bank of Hypo Real Estate Holding AG, and is wholly owned by the latter.

Corporate Strategy

In the financial year 2010, Deutsche Pfandbriefbank AG operated new business in two reporting segments throughout the Group: Real Estate Finance and Public Sector Finance. There are also the additional reporting segment Value Portfolio and the reporting column Consolidation and Adjustments.

New business is written only by Deutsche Pfandbriefbank AG. The Bank focuses on Pfandbrief-eligible new business in Public Sector Finance and Real Estate Finance, with a regional focus on Europe. The key factor of success in the new business strategy are the numerous and long-standing customer relations and the large client base which formed the basis for the new business which was written in 2010. The credit transactions are selected within the context of a conservative refinancing strategy and the resultant requirements applicable to the extent and quality of lending operations. The focus is on consistent risk analysis and concentration on business with an adequate risk-return ratio. Proactive sales management enables the requirements of investors regarding the quality of lending business to be satisfied.

The new business strategies in these two operating segments are as follows:

Public Sector Finance New Business Strategy New business in the Public Sector Finance segment focuses mainly on primary customer business. The Bank will only operate on the secondary market if necessary for extending or improving the portfolio structure.

The regional focus is placed on European countries with good ratings in which lending operations can be refinanced by way of issuing Pfandbriefe – at present, the Bank concentrates mainly on Germany and France. The Bank also operates in further selected European countries such as Belgium, Denmark, Finland, Italy, Luxembourg, the Netherlands, Norway, Sweden, Spain as well as Central and Eastern Europe.

In the Public Sector Finance segment, Deutsche Pfandbriefbank AG offers its customers the following financing instruments and consultancy services:
> Public investment finance
> Local authority and state finance
> Guaranteed loans
> Financing of public private partnerships
> Special financing with export guarantees
> Special financing – «forfeiting» (purchasing receivables)
> Interest rate hedging instruments

Real Estate Finance New Business Strategy The new business strategy in Real Estate Finance focuses on professional national and international property investors (e.g. property companies, institutional investors, property funds and also, in Germany, SMEs and customers with a regional focus). The focus is on investment financing in the Pfandbrief-eligible European markets, in particular Germany, England and France, as well as other selected European regions in which Deutsche Pfandbriefbank AG had operated in the past. Development finance is conducted on a selective basis without any speculative character.

In the field of real estate finance, Deutsche Pfandbriefbank AG offers its customers the following financing instruments:
> Financing for existing properties
> Investment loans of properties which have previously been sold or let
> Cross-border portfolio financing
> Bridging finance for investments
> Warehouse financing
> Derivatives

Management Concept

The management concept of Deutsche Pfandbriefbank AG focuses on ensuring the continued existence of the company as a going concern and simultaneously on enhancing the enterprise value in the long term. The main aspects of the concept are measures designed to protect the existing portfolio, assure liquidity and solvency and also improve the risk early warning system. With regard to liquidity management, the main consideration is to ensure that the company is able at all times to meet all payment obligations which become due. Solvency, i.e. adequate capital backing, is managed on the basis of the regulatory ratios core capital ratio and equity ratio on a HRE Group level. HRE also manages these ratios on the basis of scenario analyses, which for instance take account of rating migrations or changes in exchange rates. With regard to management of capital, the focus is on fulfilling regulatory requirements as well as the minimum capital requirements of rating agencies and business partners. In addition, Deutsche Pfandbriefbank AG has already transferred large parts of assets and liabilities to FMS Wertmanagement; this has resulted in a reduction of risk-weighted assets and a corresponding increase in the capital ratios. The risk early warning system has been revised after the crisis of HRE; it is presented in detail in the risk report.

At the same time, in order to assure the ability to reprivatise the company, it is necessary for income to be generated in excess of the capital costs, and strict cost discipline is essential for this purpose. This is monitored on the basis of absolute costs and also by means of the cost-income ratio. The cost-income ratio is the ratio between general administrative expenses and operating revenues, consisting of net interest income and similar income, net commission income, net trading income, net income from financial investments, net income from hedge relationships and the balance of other operating income/expenses. The cost-income ratio is to be improved by reducing the general administrative expenses following the restructuring process and also by way of increasing new business. The enterprise value is enhanced when the return on equity of a management unit exceeds the related capital costs on a sustainable basis. In order to determine the return on equity, the net income according to IFRS is related to average capital (excluding AfS reserve and cash flow hedge reserve). The capital costs represent the theoretical costs of capital, and define the marginal cost rate for the existing and future risk taking. The profitability of new business and the existing portfolio is investigated in accordance with economic risk by comparing return on equity with the capital costs.

Major Events

Liquidity-assurance Measures The securities which are issued by SoFFin and which have been issued by Deutsche Pfandbriefbank AG for obtaining liquidity comprised an overall volume of around € 124 billion by the end of September 2010, and have been completely transmitted to HRE and other subsidiaries of the Group. These guarantees were transferred completely to FMS Wertmanagement as part of the portfolio transfer process. There are no longer any guarantees of SoFFin for HRE. Since that time, Deutsche Pfandbriefbank AG has been refinanced primarily by way of outstanding Pfandbriefe, covered bonds and unsecured issues. The following conditions were applicable for all liquidity guarantees which HRE received from SoFFin: Deutsche Pfandbriefbank AG paid to SoFFin a proportionately calculated commitment commission of 0.1% per annum in relation to that part of the guarantee framework which was not utilised. A commission of 0.5% or 0.8% per annum was incurred for guarantees which were issued.

Recapitalisation Measures In 2010, HRE received various recapitalisation measures. Deutsche Pfandbriefbank AG has not benefited from these measures. SoFFin has provided an undertaking to pay a further € 0.45 billion in the form of a contribution to the additional paid-in capital of HRE or Deutsche Pfandbriefbank AG. This obligation depends on various factors, including conditions under aid law. Evidence that the criteria have been satisfied can be provided by 31 December 2011, and the claim to the contributions will then expire.

Proceedings at the European Commission The stabilisation measures provided to HRE Group by the Federal Republic of Germany – via SoFFin – (injections of capital, guarantees as well as the transfer of risk positions and non-strategic operations to FMS Wertmanagement) are the subject of ongoing aid proceedings at the European Commission. The conclusion of these proceedings is expected by mid-2011.

Outsourcing of Assets and Liabilities to the Deconsolidated Environment FMS Wertmanagement With effect from 1 October 2010, HRE Group transferred loans and securities with an outstanding nominal volume (excl. commitments which have not been drawn) of around € 173 billion (based on the relevant exchange rates) to FMS Wertmanagement (by way of legal and/or economic transfer) or arranged for such securities to be backed by financial guarantees of FMS Wertmanagement. The outsourcing process comprised activities which were not strategically necessary for the refocusing of the Group, as well as assets from the Public Sector Finance portfolio and the Real Estate Financing portfolio, and in particular of DEPFA Bank plc and Deutsche Pfandbriefbank AG. The nominal volume of the transferred assets of Deutsche Pfandbriefbank AG amounted to € 42 billion, and the corresponding figure for DEPFA Bank plc was € 131 billion.

The Public Sector Finance portfolio contains assets of sovereigns or sub-sovereigns with high credit quality but with a low market valuation at present. A considerable part of the Real Estate Financing portfolio which has been transferred exclusively from Deutsche Pfandbriefbank AG (€ 26 billion) is currently affected by the very difficult climate in this portfolio. In addition, the transfer comprised structured products and trading positions which are exposed to increased levels of default risk and which, where necessary, have been correspondingly impaired or whose changes in value have been included in net trading income.

In addition, derivatives which are mainly intended to protect assets against interest rate risks have also been transferred or backed by financial guarantees.

Also, the transfer of shares in subsidiaries of Deutsche Pfandbriefbank AG to FMS Wertmanagement has resulted in various companies being deconsolidated from the consolidation group of Deutsche Pfandbriefbank AG and of the Group overall. These are essentially Hypo Real Estate Capital Corp., New York, as well as Flint Nominees Ltd., London.

Asset management for the portfolio which has been transferred to FMS Wertmanagement will continue to be provided by HRE Group by way of a cooperation agreement.

The securities which have been guaranteed by SoFFin and issued by Deutsche Pfandbriefbank AG for obtaining liquidity (around € 124 billion) have also been completely transferred to FMS Wertmanagement.

The transaction has received the provisional approval of the EU Commission, and has been included in the ongoing aid proceedings. It is expected that the procedure can be concluded by mid-2011.

The transfer of the assets means that the key and most important step of restructuring and refocusing has now been taken. In particular, the strategic core bank Deutsche Pfandbriefbank AG has been refocused, and the improved balance sheet structure means that it is now not reliant on liquidity aid.

Restructuring Measures Two further non-strategic locations were closed in 2010, namely Singapore and Mumbai. The business and IT transformation programme saw major projects successfully enter production in 2010, for instance a group-wide credit limit system and SAP-based personnel management software. The IT projects necessary for the above-mentioned transfer to FMS Wertmanagement were also implemented on time.

Personnel

On 10 November 2009, the Supervisory Board of Deutsche Pfandbriefbank AG appointed Dr. Bernhard Scholz as a member of the Management Board with effect from 1 January 2010. He is responsible for Real Estate Finance and, since 19 July 2010, has also been responsible for Public Sector Finance.

Dr. Axel Wieandt laid down his position on the Management Board at Deutsche Pfandbriefbank AG with effect from 25 March 2010. On the same day, the Supervisory Board appointed Manuela Better as the CEO of Deutsche Pfandbriefbank AG on an interim basis. On 15 November 2010, she was finally ratified by the Supervisory Board as the CEO of Deutsche Pfandbriefbank AG. She also continues to perform her duties as Chief Risk Officer. On 6 December 2010, Dr. Kai Wilhelm Franzmeyer and Frank Krings stepped down from the Management Board of Deutsche Pfandbriefbank AG. The Supervisory Board appointed Wolfgang Groth as a new member of the Management Board of Deutsche Pfandbriefbank AG as of 1 January 2011; one of his duties will be to act as the treasurer. No appointment will be made to the position of the COO; the tasks of this function have been distributed within the restructured Management Board.

Ratings

The mandated rating agencies are Fitch Ratings, Moody's and Standard & Poor's.

With regard to bank and covered bond ratings, the following major rating changes took place during the business year 2010 and until 23 March 2011.

> Standard & Poor's new covered bond rating methodology, which includes linking the covered bond rating to the underlying issuer rating, was implemented in April 2010 and resulted in the mortgage-covered bonds and public sector-covered bonds issued by Deutsche Pfandbriefbank AG being downgraded from AAA to AA+. The ratings remained on credit watch. Standard & Poor's confirmed the AA+ ratings of the mortgage-covered bonds and public sector-covered bonds issued by Deutsche Pfandbriefbank AG with stable outlook in August.
> In August 2010, Fitch Ratings downgraded the short-term rating of all the HRE Group banks from F1+ to F1.
> In September 2010, Moody's affirmed the rating of the mortgage-covered bonds at Aa3 and the rating of the public sector-covered bonds issued by Deutsche Pfandbriefbank AG at Aaa.
> Following the transfer of assets and liabilities to FMS Wertmanagement, all three rating agencies undertook a review of HRE Group's ratings and the outcomes thereof were published in October 2010:
>> Moody's confirmed the A3 long-term, the P–1 short-term and the E+ Bank Financial Strength rating of Deutsche Pfandbriefbank AG. The outlook for the long-term rating was changed from negative to stable while the outlook on the Bank Financial Strength rating was changed from negative to positive.
>> Fitch Ratings has affirmed the long- and short-term ratings of Deutsche Pfandbriefbank AG and has assigned an Individual Rating of D.
>> Standard & Poor's confirmed the long-and short-term ratings of the banks in HRE Group at BBB and A–2 respectively and removed them from credit watch positive. The outlook is now stable.
> In December 2010, Moody's placed subordinated debt of German banks and of DEPFA Bank plc under review for downgrade.
> In February 2011, Moody's upgraded the rating of mortgage-covered bonds issued by Deutsche Pfandbriefbank AG from Aa3 to Aa1. Also in February, Moody's published the results of its review of subordinated debt issued by German banks and DEPFA Bank plc. The rating for subordinated debt issued by Deutsche Pfandbriefbank AG is now B2 with positive outlook. Standard & Poor's has downgraded the Lower Tier 2 ratings of Deutsche Pfandbriefbank AG from BBB– to BB–.

In general, the rating agencies continue to refine their rating methodologies and are making higher demands of issuers or rated products. See the current ratings of Deutsche Pfandbriefbank AG and its Pfandbriefs in the table below.

Ratings of Deutsche Pfandbriefbank AG and its covered bonds

as of 23 March 2011		Fitch Ratings	Moody's	Standard & Poor's
Deutsche Pfandbriefbank AG	Long-term	A–	A3	BBB
	Outlook	Stable	Stable	Stable
	Short-term	F1	P–1	A–2
Public sector Pfandbrief		AAA	Aaa	AA+
Mortgage Pfandbrief		AA+[1)]	Aa1	AA+

1) Credit watch for possible downgrade

Operation of the Supervisory Board

The Supervisory Board of Deutsche Pfandbriefbank AG consisted of the following persons from 1 January 2010 to 31 December 2010: Dr. Bernd Thiemann (Chairman), Dagmar Kollmann (Deputy Chairman), Dr. Günther Bräunig, Dr. Hedda von Wedel, Ursula Bestler (Employees' representative) and Georg Kordick (Employees' representative).

The Supervisory Board agreed to Dr. Axel Wieandt laying down his mandate on the Supervisory Board as of 25 March 2010, and also agreed to Dr. Kai Wilhelm Franzmeyer and Frank Krings laying down their mandates as of 6 December 2010. Manuela Better was appointed as the Chairman of the Management Board on 25 March 2010 by the Supervisory Board on an interim basis, and was finally appointed as Chairman of the Management Board on 15 November 2010. In its meeting of 6 December 2010, the Supervisory Board appointed Wolfgang Groth as a member of the Management Board with effect from 1 January 2011.

The Supervisory Board of Deutsche Pfandbriefbank AG did not have any committees between 1 January 2010 and 5 May 2010. Following the change of the rules of procedure of the Supervisory Board of Deutsche Pfandbriefbank AG on 6 May 2010, the new Risk Management and Liquidity Strategy Committee was set up, and Dr. Günther Bräunig (Chairman), Dagmar Kollmann and Dr. Bernd Thiemann were appointed to this committee. The requirements of the Public Corporate Governance Code of the Federal Government were implemented with the change to the rules of procedure of the Supervisory Board and also the change to the articles of incorporation which was made on 17 June 2010.

In 2010, the Supervisory Board of Deutsche Pfandbriefbank AG held 13 meetings and four telephone conferences, and adopted nine resolutions outside these meetings. All members of the Supervisory Board attended more than half of the meetings.

The Supervisory Board and Management Board extensively discussed the measures for liquidity and capital support as well as for restructuring and refocusing Deutsche Pfandbriefbank AG. The emphasis was on the transfer of assets and liabilities to FMS Wertmanagement and the EU aid proceedings. The Supervisory Board also extensively discussed the compensation for 2009 and the new compensation system for 2010. The Management Board notified the Supervisory Board regularly and promptly about the economic and financial development of Deutsche Pfandbriefbank Group, the business policy and planning, the strategy, the risk position, risk management, the liquidity strategy, all reportable exposures as well as other significant events. The Chairman of the Management Board maintained constant contact with the chairman of the Supervisory Board with regard to major developments. Regular discussions focused on the development in lending and the lending policy as a whole, the risk development, risk management, the direction of business policy as well as the developments and trends of the markets in the lending and funding business.

The Supervisory Board also considered the results of internal audit, the annual and multiple year planning of the Bank, the management and control mechanisms in lending as well as in the security and derivatives business. It discussed the compliance report (including Data Protection and Money Laundering Act), the implementation of «Basel II» and the probable effects of «Basel III», the audit of the necessary independence of the auditor, the awarding of the audit engagement to the auditor and the fee agreed with the auditor.

Expression of Thanks of the Supervisory Board The Supervisory Board wishes to thank the Management Board and all members of staff for their activity in the year under review.

Deutsche Pfandbriefbank AG as an Employer

The main staff-related issues were connected with preparing, establishing and filling a deconsolidated environment and the associated organisational changes as well as in the preparation and implementation of a new uniform compensation system throughout the Group.

Changes in the Structure Organisation The structure organisation which handles servicing for the assets and liabilities transferred to FMS Wertmanagement whilst safeguarding aspects of data protection and avoiding any conflicts of interest has been systematically changed. In preparation for these organisational changes, the necessary settlements of interests and a social plan were concluded with the Group works council; this meant that is was possible for staff to be employed in the various segments in a flexible manner in line with the relevant requirements.

Consolidation and Stabilisation Phase The workforce remained to a large extent stable in 2010. Whereas Deutsche Pfandbriefbank Group employed a total of 915 persons in 2009, the corresponding figure at the end of 2010 was 919. The adjusted fluctuation[1] at Deutsche Pfandbriefbank Group in 2010 was 15.29%.

[1] Fluctuation as a result of employment agreement being terminated by the employee or the Bank and by the expiry of temporary agreements, excluding death, retirement, early retirement, cancellation agreements or Group transfers

Compensation Report

The individual details of compensation for the financial year 2010 for each individual member of the Management Board and the Supervisory Board are detailed in the following. The amounts which the members of the Management Board and members of the Supervisory Board have received for the financial year 2010 are published.

Deutsche Pfandbriefbank does not pay any compensation for the activity of its Management Board. The compensation of the Management Board was paid exclusively by HRE Holding AG, and the pension commitments exist exclusively at HRE Holding AG. Accordingly, for information and transparency considerations, the Group compensation by HRE Holding AG and the pension commitments of the Management Board are detailed in the following:

Group compensations to members of the Management Board of HRE Holding			**2010**	**2009**
in € thousand	Fixed payments	Profit-related components[1]	**Total**	**Total**
Manuela Better, Chairman	500	13	513	482
Dr. Bernhard Scholz (from 1.1.2010)	500	18	518	–
Alexander Freiherr von Uslar-Gleichen	500	19	519	128
Dr. Axel Wieandt, Chairman (until 25.3.2010)[2]	167	14	181	1,492
Dr. Kai Wilhelm Franzmeyer (until 6.12.2010)[3]	500	2	502	850
Frank Krings (until 6.12.2010)[3]	500	28	528	864
Total[4]	**2,667**	**94**	**2,761**	**3,816**

[1] Including: cost of ancillary benefits to the usual extent; subject to taxation
[2] End of contract duration 30 April 2010
[3] End of contract duration 31 December 2010
[4] In addition, there are retirement benefit commitments in individual agreements, equivalent to a percentage of the annual fixed compensation

Pension commitments of the members of the Management Board of Hypo Real Estate Holding AG				**2010**	**2009**
in € thousand	Present value of pension claims vested	Interest expense	Outstanding past service cost	**DBO as of 31.12.2010**	**DBO as of 31.12.2009**
Manuela Better, Chairman	73	109	–	2,463	2,084
Dr. Bernhard Scholz	1,263	–	–	1,342	–
Alexander Freiherr von Uslar-Gleichen	63	95	–	2,208	1,815
Dr. Axel Wieandt, Chairman (until 25.3.2010)	40	151	–	2,351	2,873
Dr. Kai Wilhelm Franzmeyer (until 6.12.2010)	81	126	–	2,144	2,406
Frank Krings (until 6.12.2010)	68	106	–	1,560	2,017
Total	**1,561**	**587**	**–**	**12,068**	**11,195**

Provisions Supervisory Board 2010 in € thousand	Compensation	Value-added tax 19 %	**Total**
Dr. Bernd Thiemann, Chairman	10.0	1.9	11.9
Ursula Bestler	10.0	1.9	11.9
Dr. Günther Bräunig	10.0	1.9	11.9
Dagmar Kollmann	10.0	1.9	11.9
Georg Kordick	10.0	1.9	11.9
Dr. Hedda von Wedel	10.0	1.9	11.9
Total	**60.0**	**11.4**	**71.4**

Employee Remuneration

Alternative Solution for 2009 Because of the continuation of the difficult situation on the financial markets, the still negative results of the Group in 2009 and also the fact that support payments are still necessary, the Management Board did not provide a budget for any discretionary variable payments for 2009, and no such payments were made. As was the case in 2008, this was applicable for all Group companies and locations.

However, as an alternative solution for the failure to pay variable compensation in 2009, a voluntary one-off payment was granted and paid out in 2010. With regard to the form and implementation of the alternative solution, the Management Board focused primarily on ensuring operational stability and avoiding risks under labour law.

The purpose, legal background, extent and content of this payment differed from those of the discretionary variable payments made in the past. Under this alternative solution, the payment was made only to members of staff who in return waived their entitlement, in a legally valid manner, to any payment of discretionary variable compensation for 2009 and, in certain cases, additionally for 2008. The fundamental waiver has considerably reduced the labour law risks of the company with regard to potential legal action in connection with unpaid variable compensation.

The Supervisory Board and the owner have been informed and involved with regard to the alternative payment. The co-determination rights of the employees' representatives in Germany have been safeguarded. Such a payment is not envisaged for 2010.

Remuneration Committee In response to the BaFin circular 22/2009 «Regulatory requirements applicable to the compensation systems of institutions» which was published in December 2009, the Management Board set up a Remuneration Committee on 22 January 2010. The Remuneration Committee is made up of representatives from personnel, the sales units as well as Asset Management, Risk Controlling and Management, Compliance/Corporate Governance, Finance as well as – as a member without voting rights for the tasks involved – a representative from Internal Audit. The Remuneration Committee is chaired by the personnel director.

In 2010, the HRE Group's Remuneration Committee held a total of five meetings and focused on the following issues:

> Deliberations and appraisal relating to the «alternative solution 2009» in the context of the legal and regulatory requirements
> Drawing up a proposal for the applicability of the special requirements set out in Section 4 of the BaFin circular (positive self-assessment), now Section 1 InstitutsVergVO
> In connection with the interpretation of Section 4 of the BaFin circular or Section 5 InstitutsVergVO, drawing up a proposal for 2009 and 2010 with regard to the definition of risk takers to which the special requirements of Section 4 of the BaFin circular, now Section 5 InstitutsVergVO, are applicable
> Discussion and appraisal of the new compensation system prepared for introduction in the context of the prevailing legal and regulatory requirements and also with regard to the adequacy of the form of the new compensation system. With regard to the Restructuring Act which has been adopted, extensive discussions were also held relating to the possible consequences of the Restructuring Act for the Group and the effects on the implementation strategy for the new compensation system as well as the adequacy of the compensation or the new compensation system. The following criteria have been applied and the following function groups have been defined with regard to the risk takers for 2010:
>> All managing directors of the companies of Deutsche Pfandbriefbank AG have been nominated
>> All second tier senior executives,

- Employees in sales who are independently responsible for a country, a region or a group of customers as a result of carrying out their function, or who exercise an A-vote in the Risk Committee (RC)
- All function holders who are members with voting rights in the Risk Committee (RC), in the Asset and Liability Committee (ALCO), in the Ad Hoc Committee, in the Finance Committee and also in the Compensation Committee
- All employees who carry out management or specialist functions in which there may be substantial risks in the following risk types: accounting risks, risks affecting the income statement, credit, liquidity, market, legal, reporting, reputation risks or trustee risks
- In relation to a legal entity or branch, senior executives or employees who are either responsible as branch managers or who are responsible to the respective regulator

In total, approx. 10% of the workforce has been defined as risk takers. The Management Board of HRE Holding AG, Deutsche Pfandbriefbank AG as well as DEPFA Bank plc have approved the proposal of the Compensation Committee and have adopted the corresponding resolutions.

Introduction of a New Compensation System Starting in 2010 and Effectiveness of the Restructuring Act The HRE Group has developed a new compensation system for 2010 which is consistent with the regulatory and legal requirements for compensation (long-term nature, sustainability, transparency and adequacy); this new compensation system was adopted by the Management Board and Supervisory Board in May 2010 and has been agreed extensively with the owner. All necessary collective and individual implementation stages have been prepared for this system.

In October 2010, and even before the implementation of this new compensation system, the process of handing out the new employment agreements was postponed until the intentions of the legislative authorities had been definitively clarified in view of the discussions concerning new statutory regulations with regard to compensation. In December 2010, in view of the Restructuring Act which had been enacted, HRE resumed the previously postponed process of implementing the new compensation system. The adopted Restructuring Act introduced a regulation which prohibits variable compensation for companies in the financial sector which take advantage of stabilisation measures in accordance with Section 7 of this act and in which SoFFin holds at least 75% of the shares directly or indirectly via one or more subsidiaries. In addition, the monetary compensation for the members of the executive bodies and employees must not exceed € 500,000 p.a. in each case.

The new compensation system which was developed, with fixed and variable components in its concept, was maintained as a target system, whereby the regulations concerning variable compensation are not applicable for the period during which the new statutory regulation is applicable. The adjustments for further implementation of the new compensation system necessary as a result of the new act have been carried out. Measures have been taken to ensure that no new claims for variable compensation will arise as a result of the introduction of the new compensation system in the period and for the period in which the Restructuring Act is applicable. Because of the prohibition applicable for variable compensation, it has not been possible to take full account of the regulatory requirements which have also been derived from the Institution Compensation Ordinance with regard to the long-term nature and sustainability of as well as an adequate incentive effect for management and conduct.

The rules of the Restructuring Act are applied for all companies in HRE Group. This procedure has been agreed with the Supervisory Board, also with the owner and the German Federal Bank (Bundesbank).

Sustainability

Companies have responsibility in particular with regard to their owners, customers, employees, society and the environment. Due to its particular situation, HRE Group was only able to meet this obligation to a limited degree and to an extent which was adequate in the opinion of the company. However, HRE Group remains aware of its responsibilities.

Ecological Sustainability The Group considers that it is important to promote and maintain an environment in which life is worth living. It places emphasis on ensuring that manufacturers and suppliers meet the defined requirements in terms of environmental protection and that they have the corresponding certifications. Internally, the Group meets this requirement in various ways, e.g. by way of paper-saving procedures or the use of modern energy-saving equipment. Energy consumption has been reduced further by merging office locations and also by using video-conference systems in order to avoid business travel. A new company car regulation encourages the acquisition of vehicles with low CO_2 emissions.

Social Commitment In 2010, Deutsche Pfandbriefbank AG focused its social commitment primarily via its two foundations, namely pbb Stiftung Deutsche Pfandbriefbank, Munich, as well as the Foundation for Art and Science (Stiftung für Kunst und Wissenschaft) of Hypo Real Estate Bank International AG, Munich. Since being originally established in 1987 and 1968 respectively by predecessors of Deutsche Pfandbriefbank AG, these foundations have independent capital which is segregated from that of the Bank, and which is permitted to be used exclusively for fulfilling the purposes of the foundation. In this way, despite the financial situation of the Group, Deutsche Pfandbriefbank AG was still able to a limited extent to meet its social responsibility via the foundations, including the promotion of art, culture and science.

On the one hand, pbb Stiftung Deutsche Pfandbriefbank supports concerts and exhibitions. On the other hand, with its architecture prize which has gained national recognition, it takes the initiative itself to improve architectural culture in commercial properties in Germany.

The Architecture Prize rewards commercial buildings which are exemplary in terms of aesthetic and ecological aspects. Since 1992, this renowned prize has been awarded every two years. The competition is one of the small numbers of prizes in the sector which focuses exclusively on commercial buildings. In 2006, it was extended to include a junior talent prize which provides young architects with a platform and which encourages a dialogue between young architects and experienced architects, building owners and investors.

Both competitions are sponsored by the Federal Minister for Transportation, Construction and Town Planning and the Bund Deutscher Architekten (BDA).

The projects which are spread throughout the whole of Germany show the entire range of commercial building construction. They include large-scale projects as well as relatively small unusual projects, and are characterised by their holistic and environment-oriented programmes. The aim of the competition is to ensure that attention focuses to a greater extent on the balance between economic efficiency, architectural aesthetics and sustainable construction – even outside representative locations. In this way, pbb Stiftung Deutsche Pfandbriefbank wishes to combat the ghost town nature of industrial districts on the periphery of cities. Industrial districts in particular are increasingly destroying existing settlements. It is intended that the architecture prize for exemplary commercial properties will set new signals among developers, investors and building owners.

In addition to the architecture prize, the foundation also provides monetary incentives in the fields of music and the arts.

The Foundation for Art and Science of Hypo Real Estate Bank International AG sponsors intellectual and artistic work particularly in the fields of writing, painting, sculpture, music, theatre, architecture/design, regional and cultural studies as well as customs and traditions – with the main emphasis on Baden-Württemberg.

The following are examples of some of the sponsorships awarded in 2010:

- With Künstlerhaus Stuttgart, the foundation has sponsored an institution which makes a major contribution to cultural life in Baden-Württemberg and beyond, which has distanced itself from the traditional museum image and which provides art and artists with a way into the public sector.
- A further sponsorship was awarded to Studio Theater Stuttgart for the project «Prinz Friedrich von Homburg» by Heinrich von Kleist.

Development in Earnings

Deutsche Pfandbriefbank Group

Deutsche Pfandbriefbank Group is a specialist bank operating in the field of public sector finance and commercial real estate finance. The ultimate parent company of the Group is Deutsche Pfandbriefbank AG, which is wholly owned by Hypo Real Estate Holding AG (HRE Holding). Deutsche Pfandbriefbank Group is the strategic part of the Hypo Real Estate Group (HRE).

For Deutsche Pfandbriefbank Group, the year 2010 marked the transition from the process of stabilising and restructuring toward a Group structure with a new focus. In this connection, the key and most important step was the process of transferring positions on 1 October 2010 to FMS Wertmanagement which was established in July 2010 by the FMSA/SoFFin. The strategic core bank Deutsche Pfandbriefbank AG now has a new structure; the remaining assets are profitable and the improved balance sheet structure is completely independent of liquidity support. This means that the basis has been created to enable the Group to re-establish itself successfully on the credit and finance markets.

However, in 2010, development in earnings was very much affected by the transfer of positions as well as by other stabilisation and restructuring measures. Pre-tax profit/loss was again negative as expected (€ –135 million). Nevertheless, the development in 2010 has reflected a considerable upward trend. Whereas the result in the first half of 2010 was still negative at € –352 million, a positive pre-tax profit of € 119 million was achieved in the third quarter of 2010 and thus ahead of the process of transferring positions to FMS Wertmanagement. This reflected the initial success of the restructuring measures which had been initiated. The positive trend was confirmed in the fourth quarter of 2010, following the transfer of the positions to FMS Wertmanagement, with a further positive pre-tax profit of € 98 million. This means that Deutsche Pfandbriefbank Group closed the third and fourth quarters of 2010 with a profit.

The comparison with the previous year also underlines the improved development of Deutsche Pfandbriefbank Group. Overall, the pre-tax profit/loss of € –135 million was much less negative than was the case in the previous year.

The description of the development in earnings shows combined previous year figures resulting from the change to the Group structure which was carried out in the previous year. The merger of the former DEPFA Deutsche Pfandbriefbank AG with Hypo Real Estate Bank AG was completed in the second quarter of 2009. The new entity now trades as Deutsche Pfandbriefbank AG. In addition, on 30 June 2009, HRE Holding sold its subsidiary pbb Services GmbH (the former Hypo Real Estate Systems GmbH) to Deutsche Pfandbriefbank AG. In accordance with IAS 1.36, the previous year comparison information for the financial year 2009 only includes the former DEPFA Deutsche Pfandbriefbank AG and pbb Services GmbH after the date of the merger or the purchase. However, in order to enable the merger and the purchase to be shown in a meaningful comparison which makes sense for management purposes, combined figures are shown in the income statement for the previous year. For preparing the combined income statement, it has been assumed that the merger and the sale both took place before 1 January 2009. The combined financial information relating to statement, recognition and valuation has been prepared in accordance with IFRS.

On the other hand, the process of transferring positions to FMS Wertmanagement at the beginning of the fourth quarter of 2010 has not been shown separately. Instead, the effects on the development in earnings, assets and financial position are described. The positions have been transferred at the corresponding carrying amount of the transferred company in line with the accounting regulations which were applicable for the individual financial statements of the respective company. Deutsche Pfandbriefbank Group has received a claim for compensation with regard to FMS Wertmanagement in return for transferring the positions to FMS Wertmanagement.

The development in results for the year 2010 compared with the combined previous year figures is shown in detail in the following:

Key financials Deutsche Pfandbriefbank Group		1.1.–31.12.2010	Combined 1.1.–31.12.2009	Change
Operating performance				
Operating revenues	in € million	652	653	–1
Net interest income and similar income	in € million	600	863	–263
Net commission income	in € million	–10	–66	56
Net trading income	in € million	77	–44	121
Net income from financial investments	in € million	–17	–43	26
Net income from hedge relationships	in € million	–45	–23	–22
Balance of other operating income/expenses	in € million	47	–34	81
Provisions for losses on loans and advances	in € million	443	1,891	–1,448
General administrative expenses	in € million	352	305	47
Balance of other income/expenses	in € million	8	18	–10
Pre-tax profit/loss	in € million	–135	–1,525	1,390
Key ratio				
Cost-income ratio	in %	54.0	46.7	

Operating Revenues Operating revenues amounted to €652 million and were thus at the previous year level (2009: €653 million). Lower charges attributable to liquidity support in net commission income, a positive net trading income and positive effects in the balance of other operating income/expenses compensated for a decline in net interest income. The revenues were generated mainly in the third quarter (€241 million) and, after the positions had been transferred to FMS Wertmanagement, in the fourth quarter of 2010 (€191 million). The development reflects the success of the restructuring process as well as the profitability of the remaining portfolio after the transfer process had been completed.

The net interest income of €600 million was lower than the previous year figure of €863 million. It declined because the repayments which were made in line with the risk strategy considerably exceeded the volume of new business. In addition, positive interest margins were also transferred when interest-bearing assets were transferred to FMS Wertmanagement. Accordingly, net interest income in the fourth quarter of 2010, i.e. after the assets had been transferred, amounted to €109 million; despite the positive effects attributable to the redemption of financial liabilities before maturity, the figure was thus lower than the corresponding figure applicable for the previous quarters. There were hardly any changes in the refinancing costs of Deutsche Pfandbriefbank Group last financial year. Compared with the previous year, net interest income in 2010 no longer benefited from a falling level of interest rates on the money markets, which enabled an improved interest margin to be achieved briefly in 2009. Moreover, net interest income of the year 2010 was burdened by an expense of €–13 million in connection with write-ups recognised in relation to some subordinated capital instruments (2009: €138 million income in connection with impairments on some subordinated capital instruments). On the other hand, the one-off income from sales of receivables, early repayment compensation as well as redemption and repurchases of financial liabilities amounted to €43 million, and were thus higher than the corresponding figure for 2009 (€40 million). In the current year, profits from the sale of receivables were mainly attributable to the disposal of restructured loans which had been impaired in previous periods.

Net commission income amounted to €–10 million, and was thus much less negative than was the case in the previous year (€–66 million). The largest item in net commission income was an expense for guarantees and the utilisation of such guarantees in connection with the liquidity support provided by SoFFin. If these expenses are disregarded, lower commissions in lending business meant that net commission income declined from €88 million in the previous year to €64 million in the current year. The expenses of liquidity support were lower than the corresponding previous year figure because a profit-related fee of €–44 million for federal government in its capacity as guarantor was additionally included in the figures for 2009. In addition, Deutsche Pfandbriefbank Group has not required any further SoFFin liquidity guarantees since October 2010. The expenses attributable to liquidity support thus amounted to only €–2 million in the fourth quarter of 2010. Income of €3 million attributable to hedging transactions for customers as well as commissions in lending business more than compensated for these expenses, which meant that net commission income in the fourth quarter of 2010 amounted to € 10 million, and was thus positive for the first time since autumn 2008.

Net trading income amounted to € 77 million (2009: € – 44 million). Deutsche Pfandbriefbank Group does not have a trading book, i.e. portfolios with the aim of achieving short-term profits. In accordance with the regulations of IAS 39, the trading portfolio comprises certain financial guarantees and derivatives which are not shown in hedge accounting. Net trading income resulted mainly from an income from an internal HRE guarantee for the default of a monoliner for Commercial Mortgage Backed Securities (CMBS) in connection with the Halcyon and Pegasus trading portfolios (€ 106 million; 2009: € 175 million). Because the internal guarantee was cancelled after the transfer of the Halcyon and Pegasus portfolios to FMS Wertmanagement, comparable effects did not occur in the fourth quarter of 2010. In addition, decreasing market values of standalone derivatives of the bank book impacted the net trading income. Furthermore, reversals of adjustments in line with the default risk of costumer derivatives exceeded the additions by net € 4 million (2009: € – 151 million). The reversals due to portfolio improvements affected the fourth quarter figures of 2010 and caused the positive net trading income of € 15 million in this period.

In the year 2010, net income from financial investments amounted to € – 17 million. Impairments on securities (€ – 36 million) more than compensated the profits attributable to the sale of financial assets (€ 19 million) for which impairments had been recognised in previous years. The net income from financial investments of the previous year, namely € – 43 million, was mainly attributable to impairments of € – 77 million recognised in relation to cash CDOs, impairments of € – 33 million recognised in relation to a building, portfolio-based allowances of € – 10 million recognised in relation to LaR financial assets and write-ups of € 89 million in relation to Mortgage Backed Securities.

The net income from hedge relationships amounted to € – 45 million, and was thus more negative than was the case in 2009 (€ – 23 million). A negative valuation result of € – 37 million (2009: € 1 million) was attributable to designated at fair value through profit or loss (dFVTPL) assets in connection with their economic hedging instruments. The fair values of the dFVTPL assets hedged in relation to interest rate risks changed primarily as a result of the unhedged credit-spread movements on the market. Because some of the dFVTPL assets were transferred to FMS Wertmanagement, the volatility of results attributable to these holdings declined in the fourth quarter of 2010. Hedge inefficiencies within the range of 80 % to 125 % permitted in accordance with IAS 39 resulted in costs of € – 8 million (2009: € – 24 million). This year, these costs have resulted from the further decline in interest rates and the cumulative hedge effects, which had a negative impact on the income statement until the next interest rate fixing.

The balance of other operating income/expenses amounted to € 47 million (2009: € – 34 million). The main income component in this respect (€ 65 million) was attributable to pbb Services GmbH, which also renders services for the DEPFA Group. In addition, this item contains income attributable to services for the ongoing operation of FMS Wertmanagement, which amount to € 35 million after reduction of transferred fees to DEPFA Bank plc. This income compensates for the additional administrative expenses incurred at Deutsche Pfandbriefbank Group for rendering the services. On the other hand, the main expense item was additions to provisions of € – 22 million in connection with the process of transferring positions to FMS Wertmanagement. The balance of other operating income/expenses also comprises foreign currency translation effects (in particular US-Dollar) of € – 13 million (2009: € – 52 million). The expenses are mainly attributable to the impairments recognised in relation to foreign currency assets.

Provisions for Losses on Loans and Advances The situation on the commercial real estate markets improved to a certain extent in the course of 2010, but the overall situation continued to be difficult. In consequence, it was again necessary to recognise significant additions to provisions for losses on loans and advances in 2010. Overall, provisions for losses on loans and advances amounted to € 443 million (2009: € 1,891 million). However, the impairments had to be created mainly in the first three quarters of 2010. On the other hand, after the particularly high-risk exposures respectively the positions had been transferred to FMS Wertmanagement, net additions to impairments in the fourth quarter of 2010 amounted to only € 25 million.

In the whole of 2010, the individual allowances amounted to € 534 million (2009: € 1,764 million) and mainly related to real estate loans (€ 511 million). In addition, the Value Portfolio accounted for an individual allowance of € 23 million, whereas it was not necessary for any specific risk provisioning to be created for Public Sector Finance.

The challenging economic conditions on the real estate markets, due to the high levels of vacancy rates and the illiquidity of the markets, resulted in reductions in the value of real estate assets, and thus indirectly resulted in higher levels of loan defaults. In particular, the lower real estate values had an effect on financing without any direct possibility of recourse to the senior debtor, which account for most of the financing of the Group, and also had an effect on junior financing tranches. The consistent process of restructuring loans at an early stage resulted in the continuing high level of risk provisioning in 2010.

In accordance with IAS 39, portfolio-based allowances are created only for loans and receivables for which there have so far not been any indications of an individual impairment. The creation of individual allowances for sub-performing loans as well as the adjustments of the parameters with regard to the assumed time frame between the evidence and the identification of an impairment and with regard to the recognition of the economic cycle enabled portfolio-based allowances of € 110 million to be reversed (2009: addition of € 126 million).

General Administrative Expenses General administrative expenses of € 352 million are higher than the corresponding previous year figure (2009: € 305 million). A lower level of personnel expenses has partly compensated for the increase in other general administrative expenses. Personnel expenses have declined from € 123 million in the previous year to € 94 million in the current year. The release of provisions has had a positive impact. As a result of the Restructuring Act which was adopted in the fourth quarter, there is no longer any basis for the provisions because, among other things, it is no longer possible for discretionary payments to be paid out by Deutsche Pfandbriefbank Group. On the other hand, other general administrative expenses amounted to € 242 million, and was higher than the corresponding previous year figure of € 182 million. This was due to higher consultancy and IT fees incurred in connection with the project of transferring positions. The general administrative expenses of Deutsche Pfandbriefbank Group also comprise the start-up costs incurred in connection with the establishment of FMS Wertmanagement (these costs cannot be charged on). Because growth in general administrative expenses was somewhat higher than the growth in operating revenues, the cost-income ratio deteriorated slightly to 54.0 % (2009: 46.7 %). The positive development following the process of transferring to FMS Wertmanagement was, however, also reflected in the cost-income ratio, which amounted to 39.8 % in the fourth quarter of 2010.

Balance of Other Income/Expenses Balance of other income/expenses (€ 8 million) resulted partly from reversals of provisions which were originally recognised in the context of the strategic refocusing and restructuring of Deutsche Pfandbriefbank Group. In the year 2010 personnell provisions had to be reversed mainly due to the Restructuring Act (Restrukturierungsgesetz).

Pre-tax Profit/Loss The pre-tax profit/loss amounted to € −135 million in the year 2010. Despite the negative result, there were indications of the success of the process of restructuring and refocusing Deutsche Pfandbriefbank Group. The pre-tax loss was much less negative than the corresponding previous year figure (2009: € −1,525 million). All quarterly results for 2010 were also better than was the case in the corresponding previous year quarter. Moreover, a positive quarterly result of € 119 million was generated in the third quarter of 2010 for the first time since autumn 2008. Following the transfer of positions to FMS Wertmanagement, the positive trend continued in the fourth quarter of 2010 with pre-tax profit/loss of € 98 million.

Operating Segment Public Sector Finance (PSF)

Key financials Public Sector Finance		1.1.–31.12.2010	Combined 1.1.–31.12.2009	Change
Operating performance				
Operating revenues	in € million	73	125	–52
Net interest income and similar income	in € million	88	114	–26
Net commission income	in € million	–5	–11	6
Net trading income	in € million	1	22	–21
Net income from financial investments	in € million	–9	–	–9
Net income from hedge relationships	in € million	–	–	–
Balance of other operating income/expenses	in € million	–2	–	–2
Provisions for losses on loans and advances	in € million	–	3	–3
General administrative expenses	in € million	46	53	–7
Balance of other income/expenses	in € million	–	–	–
Pre-tax profit/loss	in € million	27	69	–42
Key ratio				
Cost-income ratio	in %	63.0	42.4	

The Public Sector Finance segment comprises the financing arrangements for the public sector which are eligible as cover funds in accordance with German law. Germany, Italy, France and Spain constitute the regional focus of business. In these countries, Deutsche Pfandbriefbank Group, which is the strategic core bank of HRE, has its own business locations.

The pre-tax profit/loss of the segment declined to € 27 million (2009: € 69 million). The reduction is mainly attributable to lower net interest income, lower net trading income and the negative net income from financial investments. However, a positive trend has been evident following the transfer of positions to FMS Wertmanagement. In the fourth quarter of 2010, as a result of a positive net income from financial investments and net trading income as well as decreased general administrative expenses, the segment generated a pre-tax profit (€ 19 million) which is above the average of previous quarters. As a result of an improved market climate, Deutsche Pfandbriefbank Group was able to sign more new business in the fourth quarter compared with the previous quarters.

Operating Revenues Operating revenues have fallen from € 125 million in the previous year to € 73 million in the current year. Net interest income has declined from € 114 million in the previous year to € 88 million in 2010. It was affected by the reduction in interest-bearing assets due to the process of transferring positions to FMS Wertmanagement and as a result of the repayments which exceeded the new business which was concluded in accordance with strict risk considerations. In addition, the previous year figure had been boosted as a result of a strong income resulting from decreased interest rate levels on the money market. In the year 2010, it was not possible for such income to be realised as a result of the relatively constant short-term interest rates. The interest margin of new business was considerably higher than the margin of existing business and the new business margin which existed before the outbreak of the financial crisis. At € –5 million, net commission income was less negative than was the case in the previous year (€ –11 million). The improvement was attributable to lower expenses in the customer business. Net trading income of € 1 million is attributable to the valuation of interest rate derivatives (2009: € 22 million). The net income from financial investments of € –9 million was attributable to impairments recognised in relation to securities (2009: € 0 million).

Provisions for Losses on Loans and Advances Additions to provisions for losses on loans and advances were not necessary in the current period (2009: € 3 million).

General Administrative Expenses General administrative expenses have decreased due to reversals of personnell provisions from € 53 million in the previous year to € 46 million. Because operating revenues declined more than general administrative expenses, the cost-income ratio has deteriorated to 63.0 % (2009: 42.4 %).

Operating Segment Real Estate Finance (REF)

Key financials Real Estate Finance		1.1.–31.12.2010	Combined 1.1.–31.12.2009	Change
Operating performance				
Operating revenues	in € million	571	540	31
Net interest income and similar income	in € million	551	645	–94
Net commission income	in € million	71	95	–24
Net trading income	in € million	–3	–154	151
Net income from financial investments	in € million	–2	–38	36
Net income from hedge relationships	in € million	–	–	–
Balance of other operating income/expenses	in € million	–46	–8	–38
Provisions for losses on loans and advances	in € million	422	1,884	–1,462
General administrative expenses	in € million	151	201	–50
Balance of other income/expenses	in € million	–	–	–
Pre-tax profit/loss	in € million	–2	–1,545	1,543
Key ratio				
Cost-income ratio	in %	26.4	37.2	

The operating segment Real Estate Finance comprises all commercial real estate financing arrangements of the Group. Germany, Great Britain, France and Spain constitute the regional focus in the Real Estate Finance segment. In these countries, Deutsche Pfandbriefbank Group has its own business locations.

In 2010, the pre-tax profit/loss of the segment amounted to €–2 million (2009: €–1,545 million). The increased pre-tax profit was mainly due to significantly lower provisions for losses on loans and advances. A positive pre-tax profit of €49 million was generated in the fourth quarter of 2010. The segment benefited also in this quarter from comparably low requirement for additions to provisions for losses on loans and advances.

Operating Revenues Operating revenues increased slightly to €571 million, compared with €540 million in the previous year. Net interest income declined to €551 million (2009: €645 million). This decline was attributable to the process of transferring positions to FMS Wertmanagement and further measures designed to the strategic reduction of the loan portfolio. Net interest income was also affected by the defaults of borrowers and associated losses of interest. This effect was to some extent offset by way of so-called unwinding, i.e. the process of adjusting the present value of the anticipated future cash flows. In the segment, the interest margin for the new business in 2010 was on a higher level than the margin of the existing portfolio. Net commission income of €71 million was lower than the corresponding previous year figure (2009: €95 million). However, the previous year was boosted by the recognition in the income statement of commissions for receivables which were not syndicated as originally planned. In net trading income of €–3 million (2009: €–154 million) market value deteriorations of stand-alone derivatives of the bank book were compensated to a large extent by releases of provisions for the default risk of customer derivatives. The net income from financial investments of €–2 million (2009: €–38 million) resulted from impairments recognised in relation to securities. The balance of other operating income/expenses amounted to €–46 million (2009: €–8 million) and, as was the case in the previous year, is attributable to effects of foreign currency translation (in particular US-Dollar).

Provisions for Losses on Loans and Advances Although the situation improved slightly in certain cases compared with the previous year, the situation on the commercial real estate markets continued to be difficult in 2010. The solvency of customers, which in many cases depends to a considerable extent on the cash flows of the financed properties, was very much affected by the rising vacancy rates and the difficulty of marketing new properties and refurbished properties in particular. This problem mainly affected commercial real estate financing for hotels, office and retail properties. Financing arrangements in the USA, Great Britain and Japan were mainly affected in 2010. Substantial individual allowances recognised in Germany were also a problem in this respect in view of their significance in relation to the overall portfolio. The individual allowances amounted to € 511 million. On the other hand, as a result of the creation of individual allowances for sub-performing loans and receivables, it was possible for portfolio-based allowances of € –107 million to be reversed. Overall, in 2010, provisions for losses on loans and advances amounted to € 422 million, which was considerably lower than the high figure seen in the previous year (2009: € 1,884 million). Since the transfer of positions to FMS Wertmanagement, a significantly lower level of net additions to provisions for losses on loans and advances (€ 33 million) was necessary.

General Administrative Expenses General administrative expenses of € 151 million were lower than the corresponding previous year figure (€ 201 million) due to decreased consulting expenses and releases of personnell provisions. Because operating revenues increased and because general administrative expenses declined, the cost-income ratio improved to 26.4 % (2009: 37.2 %).

Operating Segment Value Portfolio (VP)

Key financials Value Portfolio		**1.1.–31.12.2010**	**Combined 1.1.–31.12.2009**	Change
Operating performance				
Operating revenues	in € million	5	33	–28
Net interest income and similar income	in € million	–27	101	–128
Net commission income	in € million	–76	–150	74
Net trading income	in € million	79	88	–9
Net income from financial investments	in € million	–6	–6	–
Net income from hedge relationships	in € million	–	–	–
Balance of other operating income/expenses	in € million	35	–	35
Provisions for losses on loans and advances	in € million	21	4	17
General administrative expenses	in € million	52	57	–5
Balance of other income/expenses	in € million	–	–	–
Pre-tax profit/loss	in € million	–68	–28	–40
Key ratio				
Cost-income ratio	in %	>100.0	>100.0	

The operating segment Value Portfolio mainly comprises securities issued by FMS Wertmanagement and some selected structured products.

The pre-tax profit/loss of the Value Portfolio segment amounted to €–68 million, and in the current year was more negative than in the previous year (2009: €–28 million). This was due mainly to an exceptional effect arising from the writing-down of subordinate capital instruments, which had a positive impact on net interest income in the previous year and burdened net interest income of the current year. However, net commission income and balance of other income/expenses have improved significantly.

Operating Revenues The expenses incurred for the liquidity support affected operating revenues, which amounted to €5 million, compared with €33 million in the previous year. Net interest income amounted to €–27 million, and was lower than the corresponding previous year figure of €101 million. However, the previous year figure included income of €138 million due to the writing-down of some subordinate capital instruments. Instead an expense of €–13 million resulted from reversals of impairments of these instruments. If this effect is disregarded, net interest income would have been increased compared with the previous year figure. Net commission income was very negative at €–76 million (2009: €–150 million), mainly as a result of the expenses incurred for the guarantees in connection with the liquidity support; however, it was less negative than was the case in the previous year because, in 2009, a provision had to be created for a profit-related fee for the federal government as a guarantor (€–44 million); this figure was recognised in the income statement. In addition, no further liquidity support has been necessary since October 2010, which means that net commission income has not been affected any further. Net trading income was positive at €79 million (2009: €88 million). The revenues are attributable to valuation gains of €106 million (2009: €175 million) in relation to an internal HRE guarantee for the default of a monoliner for CMBS, which were partially offset by valuation losses attributable to stand-alone derivatives in the bank book. The net income from financial investments of €–6 million was attributable to impairments recognised in relation to securities and portfolio-based allowances relating to LaR investments. Balance of other operating income/expenses contains income for compensating additional costs of services for ongoing operations of FMS Wertmanagement amounting to €35 million.

Provisions for Losses on Loans and Advances Additions to provisions for losses on loans and advances amounted to €21 million in 2010 (2009: €4 million). Releases of individual allowances of €23 million were opposed by additions to portfolio-based allowances of €–2 million.

General Administrative Expenses General administrative expenses amounted to €52 million, and were lower than the corresponding previous year figure (2009: €57 million). As was the case in the previous year, the cost-income ratio amounted to more than 100%.

Consolidation & Adjustments

Key financials Consolidation & Adjustments		1.1.–31.12.2010	Combined 1.1.–31.12.2009	Change
Operating performance				
Operating revenues	in € million	3	–45	48
Net interest income and similar income	in € million	–12	3	–15
Net commission income	in € million	–	–	–
Net trading income	in € million	–	–	–
Net income from financial investments	in € million	–	1	–1
Net income from hedge relationships	in € million	–45	–23	–22
Balance of other operating income/expenses	in € million	60	–26	86
Provisions for losses on loans and advances	in € million	–	–	–
General administrative expenses	in € million	103	–6	109
Balance of other income/expenses	in € million	8	18	–10
Pre-tax profit/loss	in € million	–92	–21	–71

The Consolidation & Adjustments column is used to reconcile the total segment results with the consolidated results. In addition to consolidations, this item comprises certain expenses and income which cannot be allocated to the respective operating segments.

The pre-tax profit in the Consolidation & Adjustments column amounted to € –92 million, and was more negative than the corresponding previous year figure (€ –21 million). This was mainly due to higher consultancy fees in general administration expenses.

Operating Revenues Net interest income decreased to € –12 million compared with € 3 million in the previous year due to lower income from the investment of own funds. The net income from hedge relationships of € –45 million (2009: € –23 million) was attributable to hedge inefficiencies within the range permitted under IAS 39 and also changes in the valuation of dFVTPL assets. The balance of other operating income/expenses amounted to € 60 million (2009: € –26 million), and was attributable to an income of pbb Services GmbH from services for the DEPFA Group (€ 65 million).

General Administrative Expenses General administrative expenses amounted to € 103 million, and were considerably higher than the previous year figure of € –6 million; this is mainly attributable to expenses incurred in connection with the process of transferring positions to FMS Wertmanagement.

Balance of Other Income/Expenses Releases of personnell provisions, which were part of the provisions in connection with the strategic refocusing and restructuring of Deutsche Pfandbriefbank Group, amounted to € 8 million in the year 2010.

Development in Assets

Assets in € million	31.12.2010	31.12.2009	Change
Cash reserve	224	618	–394
Trading assets	16,168	1,435	14,733
Loans and advances to other banks	15,190	78,151	–62,961
Loans and advances to customers	132,840	91,221	41,619
Allowances for losses on loans and advances	–561	–3,326	2,765
Financial investments	16,345	30,914	–14,569
Property, plant and equipment	5	10	–5
Intangible assets	32	28	4
Other assets	5,035	11,801	–6,766
Income tax assets	1,545	4,365	–2,820
Current tax assets	64	131	–67
Deferred tax assets	1,481	4,234	–2,753
Total assets	**186,823**	**215,217**	–28,394

Total assets of Deutsche Pfandbriefbank Group amounted to € 186.8 billion as of 31 December 2010, and were thus lower than the corresponding figure at the end of the previous year (31 December 2009: € 215.2 billion).

Total assets have declined as a result of the transfer of loans and receivables, securities and derivatives. In return however, there were the following effects as of the transfer date 1 October 2010, and these effects will decline in future.

> In the case of some assets, it was not possible to transfer beneficial ownership to FMS Wertmanagement, which meant that the criteria for a derecognition were not satisfied. For instance, it is not possible for some of the mortgage financing portfolio to be transferred physically as a result of legal restrictions. Additionally, in the case of derivatives, so-called back-to-back transactions were used to transfer the market price risks of the derivative to FMS Wertmanagement by way of taking out a derivative with identical conditions, whereas the counterparty risks were retained by the Deutsche Pfandbriefbank Group. This meant that it was not possible for the original position to be derecognised. Instead, the back-to-back transactions resulted in an extension of the balance sheet.

> FMS Wertmanagement had to provide collateral for the new derivatives which were taken out between FMS Wertmanagement and Deutsche Pfandbriefbank Group (back-to-back transactions); in turn, these had to be refinanced in full by Deutsche Pfandbriefbank Group.

> Furthermore, Deutsche Pfandbriefbank Group had in the past repurchased bonds which it had issued itself and which had been guaranteed by SoFFin. These bonds were used as collateral for refinancing purposes. Under IFRS, own issue holdings have to be offset against the corresponding liabilities evidenced by certificates. After the transfer of the liabilities evidenced by certificates to FMS Wertmanagement and the retention of the own issue bonds, corresponding offsetting is not permitted, which in turn increased the balance sheet total.

> In addition, because FMS Wertmanagement does not have a banking status, Deutsche Pfandbriefbank Group currently handles certain refinancing functions for FMS Wertmanagement, for instance with the ECB or in bilateral repo transactions. The refinancing funds are passed on to FMS Wertmanagement. Deutsche Pfandbriefbank Group receives a claim against FMS Wertmanagement, which increases the balance sheet total.

The effects concerning the transfer to FMS Wertmanagement are described in Note 5.

Some of these compensating effects were reduced by the end of 2010. Work started on replacing back-to-back transactions by way of direct business relations between FMS Wertmanagement and the external customers (novation of derivatives). As a result of this novation of customer business with simultaneous termination of back-to-back transactions, the effect of back-to-back business extending the balance sheet was no longer applicable, and the balance sheet total was also reduced by the novation of the customer derivative. Moreover, the termination and novation had a significant effect on the collateral provided and received for these derivatives.

In addition to the effects in connection with the process of transferring assets to FMS Wertmanagement, the total assets also increased as a result of market-related factors. The weakening of the Euro against the US-Dollar, the Japanese Yen and Sterling resulted in an extension of the balance sheet shown in Euros, because the foreign currency assets and liabilities receive a higher carrying amount in Euros as a result of currency translation. Furthermore, as a result of the rating downgrades of some states and also as a result of the weaker Euro, Deutsche Pfandbriefbank Group had to provide additional collateral for covered refinancing, resulting in a further increase in the balance sheet total.

Without the market-related effects and the compensating effects attributable to the process of transferring assets to FMS Wertmanagement, the balance sheet total would have declined even more significantly in 2010, because the new business taken out in accordance with the new risk policy was considerably lower than the repayments and sales of assets.

Development in the Financial Position

Equity and liabilities in € million	**31.12.2010**	**31.12.2009**	Change
Liabilities to other banks	62,587	67,625	−5,038
Liabilities to customers	17,384	12,378	5,006
Liabilities evidenced by certificates	63,846	109,193	−45,347
Trading liabilities	16,294	1,872	14,422
Provisions	176	153	23
Other liabilities	18,883	13,635	5,248
Income tax liabilities	1,526	3,733	−2,207
Current tax assets	83	85	−2
Deferred tax assets	1,443	3,648	−2,205
Subordinated capital	2,766	3,895	−1,129
Liabilities	**183,462**	**212,484**	−29,022
Equity attributable to equity holders	**3,361**	**2,733**	628
Subscribed capital	380	380	–
Silent participation	999	999	–
Additional paid-in capital	5,036	5,037	−1
Retained earnings[1]	−3,124	−1,310	−1,814
Revaluation reserve	255	−858	−1,113
AfS reserve	−259	−328	69
Cash flow hedge reserve	514	−530	1,044
Consolidated loss/profit 1.1.–31.12.	−185	−1,515	1,330
Minority interest in equity	**–**	**–**	–
Equity	**3,361**	**2,733**	628
Total equity and liabilities	**186,823**	**215,217**	−28,394

[1] Including foreign currency reserve

Equity increased by € 0.7 billion to € 3.4 billion as of 31 December 2010 (31 December 2009: € 2.7 billion), mainly due to a considerable increase in the revaluation reserve, and in particular the cash flow hedge reserve. The increase in the cash flow hedge reserve to € 0.5 billion (31 December 2009: € – 0.5 billion) was attributable to the changed level of interest rates as well as maturities of hedging derivatives. A further factor was that hedge relationships shown in cash flow hedge accounting were transferred to FMS Wertmanagement. In addition, the consolidated loss in 2010 led to a reduction in equity. No capital increases or reductions were carried out in the financial year 2010.

The total Group liabilities amounted to € 183.5 billion as of 31 December 2010, compared with € 212.5 billion as of 31 December 2009. As was the case on the assets side of the balance sheet, the changes on the liabilities side were also mainly attributable to the process of transferring positions to FMS Wertmanagement. The balance sheet total declined as a result of the transfer of liabilities. This reduction was offset by opposite effects. For instance, the fact that back-to-back derivatives have been concluded in order to transfer the risk of items which cannot be physically transferred has resulted in an increase in the balance sheet total. Moreover, because FMS Wertmanagement does not have a bank status, Deutsche Pfandbriefbank Group also handles the transmission functions for central bank borrowings. This transmission of ECB refinancing or bilateral repo transactions has also increased the balance sheet total at Deutsche Pfandbriefbank AG.

In addition, market-related effects have increased the balance sheet total on the assets side and also on the liabilities side of the balance sheet. As a result of the weaker Euro, there has been an increase particularly in liabilities to other banks and liabilities to customers. The liabilities have also increased because it was necessary to refinance the collateral which Deutsche Pfandbriefbank Group had to provide on the market additionally as a result of the rating downgrades of some countries and also as a result of the weaker Euro.

Moreover, liabilities evidenced by certificates decreased as matured issues had not been replaced by new issues in the same amount.

The contingent liabilities declined to € 0.1 billion as of 31 December 2010 (31 December 2009: € 0.7 billion). No contingent liabilities were transferred physically to FMS Wertmanagement. Instead, the opportunities and risks for some obligations were transferred by way of entering into a corresponding contingent asset with FMS Wertmanagement; however, this type of transfer does not qualify for netting purposes. Compared with the end of the previous year (€ 2.7 billion), the other commitments declined to € 0.8 billion. The loans and receivables which have not been paid out or which have not been paid out in full are reflected in the irrevocable loan commitments, and amounted to € 0.8 billion as of 31 December 2010, compared with € 2.6 billion as of 31 December 2009. The decline in the irrevocable loan commitments was attributable to the higher drawing rate, the reduction of commitments and the transfer of loans and receivables to FMS Wertmanagement.

Regulatory Indicators According to German Solvency Regulation

In accordance with the waiver rule set out in Section 2a KWG, Deutsche Pfandbriefbank AG is not obliged to determine equity and core capital ratios at the level of the institution.

Summary

The result of Deutsche Pfandbriefbank Group amounted to € –135 million in 2010. However, it was much less negative than in the corresponding previous year period (€ –1,525 million). In addition, the quarterly development of 2010 indicated a constantly improved position in terms of results. This development resulted in profits being generated in the third and fourth quarters of 2010. Overall, these trends illustrate the success achieved by Deutsche Pfandbriefbank Group in restructuring and refocusing the Group, and also demonstrate the profitability of the portfolio after the transfer of positions to FMS Wertmanagement.

Events after 31 December 2010

In March 2011 a natural and nuclear disaster occured in Japan. The consequences for Deutsche Pfandbriefbank Group cannot be foreseen at the moment. However, Group's main concern is the welfare of approximately 40 colleagues located in Japan. Deutsche Pfandbriefbank Group's credit exposure to Japanese counterparties based on exposure of default amounted to € 1.5 billion in the segment Real Estate Finance and to € 0.7 billion in the segments Public Sector Finance/Value Portfolio as of 31 December 2010. A loan with an amount of € 0.7 billion was repaid in the segment real estate finance in March 2011.

Apart from the above, no other notable events have taken place after 31 December 2010.

In 2010, the situation on the capital markets reflected the uncertain development of the debt situation of the European countries which are currently at the focus of attention, in particular Portugal, Spain, Italy, Ireland and Greece. The market for European government bonds was overall extremely volatile in 2010. Following a somewhat calmer pause for breath, the focus has recently been directed to the above-mentioned countries in the eurozone. The decision of Ireland to take advantage of the rescue facility briefly stabilised the situation; however, it is uncertain whether the risk spreads will sustainably and significantly narrow. The spreads are still very volatile and are considerably higher than the corresponding level seen in previous years.

After risk positions and portfolios were transferred to the newly established institution constituted under public law, FMS Wertmanagement as of 1 October 2010, the remaining Deutsche Pfandbriefbank Group is now affected to a lesser extent by the uncertain development of the ability of the European countries which are currently at the focus of attention to service their debts. Greek and Irish government bonds have been completely transferred or wound down; in addition to a minor exposure to Portugal, some of the Italian and Spanish state exposure will be retained in the portfolio of Deutsche Pfandbriefbank Group. However, the further development of the various European countries which are currently at the focus of attention will have to be precisely observed in view of their fundamental relevance for the business policy of Deutsche Pfandbriefbank Group.

The situation on the real estate markets has improved somewhat; in some countries, real estate transactions are now rising again – starting from a low level and also supported by the very low mortgage interest rates. However, high vacancy rates which are depressing prices for commercial properties are still posing problems. In particular, the mortgage markets in Spain and Ireland will probably not recover even in the medium term because the underlying real estate markets will continue to be weak.

The refinancing situation in 2010 was among other things affected by a strain imposed on liquidity resulting from the fact that the euro weakened by approx. 8% against the US Dollar. Further major factors in this respect are explained in the section concerning liquidity risks. The effects were offset by the liquidity support measures of SoFFin, which the Group again relied on in the second half of 2010, until the transfer of positions to FMS Wertmanagement, and which are explained in detail in the section «Major Events» of the management report. Deutsche Pfandbriefbank AG was again able to carry out private placings and benchmark transactions on the market in 2010.

Deutsche Pfandbriefbank Group is integrated into the higher-ranking risk management system of HRE.

Transfer of Assets and Liabilities to FMS Wertmanagement

As described in the comments concerning major events in the management report, Deutsche Pfandbriefbank Group as part of HRE transferred assets and liabilities to FMS Wertmanagement with effect from 1 October 2010. The balance sheets of Deutsche Pfandbriefbank Group and the balance sheets of FMS Wertmanagement are not consolidated. This arrangement has accordingly achieved a balance sheet reduction and structural improvements as well as a reduction of the strain imposed on capital and also an improvement in the liquidity position.

Specific selection transfer criteria have been used for transferring real estate assets and also non-real-estate assets of Deutsche Pfandbriefbank Group to FMS Wertmanagement. Selection criteria for reducing the credit risk for instance identified object classes with a fundamentally higher level of risk as well as standard risk parameters (e.g. loan-to-value, loss-given default, interest service coverage, rating) with increased risk values. The selection also focused on assets as part of concentration risks as well as positions with an extremely long remaining term or positions which are denominated in currencies other than the euro. In addition, assets which are not eligible for repo purposes and not eligible for ECB funding purposes as well as transactions in countries which are not eligible for use as cover funds or which lead to excessive collateral requirements due to uncertainty regarding the development in ability to service debt have been selected in order to optimise liquidity.

Organisation and Principles of Risk and Capital Management

HRE has set up a Group-wide risk management and risk controlling system. This represents as well an important precondition for the application of the so-called waiver. 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. Operational implementation is the responsibility of the respective subsidiary and therefore also for Deutsche Pfandbriefbank Group and significantly Deutsche Pfandbriefbank AG.

Organisation and Committees

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

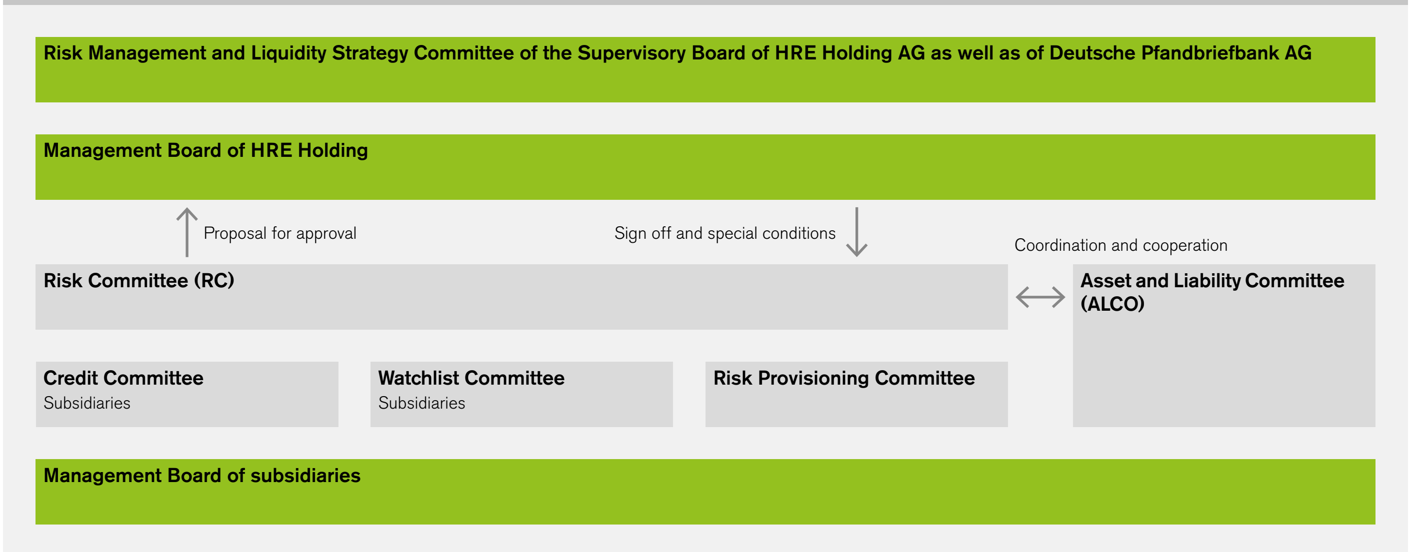
The Management Board of HRE Holding is responsible for the Group-wide risk management system, and is responsible for taking decisions relating to all strategies and the main issues of risk management and risk organisation. The risk management system is a system which covers all business activities of the Group, and comprises the plausible and systematic identification, analysis, valuation, management, documentation and communication of all major risks and related monitoring on the basis of a defined risk strategy which is revised annually.

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

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

Organisation of risk management of HRE Holding

as of 31 December 2010



The Management Board of Deutsche Pfandbriefbank AG notifies the Supervisory Board of Deutsche Pfandbriefbank AG with regard to changes in the business and risk strategies as well as the risk profile of Deutsche Pfandbriefbank Group. The Risk Management and Liquidity Strategy Committee (RLA) of the Supervisory Board of Deutsche Pfandbriefbank AG 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 HRE, in which Deutsche Pfandbriefbank AG is integrated. The Management Board notifies this committee of all increases to individual allowances and the creation of new individual allowances in excess of €5 million and has also notified this committee at regular intervals of major exposures with higher levels of risk.

The **Risk Committee (RC)** of HRE consists of the Chief Risk Officer (CRO; Chairman) of HRE Holding acting as Chief Risk Officer of Deutsche Pfandbriefbank AG, the Chief Financial Officer (CFO), the Chief Credit Officers (CCOs) of the operating segments as well as the Head of Risk Management & Control. In general, the committee meets on a monthly basis and adopts guidelines/policies[1], methods for risk measurement, the related parameters as well as methods of monitoring all risk types. It submits decision-making proposals to the Management Board of HRE Holding and the Management Board of Deutsche Pfandbriefbank AG with regard to risk limits on the HRE Group level and on the level of Deutsche Pfandbriefbank Group as well as risk strategies.

The Risk Committee monitors the development of risk-bearing capacity, economic capital, the risk cover funds, the credit portfolio and the compliance with limits. It takes decisions regarding suitable measures of credit risk management.

The respective CRO of Deutsche Pfandbriefbank AG as well as the CCOs of the segments Real Estate Finance and Public Sector Finance as well as Treasury and Asset Management of HRE are responsible for adapting and carrying out the decisions which have been taken.

The **Asset and Liability Committee (ALCO)** of HRE is chaired by the member of the Management Board responsible for Treasury and comprises the Chief Risk Officer, the Chief Financial Officer as well as the heads of Treasury and Asset Management, Finance, Risk Management & Control. It meets on a monthly basis. Its tasks comprise liquidity management, management of the balance sheet structure of HRE and of Deutsche Pfandbriefbank Group, funds transfer pricing as well as market risk management and management of the regulatory capital ratios. This committee is also responsible for preparing decision-making documents for liquidity and refinancing strategies which, following discussions in the Risk Committee, are decided in the same way as acquisitions and disinvestments in the Management Board of HRE.

The **Credit Committee** at Deutsche Pfandbriefbank Group comprises the CRO (chairman), the CCOs of the operating segments, the Senior Credit Executives and the head of Risk Management & Control as well as representatives of the front office. The front office representatives have a voting right as part of front office responsibility. In general, the committee meets at least once every week, and is responsible for competence-based credit decisions for new business, prolongations and material changes in the credit relationship. It also votes on all credit decisions which come under the responsibility of the Management Board of Deutsche Pfandbriefbank AG which have to be approved by the Supervisory Board. The Credit Committee ensures that the credit decisions are consistent with the prevailing business and risk strategy.

The **Watchlist Committee** of Deutsche Pfandbriefbank Group meets every month. Its voting members are the CCOs of the respective operating segments (chair), the senior credit executives, and optionally the CRO as well as the relevant head of Credit Risk Management. All exposures of Deutsche Pfandbriefbank Group identified by the early warning system are discussed and, if appropriate, individual measures are decided by this body; these measures have to be subsequently implemented by the relevant departments. Where necessary, the committee takes decisions regarding the need to transfer exposures to Global 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 of Deutsche Pfandbriefbank Group.

If there are any indications of an objective impairment in the exposure, the extent of the impairment is first determined and the result is presented in the **Risk Provisioning Committee.** The committee meets on a regular basis, and comprises the CRO (chairman), the CFO, the head of Global Workout as well as the CCOs of the operating segments. It takes decisions within the framework of a predefined set of allocated powers, and provides recommendations regarding the creation and reversal of provisions for losses on loans and advances as well as any necessary rescue acquisitions. The recommendations made by the committee have to be decided by the Management Board of Deutsche Pfandbriefbank AG in line with the relevant set of rules governing powers.

[1] Policies and guidelines which comprise strategic decisions have to be approved by the Central Management Board of Deutsche Pfandbriefbank AG

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

Organisation of Chief Risk Officer of Deutsche Pfandbriefbank Group

as of 31 December 2010

Group Chief Risk Officer (CRO)

Risk Management & Control	Credit Officer Real Estate I	Credit Officer Public Sector, Financial Institutions & Value Portfolio I	Global Workout Real Estate Europe/Asia	Credit Secretary	ImmoTrading

The organisation of the CRO function comprises the following monitoring and back-office entities on HRE Group level

> The entity Risk Management & Control which is also responsible for monitoring and managing market, counterparty, operational and liquidity risks of Deutsche Pfandbriefbank Group and which is also responsible for Group-wide uniform risk measuring methods, risk reports and credit processes

> The entities Credit Officer Real Estate I of Deutsche Pfandbriefbank Group and the Credit Officer Public Sector, Financial Institutions & Value Portfolio I, who are each responsible for portfolio management and the analysis of selective new business

> The entity Global Workout RE Europe/Asia, which is responsible for the restructuring and workout of all critical exposures in the real estate financing segment. The various Credit Risk Management (CRM) segments are responsible for processing in the Public Sector Finance and Value Portfolio segments

> The Credit Secretary, responsible particularly for organisation of the Credit Committee

> ImmoTrading which – inter alia – is responsible for property management of real estate which is included in the portfolio

The Credit Quality Control entity was allocated to Risk Management & Control, and forms the Risk Governance department. It is responsible for monitoring risk-bearing capacity, the risk strategy, guaranteeing the MaRisk compliance of processes and also instructions and quality insurance relating to credit processes on the HRE Group level as well as on the level of Deutsche Pfandbriefbank Group.

In the period under review Property Analysis & Validation, which is responsible for the analysis and uniform valuation of the collateral properties using market and LTV methods, reported to the CEO.

In addition to the CRO function, the Compliance/Corporate Governance entity and the Audit entity extend the risk management system of Deutsche Pfandbriefbank Group. The area of responsibility of Audit comprises the regular as well as the event-driven audit of processes and systems and significant transactions. Risk management is also supported by the Legal entity.

In addition to assessing its own portfolios, Deutsche Pfandbriefbank Group also handles servicer functions, the extent of which is set out in service level agreement and a cooperation agreement. There are only minor decision-taking powers within the predefined framework.

Risk Strategy and Policies

The risk strategy of HRE Group is based on the business strategy and the results of the Group-wide financial planning process. It is applicable for the operating segments and legal entities of HRE and therefore as well for Deutsche Pfandbriefbank Group, and also constitutes the framework for the risk and business strategies of the HRE operating segments as well as for the Group-wide risk manual. The risk strategy was adopted in December 2010 by the Management Board of Deutsche Pfandbriefbank AG, and was presented to the Risk Management and Liquidity Strategy Committee of the Supervisory Board of Deutsche Pfandbriefbank AG on 10 February 2011 to be noted.

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

Operational specification 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 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

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

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

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

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

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

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

The Risk and Liquidity Strategy Committee of the Supervisory Board of Deutsche Pfandbriefbank AG has been notified of all major exposures of Deutsche Pfandbriefbank Group as well as individual allowances over € 5 million.

Risk Quantification and Risk Management

The Value at Risk (VaR) approach is used in Deutsche Pfandbriefbank Group for quantifying risk and also for determining the economic capital for the main risk types apart from liquidity risk. The individual calculation methods are described in detail in the risk report in section «Result of Risk-bearing Capacity Analysis».

Further risk types considered being material as a result of the regular internal risk inventory, such as strategic, regulatory and model risk as well as pension, participation and property risk which are considered to be immaterial, are not measured quantitatively. Instead, they are managed and limited by means of regular detailed reports, clear specifications, e.g. regulations concerning compliance and corporate governance.

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

1. Monitoring the risk-bearing capacity on the basis of comparing economic capital and the available financial resources of Deutsche Pfandbriefbank Group, also considering stress test results.
2. Monitoring of the risk-weighted assets (RWA) of Deutsche Pfandbriefbank Group at the portfolio level by means of stress tests which are intended to ensure that the overall capital ratio does not fall below 8.5 %.
3. Operational risk management via:
   > The use of Basel-II-compliant risk parameters in lending business of Deutsche Pfandbriefbank Group. The Basel-II-compliant management approach shows the average expected loss at the borrower level, and is therefore a major component in risk early recognition and ongoing profitability monitoring. The parameters are reviewed and recalibrated annually.
   > An improved limit system for counterparty and issuer risks which was introduced in the first quarter of 2010 in Deutsche Pfandbriefbank Group, 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.

Risk management of Deutsche Pfandbriefbank Group will be further expanded by integrating the economic capital in the business planning process in 2011.

Economic Capital and Monitoring the Risk-bearing Capacity

Deutsche Pfandbriefbank Group has established a risk-bearing capacity analysis which is based on the Internal Capital Adequacy Assessment Process (ICAAP). The assessment of internal capital adequacy is based on the concept of economic capital. Deutsche Pfandbriefbank Group's economic capital calculation methodology is based on the need and requirements of its business. A further criterion is compliance with the pillar-2 criteria under Basel II for banks as well as the specification of these criteria in accordance with the German Minimum Requirements for Risk Management (MaRisk). These require adequate internal capitalisation.

Economic capital is defined as «the quantity of capital required by a bank in order to cover the largest potential unexpected total loss with a defined probability over a time horizon of one year». The standard used by Deutsche Pfandbriefbank Group for the probability of loss is the probability of default associated with a long-term credit rating (A– at Standard & Poor's, A/A2 at Moody's and Fitch). After the effects of the financial crisis, the corresponding value calculated on the basis of the estimate of the rating agency Standard & Poor's for the long-term probability of default of senior unsecured obligations with an A– rating is 0.08 %, which would justify the confidence level being reduced to 99.92 %. However, in order to be even more conservative than would be applicable on the basis of the target rating, the Bank has decided to leave the confidence level, which is used as the basis of calculating the economic capital, unchanged at 99.95 %.

The individual specific methods of calculating the VaR for the individual risk types are described in greater detail in section «Result of Risk-bearing Capacity Analysis». As is normal for the sector, economic capital is not calculated for liquidity risk; however, the risk is taken into consideration in stress scenarios.

In order to evaluate the adequacy of the capital resources of Deutsche Pfandbriefbank Group, the amount of economic capital is compared with the financial resources available to the Bank within one year. The definition of the «available financial resources» for one year comprises customary components such as essentially the shareholders' equity in accordance with IFRS, components similar to shareholders' equity (subordinated and hybrid capital with a holding period of at least one year) as well as the planned result for the next twelve months. These components are suitable for alleviating the impact of potential losses and for maintaining a corresponding risk buffer. The available financial resources must always be greater than the economic capital.

The most significant risk type on the basis of the ICAAP (measured in terms of the economic capital and without explicitly taking account of liquidity risk) is credit risk which accounts for 66 % of the undiversified economic capital.

In terms of economic capital, Deutsche Pfandbriefbank Group is adequately capitalised again following the transfer of positions to FMS Wertmanagement. The bank has thus met all requirements regarding risk-bearing capacity since October 2010.

The results of the capital adequacy assessment process and of the stress tests are regularly presented to the central Management Board and the Risk Committee. The results are discussed and if necessary management measures are defined by the central Management Board and the Risk Committee.

In the first quarter of 2010 a significant alignment of the ICAAP methodology to the changed business strategy of HRE and thus also of Deutsche Pfandbriefbank Group was implemented. The strategic refocusing with a much stronger focus on assets held to maturity, the new ownership structure as well as the changed funding profile were explicitly taken into consideration in the model. Moreover, the complete risk inventory carried out in the third and fourth quarter also resulted in some changes to the ICAAP model. The participation and property risks are now classified as immaterial as a result of the changed portfolio after the transfer of positions to

FMS Wertmanagement. Accordingly, these risks are no longer taken into consideration for calculating the economic capital. The systemic risk factors of the credit portfolio model have also been adjusted to reflect the new composition of the portfolio. Details concerning the changes in method are set out in the section «Result of Risk-bearing Capacity Analysis».

Major Projects in Risk Management of Deutsche Pfandbriefbank Group

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

Limit System The HRE Group-wide limit system for credit risks, which covers all borrowers and products of all consolidated legal entities of the Group, was implemented in the first quarter of 2010. Further improvements as well as upgrades will follow in the first half of 2011.

Management Information System MIS Since the beginning of 2010, internal and external credit risk reporting has to a large extent been based on the reporting platform «MIS/Risk Cockpit» which has been introduced throughout the Group. Further fine-tuning took place in the remainder of 2010, additional information and a higher degree of automation for preparing the reports have been implemented, and these activities will also be continued.

Standardisation of Market Risk As part of the process of concern-wide standardisation of market risk management implemented in phases, the year 2010 saw the focus placed on further developing aspects of the methods involved. Further project phases are planned in the following releases within the context of the program New Evolution – TOPP 2011.

Liquidity Risk Management The fourth quarter of 2010 saw the development of an application which meets the reporting requirements with regard to concern-wide and uniform liquidity risk management and which was implemented in January 2011. In 2011, there will be a further stage which adequately takes account of the constantly expanding regulatory aspects.

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

Internal Control and Risk Management System with Regard to the Accounting Process

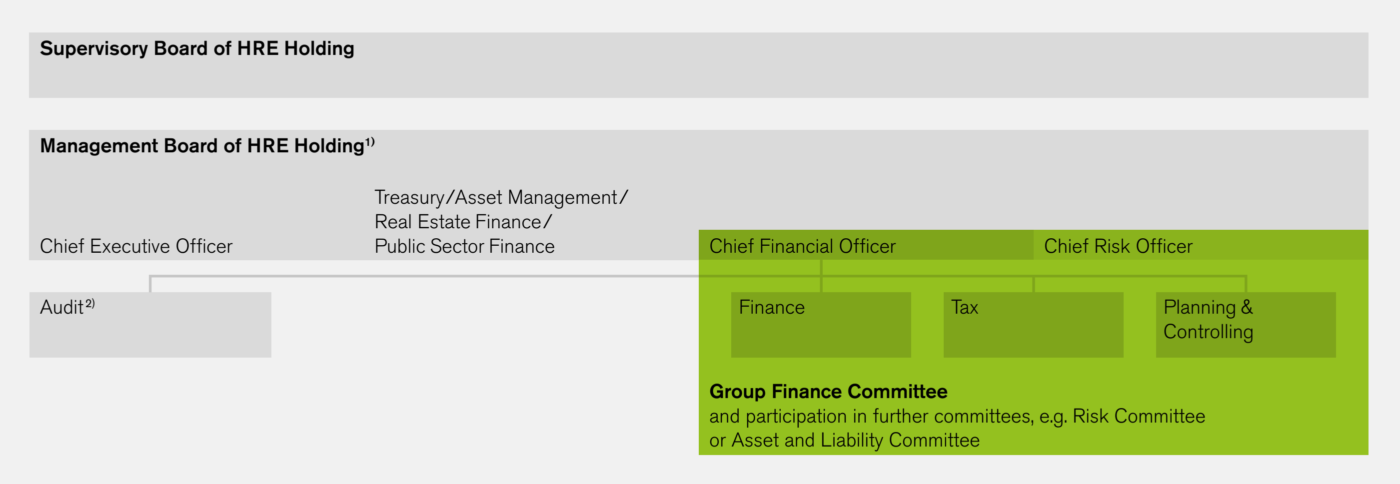
Conception The internal control and risk management system with regard to the accounting process comprises the principles, procedures and measures designed to assure the effectiveness and efficiency of accounting and also to assure compliance with the relevant legal regulations. The aim of the risk management system with regard to the accounting process is to identify and evaluate risks which may oppose the objective of ensuring that the financial statements comply with the relevant rules, to limit risks which have been identified and to check the impact of such risks on the financial statements and also the way in which these risks are presented. The internal control system with regard to the accounting process is an integral component of the risk management system and is designed, by way of implementing controls, to guarantee adequate assurance that the financial statements which are prepared comply with the relevant rules despite the risks which have been identified.

However, an internal control and risk management system with regard to the accounting process cannot provide absolute assurance regarding success in attaining the associated objectives. As is the case with all discretionary decisions, decisions relating to the establishment of appropriate systems may also be errored as a result of faults, errors, changes in ambient variables or deliberate violations and criminal actions. These problems mean that it is not possible with absolute assurance to identify or prevent misstatements in the financial statements.

At Deutsche Pfandbriefbank Group the internal control and risk management system with regard to the accounting process is reflected in the structure and procedure organisation. In terms of structure organisation, the internal control and risk management system with regard to the accounting process mainly comprises the Management Board, the Supervisory Board as the control body of the Management Board, the departments which report to the Chief Financial Officer (CFO) and the Group Finance Committee.

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

as of 31 December 2010



[1] From 1 January 2011 enlarged by the Management Board section Treasury
[2] From April 2010 assigned to the CFO; until April to the CEO

In accordance with Section 290 HGB in conjunction with Section 242 HGB, the Management Board of Deutsche Pfandbriefbank AG is required to prepare consolidated financial statements and a management report. In conjunction with the obligation to introduce a Group-wide internal control and risk management system, the Central Management Board of Deutsche Pfandbriefbank AG also bears responsibility to develop, in terms of conception, implementation maintenance as well as monitoring an adequate and effective internal control and risk management system with regard to the accounting process. The Central Management Board takes decisions in this respect with regard to all strategies at the suggestion of the Chief Financial Officer (CFO).

The Supervisory Board is responsible for monitoring the Management Board. For this purpose, the Supervisory Board may specify that its approval is required for management measures. In addition, the Supervisory Board also has audit obligations and reporting obligations. In accordance with Section 100 (5) AktG, at least one member of the Supervisory Board must have specialist knowledge of accounting and auditing. The Supervisory Board is of the opinion that it meets these requirements.

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

The CFO is also responsible for managing Finance, Tax and Planning and Controlling, and also Audit since April 2010. In the CFO department, the consolidated financial statements are prepared in accordance with IFRS, and the accounting-relevant capital market information is provided. The companies of Deutsche Pfandbriefbank Group prepare their financial statements in accordance with the respective local legal requirements. For Group accounting purposes, the financial statements are harmonised in relation to uniform accounting policies in accordance with IFRS. Each company included in the consolidated financial statements reports its balance sheet, income statement and notes via the consolidation software to a central department in Group Accounting. In Group Accounting, the data of the foreign currency companies are translated into euros by means of the consolidation software. In addition, this is where the data is checked for plausibility, analysed and consolidated.

The Management Board has set up a Group Finance Committee at HRE Group level for making recommendations to the Management Board. This includes responsibility for defining and monitoring the guidelines and procedures for accounting and reporting for all entities and segments of the Group, including all entities of Deutsche Pfandbriefbank Group. In order to ensure close communication with other departments, the CFO or the Heads of the CFO departments also serve on other committees, for instance the Risk Committee with its sub-committees or the Asset and Liability Committee.

In terms of procedure organisation, the internal control and risk management system with regard to the accounting process is based on an intended far-reaching standardisation of processes and software. For core activities and processes, there is a Guideline department and a code of conduct. In addition, the four-eyes principle is mandatory for major transactions. Data and EDP systems are protected against unauthorised access. In addition, certain relevant information is made available only to employees who actually require such information for their work. Where necessary, results are agreed on a Group-wide basis.

Implementation Deutsche Pfandbriefbank Group has implemented the concept of the internal control and risk management system with regard to the accounting process in various measures for identifying, evaluating and limiting the risks. The structure organisation measures relate to the committees and the CFO departments. To a large extent, the same persons serve on the committees of the major HRE Group companies; this means that uniform management is possible. For instance, the members of the Management Board also form the Management Board of Deutsche Pfandbriefbank AG.

There is clear functional segregation within the CFO department, which is for instance reflected in separate departments for processing IFRS fundamental issues and the process of preparing financial statements. In addition, separate groups are responsible for preparing the consolidated financial statements and for preparing the separate financial statements. The Group Finance Committee and other committees as well as department discussions constitute links between the various tasks. In addition, executive, posting and administrative activities, such as payment and recording the payment, are clearly segregated or are subject to the four-eyes principle. In addition, the entities included in the consolidated financial statements report the data to a central department within the Group, thus ensuring that the data are further processed in a uniform process.

Within the structure organisation, there are automatic or system-based and manual or non-system-based measures for managing the risks and for internal controls. In system-based solutions, standard software is used as far as possible for posting, reconciling, controlling and reporting the data in order to avoid errors. This is also applicable for consolidation, which is carried out by means of software which is widespread in the market. The consolidation software provides technical support for harmonising internal relations in a clearly regulated process in order to guarantee that these internal relations are completely and properly eliminated. The data of the entities included in the consolidated financial statements are reported in a uniform standardised position plan. Automated plausibility checks are used for instance for reporting the data of the subsidiaries for consolidation purposes. The balances carried forward are checked with system support. In order to provide protection against losses, the data of the consolidation software are backed up daily, and are also backed up on tape. In general, the software of Deutsche Pfandbriefbank Group is protected against unauthorised access by a clearly regulated administration and release of authorisations.

In addition to the system-based measures, Deutsche Pfandbriefbank Group has also implemented manual and non-system-based procedures. For instance, a standard process is used to check whether the reported data are correct and complete. For this purpose, variance analyses in the form of budget-actual comparisons are also carried out. The consolidated balance sheet and the income statement are also established on a monthly basis, and some positions are even established on a daily basis. Extrapolations and forecasts are also prepared. A better understanding is achieved as a result of the continuous and frequent analysis of figures. Mandatory accounting principles applicable throughout the Group are defined and communicated, also in the form of a manual. These procedures comprise the analysis and interpretation of the new and existing IFRS standards and interpretations in order to permit uniform accounting and evaluation throughout the Group. Generally recognised valuation methods are used. The methods which are used and also the underlying parameters are regularly checked and, where necessary, adjusted. Schedules are also defined in order to permit a timely response in the event of deadline problems.

In order to improve the quality of controls, various departments are integrated in certain processes and are obliged to take part in the harmonisation process. For instance, the enterprise-wide new product process and the check performed on existing products with the right of veto by the Finance department are designed to ensure that the products are uniformly and systematically presented in the accounts. A further example of enterprise-wide harmonisation is the process for preparing the annual report and interim report. All departments involved must have these report certified before preparation by the Management Board (so-called sub-certification process), thus achieving a further control stage for the products to be disclosed. All affected departments agree in advance the contents of essential parts of the annual reports in editorial meetings.

As part of the risk management system with regard to the accounting process, Deutsche Pfandbriefbank Group takes measures designed to avert fraudulent actions and deliberate violations to the detriment of Deutsche Pfandbriefbank Group. Examples of fraudulent actions to the detriment of Deutsche Pfandbriefbank Group are theft, embezzlement or misappropriation. With regard to the accounting process, deliberately incorrect accounting is also defined as a fraudulent action. Deutsche Pfandbriefbank Group identifies and evaluates the risks and sets up measures to avert such fraudulent actions and deliberate violations. A newly developed system-based concept is also used to provide training for employees in compliance regulations.

Maintenance Deutsche Pfandbriefbank Group constantly checks and improves its internal control and risk management system with regard to the accounting process in meetings of the Management Board, the Group Finance Committee and internally in order to ensure that the risks are identified, evaluated and limited as correctly and comprehensively as possible. In consequence, the internal control and risk management system with regard to the accounting process is also adjusted to reflect new circumstances such as changes in the structure and the business model of Deutsche Pfandbriefbank Group or new legal requirements.

The risk of fraudulent actions and deliberate violations is regularly analysed in order to enable countermeasures to be taken. Due consideration is also given to unusual events and changes in the situation of Deutsche Pfandbriefbank Group and individual employees.

Deutsche Pfandbriefbank Group is required to comply with legal regulations. If the legal regulations change, for instance in the form of new or changed IFRS standards, these changes have to be implemented. The necessary changes to the processes and IT systems are where necessary implemented in separate projects for all departments and with clear functional allocation. As part of the implementation process, the risk management system with regard to the accounting process is also adjusted to bring it into line with the changed regulations.

As part of the process of restructuring Deutsche Pfandbriefbank Group, companies have been liquidated and merged, branches have been closed and the workforce has been reduced.

Deutsche Pfandbriefbank Group combats the risk in relation to the process of preparing the consolidated financial statements by way of clear functional allocations, centralisation of project management for restructuring and also close cooperation between the various departments.

The IT landscape of Deutsche Pfandbriefbank Group is of a heterogeneous nature mainly due to numerous acquisitions of companies in the past. Within the framework of the New Evolution project, the systems and the processes will therefore be standardised as far as possible in the course of the next few years.

Monitoring The Audit department is responsible for checking the adequacy of transactions and for identifying inefficiency, irregularities or manipulation. The Audit department also applies the rules of minimum requirements for risk management (MaRisk) to check the effectiveness and adequacy of risk management and the internal control system in a risk-oriented manner, and where appropriate identifies problems in the identification, evaluation and reduction of risks. This also includes auditing the IT systems of HRE as well as the processes and controls in CFO functions. Specific plans of measures with defined deadlines are drawn up and tracked in order to process the errors which are identified. Since April 2010, the Audit department has reported directly to the CFO. Until April 2010, it reported directly to the Chairman of the Management Board. The Audit department is not integrated in the work process, nor is it responsible for the result of the process to be audited. In order to enable it to carry out its duties, the Audit department has a complete and unrestricted right to obtain information regarding the activities, processes and the IT systems.

As a Control and Advisory Committee of the Management Board, the Supervisory Board is able to inspect and audit the accounts and the assets of the company in accordance with Section 111 (2) AktG. In addition, the Management Board regularly reports to the Supervisory Board. The internal control and risk management system with regard to the accounting process is a subject of the deliberations of the Supervisory Board. The Supervisory Board engages the auditor to audit the annual financial statements and the consolidated financial statements in accordance with Section 290 HGB. The Supervisory Board approves the consolidated financial statements and Group management report which have been prepared by the Management Board and certified by the independent auditor.

The auditor attends the meetings related to the consolidated financial statements of the Supervisory Board and attends all meetings of HRE Audit Committee, and reports on the major results of the audit, in particular major weaknesses of the internal control and internal risk management system with regard to the accounting process. In addition, the auditor also reports immediately on all findings and events which are of a material nature for the tasks of the Supervisory Board and which result when the audit is carried out. The Supervisory Board discusses the main emphasis of the audit with the auditor in advance.

Major Risk Types

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

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

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

Credit Risk

Definition

Credit risk is defined as the risk of the loss of value of a receivable or the partial or complete default of a receivable due to the default or downgrading of the rating of a business partner. The credit risk also comprises the counterparty, issuer and country risk, which are defined as follows:
> Counterparty risks are defined as potential losses of value of unfulfilled transactions, and in particular derivatives, attributable to the default of the counterparty. The following sub-categories are distinguished in this respect:
>> Settlement risk, which is defined as the risk that, when a trade is settled, the counterparty fails to deliver the necessary consideration
>> Replacement risk is defined as the risk that, in the event of a counterparty default, the contract has to be replaced on less favourable terms
>> Cash risk is defined as the risk that the counterparty might not repay (cash) loans which have been raised or that the counterparty might not transmit option premiums
> Issuer risk is the risk of the complete or partial loss of receivables from security investments due to the default of the issuer.
> Country risks are broken down into transfer and conversion risks as well as default risks. Transfer and conversion risks may arise as a result of state intervention which limits or prevents the ability to obtain foreign currency or the cross-border capital transfer of a solvent debtor. Counterparty risks may arise as a result of the default or downgraded rating of a country in its capacity as a debtor.

Credit Risk Strategy and Principles

As part of the restructuring process, HRE and hence Deutsche Pfandbriefbank Group have broken down the overall credit portfolio into a strategic portfolio (REF and PSF) and a Value Portfolio. The new portfolio structure was implemented in the first quarter of 2010. The adopted risk strategy of Deutsche Pfandbriefbank Group already reflects the new structure:

The strategic portfolio comprises the following:
> Public Sector Finance (PSF) segment, which comprises the public sector finance operations of Deutsche Pfandbriefbank Group.
> Real Estate Finance (REF) segment which comprises the former commercial real estate finance portfolio.

In the Public Sector Finance segment, new business of Deutsche Pfandbriefbank Group will focus on low-risk Pfandbrief-eligible financing of sovereigns and sub-sovereigns in Western Europe, particularly in Germany, France, Spain and Italy, as well as state-guaranteed public private partnerships (PPPs).

New business in Real Estate Business focuses on Pfandbrief-eligible financing of commercial real estate with sustainable cash flow in Europe, with the main emphasis on Germany, France and Great Britain. The main target customers of these operations are professional investors, institutional clients, real estate funds and selective developers. The intended range of products comprises less complex loan structures, selectively extended to include derivative hedging products.

New business is to be refinanced largely via Pfandbrief issues with matching maturities.

The Value Portfolio comprises non-strategic portfolios of Deutsche Pfandbriefbank Group as well as parts of the transactions which exist with the counterparty FMS Wertmanagement. With regard to the non-strategic portfolios within Value Portfolio especially derivative deals with financial institutions have to be mentioned. In the Value Portfolio, emphasis is placed on the reduction of existing assets in a manner which poses minimum strain on capital and which is designed to maintain value. As described initially in the risk report, further assets and liabilities were transferred to FMS Wertmanagement at the beginning of the fourth quarter of 2010.

Credit Risk Reports

In the financial year 2010, reporting on credit risks was thoroughly revised – also taking account of the additional requirements in accordance with MaRisk.

> The 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. The report shows the credit risk at the level of the Group and also at the level of the bank 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 which are relevant for management purposes, such as the development of the EaD, the EL and the Credit VaR are integrated in this report and are discussed by the Management Board of Deutsche Pfandbriefbank AG.

> The credit risk report contains details concerning the portfolio and risk parameters at the Group level and also at the level of the subsidiary institutes and is discussed in the Management Board of Deutsche Pfandbriefbank AG. Moreover, the credit risk report is presented to the Risk Management and Liquidity Strategy Committee of the Supervisory Board of HRE.

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

> In the current month, 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 by way of so-called «credit issue notes».

Credit Risk Quantification via Economic Capital and Risk-weighted Assets under Basel II

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

Stress Tests The stress tests for economic capital in credit risk are described in greater detail in 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, LGD, currency) can change before the minimum capital ratio (currently 8.5%) is no longer met. Tolerance change levels have been defined for all tested risk parameters; these levels must not be violated if the test of Deutsche Pfandbriefbank Group is to be successfully completed.

Credit Risk Quantification According to Basel II Deutsche Pfandbriefbank Group – apart from the former DEPFA Deutsche Pfandbriefbank AG – has already received regulatory approval to apply the so-called Advanced Internal Rating-Based Approach (Advanced-IRBA) for determining the regulatory capital backing. The result of the regulatory audit for the introduction of the Advanced IRBA at DEPFA Deutsche Pfandbriefbank AG is expected in 2011.

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 risk cover funds, and include for Deutsche Pfandbriefbank Group:
> Limiting of country risks
> Definition of strategic risk parameters (e.g. target customers, 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:
> Determining the credit risk VaR at the portfolio level by way of a credit portfolio model; analysis of concentration risks and various stress tests
> Central concern-wide monitoring of risk concentrations by way of special regular and ad hoc evaluations, such as regional, product-specific evaluations
> Continuous analysis of the portfolio and the relevant markets by the Credit Risk Management units
> Regular evaluation of the collateral
> Special reports for exposures which are potentially at risk (e.g. «credit issue notes»)

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. In the period under review, new business is signed exclusively at the Management Board level. A new set of competence rules comprising a delegation of competences was adopted in December 2010.

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 and prolongations as well as the procedures for transferring exposures to the watchlist or workout.

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

The credit risk management entities (Credit Officer Real Estate and Credit Officer PS I, FI & Value Portfolio I) carry out the initial risk analysis for new business and annual risk analysis for existing business. PD and LGD rating tools, which are developed by Credit Risk for 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 Germany/Property Analysis Europe provides support for analysing and valuing the securities. The application is checked by the relevant credit risk management entity.

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 analysed by Credit Risk Management (CRM). If any problems are identified, an exceptional test is performed on the credit default risk (incl. 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 Watchlist Committee.

If there are any objective indications of an impairment, the extent of such an impairment is determined. In the 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 Risk Provisioning Committee.

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

Hedging and Minimising Risk by Collateral

At Deutsche Pfandbriefbank Group, property liens relating to the financed properties are particularly important in the Real Estate Finance segment. Other financial securities and guarantees in particular are also accepted as collateral (e.g. credit insurances, guarantees, fixed-income securities, etc.) in the Public Sector Finance field.

The credit officers review the value of the collateral as part of the regular annual rating assessment of borrowers of Deutsche Pfandbriefbank Group. In the case of property collateral, the value, where necessary, is reviewed by external or internal experts.

Credit Portfolio

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

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

The Group-wide EaD of the credit portfolio amounted to € 117.2 billion as of 31 December 2010 (EaD 31 December 2009: € 198.5 billion). The considerable decline compared with the end of 2009 is mainly attributable to the transfer of assets and liabilities to FMS Wertmanagement which was carried out at the beginning of October 2010 and which is described in greater detail initially in the risk report. On the other hand, the approx. 8 % weakening of the euro against the US-Dollar between the end of 2009 and the end of 2010 had the effect of increasing EaD to a minor extent.

€ 28.3 billion of the above-specified Group-wide credit portfolio EaD of € 117.2 billion is attributable solely to the counterparty FMS Wertmanagement. This figure is broken down as follows. For most of the derivatives earmarked to be transferred to FMS Wertmanagement, it was not possible initially to arrange for beneficial ownership to be transferred, which meant that the market price risks of the derivatives were transferred to FMS Wertmanagement by way of concluding derivatives with identical conditions between Deutsche Pfandbriefbank Group and FMS Wertmanagement. These so-called back-to-back transactions account for an EaD of € 9.6 billion. Because FMS Wertmanagement does not have the status of a bank, Deutsche Pfandbriefbank Group also handles certain refinancing functions for the deconsolidated environment, for instance with the ECB or in bilateral repo transactions, which accounted for an EaD of € 10.7 billion as of 31 December 2010. And finally, Deutsche Pfandbriefbank Group still holds bonds with an EaD of € 7.9 billion issued by FMS Wertmanagement, which were provided by FMS Wertmanagement in connection with the claim for compensation of Deutsche Pfandbriefbank Group for the transferred assets and liabilities.

In addition, the credit portfolio EaD of € 117.2 billion also includes assets with an EaD of € 1.0 billion which have been 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. With effect from 1 December 2010, the credit risks of these assets was transferred by means of guarantees provided by FMS Wertmanagement, so that Deutsche Pfandbriefbank Group ultimately retains a counterparty risk with regard to FMS Wertmanagement in connection with these positions.

In order to constantly avoid EaD fluctuations and distortions in the strategic operating segments of Deutsche Pfandbriefbank Group resulting from the refinancing function which has been taken on, and also to properly reflect the actual economic risk in Deutsche Pfandbriefbank Group, the above EaDs attributable to transactions with FMS Wertmanagement have been detailed merely for information purposes in the following overviews of the portfolio development and structure. The EaD for the total exposure of HRE determined without the above position amounted to € 87.9 billion.

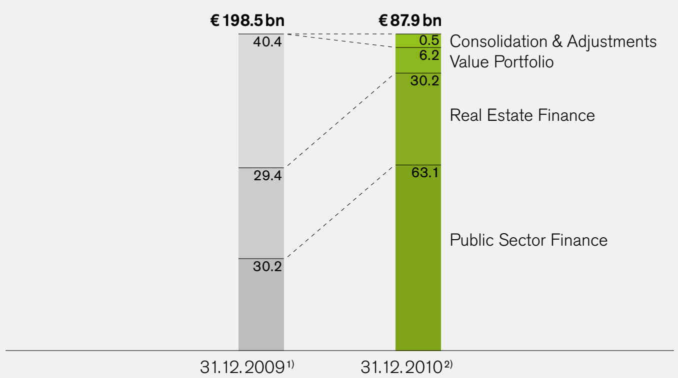
New business of Deutsche Pfandbriefbank Group comprising a total of € 4.1 billion commitments in the operating segments described in the following mainly concentrated on Real Estate Finance business with € 3.1 billion. Of this figure, € 1.7 billion is attributable to selected prolongations of existing business. The remaining new business of € 1.0 billion is attributable to the Public Sector Finance segment.

Overview of the Total Exposure of Deutsche Pfandbriefbank Group: € 87.9 billion EaD The credit portfolio is broken down into the following strategic segments
> Public Sector Finance (PSF)
> Real Estate Finance (REF)
and as well as the non-strategic Value Portfolio (VP) which is earmarked for being wound down.

In addition, the category «Consolidation & Adjustments» includes internal reconciliation and consolidation positions and a small number of individual positions which cannot be allocated to any other category.

Total exposure: EaD according to business segments

in %



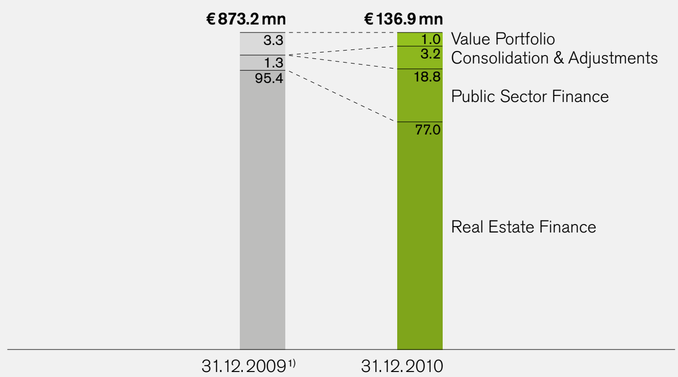
1) Including portfolio transferred to FMS Wertmanagement on 1 October 2010
2) In addition € 29.3 billion EaD with regard to the counterparty FMS Wertmanagement including guaranteed positions of € 1.0 billion (PSF: € 27.7 billion; VP: € 1.6 billion)

The total exposure of Deutsche Pfandbriefbank Group has declined by more than half in 2010 to € 87.9 billion (31 December 2009: € 198.5 billion). This was due to the transfer of positions to FMS Wertmanagement as of 1 October 2010. Within the segments, there has been a significant shift in the percentages in the direction of the Public Sector Finance segment. The segment Real Estate Finance with a portion of 30.2 % (€ 26.5 billion) has remained virtually stable (31 December 2009: 29.4 % or € 58.3 billion). The portion of the Value Portfolio has been reduced significantly from 40.4 % (€ 80.2 billion) in the preceding year to 6.2 % (€ 5.5 billion).

Risk Parameters Expected Loss The expected loss (EL), which is calculated from the annual probability of default (PD), the loss-given default (LGD) and the EaD, amounted to € 105.4 million as of 31 December 2010 using the parameters specified by Basel II (December 2009: € 1.1 billion) for Deutsche Pfandbriefbank Group. The expected loss for a period of one year is a key management parameter for the portfolio and is calculated for the entire exposure, with the exception of business with other institutes within HRE and non-performing loans for which an individual allowance has already been recognised.

Total exposure: expected loss according to business segments

in %



1) Including portfolio transferred to FMS Wertmanagement on 1 October 2010

The increase in the expected loss for the portfolio of the Public Sector Finance segment is mainly attributable to one major financing arrangement in the Public Sector segment (€ + 17 million EL) for which the borrower was experiencing payment difficulties. However, there is a positive outlook for financial recovery.

Using the parameters defined under Basel II, the expected loss (EL) for the Real Estate Finance portfolio is € 105 million as of 31 December 2010. It has accordingly declined appreciably compared with December 2009 (€ 833 million), due primarily to the transfer of a considerable part of the portfolio to FMS Wertmanagement.

Using the parameters defined under Basel II, the expected loss for the Value Portfolio was € 1 million as of 31 December 2010. It has accordingly declined appreciably compared with December 2009 (€ 30 million) due primarily to the transfer of a significant part of the portfolio to FMS Wertmanagement.

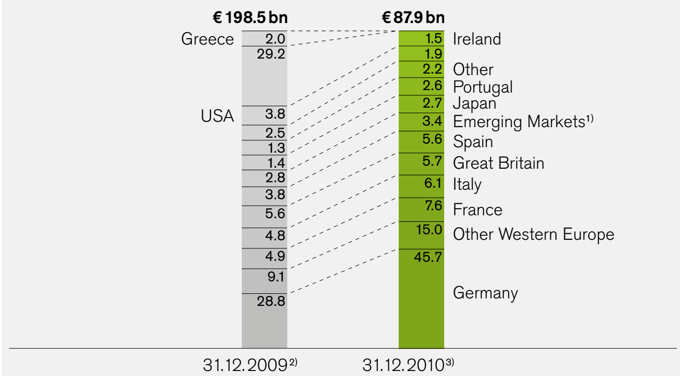
Economic Credit Risk Capital The unexpected loss of the credit portfolio, the credit value at risk, is calculated using a credit portfolio model for a period of one year and a confidence level of 99.95 % within the framework of risk-bearing capacity analysis of Deutsche Pfandbriefbank Group and amounts to € 1.3 billion as of 31 December 2010 (31 December 2009: € 2.2 billion) excluding diversification effects to other risk types. Details of the calculation are set out in section «Result of Risk-bearing Capacity Analysis».

Regional Breakdown of the Portfolio As was the case last year, the exposure of Deutsche Pfandbriefbank Group is still concentrated in Western Europe even after the transfer of large parts of the portfolio to FMS Wertmanagement. Germany alone accounts for amost half (45.7 %) or € 40.2 billion of the total exposure. The most significant reduction in volume in absolute as well as relative terms (31 December 2010: € 1.3 billion; previous year: € 57.9 billion) relates to Ireland, and is almost entirely attributable to a decline in the exposure to the affiliate DEPFA Bank plc. The exposure in the USA relates almost entirely to financial institutions located in the USA.

The percentage of the category «Other Western Europe» has increased from 9.1% in the previous year to 15.0 %, and contains as largest items Austria € 6.9 billion (31 December 2009: € 7.7 billion), Switzerland with € 1.2 billion (31 December 2009: € 1.5 billion), Belgium with € 0.8 billion (31 December 2009: € 1.1 billion) and the Netherlands with € 0.6 billion (31 December 2009: € 2.0 billion) Compared with the previous year, the percentage of the exposure to «Emerging Markets» in accordance with the IMF definition has slightly increased and mainly comprises Poland with € 1.8 billion (31 December 2009: € 2.1 billion) and Hungary with € 0.8 billion (31 December 2009: € 1.1 billion). Operations have been withdrawn completely from emerging market countries, such as the United Arab Emirates and the Ukraine; apart from a minor percentage, the exposure to Russia has also been considerably reduced.

Total portfolio: EaD according to regions

in %



[1] Emerging markets in accordance with the IMF definition
[2] Including portfolio transferred to FMS Wertmanagement on 1 October 2010
[3] In addition, € 29.3 billion EaD to the counterparty FMS Wertmanagement including guaranteed positions of € 1.0 billion. The figure without guaranteed positions is fully attributable to Germany (€ 28.3 billion). The guaranteed positions relate 100 % to Italy (€ 1.0 billion)

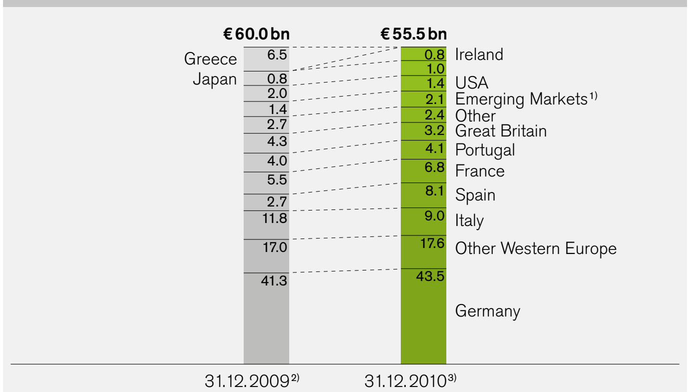
Public Sector Finance: € 55.5 billion EaD Portfolio Development and Structure The portfolio of the strategic operating segment Public Sector Finance (PSF) amounted to € 55.5 billion as of 31 December 2010, and is thus lower than the comparison figure of € 60.0 billion at the end of 2009.

The € 4.5 billion net decline in EaD is mainly attributable to the transfer of assets and liabilities to FMS Wertmanagement. However, currency effects and the internal process of changing over the method of calculating EaD of the former DEPFA Pfandbriefbank, Eschborn, which has since been merged with Deutsche Pfandbriefbank AG, Munich, from the standard approach to the Advanced IRB approach has had the effect of increasing EaD. The Advanced IRB approach in particular has the effect of increasing the EaD of derivatives and repo transactions.

Most of the exposure is to be found in Western Europe. With the exception of Greece, which is no longer included in the portfolio of the segment (unlike the situation last year) as well as Italy and Spain, the percentages of the countries in the segment portfolio have remained virtually stable. Major countries under «Other Western Europe» include Austria (€ 6.8 billion; December 2009: € 7.1 billion) and Switzerland (€ 0.9 billion; 31 December 2009: € 0.8 billion). The exposure in the USA relates almost entirely to financial institutions located in the USA.

Public Sector Finance: EaD according to regions

in %



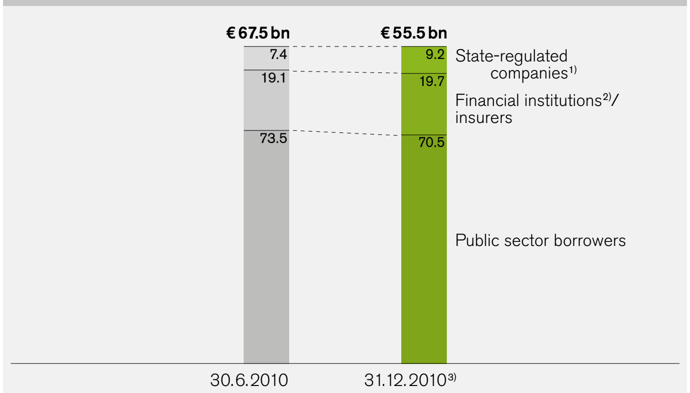
[1] Emerging markets in accordance with the IMF definition
[2] Including portfolio transferred to FMS Wertmanagement on 1 October 2010
[3] Also € 27.7 billion EaD to the counterparty FMS Wertmanagement, which is fully attributable to Germany; the Public Sector Finance segment does not include any positions guaranteed by FMS Wertmanagement

The counterparty structure in the Public Sector Finance portfolio of Deutsche Pfandbriefbank Group was revised throughout HRE Group in the first half of 2010, and therefore cannot be compared with the structure as detailed in the risk report of the annual report at the end of 2009.

The position «Public Sector Borrowers» includes receivables due from sovereigns (25 %), public sector enterprises (32 %) and municipalities (43 %).

Public Sector Finance: EaD according to counterparty structure

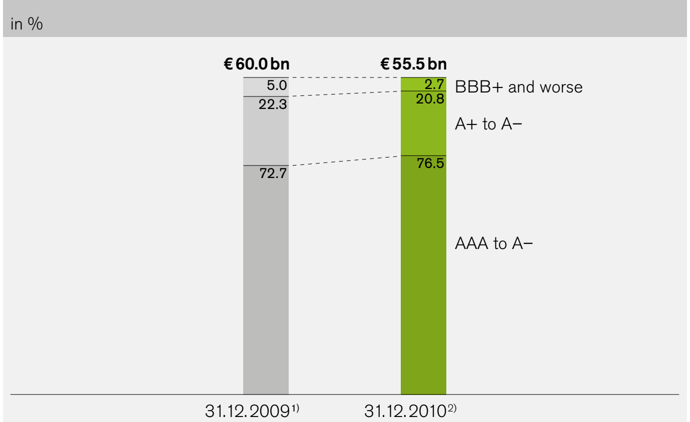
in %



[1] E.g. water utilities, power supply utilities, etc.
[2] Financial institutions with a state-background or state guarantee
[3] The December figures include an additional amount of € 0.4 billion (0.6 %) attributable to the counterparty category «Other».

The still high percentage of public sector borrowers in this segment, which are mostly still classified as «investment grade», is reflected in the rating. The content of positions with a rating of BBB and worse has declined from € 3.0 billion in December 2009 to € 1.5 billion, and reflects the transfer of assets and liabilities to FMS Wertmanagement. The exposure in the non-investment-grade field is € 0.1 billion or 0.2 % (December 2009: € 0.9 billion) and comprises transactions with other financial institutions as well as sovereigns and sub-sovereigns in Europe.

Public Sector Finance: EaD according to internal ratings



[1] Including portfolio transferred to FMS Wertmanagement on 1 October 2010
[2] Also € 27.7 billion EaD to the counterparty FMS Wertmanagement, which is fully attributable to the rating class AAA. The Public Sector Finance segment does not include any positions guaranteed by FMS Wertmanagement

Key Risk Aspects Exposure of Deutsche Pfandbriefbank Group to European Countries Greece, Italy, Portugal, Ireland and Spain The exposure in the Public Sector portfolio in these countries amounted to a total of € 12.2 billion as of 31 December 2010. The decline of € 2.7 billion in the exposure compared with 31 December 2009 is mainly due to the transfer of the Greece exposure to FMS Wertmanagement or to the winding down of this exposure (31 December 2009: € 3.9 billion). Most of the exposure is attributable to Italy (€ 5.0 billion or 40.9 %; 31 December 2009: € 7.1 billion) followed by Spain (€ 4.5 billion or 37.0 %) as well as Portugal (€ 2.3 billion or 18.4 %) and Ireland (€ 455 million or 3.7 %).

The direct exposure to the central authorities in the above countries amounted to a total of € 3.2 billion (31 December 2009: € 7.7 billion), whereby most of this figure is attributable to Italy (€ 2.9 billion; 89 %; 31 December 2009: € 4.9 billion). A further € 0.3 billion (11 %) is attributable to Portugal. There is an exposure of € 2.5 billion to financial institutions, with an emphasis on Spain (€ 1.7 billion, 67 %).

Real Estate Finance: € 26.5 billion EaD Portfolio Development and Structure The EaD of the Real Estate Finance portfolio of Deutsche Pfandbriefbank Group has declined by a total of € 31.8 billion compared with 31 December 2009 mainly as a result of the transfer of positions to FMS Wertmanagement. The customer derivatives included in the portfolio accounted for EaD of € 0.6 billion as of 31 December 2010, compared with a figure of € 1.6 billion EaD at the end of 2009. Whereas the percentage of Germany in relation to the portfolio has increased, the corresponding figures for the USA have been reduced completely, and the percentages of Italy and Spain as well as other Western European countries have been partially reduced. Operations have been withdrawn completely from emerging market countries such as the United Arab Emirates and the Ukraine; apart from a minor percentage, the exposure to Russia has also been considerably reduced.

The commitments amounted to € 25.6 billion as of 31 December 2010. Receivables amounted to € 25.2 billion at the same date. Accordingly, undrawn credit lines amounted to € 0.4 billion as of 31 December 2010.

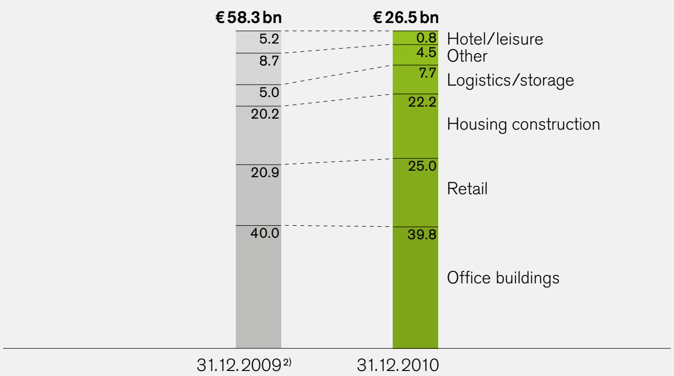
Real Estate Finance: EaD according to regions[1]

[1] Breakdown including customer derivatives for approx. € 0.6 billion (31 December 2009: € 1.6 billion)
[2] Emerging markets in accordance with the IMF definition
[3] Including portfolio transferred to FMS Wertmanagement on 1 October 2010
[4] In the Real Estate Finance segment, there is no exposure to the counterparty FMS Wertmanagement

The breakdown of the portfolio according to types of property at the end of 2010 has not fundamentally changed compared with 2009 despite a considerably lower overall portfolio. Particular mention has to be made of the almost complete reduction in the property type «Hotel/Leisure». The percentage of office buildings has remained surprisingly stable at 40 % (31 December 2009: 40 %). Financing of residential properties (mostly portfolio transactions) account for approximately 22 % of the portfolio (31 December 2009: 20 %). In addition, retail property financing accounts for a considerable amount of the Real Estate Finance segment (25 %; 31 December 2009: 21 %).

Real Estate Finance: EaD according to property types[1)]

in %

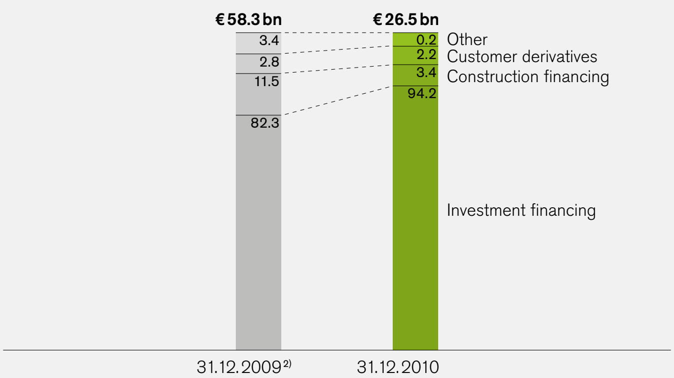


[1)] In the Real Estate Finance segment, there is no exposure to the counterparty FMS Wertmanagement
[2)] Including portfolio transferred to FMS Wertmanagement on 1 October 2010

At the end of 2010, the portfolio was dominated by investment financing to an even greater extent (94.2 %; December 2009: 82.3 %). Higher risk construction projects in the building phase (building finance) account for only 3.4 % of the EaD (December 2009: 11.5 %). 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 types[1)]

in %



[1)] In the Real Estate Finance segment, there is no exposure to the counterparty FMS Wertmanagement
[2)] Including portfolio transferred to FMS Wertmanagement on 1 October 2010

Key Risk Aspects The developments on the real estate markets in 2010 are discussed in detail in the section «Sector-specific Situation» of the management report. Comments concerning possible future developments are set out in the forecast report of the management report in the annual report of Deutsche Pfandbriefbank Group.

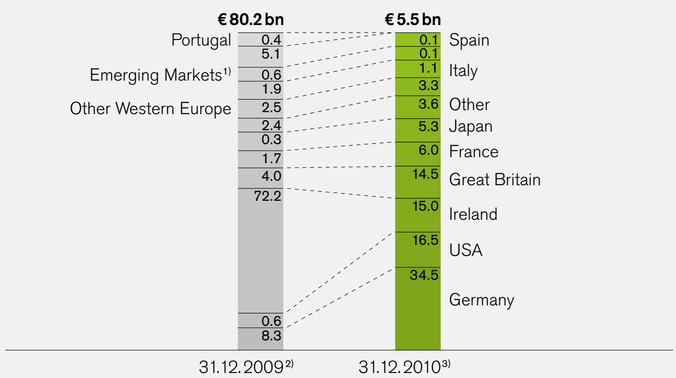
The Real Estate Finance exposure of Deutsche Pfandbriefbank Group in the European countries Italy, Portugal and Spain amounted to € 0.8 billion as of 31 December 2010. There is no exposure to Greece and Ireland as of 31 December 2010. There has been a decline of € 2.2 billion compared with December 2009. Most of the exposure (€ 0.4 billion) is attributable to Spanish loans.

Value Portfolio: € 5.5 billion EaD Portfolio Development and Structure The Value Portfolio comprises non-strategic portfolios of Deutsche Pfandbriefbank Group as well as a part of the transactions which exist with the counterparty FMS Wertmanagement. With regard to the non-strategic portfolios in the Value Portfolio in particular derivate business with financial institutions has to be mentioned. In the Value Portfolio, emphasis is placed on the reduction of existing assets in a manner which poses minimum strain on capital and which is designed to maintain value. As described initially in the risk report, further portfolios were transferred to FMS Wertmanagement at the beginning of the fourth quarter of 2010.

The considerable decline of the exposure as of 31 December 2010 compared with 31 December 2009 of € 74.7 billion is mainly attributable to the transfer of most of the assets and liabilities to FMS Wertmanagement. Germany, the USA, Great Britain and Ireland in particular form a regional emphasis in the remaining portfolio as of 31 December 2010.

Value Portfolio: EaD according to regions

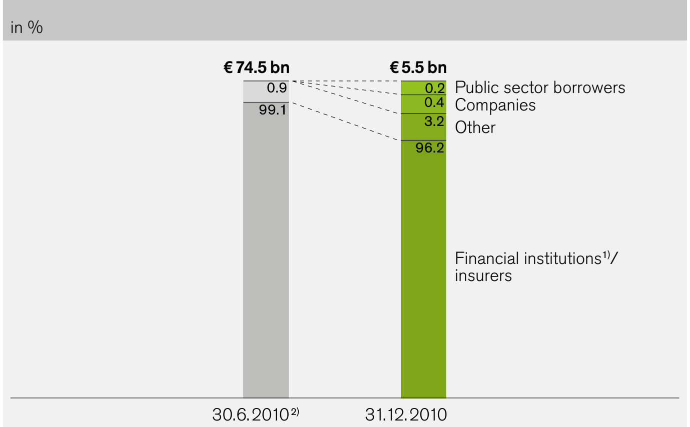
in %



[1)] Emerging markets in accordance with the IMF definition
[2)] Including portfolio transferred to FMS Wertmanagement on 1 October 2010
[3)] Also € 1.6 billion EaD to the counterparty FMS Wertmanagement, including guaranteed positions of € 1.0 billion. The content without guarantees is fully attributable to Germany. The guaranteed positions are fully attributable to Italy

The counterparty structure in the Value Portfolio of Deutsche Pfandbriefbank Group was revised in 2010 as part of the process of creating new segments, and the allocation to counterparties was standardised throughout HRE Group. Accordingly, it is not possible for a comparison to be made with the counterparty structure in December 2009. Instead, comparison figures of June 2010 have been used for this purpose.

Value Portfolio: EaD according to counterparty structure



[1] Including exposure to the affiliated institution DEPFA Bank plc of € 0.6 billion
[2] Including portfolio transferred to FMS Wertmanagement on 1 October 2010

Key Risk Aspects The exposure in the Value Portfolio to Ireland, Italy and Spain amounted to a total of € 0.9 billion as of 31 December 2010, whereby Ireland alone accounted for € 0.8 billion of this figure. There was no exposure to Portugal and Greece as of 31 December 2010. The significant decline of € 62.8 billion compared with December 2009 is mainly attributable to a reduction in the Irish exposure to the affiliate DEPFA Bank plc.

Structured Products

As of 31 December 2010, Deutsche Pfandbriefbank Group has fully state-guaranteed collateralised debt obligations with a nominal value of € 0.85 billion and a current internal fair value of € 0.74 billion.

The nominal holdings of non-state-guaranteed structured securities, which Deutsche Pfandbriefbank Group breaks down into property-related real-estate-linked investments such as commercial mortgage-backed securities (CMBS), residential mortgage-backed securities (RMBS) and credit-linked investments such as collateralised debt obligations (CDOs, in the narrower sense of the term) and collateralised loan obligations (CLOs) amounted to € 0.46 billion as of 31 December 2010 (31 December 2009: € 3.2 billion).

A recognised discounted cash flow model is used as the basis of measuring the value of the CMBS and RMBS securities. Unlike the process used for measuring more simple CDO structures, a separate valuation model is mainly used for complex structures or illiquid underlying collateral. In this internal valuation model, the US and EU CDOs are measured using expected losses with a bottom-up distribution. Essentially, the valuation of this portfolio reflects the development of the underlying collateral, consisting primarily of ABS, MBS or CDO tranches.

The current internally calculated fair value of these securities which securitise credit risks amounted to € 11 million as of 31 December 2010 (31 December 2009: € 1.46 billion).

Special-purpose Vehicles in Deutsche Pfandbriefbank Group

In the past, special-purpose vehicles have generally been used to isolate assets from operating companies in a manner which is (to a large extent) protected against insolvency and to enable these assets, which are frequently used as security, to be sold more easily if necessary.

In the financial year 2010, virtually all special-purpose vehicles were wound down or transferred to FMS Wertmanagement as part of the process of outsourcing assets and liabilities.

The remaining special purpose vehicle is an ABS structure which has been completely written down so that no further risks can result for Deutsche Pfandbriefbank Group from this special-purpose vehicle.

Watchlist and Non-performing Loans: € 1.5 billion[1)]

Early Warning System The early warning system of Deutsche Pfandbriefbank 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. LTV, 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 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, individual allowances have been recognised.

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

Breakdown of watchlist and non-performing loans				31.12.2010				31.12.2009	
Commitment in € million	PSF	REF	VP	**Total**	PSF	REF	VP	**Total**	Δ in € million
Workout loans	–	14	42	56	–	918	44	962	–906
Restructuring loans	38	1,103	–	1,141	462	8,023	3	8,488	–7,347
Non-performing loans	**38**	**1,117**	**42**	**1,197**	**462**	**8,941**	**47**	**9,450**	**–8,253**
Watchlist loans	–	315	–	315	16	3,449	8	3,473	–3,158
Total	**38**	**1,432**	**42**	**1,512**	**478**	**12,390**	**55**	**12,923**	**–11,411**

The reason for the € 11.4 billion decline in watchlist and non-performing loans to € 1.5 billion is mainly the transfer of assets to FMS Wertmanagement as of 1 October 2010. Since the transfer, the portfolio of watchlist and non-performing loans has been to a large extent stable. There have been no re-groupings/changes in the PSF portfolio and the Value Portfolio. In the REF portfolio, the watchlist exposure has declined by € 113 million since the transfer of positions to FMS Wertmanagement; the exposure to non-performing loans has increased slightly by € 21 million.

[1)] To allow a comparison to the previous year based on the available data the watchlist and problem loans are shown as commitment

Impairments and Provisions

Individual Allowances and Portfolio-based Allowances A regular impairment test is carried out for all loans of Deutsche Pfandbriefbank Group. The first step is to check whether there are any objective indications of an impairment, and the extent of the impairment is then calculated as the difference between the carrying amount and the present value of cash flows expected in future.

Portfolio-based allowances are calculated using risk parameters which are compliant with Basel II, such as probability of default (PD) and loss-given default (LGD). The resultant expected loss in relation to a time horizon of one year is scaled using an IFRS-compliant conversion factor to the period which on average is required for identifying the impairment event.

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 impairments are approved in the Risk Provisioning Committee in which the CROs of all subsidiary institutions hence as well in Deutsche Pfandbriefbank Group are represented.

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

The reported decline in individual allowances to € 461 million (31 December 2009: € 2.8 billion) is attributable to the transfer of assets to FMS Wertmanagement.

The portfolio-based allowances amounted to € 100 million as of 31 December 2010 (31 December 2009: € 550 million). This decline is mainly due to the fact that a considerable portion of the portfolio relevant for global allowances has been transferred to FMS Wertmanagement.

Cover Provided for Non-performing Loans

As of 31 December 2010, there was 33.7 % cover for the non-performing loans of Deutsche Pfandbriefbank Group in Real Estate Finance (REF; 31 December 2009: 34.8 %).

The provisions for contingent liabilities and other obligations mainly comprise provisions for guarantee risks, letters of credit and irrevocable loan commitments in lending business. They amounted to € 34 million as of 31 December 2010 (€ 11 million as of 31 December 2009).

Market Risk

Definition

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

Market Risk Strategy

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

Organisation of Market Risk Management

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

Market Risk Reports

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

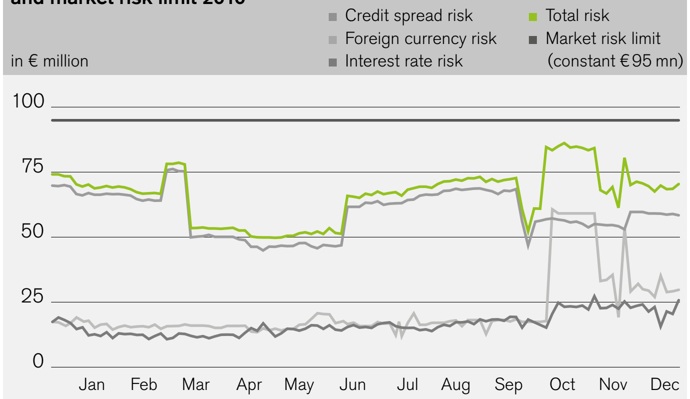
Measurement and Limiting of Market Risk

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 included, whereby the credit spread VaR from positions which are included in the IFRS category Loans & Receivables is not taken into consideration.
> The correlations and volatilities which are used are based on historical time series of the previous 250 trading days, which are included in the calculation on an equally weighted basis.
> For the daily operational risk management, the VaR relates to a holding period of ten days and a one-sided 99% confidence interval.
> When the individual market risk components, such as the interest, FX and credit spread VaR, are aggregated to form a total VaR, which constitutes the basis for the limits, it is assumed that the market risk categories are not correlated. This assumption is regularly and explicitly checked and validated for significant portfolios of HRE Group.

The market risk VaR amounted to €70.2 million as of 31 December 2010 (comparative value as of 31 December 2009: €74.2 million). The complete first half of 2010 the market risk limit constantly at €95 million. In the reported period no limit breaches have occurred.

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%) individual risk types and market risk limit 2010



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

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

The credit spread risk reflects the potential change in the present value of positions as a result of changes in the corresponding credit spreads. Risk measuring systems for determining credit spread risks exist for all relevant positions of Deutsche Pfandbriefbank Group. Most of the credit spread risk is attributable to assets eligible as cover for Pfandbriefe.

Stress Testing Whereas the VaR measurement simulates the market risk under «normal» market conditions, and is not to be understood as a standard for a potential maximal loss, stress scenarios show the market risk under extreme conditions. At Deutsche Pfandbriefbank Group, uniform hypothetical stress scenarios are calculated on a monthly basis for all key risk drivers (credit spreads, interest rates, foreign currency rates). Historical stress scenarios are also simulated. For example, a parallel shift of 200 BP in the interest rate curve of all positions of Deutsche Pfandbriefbank Group would result in a change of approx. € 52.8 million in the market value. The corresponding figure for the end of 2009 was € 158.6 million. The Management Board and the corresponding committees are regularly informed of the results of the scenario analyses.

Economic Market Risk Capital

For calculating the economic market risk capital, which is taken into consideration for the risk-bearing capacity analysis, the market risk VaR is scaled to a period of one year and also to a higher confidence level (from 99 % to 99.95 %). Deutsche Pfandbriefbank Group's economic capital for market risk, disregarding diversification effects for other risk types, amounted to € 488 million as of 31 December 2010 (December 2009: € 178 million).

Market Risk Management, Monitoring and Reduction

Deutsche Pfandbriefbank 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, the market risk is monitored by a combination of Value-at-Risk (VaR) limits and sensitivities monitored by Risk Management & Control.

Development of the Relevant Market Risk Types

General Interest Rate Risk The total general interest rate risk of Deutsche Pfandbriefbank Group, amounted to € 26.3 million as of 31 December 2010 (compared with € 18.4 million as of 31 December 2009). On average, the interest rate risk of € 16.5 million for 2010 (max. € 27.8 million; min. € 10.5 million) remained at a low level (average VaR for 2009 € 15.1 million; max. € 29.3 million; min. € 3.5 million).

Credit Spread Risk The major part of credit spread risk is attributable to assets eligible as cover for Pfandbriefe. Subject to VaR limitation are only the credit spread risks of AFS and FVtPL stocks but not the LaR positions. The VaR limit is applicable only to the credit spread risks of AfS and FVtPL holdings, and is not applicable for the LaR positions.

Therefore credit spread VaR of AFS and FVtPL stocks accounts for € 58.4 million as of the end of December 2010 (year end 2009: € 70.2 million).

Foreign Currency Risk and Other Market Risks The foreign currency risk which is calculated as a present value amounted to € 28.9 million as of 31 December 2010; the corresponding figure at the end of 2009 was € 15.2 million. The general strategy aims to hedge foreign currency risks as far as possible.

The Group is not exposed to equity price, commodity and inflation risks, or any such risks are essentially hedged.

Financial derivatives are used mainly for hedging purposes.

Liquidity Risk

Definition

Liquidity risk is defined as the risk of not being able to meet the extent and deadlines of existing or future payment obligations in full or on time.

Liquidity Risk Strategy

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

Organisation of Liquidity Risk Management

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

Liquidity Risk Report

The liquidity management reports are prepared daily on a Group-wide basis and reported to the entire Management Board as well as to the Bundesbank, Bafin and SoFFin. The reports contain the daily liquidity situation as well as projections on the basis of contractual cash flows and assumptions made in relation to future events which will influence the probable liquidity development.

Measuring and Limiting Liquidity Risk

A system for measuring and limiting short-term and medium-term variances within the cash flows has been installed in order to manage the liquidity risks. Contractual cashflows as well as optional cashflows are recognised. These data are regularly subjected to backtesting.

The liquidity position resulting from the contractual and optional cashflows is measured in different scenarios. Various 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

The limit system was extended after balance sheet items had been spun off to FMS Wertmanagement. For the liquidity risk, a limit has been defined for a period of 12 months for the various liquidity scenarios.

The limit system consists of:

- Limit relating to the liquidity stress profile for HRE Group (risk scenario and (historic) stress scenario) and trigger for the base scenario
- Limit system for Deutsche Pfandbriefbank Group

In addition to reporting, HRE uses regular stress tests for investigating the effect of additional stress events on the liquidity position.

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

The scenarios are reported to the Management Board of HRE and to Deutsche Pfandbriefbank Group as well as to external bodies, e.g. the Bundesbank and SoFFin are analysed.

Additional measures and requirements will be implemented in the first quarter of 2011 as part of the process of improving the measurement of liquidity risk and in line with the new minimum requirements for risk management (MaRisk).

Liquidity Risk Monitoring and Management

Monitoring of the liquidity risks is assured by the daily reporting of the liquidity situation of HRE and a defined escalation process. A liquidity emergency plan 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 in turn are based on a «liquidity risk tolerance» defined by the Management Board. This ensures that the individual companies of HRE and hence Deutsche Pfandbriefbank Group have adequate liquidity reserves transactions.

Hedging and Reduction of Liquidity Risk

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

The limits applicable for risk tolerance in line with the stress scenarios are regularly determined and adjusted.

Development of the Risk Position of Deutsche Pfandbriefbank Group

After balance sheet items were transferred to FMS Wertmanagement on 1 October 2010, the liquidity position of Deutsche Pfandbriefbank Group developed in line with planning. The liquidity risk measurement as of 31 December 2010, determined in line with the cumulative liquidity position in the base scenario, amounted to € 8.7 billion for a twelve-month horizon.

The liquidity requirement of Deutsche Pfandbriefbank Group continues to be dependent on market fluctuations. Interest rate, currency and credit spread fluctuations have to be mentioned particularly in this respect. However, this exposure has been reduced considerably as a result of the transfer of assets to FMS Wertmanagement.

The liquidity ratio in accordance with the Liquidity Ordinance amounted to 1.18 at Deutsche Pfandbriefbank AG as of 31 December 2010; it is thus higher than the statutory minimum of 1.0.

For refinancing, covered and uncovered issues are available as the main financing instruments to Deutsche Pfandbriefbank Group. Because of their high quality and acceptance on international capital markets, Pfandbriefe are comparatively less affected by market fluctuations than many other sources of refinancing.

The refinancing markets continued to stabilise in the initial months of 2010. At the beginning of the year, the market was characterised by a large number of successful benchmark transactions in a wide range of areas. Covered bonds and Pfandbriefe in particular have been successfully placed. Large numbers of relatively small private placings have also taken place.

Issuing activity declined appreciably following the arrival of the debt crisis in the European Union in May 2010 and the high volatilities in government bonds. This resulted in a considerable decline in levels of activity on the private placing markets, although it was still possible for some benchmark transactions to be placed. Lending on the interbank market was also very much reduced in individual phases.

The stabilisation measures of the ECB due to the purchasing of government bonds have stabilised the markets to a certain extent, although volatilities are still very high. At the same time, long-term rates have fallen to all-time lows and are remaining at this low level.

In 2010, Deutsche Pfandbriefbank Group succeeded in placing approx. € 1.3 billion public Pfandbriefe, € 0.5 billion mortgage Pfandbriefe and approx. € 2.8 billion senior unsecured transactions on the long-term market. The volumes comprise only one benchmark transaction (€ 1 billion public Pfandbrief); the remainder was absorbed by the market by way of private placings.

Forecast Liquidity Requirement

From the point of view of Deutsche Pfandbriefbank Group the current liquidity situation can be classified as comfortable.

However, in addition to the forecast liquidity requirement for new business activities, the actual extent of the future liquidity requirement depends on numerous external factors:
> 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 surplus cover in the cover funds

Following the transfer of assets to FMS Wertmanagement, the risk for the liquidity of Deutsche Pfandbriefbank Group which might be caused by turmoil on the financial markets has declined appreciably.

Operational Risk

Definition

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

Operational risks are associated with most of the business activities of Deutsche Pfandbriefbank Group, and cover a wide range of different risks.

Strategy for Operational Risks

The overriding aims of Deutsche Pfandbriefbank Group are the early recognition, recording, assessment as well as monitoring, prevention and limiting of operational risks as well as an early and meaningful report to management. Deutsche Pfandbriefbank Group does not attempt to completely preclude the possibility of risk; instead, it aims to minimise potential losses by way of specific early recognition measures. The provision of sufficient information is the basis for decisions regarding the limitation of risk.

Organisation of Operational Risk Management

In the field of Risk Management & Control, the Group Operational Risk & MaRisk department is responsible for uniform Group-wide processes, instruments and methods for recording, assessing, monitoring and reporting operational risks in HRE. This also comprises the Deutsche Pfandbriefbank Group.

Risk Reports, Monitoring and Management of Operational Risks

Operational risks are monitored by means of a network of controls, procedures, reports and responsibilities. Within Deutsche Pfandbriefbank Group, each individual unit takes on responsibility for its own operational risks, and provides appropriate resources and processes for limiting such risks. The focus is primarily on the early recognition, reduction and management of risks as well as the measurement and monitoring of risks.

Deutsche Pfandbriefbank Group uses the following Group-wide processes and method for management, measurement, monitoring and reporting of operational risks:

> Quarterly report for key risk indicators (KRI) which is suitable for identifying problems at an early stage
> Performance of annual risk self-assessments for assessing possible effects of potential risk sources and existing controls for reducing risks. In the case of risks which are classified as significant, the risk reduction plans are monitored by Group Operational Risk
> Collecting loss data, reporting and analysis of operational risks for identifying process, control and system weaknesses in order to enable countermeasures for reducing risk to be taken at an early stage
> Focused analysis of predefined main risk areas in conjunction with the affected specialist units as well as drawing up suitable recommendations for reducing risks
> Coordination of the new product process of the Group by Group Operational Risk for measuring and monitoring risks which may be associated with new products or business activities

The collected information is used in order to determine the operational risk profile of Deutsche Pfandbriefbank Group and the necessary measures to reduce risks.

Regular reports are prepared for the Chief Risk Officer (CRO) and the Risk Committee. The monthly Group Risk Report contains operational claims and losses as well as major risk-relevant issues with an effect on Deutsche Pfandbriefbank Group. In addition, a quarterly risk report regarding major risk indicators notifies the Management Board of potential risk sources. The results of the annual risk self-assessments in the specialist units are also reported to the Risk Committee after the assessment process has been completed. When a detailed risk analysis has been completed, the relevant member of the Management Board receives a final report.

Risk Measurement

The economic capital for operational risk amounted to € 135 million as of 31 December 2010 (31 December 2009: € 290 million). As a result of the adjustment to the method for calculating the economic capital described in the section «Result of Risk-bearing Capacity Analysis», the figures for the two dates are only comparable to a limited extent.

In line with the standard approach in accordance with Basel II, the regulatory capital backing for operational risks, which is calculated at the end of each year, is € 80 million as of 31 December 2010 (31 December 2009: € 30 million).

Major Operational Risks of Deutsche Pfandbriefbank Group

Major operational risks result from the continuing restructuring of HRE and therefore as well of Deutsche Pfandbriefbank Group. This also comprises the process of rendering services for FMS Wertmanagement since 1 October 2010. Operational risks are attributable in particular to the high number of manually recorded transactions as well as the high number of different processing and monitoring systems. The systems are currently being consolidated. Until the current consolidation process has been completed, there will be an increased level of susceptibility to faults with regard to the manual processes and controls which are carried out for ensuring data consistency.

There is also a significant reliance on know-how of key personnel for implementing restructuring processes on the one hand (predominantly completed by year-end 2010) and for operating daily business on the other. This is particularly important in view of the existing system landscape as well as manual processes and controls. The loss of know-how represents an increased level of risk in the current situation of Deutsche Pfandbriefbank Group. Fluctuation in the workforce of Deutsche Pfandbriefbank Group remained at a high level in 2010.

Deutsche Pfandbriefbank Group suffered losses of € 1.5 million in total from operational risks in the course of the financial year 2010. The losses are mainly attributable to errors in connection with manual processes and controls. Process and control improvements have been implemented in order to minimise or exclude the underlying causes of the losses which have occurred.

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

Result of Risk-bearing Capacity Analysis

Economic capital according to risk types Excluding diversification effects in € million	31.12.2010	31.12.2009	Δ in € million
Credit risk	1,329	2,170	–841
Market risk	488	178	310
Operational risk	135	290	–155
Business risk	62	261	–199
Risk of the Bank's own real estate holdings	–	80	–80
Risk of investment holdings	–	2	–2
Total before diversification effect	**2,014**	**2,981**	–967
Total after diversification effect	**1,811**	**2,631**	–820
Available financial resources	5,156	5,585	–429
Capital buffer	3,345	2,954	391

Excluding the diversification effects between the individual risk types, the economic capital of Deutsche Pfandbriefbank Group is approx. € 2.0 billion (December 2009: € 3.0 billion). If these effects are taken into consideration, the economic capital falls to around € 1.8 billion (December 2009: € 2.6 billion).

The transfer of assets to FMS Wertmanagement has resulted in an improvement in the AfS reserve which previously was negative. In addition, beginning with the fourth quarter the bank is expecting to see a positive forecast result for the next 12 months again. However, these two factors were more than compensated for by a reduction of subordinated debt following the de-consolidation of DEPFA Finance N.V., resulting in a € 0.4 billion decline in the available financial resources.

According to the ICAAP model which is a regulatory requirement and which determines the economic risk-bearing capacity of the company, there is a significant economic capital buffer of around € 3.3 billion for a one-year observation period as of 31 December 2010.

Method Used for the Individual Risk Types

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

The method of calculating the economic capital for the individual risk types is explained in the following. As a result of the risk inventory property and participation risk are considered to be immaterial after the transfer of positions to FMS Wertmanagement, and therefore are no longer included in the calculation of economic capital.

Credit Risk For calculating credit risk at the portfolio level, Deutsche Pfandbriefbank Group uses a credit portfolio model which follows the approach of a so-called asset value model. The main underlying idea of this approach is that by repeated simulations of correlated rating migrations and borrower defaults as well as a calculation of resulting value changes arising from a corresponding revaluation of the portfolio, 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 a value at risk figure. This defines the maximum unexpected loss calculated for a confidence level of 99.95 % 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-adjusted allocation of the credit risk capital measured in this way to the individual borrower units using the so-called expected shortfall principle. This ensures proper allocation to the borrowers, and thus constitutes a major module in the risk-oriented management of the credit portfolio.

As a result of the ICAAP methodology alignment to the changed business model, the market fluctuations of credit spreads in the IFRS category Available for Sale (AfS) will in the future be shown under market risk. In order to avoid double counting, only credit spread changes caused by rating migrations as well as credit defaults are now contained in the credit portfolio model. At the end of 2009, the credit risk additionally reflected the maximum historical spread increases within one year for the AfS positions. This adjustment has resulted in a shift of economic capital away from credit risk and towards market risk. The main reasons for this adjustment are as follows:

> Uniform treatment of all IFRS categories which influence the available financial resources (held-for-trading, fair-value-through-P&L, available-for-sale)
> Harmonisation of market risk definition in the ICAAP with internal management
> Pro-cyclical behaviour of market volatilities instead of the previously more static historical scenarios
> Adjustment of the distinction between market and credit risk to the usual standard for the sector

In addition, transfer and conversion risk of currencies were classified as material as a result of the risk inventory and were included in the modelling of economic capital for credit risk in the fourth quarter of 2010.

For a confidence level of 99.95 % and a time horizon of one year the economic capital for credit risk calculated using the credit portfolio model, disregarding diversification effects to other risk types, is € 1.3 billion (December 2009: € 2.2 billion). The decline of € 0.8 billion is mainly attributable to two components. Firstly, the capital for credit risk has declined as a result of the change of method described above, offset by an increase of roughly the same amount in the economic capital for market risk. Secondly, the inclusion of non-strategic and in certain cases high-risk assets and derivatives in FMS Wertmanagement has resulted in a considerable reduction of the credit risk. This reduction is mainly due to the complete transfer of the exposure to Greece, which had previously dominated the economic capital for credit risk.

Market Risk The calculation of economic capital for market risk comprises the VaR used for market risk management extended by the VaR figures for the capital investment books. The market risk VaR is scaled accordingly in order to take account of the higher confidence level and the one-year period of the capital adequacy assessment process.

The economic capital for market risk over a one-year horizon was € 488 million as of 31 December 2010, excluding diversification effects to other risk types (December 2009: € 178 million). The significant increase in market risk capital is essentially attributable to the following three components:

> Shifting of credit spread risk of AfS positions from economic credit to market risk capital, which was introduced with the change in ICAAP methods in March 2010
> Increase in the market risk following the increase in volatility of the credit spreads of some European countries which are currently the focus of attention
> The increase in the market risk was partially offset by the transfer of assets to FMS Wertmanagement, slightly reducing the market risk

Operational Risk The calculation of economic capital for operational risk includes the result of the calculation using the standard approach in accordance with Basel II. For the purpose of the capital adequacy assessment process, the capital requirement specified by the regulator is scaled to reflect the higher confidence level (from 99.9 % to 99.95 %).

The economic capital for operational risk amounted to € 135 million as of 31 December 2010 (31 December 2009: € 290 million). As a result of the ICAAP methodology alignment, the figures for the two dates are only comparable to a limited extent. Up to the end of 2009, a fixed percentage in relation to target equity was used; the current approach involves harmonising with the standard approach for calculating the regulatory capital requirement.

Business Risk The calculation of risk capital for business risk was revised to a large extent as part of the process of introducing the new ICAAP model. The economic capital is now calculated on the basis of the following two components:

1. No income for new business
2. Higher funding costs

1. No Income for New Business The available financial resources comprise forecast figures for net interest income and net commission income for the following four quarters. The calculation of economic business risk capital is based on the assumption that no new business will be generated for Deutsche Pfandbriefbank Group in the following year. As a consequence, risk capital is calculated as the portion of the forecast figures for net interest income and net commission income which is attributable to new business. This assumes the maximum unexpected deviation from the expected value.

2. Higher funding costs Higher funding costs may result from the following two reasons:

> Higher funding requirement
> Increase in the unsecured funding rate

As part of the liquidity risk measurement, the increased funding requirement which would occur in conjunction with certain market events is simulated every month using stress scenario «Further decline». For the unsecured funding rate an increase to the historic maximum of credit spreads of the Bank's own rating observed on the market is simulated. It is assumed conservatively that both events will occur simultaneously.

As a result of the change in methodology, the figures for business risk capital as of 31 December 2010 and as of the end of 2009 are only comparable to a limited extent. The figure had previously been calculated on the basis of operating costs.

Liquidity Risk Capitalising for liquidity risk in the narrower sense is neither possible nor is such a procedure standard practise in the sector. Liquidity risk in the broader sense of an increase in funding costs is recognised in the economic capital for the business risk.

Stress Tests

Stress tests in relation to the economic capital are used in order to obtain a better understanding of the sensitivity of the results to changes in the risk parameters underlying the model. Deutsche Pfandbriefbank Group carries out stress tests as an instrument for appropriate economic capital management for five individual categories, each in relation to an isolated risk type:

- Downgrading of the main counterparties, measured in terms of economic capital
- Stress tests of the creditworthiness of all counterparties
- Stress tests with regard to collateral
- Operational risk
- Business risk

In addition, there are two integrated stress test scenarios, i.e. scenarios applicable for all risk types. Both scenarios are based on theoretical and historical events. However, the integrated stress tests are only calculated on Group level.

Macro-economic Development

For the year 2011, there are worldwide expectations that the economic recovery following the crisis year of 2009 will essentially continue, although the rates of growth compared with 2010 are expected to be somewhat lower. However, a key aspect of the forecasts is that the differences between the various countries – and particularly within the euro zone – are very pronounced. Indeed, economic activity is expected to contract further in Ireland, Portugal and (at –3.9 % to a particularly significant degree) Greece. These disparate developments are attributable to various factors, including the unavoidable budget consolidation in these countries and the resultant lack of scope for fiscal action.

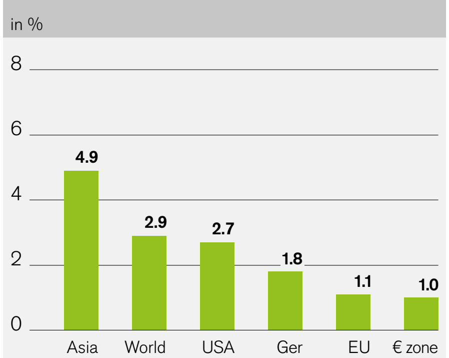
Accordingly, the further development on the markets for government bonds is a considerable factor of uncertainty, particularly at the level of individual countries. Although the auctions of new government debt have so far been successful even in the countries which are the focus of attention thanks to the rescue package mentioned in the management report, the risks of higher interest rates which could further exacerbate the fiscal problems are particularly significant for the state budgets.

These risks are exacerbated by the fact that the expansionary monetary and fiscal policy of the recent past involves potential for higher inflation. The central banks – and particularly also the European Central Bank (ECB) – are sooner or later likely to respond with rate hikes. It is thus expected in many quarters that 2011 will mark the turnaround to a period of further increasing rates. Experience has, however, shown that the rate hikes are likely to be relatively moderate, particularly as there can scarcely be any talk of over-utilised capacities at the macro-economic level and associated pressure on prices as the economy is just starting to recover. There is also a certain threat of inflation on the commodity markets, particularly emanating from some raw material markets. The differences in international growth mentioned at the beginning of the forecast report might make it difficult for the ECB to formulate the uniform monetary policy which is necessary for the euro zone.

Particularly in Germany, somewhat more aggressive wage settlements can be expected again in view of the much improved labour market situation. However, the restrictions on the free movement of labour and – an aspect which is almost even more important – the free movement of services which will be abolished at the end of April 2011 between Germany and eight economies of Eastern Europe – including Poland, the Czech Republic and Hungary – are likely to have an opposite effect at least in some segments, albeit to a limited extent in terms of quantity. However, with regard to the assessment of inflation risks, it also has to be borne in mind that, despite the recovery in 2010, economic activity has not yet returned to the levels seen before the crisis in Germany – as is also the case in many other countries – and that the risks of inflation for the immediate future are somewhat limited.

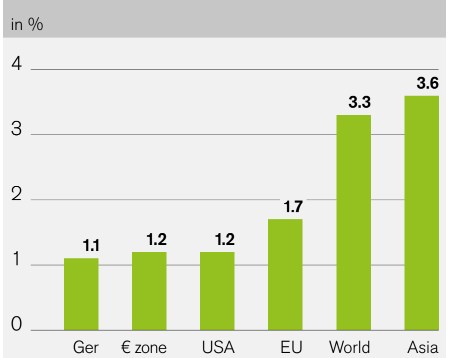
Fiscal policy is not expected to provide any further impetus in most countries in 2011. Whereas the problematical fiscal situation described above will ensure that state demand will probably have a negative impact in some countries, the economic support measures even in countries which have a stronger base in terms of fiscal policy are also expiring.

Real GDP growth, forecast 2011



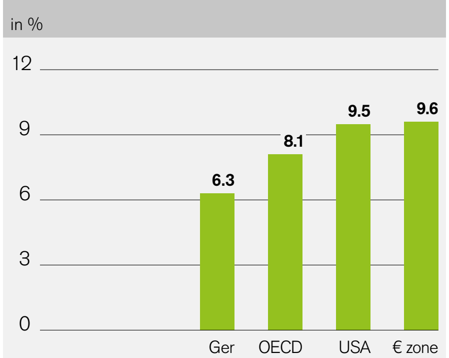
Source: EIU, obtained from Datastream

Consumer price inflation, forecast 2011



Source: EIU, obtained from Datastream

Unemployment rates, forecast 2011



Source: OECD, Economic Outlook No. 88, 11/2010

One of the main dangers for the economic development is being posed by the further development of the so-called «euro crisis». The main problem in this respect is not misguided monetary policy, as is otherwise the case in currency crises; on the contrary, the main problem is being posed by fiscal difficulties in some member states of the euro zone. Nevertheless, the experience gained in the first half of 2010 that merely the risk of state insolvency – N.B. despite the rescue package – can easily lead to massive devaluation due to investors shifting their investments into other currencies. Very much will depend on how effectively, credibly and sustainably the necessary progress can be made with consolidating state budgets.

It is assumed that there will be a recovery, although mostly very slight, on the labour markets of most of the important economies. In Germany, as a result of demographic developments and also as a result of a strong increase in «untypical employment arrangements», the unemployment rate will probably continue to fall to 6.3% in the further course of the year, whereas the unemployment rate in the USA will decline only slightly to 9.5%. Accordingly, it cannot be assumed that there will be an upswing in the USA in 2011 with an impact on the labour market and a correspondingly positive impact on private consumer demand.

Sector-specific Conditions

Overall Situation of the Banking Sector

The banking sector continues to face major challenges in the year 2011. However, the extent of these challenges very much depends on further economic developments and also the extent to which the money, capital and currency markets settle down or return to normal. Many of the problems seen last year will still not be solved for all banks in 2011. Examples of these problems are a high volume of loans which have to be refinanced, but whose parameters have not yet returned to the level before the point at which the original loan was extended. The real estate markets which have not yet recovered as well as other high-risk assets in particular might result in further problems in this segment. Banks will respond with more intense restructuring efforts in this respect. If there is no improvement in the ratings of countries which are at the focus of attention, it will be necessary for additional collateral to be provided for such bonds in the bank portfolios. Government aid provided during the financial crisis will have to be repaid. The reprivatisation efforts of institutions which have been partially or entirely nationalised will also be stepped up in 2011, particularly in Europe. The new Basel III regulations will ensure that the entire sector will have to deal with strategies for obtaining additional capital.

Public Sector Finance

In general, a restructuring process is taking place on the public finance market. This market correction will take place in the course of the next two to three years. In 2010, the increasing interest of banks in low-risk lending will result in an increase in supply in the field of public finance. The withdrawal of some providers will be partially offset by the entry of local banks into the market. In the strategic core markets of Deutsche Pfandbriefbank AG, such as Germany, France, Italy and Spain, local and regional credit institutions have taken on the main role in the public sector finance market. Possible prospects for these core markets are based on a planned increase in gross new public sector borrowing in the course of the next few years; this is considered to be a positive aspect despite parallel consolidation efforts. In Germany, margins have stabilised at a still low level. Overall, however, there is now more movement among margins. This trend is likely to continue in view of the unsolved problems in connection with the financial situation of German cities and local authorities, and is likely to lead to greater differentiation. In France, margins are being depressed due to the stronger levels of activity of the French savings banks in public sector finance. On the other hand, there are clear signs of higher margins at other competitors (in particular Dexia and Société Générale), so that overall margins are expected to recover slightly. In Spain, demand will be limited by the prohibition imposed on Spanish local authorities for raising new debt in 2010; this is likely to have a positive impact on the positioning of other players in other market segments. As long as the scenario of a central government default is disregarded, margins continue to be very attractive in direct business with the better Spanish regions and other public sector enterprises measured in terms of their fundamental data. Because the necessary follow-up financing in Spain still has to peak, it is expected that margins will continue to be high overall when compared with the situation in the past. In Italy, the abolition of legal maximum interest for local authorities and regions will also enable much higher margins to be attained. Overall, the year 2011 will show how far the countries which are at the focus of attention will press on ahead with their consolidation efforts and also the extent to which the capital markets will recognise such progress in the form of higher prices for government bonds of these countries. The more progress is achieved in this respect, the greater will be the benefit for banks with large public finance portfolios.

Real Estate Finance

The positive economic environment on the strategic core markets of Deutsche Pfandbriefbank AG is expected to continue in 2011. Investor demand for property let on a long-term basis will continue to be strong in 2011 and will be a key factor which dominates the overall volume of investment. The limited supply of low-risk products will continue to be a limiting factor. However, it is expected that, as the economy continues to recover and as fears of inflation increase, there will be stronger investor interest in properties which are not let on a long-term basis and which are not situated in premium locations as well as properties in sub-prime locations and secondary cities. However, a continuation of the stable market development without any turmoil on the capital markets is an essential requirement for this favourable development. From the point of view of investors, the main real estate markets in 2011 will again be Great Britain, Germany and France. In addition, there will also be attractive opportunities in Scandinavia and in the core countries of Eastern Europe. Investors as well as the financing banks will focus on the security and consistency of cash flows.

With regard to the vacancy rates of commercial properties, it is not very likely that the situation will recover rapidly. The excess supply of available premises, particularly in the office market, will not be able to decline significantly (despite reduced completion volumes); instead, supply should remain stable at least at the current level. Whereas the opportunities in conjunction with modern sustainable and well-appointed properties are likely to improve, it will continue to be difficult to let existing buildings for which there is less demand. In view of the expected positive development on the rental markets, investors will probably also be interested in properties with shorter terms. This positive development means that the rental markets might also continue to improve.

Overall, we continue to expect that the prospects for commercial markets in Germany will be positive. For Great Britain, further strong interest in premium properties is expected, which would tend to slow down a further broad upswing in 2011. In France, we expect to see a positive development of real estate markets, particularly also in the Greater Paris region. For Spain, we also do not expect to see any clear indications of a sustainable recovery in 2011, but we expect to see transactions being closed on an opportunistic basis.

Financing will continue to be conservative in 2011. The Pfandbrief will continue to be the main instrument in this respect. Credit institutions will not be able to provide any further capital to borrowers with properties or tenants of medium quality without the borrowers providing additional equity or collateral. Due to the announcement that major competitors will gradually withdraw from the market, it is likely that the situation for large and complex financing arrangements will not improve in the medium term.

Refinancing Markets

As was the case in 2009, the year 2010 reflected the influence of the financial crisis. Whereas in global terms, the central banks of the G7 states with the exception of Canada have maintained base rates unchanged at all-time lows, various stimulation programmes (e.g. QE2 in the USA) have had a positive impact on macro-economic developments. Particularly in the second and third quarters, the refinancing problems experienced by Greece and Ireland not only resulted in significantly wider spreads compared with German government bonds; they also ensured that the euro ten-year swap rate reported a record low at 2.4% per annum. However, the fourth quarter of 2010 saw considerable rate hikes, particularly at the long end of the rate structure curve; this was primarily due to initial fears of inflation, so that the euro ten-year swap rate rose again to 3.28% per annum by the end of the year.

Three issues will probably affect the development of interest rates in 2011:

> Will it be possible for confidence in the euro to be restored and for refinancing of all euro states to be assured?
> Will the increase in prices for commodities and agricultural products be so continuous that, together with stable economic growth, it will result in higher expectations of inflation particularly in the BRIC countries and motivate at least some central banks to implement initial rate hikes?
> Will the fiscal policy support which has so far been provided in the USA be sufficient to generate so much growth that the labour market will also stabilise?

In this context, it is conceivable that rates in various maturity buckets will rise further.

In January 2011, the refinancing markets were characterised by very strong activity on the covered bond market and agency market. Despite high volumes, the issues were placed, although increased margins had to be accepted. The refinancing markets in 2011 will continue to reflect the problem of coping with the «state crises». The benchmark Pfandbrief market which is important for us will probably be characterised by much higher maturities than is the case with new issues; this might improve the situation with regard to the premiums to be paid. Selective individual markets will probably continue to achieve a stable performance – particularly if the state support programmes start to have an effect. It is very difficult to estimate how the risk premiums in the market for bank issues will develop in view of the current volatilities. Overall, it is possible that there might still be longer-term problem phases for some sub-markets or for the overall market.

The Pfandbrief will therefore continue to be the main refinancing instrument of banks in future. Covered financing will continue to be very important.

Company-specific Conditions

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

Risks Threatening the Existence

Although major progress has been achieved with regard to stabilising and restructuring Deutsche Pfandbriefbank Group since autumn 2008, and although the Group closed the third and fourth quarters of 2010 with positive pre-tax profit, the companies of Deutsche Pfandbriefbank Group continued to be exposed to risks threatening their very existence throughout the whole of 2010.

The continuing existence of Deutsche Pfandbriefbank AG and its subsidiaries is dependent upon the European Commission approving the support measures which have been implemented by the German Finanzmarktstabilisierungsfonds. In addition, the ability of Deutsche Pfandbriefbank AG and its subsidiaries to continue as going concerns is dependent upon the European Commission not imposing any conditions which would not permit Deutsche Pfandbriefbank Group to implement an economically sustainable business plan and, in particular, does not undo the regulatory effectiveness of the capital support measures.

The Management Board of Deutsche Pfandbriefbank Group has engaged the services of an auditing company to carry out an independent appraisal of the going concern assumption. In its report this auditing company concludes that it considers that it is more than likely that Deutsche Pfandbriefbank AG and its subsidiaries will be able to continue as going concerns in the relevant period until 30 September 2012. The report which the Management Board and Supervisory Board have requested a reputable investment bank to prepare has also confirmed the viability of the business model which has been adopted.

On 28 March 2009, SoFFin confirmed to HRE Holding and Deutsche Pfandbriefbank AG (formerly Hypo Real Estate Bank AG) that it intends to stabilise HRE Holding by way of adequate recapitalisation, and that it also intends to stabilise Deutsche Pfandbriefbank AG by way of providing further adequate guarantees. On 6 November 2009, SoFFin renewed this declaration of intent. In particular, SoFFin has confirmed that it will provide adequate capital in order to at least assure the continued existence of HRE Holding and its major subsidiaries as going concerns and also to assure the necessary viable business model, particularly of Deutsche Pfandbriefbank AG. The support measures are conditional on the aid law requirements of the European Commission being fulfilled. A positive conclusion to this procedure is expected in the first half of 2011.

Future Development in Assets, Financial Position and Earnings

Deutsche Pfandbriefbank Group has closed the year 2010 with a pre-tax loss. However, the loss was less negative than was the case in the previous year. Moreover, the economic situation of Deutsche Pfandbriefbank Group has improved in the course of the financial year 2010. On an isolated quarterly assessment, Deutsche Pfandbriefbank Group reported a pre-tax profit in the third quarter 2010 for the first time since the outbreak of the financial crisis. The positive trend continued due the transfer of positions to FMS Wertmanagement. Deutsche Pfandbriefbank Group again reported a pre-tax profit in the fourth quarter. For 2011, the Management Board currently expects to be profitable and that a slightly positive result will be generated. In 2012, it is expected that results will increase compared with 2011, and a positive result is also expected. Compared to the prior year we expect a higher new business of about €8 billion primarily in the operating segment Real Estate Finance. For 2012, the volume of new business is planned to be expanded compared with 2011. In total, the forecast of the new business volume depends on the outcome of the EU procedure.

Despite the transfer of positions to FMS Wertmanagement, the total assets of Deutsche Pfandbriefbank Group at the end of 2010 were not significantly lower than was the case at the end of the previous year, because the reducing effects were partly offset by opposite effects in connection with FMS Wertmanagement such as the transmission of assets and liabilities. However, the extent of these opposite effects will probably decline in future. For instance, some of the assets for which the risks and rewards have previously been synthetically transferred will in future be physically transferred. Debtor changes (novations) will be carried out for some instruments. In addition, FMS Wertmanagement will increasingly refinance its operations on an independent basis and will thus no longer require Deutsche Pfandbriefbank Group to transmit funds. Overall, the total assets are expected to decline appreciably in 2011. For 2012, the balance sheet total is also expected to decline; however, the decline will be less significant than was the case in 2011. However, the extent of the reduction in the total assets is still uncertain and is not entirely within the control of Deutsche Pfandbriefbank Group.

Opportunities The development in assets, financial position and earnings which have already occurred in the third and fourth quarters of 2010 as well as the anticipated developments illustrate the potential for Deutsche Pfandbriefbank Group. The main opportunities are as follows:

> The risks facing Deutsche Pfandbriefbank Group have declined significantly following the transfer of the positions to FMS Wertmanagement. This means that the development in assets, financial position and earnings of Deutsche Pfandbriefbank Group will be much less affected by volatility. For instance, the extent to which the income statement is exposed to fluctuations in credit spreads will decline considerably. Market volatilities will also have a much less significant impact on the refinancing position of Deutsche Pfandbriefbank Group. Because situations involving non-matching maturities in refinancing have to a large extent been eliminated, liquidity gaps have become much less likely.

> Due to the transfer of the positions to FMS Wertmanagement, Deutsche Pfandbriefbank Group can concentrate on public sector finance and commercial real estate finance in selected markets in line with its overall strategy, and will thus be able to bundle its forces. Synergy possibilities between the two segments can also be utilised.

> In the field of public sector finance, numerous competitors have been affected by the financial market crisis or have withdrawn from the market. Competitors in the field of commercial real estate finance have also withdrawn from the market or have been seriously weakened. Moreover, lending in general has become more restricted. Financial flows have become globalised, and investors of projects will appreciate a specialist commercial real estate financier such as Deutsche Pfandbriefbank Group with its specific market and product knowledge, with expertise which is recognised on the market and with existing customer relations which it can utilise. The experience of Deutsche Pfandbriefbank Group in Pfandbrief business will also be beneficial. Accordingly, Deutsche Pfandbriefbank Group will search out market opportunities and write new business subject to attractive margins in 2011 and in subsequent years. In line with overall strategy, the focus will be on Pfandbrief-eligible follow-up financing and newly acquired business in public sector finance and real estate finance.

> Deutsche Pfandbriefbank Group will base the refinancing of new business and the existing portfolio mainly on Pfandbriefe. Because of their high quality and stable maturity profile, Pfandbriefe are not very affected by market turmoil. Deutsche Pfandbriefbank Group will therefore use a capital market instrument which is still in demand.

Risks However, there is also the possibility of problems facing the future development in assets, financial position and earnings. The extent of these possible problems will be influenced particularly by the occurrence or non-occurrence of the following risks which might materialise, and the extent to which such risks materialise:

> The support measures which have been received and the FMS Wertmanagement which has been established are currently being reviewed by the European Commission in ongoing aid proceedings. In its final decision, the European Commission will very probably impose some major conditions on Deutsche Pfandbriefbank Group, including a significant reduction in the balance sheet total and the specification of a deadline for reprivatising Deutsche Pfandbriefbank AG. However, if the European Commission comes to the conclusion that the state aid is not (or is not completely) consistent with the EC Treaty, it is possible that it will compel Germany to suspend or redesign this aid within a specific deadline, or it may order the repayment. The future development in assets, financial position and earnings can be considerably affected by the final decision of the European Commission.

> On 15 February 2011, a council of experts installed by the federal government handed over to the Federal Minister of Finance an appraisal regarding the development of exit strategies from crisis-related investments of the federal government in companies in the financial sector. The council of experts is aware of the appraisals prepared for HRE and for SoFFin and has extensively considered these appraisals; it recommends that the federal government, considering the opportunities and risks applicable for successful privatisation and also in view of the possible effects of their decision on the competitive structure of the market economy, should seriously consider the exit option of winding down the entire HRE – including Deutsche Pfandbriefbank Group. The federal government has noted the appraisal with interest as an important contribution to the process of determining its opinion. It does not agree with all assessments of the council of experts, particularly with regard to the consequences of winding down institutions for financial market stability. If the federal government were to hold a different opinion, this would have a considerable impact on the net assets, financial position and results of operations of Deutsche Pfandbriefbank Group.

> Within the context of the transfer of positions of Deutsche Pfandbriefbank Group to FMS Wertmanagement, the FMSA reserves the right to impose a payment condition for the stabilisation measure in accordance with Section 8a (4) No. 8 FMStFG against HRE for payment to FMS Wertmanagement; this figure must not exceed € 1.59 billion. The payment condition can also be fixed in several notices. However, the extent of the payment condition must be fixed in such a way that by fixing the condition regulatory core capital ratio of the bank entities within the HRE sub-groups Deutsche Pfandbriefbank and DEPFA do not fall below 15 % in each case as of 31 March 2011. In addition, the fixing of the payment condition must not result in the sub-groups or their parent companies.

a) becoming insolvent, illiquid or result in a negative going concern assumption,
b) relevant regulatory capital ratios, major credit limits or other legal or regulatory requirements being violated,
c) their rating falling below investment grade, or
d) the purchase price, taking account of the payment condition, falling below the market value of the transferred positions.

A possible payment obligation may have a significantly negative impact on the business situation of Deutsche Pfandbriefbank Group.

> Although it has improved somewhat to a certain extent, the situation on some markets is still difficult, and the macroeconomic situation is uncertain. In consequence, it is not possible to preclude the possibility of significant impairments being recognised in relation to loans and receivables. These impairments might particularly affect real estate financings as a result of the difficult economic conditions on the commercial real estate markets.
> Due to high fiscal deficits, refinancing for some countries has become significantly more difficult, and in certain cases is now only possible with external assistance. It is possible that some countries, in particular the countries in focus, will not be able to service their interest and principal repayment obligations. In such a case, it may be necessary to recognise considerable impairments in relation to securities or loans, and this would in particular have a negative impact on net income from financial investments and provisions for losses on loans and advances.
> The difficult situation and the measures which have been subsequently implemented in order to stabilise Deutsche Pfandbriefbank Group have resulted in debates on the political scene, in the media and in public. Overall, the image of Deutsche Pfandbriefbank Group has suffered. Even if success has now been achieved in returning to markets, it is still possible that there might be negative consequences for future business and customer relations. This means that Deutsche Pfandbriefbank Group might not meet its new business targets with regard to lending and refinancing, and this in turn would have a negative impact on the development in assets, financial position and earnings.
> The refocusing of Deutsche Pfandbriefbank Group and the harmonisation of the IT infrastructure and processes will result in further costs, which will have a negative impact particularly on general administrative expenses.
> Litigation which is currently pending and which might become pending in future might have a considerably negative impact on earnings of Deutsche Pfandbriefbank Group. This litigation is described extensively in the notes.
> Deutsche Pfandbriefbank Group is exposed to operational risks resulting from its restructuring, for instance its reliance on key positions, technology risks resulting from the large number of accounting systems and an increased level of staff fluctuation. The risks can also be relevant for the obligation taken by Deutsche Pfandbriefbank AG to service the current operations of FMS Wertmanagement. These risks might result in significant losses.
> In September 2010, the Basel Committee on Banking Supervision adopted new recommendations, which are also known as Basel III. These include a tightening-up of the regulations regarding equity backing by way of increasing the minimum capital ratios. With the so-called leverage ratio, a new equity ratio which is not linked to the risk weighting of assets has also been introduced. New standards for the supply of liquidity are also being introduced. For Deutsche Pfandbriefbank Group, the revised regulations will involve an increased need for equity as well as liquidity and will have a negative impact on profitability. Further tightening of the rules and additional charges would exacerbate this effect even further. Legislative bodies have approved additional charges and taxes to avoid future financial market crises. Further measures are currently being discussed. These statutory changes may burden the profitability.

Dipol Holdings WestEnd City Center, Budapest

€ 384.5 million

Syndication loan
Arranger Real Estate Finance, London
October 2010

With this syndicated follow-up loan, pbb together with MKB Bank is the arranger as well as co-underwriter with K&H Bank, MKB Bank, OTP Bank, UniCredit Hungary and Unicredit Bank Austria. The WestEnd City Center is a prime location in Budapest with 44,842 m² retail space, 16,633 m² of offices, the WestEnd Hilton Hotel and a 22,300 m² rooftop garden and park.

Consolidated Financial Statements

Consolidated Financial Statements

Income Statement

Income/expenses in € million	Note | Page	2010	2009	Δ in € million	Δ in %
Operating revenues		652	561	91	16.2
Net interest income and similar income	32 | 100	600	785	–185	–23.6
Interest income and similar income		4,949	5,256	–307	–5.8
Interest expenses and similar expenses		4,349	4,471	–122	–2.7
Net commission income	33 | 100	–10	–60	50	83.3
Commission income		79	109	–30	–27.5
Commission expenses		89	169	–80	–47.3
Net trading income	34 | 100	77	–45	122	> 100.0
Net income from financial investments	35 | 101	–17	–43	26	60.5
Net income from hedge relationships	36 | 101	–45	–6	–39	< –100.0
Balance of other operating income/expenses	37 | 101	47	–70	117	> 100.0
Provision for losses on loans and advances	38 | 102	443	1,890	–1,447	–76.6
General administrative expenses	39 | 102	352	259	93	35.9
Balance of other income/expenses	40 | 102	8	16	–8	–50.0
Pre-tax profit/loss		**–135**	**–1,572**	1,437	91.4
Taxes on income	42 | 104	50	–2	52	> 100.0
Net income/loss		**–185**	**–1,570**	1,385	88.2
attributable to: Equity holders (consolidated profit/loss from the parent company)		–185	–1,570	1,385	88.2

Statement of Comprehensive Income

Statement of comprehensive income in € million	2010 Before tax	2010 Tax	2010 Net of tax	2009 Before tax	2009 Tax	2009 Net of tax
Net income/loss	**−135**	**50**	**−185**	**−1,572**	**−2**	**−1,570**
AfS reserve	95	26	69	126	34	92
Cash flow hedge reserve	1,427	383	1,044	597	163	434
Retained earnings	−298	–	−298	−1	–	−1
Foreign currency reserve	−1	–	−1	10	–	10
Additional paid-in capital	−1	–	−1	–	–	–
Total other comprehensive income of the period	1,222	409	813	732	197	535
Total comprehensive income of the period	**1,087**	**459**	**628**	**−840**	**195**	**−1,035**
attributable to: Equity holders (consolidated profit/loss from the parent company)	1,087	459	628	−840	195	−1,035

Disclosure of components of comprehensive income in € million	2010	2009
Net income/loss	**−185**	**−1,570**
AfS reserve	69	92
Gains/losses arising during the year	−69	92
Changes due to transfer to FMS Wertmanagement	138	–
Cash flow hedge reserve	1,044	434
Gains/losses arising during the year	108	434
Changes due to transfer to FMS Wertmanagement	936	–
Retained earnings	−298	−1
Gains/losses arising during the year	−113	−1
Changes due to transfer to FMS Wertmanagement	−185	–
Foreign currency reserve	−1	10
Gains/losses arising during the year	−1	10
Changes due to transfer to FMS Wertmanagement	–	–
Additional paid-in capital	−1	–
Gains/losses arising during the year	–	–
Changes due to transfer to FMS Wertmanagement	−1	–
Total other comprehensive income of the period	813	535
Total comprehensive income of the period	**628**	**−1,035**

Balance Sheet

Assets in € million	Note | Page	31.12.2010	31.12.2009	Δ in € million	Δ in %	31.12.2008
Cash reserve	8 | 90, 43 | 105	224	618	−394	−63.8	546
Trading assets	9 | 90, 44 | 105	16,168	1,435	14,733	> 100.0	131
Loans and advances to other banks	10 | 90, 45 | 105	15,190	78,151	−62,961	−80.6	72,126
Loans and advances to customers	10 | 90, 46 | 105	132,840	91,221	41,619	45.6	69,938
Allowances for losses on loans and advances	11 | 91, 48 | 106	−561	−3,326	2,765	83.1	−1,841
Financial investments	12 | 91, 49 | 107	16,345	30,914	−14,569	−47.1	28,934
Property, plant and equipment	13 | 91, 50 | 109	5	10	−5	−50.0	12
Intangible assets	14 | 92, 51 | 109	32	28	4	14.3	23
Other assets	15 | 92, 52 | 110	5,035	11,801	−6,766	−57.3	10,204
Income tax assets	24 | 94, 53 | 111	1,545	4,365	−2,820	−64.6	4,423
Current tax assets		64	131	−67	−51.1	82
Deferred tax assets		1,481	4,234	−2,753	−65.0	4,341
Total assets		**186,823**	**215,217**	−28,394	−13.2	**184,496**

Equity and liabilities in € million	Note | page	31.12.2010	31.12.2009	Δ in € million	Δ in %	31.12.2008
Liabilities to other banks	16 | 92, 57 | 112	62,587	67,625	−5,038	−7.4	56,464
Liabilities to customers	16 | 92, 58 | 112	17,384	12,378	5,006	40.4	13,985
Liabilities evidenced by certificates	59 | 112	63,846	109,193	−45,347	−41.5	95,461
Trading liabilities	17 | 92, 60 | 112	16,294	1,872	14,422	> 100.0	1,033
Provisions	18 | 92, 61 | 113	176	153	23	15.0	168
Other liabilities	19 | 93, 62 | 117	18,883	13,635	5,248	38.5	11,118
Income tax liabilities	24 | 94, 63 | 117	1,526	3,733	−2,207	−59.1	3,576
Current tax liabilities		83	85	−2	−2.4	31
Deferred tax liabilities		1,443	3,648	−2,205	−60.4	3,545
Subordinated capital	20 | 93, 64 | 117	2,766	3,895	−1,129	−29.0	2,237
Liabilities		**183,462**	**212,484**	−29,022	−13.7	**184,042**
Equity attributable to equity holders		3,361	2,733	628	23.0	454
Subscribed capital	65 | 118	380	380	–	–	380
Silent participation	21 | 93, 65 | 118	999	999	–	–	–
Additional paid-in capital		5,036	5,037	−1	–	2,988
Retained earnings[1]	65 | 118	−3,124	−1,310	−1,814	< −100.0	688
Revaluation reserve		255	−858	1,113	> 100.0	−1,239
AfS reserve		−259	−328	69	21.0	−275
Cash flow hedge reserve		514	−530	1,044	> 100.0	−964
Consolidated profit/loss 1.1.–31.12.		−185	−1,515	1,330	87.8	−2,363
Equity		**3,361**	**2,733**	628	23.0	**454**
Total equity and liabilities		**186,823**	**215,217**	−28,394	−13.2	**184,496**

[1] Including foreign currency reserve

Statement of Changes in Equity

Statement of changes in equity									
	Equity attributable to equity holders								
						Revaluation reserve			
in € million	Subscribed capital	Silent participation	Additional paid-in capital	Retained earnings including unappropriated net income	Foreign currency reserve	AfS reserve	Cash flow hedge reserve	Consolidated profit/loss	**Equity**
Equity at 1.1.2009	**380**	**–**	**2,988**	**732**	**–44**	**–275**	**–964**	**–2,363**	**454**
Capital increase	–	–	1,300	–	–	–	–	–	1,300
Transaction costs of capital measures	–	–1	–2	–	–	–	–	–	–3
Treasury shares	–	–	–	–	–	–	–	–	–
Distribution	–	–	–	–	–	–	–	–	–
Total comprehensive income for the year	–	–	–	–1	10	92	434	–1,570	–1,035
Transfer to retained earnings	–	–	–	–2,363	–	–	–	2,363	–
Proceeds from silent participation	–	1,000	–	–	–	–	–	–	1,000
Changes in the group of consolidated companies	–	–	751	356	–	–145	–	55	1,017
Equity at 31.12.2009	**380**	**999**	**5,037**	**–1,276**	**–34**	**–328**	**–530**	**–1,515**	**2,733**
Equity at 1.1.2010	**380**	**999**	**5,037**	**–1,276**	**–34**	**–328**	**–530**	**–1,515**	**2,733**
Capital increase	–	–	–	–	–	–	–	–	–
Transaction costs of capital measures	–	–	–	–	–	–	–	–	–
Treasury shares	–	–	–	–	–	–	–	–	–
Distribution	–	–	–	–	–	–	–	–	–
Total comprehensive income for the year	–	–	–	–113	–1	–69	108	–185	–260
Transfer to retained earnings	–	–	–	–1,515	–	–	–	1,515	–
Changes in the group of consolidated companies	–	–	–	–	–	–	–	–	–
Changes due to transfer to FMS Wertmanagement (transaction with owners)	–	–	–1	–185	–	138	936	–	888
Equity at 31.12.2010	**380**	**999**	**5,036**	**–3,089**	**–35**	**–259**	**514**	**–185**	**3,361**

Cash Flow Statement

Statement of cash flows[1] in € million	2010	2009
Net income/loss	**–185**	**–1,570**
Write-downs, provisions for losses on, and write-ups of, loans and advances and additions to provisions for losses on guarantees and indemnities	450	1,880
Write-downs and depreciation less write-ups on non-current assets	–81	169
Change in other non-cash positions	–609	62
Result from the sale of investments, property, plant and equipment	–15	4
Other adjustments	–494	–785
Subtotal	**–934**	**–240**
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	199	575
Loans and advances to other banks	–16,071	1,340
Loans and advances to customers	5,633	8,888
Other assets from operating activities	–121	15
Liabilities to other banks	27,490	7,287
Liabilities to customers	1,702	–1,886
Liabilities evidenced by certificates	–23,411	–25,517
Other liabilities from operating activities	–705	–710
Interest income received	4,894	6,667
Dividend income received	–	–
Interest expense paid	–4,532	–6,665
Taxes on income paid	64	–30
Cash flow from operating activities	**–5,792**	**–10,276**
Proceeds from the sale of non-current assets	5,650	8,521
Payments for the acquisition of non-current assets	–206	–309
Proceeds from the sale of investments	–	–
Payments for the acquisition of investments	–	–3
Cash flow from investing activities	**–5,444**	**8,209**
Proceeds from capital increases	–1	2,297
Subordinated capital, net	–32	–165
Cash flow from financing activities	**–33**	**2,132**
Cash and cash equivalents at the end of the previous period	**618**	**546**
+/– Cash flow from operating activities	–5,792	–10,276
+/– Cash flow from investing activities	5,444	8,209
+/– Cash flow from financing activities	–33	2,132
+/– Effects of exchange rate changes and non-cash valuation changes	–13	7
Cash and cash equivalents at the end of the period	**224**	**618**

[1] Explanations in Note 68

Notes

1 General Information

Deutsche Pfandbriefbank Group combines the strategic assets and new business of Hypo Real Estate Group (HRE) in its segments Public Sector Finance and Real Estate Finance. The Group concentrates its activities in regional terms, and focuses on Germany and Europe. Depending on the particular area of activity, it is also active in other international markets. The focus is mainly on the eligibility of business for Pfandbrief funding. Deutsche Pfandbriefbank AG is incorporated in the commercial register of the Amtsgericht (local court) Munich (HRB 41054) and is a 100% subsidiary of Hypo Real Estate Holding AG (HRE Holding). HRE Holding is a 100% subsidiary of SoFFin. With the incorporation in the commercial register by the Amtsgericht Munich as of 29 June 2009, the merger of the former DEPFA Deutsche Pfandbriefbank AG with the former Hypo Real Estate Bank AG is from the economical view retrospectively effective as of 1 January 2009. The new entity trades under the name of Deutsche Pfandbriefbank AG, and has its registered office in Munich.

The so-called predecessor accounting was used to account the merger of DEPFA Deutsche Pfandbriefbank AG and the former Hypo Real Estate Bank AG. The assets and liabilities taken over in the context of the merger were measured at group carrying amounts of DEPFA Deutsche Pfandbriefbank AG as of transaction date (30 June 2009).

Accounting Policies

2 Principles

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

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

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

The Management Board of Deutsche Pfandbriefbank AG has prepared the consolidated financial statements on 23 March 2011 on the going concern assumption. With regard to the going concern assumption, material factors of uncertainty are known at the point at which the consolidated financial statements were prepared in connection with events and conditions which cast doubts on the ability of Deutsche Pfandbriefbank AG and its major subsidiaries to continue as going concerns. The continuing existence of Deutsche Pfandbriefbank AG and its subsidiaries is dependent upon the European Commission approving the support measures which have been implemented by SoFFin. In addition, the ability of Deutsche Pfandbriefbank AG and its subsidiaries to continue as going concerns is dependent upon the European Commission not imposing any conditions which would not permit Deutsche Pfandbriefbank Group to implement an economically sustainable business plan and, in particular, does not undo the regulatory effectiveness of the capital support measures.

The Management Board of Deutsche Pfandbriefbank AG has engaged the services of an auditing company to carry out an independent appraisal of the going concern assumption. In its report this auditing company concludes that it is more than likely that HRE Holding and its subsidiaries will be able to continue as going concerns in the relevant period until 30 September 2012. The report which the Management Board and Supervisory Board have requested a reputable investment bank to prepare has also confirmed the viability of the business model which has been adopted.

On 28 March 2009, SoFFin confirmed to HRE Holding and Deutsche Pfandbriefbank AG (formerly Hypo Real Estate Bank AG) that it intends to stabilise HRE Holding by way of adequate recapitalisation, and that it also intends to stabilise Deutsche Pfandbriefbank AG by way of providing further adequate guarantees. On 6 November 2009, SoFFin renewed this declaration of intent. In particular, SoFFin has confirmed that it will provide adequate capital in order to at least ensure the continued existence of HRE Holding and its major subsidiaries as going concerns and also to ensure the necessary viable business model, particularly of Deutsche Pfandbriefbank AG. The support measures are conditional on the Aid Law requirements of the European Commission being fulfilled. The positive conclusion of these proceedings is expected in the first half of 2011.

Initially Adopted IFRSs and Interpretations Respectively Their Revisions and Amendments as well as Earlier Adopted Standards and Interpretations In the financial year 2010 the following new or revised standards and interpretations were applied initially:
> IFRS 1 (revised) First-time Adoption of IFRS
> IFRS 3 (revised) Business Combinations and IAS 27 (revised) Consolidated and Separate Financial Statements
> IAS 24 (revised) Related Party Disclosures
> IFRIC 12 Service Concession Arrangements
> IFRIC 17 Distributions of Non-Cash Assets to Owners
> Amendment to IFRS 2 Group Cash-settled Share-based Payment Transactions
> Amendment to IAS 39 Financial Instruments: Recognition and Measurement: Eligible Hedged Items
> Amendment to IFRS 1 Additional Exemptions for First-time Adopters
> Annual Improvements to IFRSs 2009

On 10 January 2008 the IASB published the standards IFRS 3 (revised) Business Combinations and IAS 27 (revised) Consolidated and Separate Financial Statements. IFRS 3 (revised) revises, amongst others, the application of the acquisition method for business combinations. Major revisions to IAS 27 concern the accounting of transactions in which an entity retains control as well as transactions in which control is lost. Both standards have to be initially applied for business combinations and transactions within financial years beginning on or after 1 July 2009. There have not been any impacts on Deutsche Pfandbriefbank Group so far, and any such impacts will depend in future on potential business combinations respectively on potential transactions.

IFRS 5 Non-current Assets Held for Sale and Discontinued Operations has been amended in connection with IFRIC 17. The regulations of recognition, measurement and disclosure are applicable as well in relation to assets which meet the criteria for being classified as held for distribution to owners. There have been impacts on Deutsche Pfandbriefbank Group during the financial year concerning a part of financial instruments transferred to FMS Wertmanagement. In the published condensed interim report as of 30 June 2010 Deutsche Pfandbriefbank Group disclosed all financial instruments transferred to FMS Wertmanagement in the note disposal group. The current consolidated financial statement as of 31 December 2010 is not longer affected by the amendments to IFRS 5 described above because the disposal group was transferred on 1 October 2010.

The standard IAS 24 (revised) Related Party Disclosures remedies inconsistencies regarding the definitions of a related entity and a related person. In addition, it is necessary to disclose information only about significant transactions with government-controlled entities which are controlled or significantly influenced by the same government. The standard has to be adopted initially and applied prospectively for financial years beginning on or after 1 January 2011. Earlier adoption is permitted. Deutsche Pfandbriefbank exercised the option to already adopt IAS 24 (revised) for the financial year beginning on 1 January 2010.

The other initially applicable standards and interpretations as well as their revisions and amendment did not have any material impacts on Deutsche Pfandbriefbank Group or are not relevant for the Group.

Published and Endorsed Standards and Interpretations Respectively Their Revisions and Amendments, Whose Initial Adoption is not Mandatory and Which are not Adopted Earlier The following material amended and endorsed standards and interpretations have not been applied earlier by Deutsche Pfandbriefbank Group:

- > IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments
- > Amendment to IAS 32 Financial Instruments: Presentation on Classification of Rights Issues
- > Amendment to IFRS 1 Limited Exemptions from Comparative IFRS 7 Disclosures for First-time Adopters
- > Amendment to IFRIC 14 Prepayments of Minimum Funding Requirements

IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments clarifies the accounting when an entity issues equity instruments to extinguish all or parts of a financial liability. The interpretation has to be adopted initially and applied prospectively for financial years beginning on or after 1 July 2010. Impacts on Deutsche Pfandbriefbank Group will depend on future transactions.

The Amendment to IAS 32 Financial Instruments: Presentation on Classification of Rights Issues addresses the accounting for rights, options and warrants to acquire a fixed number of an entity's own equity instruments that are denominated in a currency other than the functional currency of the issuer. The amendment has to be adopted initially and applied prospectively for financial years beginning on or after 1 February 2010. As Deutsche Pfandbriefbank Group has not issued any such rights, at the moment, the amendment will not have any impacts on the Group.

Amendment to IFRS 1 Limited Exemptions from Comparative IFRS 7 Disclosures for First-time Adopters has to be adopted initially and applied prospectively for financial years beginning on or after 1 July 2010. The amendment will not have any impacts on Deutsche Pfandbriefbank Group.

Amendment to IFRIC 14 Prepayments of Minimum Funding Requirements concerns accounting requirements of pension plans. The amendment is applicable if an entity supplies prepayments to fulfil the minimum funding requirements regarding its pension plan. Because this is not the case for the pension plans of Deutsche Pfandbriefbank Group, there will not be any impacts on the Group.

Published Standards and Interpretations Respectively Their Revisions and Amendments, Which are not Endorsed on Balance Sheet Date The following new or material amended standards and interpretations have not been applied earlier by Deutsche Pfandbriefbank Group. These standards and interpretations are not applicable mandatory yet and are not endorsed by the European Commission:

- > IFRS 9 Financial Instruments
- > Amendment to IFRS 7 Financial Instruments: Disclosures
- > Amendment to IFRS 1 Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters
- > Amendment to IAS 12 Deferred Taxes on Investment Property
- > Annual Improvements to IFRSs 2010

The IASB is replacing the standard IAS 39 by IFRS 9 Financial Instruments in several project phases. The IASB published new policies in 2009 and 2010 for the first project phase Classification and Measurement. On the other hand, finally adopted standard parts are not yet available for the two other project phases Impairment Methodology and Hedge Accounting. With regard to the classification of the financial instruments, the Classification and Measurement part now only provides the two categories measurement at fair value and measurement at amortised cost. Financial debt instruments are classified on the assets' side of the balance sheet depending on the business model of the entity for managing financial assets and the characteristics of the contractual cash flows of the financial asset. On the other hand, equity instruments and dFVTPL assets generally have to be measured at fair value. On the liabilities side of the balance sheet, all non-derivative liabilities which are not used for trading purposes or which are not designated for measuring at fair value have to be measured at amortised cost. In the case of the dFVTPL liabilities, changes in value which are attributable to the change in the entity's own credit risk have to be recognised directly in equity. The initial application of the new standard IFRS 9 Financial Instruments, which is envisaged for financial years beginning on or after 1 January 2013, will probably have a material impact for Deutsche Pfandbriefbank Group. In future, it will be necessary for some assets and liabilities which have previously been measured at amortised cost presumably to be measured at fair value, and vice versa. However, it will only be possible to make a definitive assessment of this impact when all parts of IFRS 9 Financial Instruments have been completely published.

Amendment to IFRS 7 Financial Instruments: Disclosures shall enhance the qualitative characteristics of financial statements, in particular regarding transactions with the objective of transferring financial assets (for example securitisations and factoring). The amendment will have no impacts on recognition and measurement. However, supplemental disclosures will have to be added to the notes

The main amendments to IFRS 1 Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters concern entities, which adopt IFRS for the first time and whose functional currency was effected by hyperinflation. These amendments are not relevant for Deutsche Pfandbriefbank Group.

By means of the amendment to IAS 12 Deferred Taxes on Investment Property, the IASB clarifies, that temporary tax differences concerning investment properties will reverse generally solely in the course of disposal. Deutsche Pfandbriefbank Group currently does not hold any investment properties. Therefore, impacts on Deutsche Pfandbriefbank Group will depend on future transactions.

In the course of the project Business Combination Phase II the following standards and interpretations were amended and were combined in Annual Improvements to IFRSs 2010:
> IFRS 3 (revised) Business Combinations
> IAS 27 (revised) Consolidated and Separate Financial Statements
> IAS 21 The Effects of Changes in Foreign Exchange Rates
> IAS 28 Investment in Associates
> IAS 31 Interests in Joint Ventures

Additionally, Annual Improvements to IFRSs 2010 comprises the amendments of the following standards and interpretations:
> IFRS 1 First-time Adoption of International Financial Reporting Standards
> IFRS 7 Financial Instruments: Disclosures
> IAS 1 Presentation of Financial Statements
> IAS 34 Interim Financial Reporting
> IFRIC 13 Customer Loyalty Programmes

The majority of the amendments are applicable for financial years beginning on or after 1 January 2011. Annual Improvements to IFRSs 2010 will probably not have material impacts on Deutsche Pfandbriefbank Group.

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

Consolidated Financial Review The consolidated financial review meets the requirements of section 315 (1) and (2) HGB (German Civil Code) and DRS 15. It comprises a report on the business and conditions, a report on the net assets, financial position and results of operations, a report of significant events after 31 December 2010, and a forecast report as well as a risk report. The risk report contains information which, under IFRS 7, is required to be disclosed (especially in the chapters Credit Risk, Market Risk and Liquidity Risk). Events after the balance sheet date are described in the report of events after 31 December 2010 and the major events.

3 Consistency

Deutsche Pfandbriefbank Group applies accounting policies consistently in accordance with the framework of IFRS as well as IAS 1 and IAS 8. In principal, in financial year 2010 no accounting policies for recognition, measurement and disclosure were changed.

4 Uniform Consolidated Accounting

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

5 Transfer of Positions to FMS Wertmanagement

In January 2010, HRE submitted an application to the FMSA for a stabilisation measure in accordance with Section 8a (1) Clause 1 FMStFG (establishment of a deconsolidated environment) in order to transfer assets and liabilities of Deutsche Pfandbriefbank Group and its direct and indirect subsidiaries to a deconsolidated environment. This application was approved by the FMSA, and the deconsolidated environment FMS Wertmanagement was established on 8 July 2010. The transferred positions mainly comprise financial instruments in accordance with IAS 39.9.

At the end of September, Deutsche Pfandbriefbank Group concluded the agreements necessary for the transfer with FMS Wertmanagement; previously, the European Commission had provisionally approved the transaction within the framework of the on-going aid proceedings. The positions were transferred to FMS Wertmanagement with legal and/or economic effect as of 1 October 2010, 00.00 hours; however, no legal and/or economic transfer was originally intended for some of the positions to be transferred. On the contrary, they have been backed by a financial guarantee of FMS Wertmanagement; any legal and/or economic transfer in this respect will only take place at a later date. The transfer is a non-cash transaction between companies under common control.

The positions were transferred to FMS Wertmanagement by way of a spin-off for inclusion in an existing company in accordance with Section 8a (8) FMStFG in conjunction with Section 123 (2) No. 1 UmwG, as follows: Deutsche Pfandbriefbank AG and also HRE Holding AG have each spun-off parts of their assets to FMS Wertmanagement and have received compensation claims in return; in addition, SoFFin – as a further consideration – has also received a stake in the share capital of FMS Wertmanagement of € 1 million.

Whereas most of the transferred positions have resulted in a derecognition at Deutsche Pfandbriefbank Group due to the transfer of at least economic ownership to FMS Wertmanagement, this is not applicable for the positions which are merely backed by way of the financial guarantee and also in the case of the real estate loans which are recorded in the mortgage cover pool assets and which enjoy special-protection in favour of the Pfandbrief holders due to considerations of Pfandbrief Law. The collateralised lending transactions have also not resulted in a derecognition.

In addition, Deutsche Pfandbriefbank Group has also concluded so-called back-to-back derivatives with FMS-Management; these have been used to transfer the market risks of existing derivatives, whereas the so-called counterparty risk was retained by Deutsche Pfandbriefbank Group. These back-to-back derivatives have resulted in a significant increase in the derivative position of Deutsche Pfandbriefbank Group as of 1 October 2010.

A so-called upgrade of the transfer methods is being considered for the transactions which have so far not resulted in a derecognition, in order to meet the derecognition requirements at a later date.

The positions have been transferred with the respective carrying amount of the transferred company in line with the accounting regulations which were applicable for the separate financial statements of the respective company. The amount of the compensation claim which Deutsche Pfandbriefbank Group as well as the other transferring subsidiaries received from FMS Wertmanagement as of 1 October 2010 is calculated as the difference between the carrying amount of the assets transferred by the respective company and the transferred liabilities.

The transfer resulted in capital effects recognised in equity as of 1 October 2010. The effect was attributable to deconsolidation effects and also to valuation differences between the carrying amounts shown in the IFRS financial statements and the corresponding carrying amounts recognised in the separate financial statements prepared in accordance with local accounting regulations.

The transfer of the positions to FMS Wertmanagement had the following impact on the balance sheet of Deutsche Pfandbriefbank Group as of 1 October 2010:

Transfer of positions to FMS Wertmanagement in € million	**Balance sheet as of 30.9.2010**	Transfer of assets and liabilities	Transfer of allowances for losses on loans and advances	Transfer of derivatives derecog-nised	HRE internal financing	Opposite effects	Pro forma balance sheet after transfer to FMS Wertmana-gement	Changes in opposite effects until 31.12.2010	Pro forma balance sheet as of 31.12.2010	Other changes	**Balance sheet as of 31.12.2010**
Assets											
Cash reserve	263	–	–	–	–	–	263	–	263	–39	224
Trading assets	2,279	–	–	38	–	17,841	20,158	–4,288	15,870	298	16,168
Loans and advances to other banks	89,893	–383	–	1,106	–76,109	–	14,507	–182	14,325	865	15,190
Loans and advances to customers	87,315	–29,968	–	–	–	95,548	152,895	–15,096	137,799	–4,959	132,840
Allowances for losses on loans and advances	–3,164	–	2,544	–	–	–	–620	–	–620	59	–561
Financial investments	27,724	–10,873	–	–	–	–	16,851	–	16,851	–506	16,345
Property, plant and equipment	6	–	–	–	–	–	6	–	6	–1	5
Intangible assets	24	–	–	–	–	–	24	–	24	8	32
Other assets	16,330	–	–	–7,541	–	–15	8,774	–30	8,744	–3,709	5,035
Income tax assets	5,043	–28	–	–3,368	–	–	1,647	–	1,647	–102	1,545
Total	**225,713**	**–41,252**	**2,544**	**–9,765**	**–76,109**	**113,374**	**214,505**	**–19,596**	**194,909**	**–8,086**	**186,823**
Compensation claim	–	40,304	–2,552	–568	76,109	–109,153	4,140	–4,140	–	–	–
Total assets	**225,713**	**–948**	**–8**	**–10,333**	**–**	**4,221**	**218,645**	**–23,736**	**194,909**	**–8,086**	**186,823**
Equity and liabilities											
Liabilities to other banks	89,331	–	–	1,294	–	–6,512	84,113	–22,480	61,633	954	62,587
Liabilities to customers	14,805	–61	–	–	–	–	14,744	3,418	18,162	–777	17,384
Liabilities evidenced by certificates	90,347	–	–	–	–	–21,491	68,856	–	68,856	–5,010	63,846
Trading liabilities	2,465	–	–	–204	–	17,871	20,132	–4,318	15,814	480	16,294
Provisions	166	–	–3	–	–	–	163	–	163	13	176
Other liabilities	17,412	–	–	–9,334	–	13,500	21,578	–356	21,222	–2,339	18,883
Income tax liabilities	4,580	10	–1	–3,025	–	–	1,564	–	1,564	–38	1,526
Subordinated capital	3,826	–	–	–	–	–	3,826	–	3,826	–1,060	2,766
Equity	2,781	–897	–4	936	–	853	3,669	–	3,669	–308	3,361
thereof: Additional paid-in capital	5,037	–1	–	–	–	–	5,036	–	5,036	–	5,036
Retained earnings	–2,817	–1,034	–4	–	–	853	–3,002	–	–3,002	–122	–3,124
AfS reserve	–413	138	–	–	–	–	–275	–	–275	16	–259
Cash flow hedge reserve	–158	–	–	936	–	–	778	–	778	–264	514
Total equity and liabilities	**225,713**	**–948**	**–8**	**–10,333**	**–**	**4,221**	**218,645**	**–23,736**	**194,909**	**–8,086**	**186,823**

As part of the process of transferring the positions, Deutsche Pfandbriefbank AG also assumed responsibility for managing the transferred portfolios for FMS Wertmanagement as part of a co-operation agreement, whereby Deutsche Pfandbriefbank AG also uses services of other subsidiaries of HRE for rendering this service. The cooperation agreement is initially due to run until 30 September 2013.

In addition, Deutsche Pfandbriefbank AG has provided a commitment to FMS Wertmanagement that it will implement certain IT functionalities. Deutsche Pfandbriefbank Group is also considering whether to transfer legal and economic ownership of certain portfolios to FMS Wertmanagement for those cases in which the transfer to FMS Wertmanagement has so far not resulted in a derecognition.

For these obligations in connection with the transfer of the positions, Deutsche Pfandbriefbank Group has created provisions as of 31 December 2010 for IT and reporting adjustments (€ 8 million), setting up FMS Wertmanagement (€ 3 million), the provisions for transfer taxes (€ 7 million) and the upgrade of positions (€ 3 million).

6 Consolidation

Deutsche Pfandbriefbank AG and subsidiaries (including special-purpose entities)	Fully consolidated		Not fully consolidated (due to immateriality/not to be consolidated according to SIC-12)		
	Total	Thereof special-purpose entities	Total	Thereof special-purpose entities	**Total**
1.1.2010	**39**	**24**	**19**	**5**	**58**
Additions	2	2	1	1	3
Disposals	29	22	10	4	39
31.12.2010	**12**	**4**	**10**	**2**	**22**

Associated companies and other investments	Associated companies	Other investments	**Total**
1.1.2010	**12**	**6**	**18**
Additions	–	3	3
Disposals	8	3	11
31.12.2010	**4**	**6**	**10**

These financial statements set out a list of shareholdings in the chapter Holdings. In this list, the subsidiaries are structured on the basis of whether or not they are consolidated. Other shareholdings are also listed. All fully consolidated companies have prepared their financial statements basically for the period ended 31 December 2010.

The balance sheet effects of the contractual relations between the Group companies and the subsidiaries which are not consolidated are set out in the consolidated financial statements. The pooled results of the subsidiaries, which have not been consolidated in view of their minor significance, total € 1 million. Net losses are almost completely included in the Group financial statement by depreciation on investments, provisions and profits transferred. The pooled total assets of the non-consolidated subsidiaries account for 0.1 % of the Group total assets. The shares in the non-consolidated companies are disclosed as AfS financial investments.

Deutsche Pfandbriefbank AG holds 100 % of the interest on DEPFA Finance N.V., Amsterdam. As the majority of risks and rewards is held group externally Deutsche Pfandbriefbank AG does not consolidate the special-purpose entity.

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

Hypo Real Estate Systems GmbH, Munich, was renamed pbb Services GmbH on 28 January 2010.

The special-purpose vehicle Liffey 1110 Park LLC, Delaware, was founded and initially consolidated as a wholly controlled subsidiary of Hypo Real Estate Capital Corp., New York, on 1 February 2010. The special-purpose entity has taken over a salvage acquisition in the USA for which the carrying amount was stated as US$ 7 million on 4 March 2010. The initial consolidation has otherwise not had any major impact on the income statement and the statement of financial position. The salvage acquisition was sold on 4 August 2010. As part of the process of transferring positions to FMS Wertmanagement, the company was transferred to FMS Wertmanagement on 1 October 2010.

The special-purpose entitiy Little Britain Holdings Limited, Jersey, was initially consolidated on 26 February 2010. The wholly controlled subsidiary of Hypo Property Investments Ltd., London, has taken over a salvage acquisition in Great Britain. On 23 September 2010, the company was sold by Hypo Property Investments Ltd., London, to Deutsche Pfandbriefbank AG. The carrying amount of the salvage acquisition amounted to GB£71 million as of 31 December 2010. On initial consolidation date the carrying amount was GB£60 million.

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

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

The special-purpose entities Liffey Belmont I LLC, Wilmington, Liffey Belmont II LLC, Wilmington, and Liffey Belmont III LLC, Wilmington, have been deconsolidated because they were wound up on 13 August 2010. The assets of the companies were sold in 2009, which meant that the deconsolidation did not have any major impact on the income statement or balance sheet.

The special-purpose entity Hypo Property Participation Ltd., London, has been deconsolidated because the process of liquidating the Company was completed on 31 August 2010. The deconsolidation process did not have any major impact on the income statement or the balance sheet because the Company did not have any assets, liabilities and equity in 2010.

Furthermore, the following special-purpose entities were transferred to FMS Wertmanagement:
> E.L.A.N. Ltd., Jersey
> Octagon Ltd., Grand Cayman
> Xenon Structured Funding Ltd., Dublin

On 1 October 2010 positions were transferred to FMS Wertmanagement. The following table shows the transferred companies as well as their total assets as of the date of transfer and their net profit or loss realised until 30 September 2010.

Total assets and net income/loss as of 30 September 2010 of the consolidated companies transferred to FMS Wertmanagement	Currency	Total assets in thousand	Net income/loss in thousand
Flint Nominees Ltd., London	GB£	161,117	476
Hypo Property Investment (1992) Ltd., London	GB£	1	–
Hypo Property Investment Ltd., London	GB£	310	–205
Hypo Property Services Ltd., London	GB£	112	–
Hypo Real Estate Capital Corp., New York	US$	3,770,983	7,399
Hypo Real Estate Transactions S.A.S., Paris	€	57,672	45
Liffey Camelback, LLC, Wilmington/Delaware	US$	17,696	–
Liffey NSYC, LLC, Wilmington/Delaware	US$	31,112	–
Liffey 1110 Park LLC, Delaware (new in 2010)	US$	727	–
Quadra Realty Trust, Inc., Maryland	US$	–	–
WH-Erste Grundstücks GmbH & Co. KG, Schoenefeld	€	80,530	–1,810
WH-Zweite Grundstücks GmbH & Co. KG, Schoenefeld	€	44,710	–47
Zamara Investments Ltd. i.L., Gibraltar	GB£	–	–

Additionally, in the year 2010 the following special-purpose entities without equity investment were deconsolidated because the underlying transactions were finished:
> DUKE 2002 Ltd., Jersey
> Estate Germany 2007-1 Ltd., Dublin
> GECO 2002 Ltd., Dublin

Because Deutsche Pfandbriefbank AG and also FMS Wertmanagement are subsidiaries of SoFFin, the transfer of the subsidiaries is a transaction under common control. The deconsolidation of the subsidiaries resulted in an effect of € –146 million recognised directly in equity in the consolidated financial statements.

As of 31 December 2010, DEPFA Finance N.V., Amsterdam, was deconsolidated. Based on a reassessment Deutsche Pfandbriefbank AG does not hold the majority of risks and rewards of the special-purpose entity anymore. Expenses of € 4 million resulted from the deconsolidation of the special-purpose entity. Total assets of the entity amounted to € 1.2 billion as of 31 December 2010 consisting of loans and advances to other banks on the assets side and subordinated capital on the liabilities side.

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.

7 Financial Instruments

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

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

In principle, the purchases or sales of financial instruments are recognised on the trade date. Premiums and discounts are recognised in the position net interest income 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 Deutsche Pfandbriefbank Group which result in partial derecognition due to a continuing involvement.

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

Categories 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 trading instruments are recognised in net trading income.

If there is a difference between transaction price and market value at trade date and the difference results from unobservable data that have a significant impact on the 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.

Designated at Fair Value through Profit or Loss (dFVTPL) If certain conditions are satisfied, financial assets or liabilities can be classified 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. Deutsche Pfandbriefbank Group classifies financial assets under the dFVTPL category only for the first two cases. As of 31 December 2010, only fixed-income securities and loans and advances are held in the category dFVTPL. Financial liabilities are not classified into this category. The portfolio of fixed-income securities and loans and advances is managed on fair value basis. In addition, open interest risk positions of the portfolio are to a large extent closed by hedging derivatives. Because changes in the fair value of derivatives under IAS 39 in principle have to be recognised in profit or loss, the designation of fixed-income securities and loans and advances into the category dFVTPL will avoid inconsistency in terms of measurement. As a result of the designation of fixed-income securities and loans and advances, the opposite movements relating to the hedged risk in the income statement cancel each other to a large extent. The accounting treatment is accordingly consistent with risk management and the investment strategy.

dFVTPL financial instruments are measured at fair value. Changes in fair value are recognised in profit or loss. The amount of change in the fair value of the loan and advance during the period and since initial recognition which is attributable to changes in the credit risk of the financial asset is disclosed in the notes. The amount is determined as the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risks. Hence, the amount resulting from credit risk is the difference between the total change of fair value and the change attributable to market risks. Because financial liabilities are not designated into the category dFVTPL, Deutsche Pfandbriefbank Group does not have any effect resulting from the instruments being measured at the own current credit risk. The fixed-income securities in the category dFVTPL are disclosed as financial investments, the loans and advances as loans and advances to customers. Interest income from the securities and loans and advances is recognised in net interest income and similar income. The changes in value to be recognised in profit or loss (net gains and net losses from fair value option) are recognised in net income from hedge relationships in the same way as the changes in value of the corresponding derivatives.

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

In the past, Deutsche Pfandbriefbank Group has used the HtM category. As a result of the changed intention of HRE of not necessarily holding the financial investments to maturity the entire portfolio of HtM investments was reclassified as of 1 July 2007 in accordance with IAS 39.51 into the category AfS. In financial years 2010 and 2009, no financial assets were classified as HtM.

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 loans.

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 income 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 banks are disclosed in net interest income 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 provisions for losses on loans and advances 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. Deutsche Pfandbriefbank 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 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 income and similar income. Net gains and net losses generated by the disposal of AfS financial instruments as well as by changes in value as a result of impairment or 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 liabilities evidenced by certificates. Subordinated liabilities are recognised in subordinated capital. Interest expenses from financial liabilities at amortised cost are recognised in net interest income and similar income. In addition, the position net interest income and similar income includes net gains and net losses attributable to repurchases or withdrawals 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 hedge relationships. The interest from trading derivatives is recognised in net trading income. 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 the profit or loss.

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

Valuation Methods Financial instruments 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 neither 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 Deutsche Pfandbriefbank Group assesses on a case-by-case basis whether there is objective evidence for impairment. The criteria used to determine if there is such objective evidence included:
- significant financial difficulties of the borrower
- overdue contractual payments of either principal or interest or other breaches of contract
- becoming probable that the borrower will enter bankruptcy or other financial reorganisation
- renegotiations due to economic problems
- when available, the market price of the asset
- for AfS equity instruments a significant and/or prolonged decline in the fair value

Two types of allowances are in place: individual 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. Individual allowances on AfS financial investments as well as individual allowances and portfolio-based allowances on LaR financial assets are directly deducted from the carrying amount of the assets. The expense is 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.

Deutsche Pfandbriefbank 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:

- Deutsche Pfandbriefbank Group's aggregate exposure to the customer
- the amount and timing of expected interest and redemption payments
- the realisable value of collateral and likelihood of successful repossession
- the likely deduction of any costs involved in recovering amounts outstanding
- the market price of the asset if available

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

- historical loss experience in portfolios of similar credit risk characteristics
- a judgement whether current economic conditions and credit conditions improved or deteriorated compared to the past
- the estimated period between impairment occurring and the 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 are mainly interest rate derivatives, for example interest rate swaps and options. Mainly interest rate risks are hedged but also other types of risk, for instance currency risks.

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

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

For cash flow hedge accounting purposes derivatives are used to hedge the interest rate risk as part of asset/liability management. 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 hedge 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 or statistical methods are used to assess efficiency.

In those periods in which the cash flows of the hedged item have an impact on profit or loss for the period, the cash flow hedge reserve is released through profit or loss. 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 derivative initially recognised in equity remain in equity until the committed or forecast transaction occurs or is no longer expected to occur. At this point, the gains or losses have to be recognised in profit or loss.

Due to the transfer of positions to FMS Wertmanagement the positioning of Deutsche Pfandbriefbank Group has changed also affecting hedge accounting relationships. Deutsche Pfandbriefbank Group uses fair value hedge accounting increasingly instead of cash flow hedge accounting. Hedged items and hedging instruments were dedesignated from cash flow hedge in this context. The part of the cash flow hedge reserve relating to the dedesignated instruments will be amortised affecting income statement.

Hedge of a Net Investment in a Foreign Operation A net investment hedge is a hedge of the foreign currency exposure on a net investment in a foreign operation. Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Deutsche Pfandbriefbank Group does not hedge a net investment in a foreign operation in the financial year 2010 and as of 31 December 2009.

8 Cash Reserve

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

9 Trading Assets

Trading assets comprise positive market values of stand-alone derivatives of the bank book. Trading assets are measured at fair value. In the case of derivative and non-derivative financial transactions which are not listed on an exchange, internal price models based on present value considerations and option price models are used as the basis of fair value measurement. Unrealised and realised gains and losses attributable to trading assets are recognised in net trading income in profit or loss.

10 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. dFVTPL financial instruments are measured at fair value. Changes in fair value are recognised in profit or loss. As of 31 December 2010, and as of 31 December 2009, Deutsche Pfandbriefbank 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. All other income and expenses from loans and advances, including net gains and net losses, are recognised in net interest income and similar income.

11 Allowances for Losses on Loans and Advances and Provisions for Contingent Liabilities and other Commitments

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 macro-economic parameters on an individual and portfolio basis.

Individual Allowances For all recognisable default risks, the extent of the allowance for losses on loans and advances is calculated as the difference between the carrying amount of the asset and the present value of the expected future cash 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 individually 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 the profit or loss, all effects are disclosed as provisions for losses on loans and advances apart from time-related increases in the present value of impaired receivables which are disclosed in net interest income and similar income.

12 Financial Investments

dFVTPL, LaR and AfS securities are recognised and disclosed as financial investments. dFVTPL and AfS financial assets are measured at fair value. Changes in the fair value are through profit or loss in case of dFVTPL financial assets and are recognised in net income from hedge relationships. 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 an 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. Individual 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 fair value hedge accounting. LaR financial investments are measured at amortised cost. Individual allowances and portfolio-based allowances on LaR financial investments are directly deducted from the carrying amount of the assets. In the financial years 2010 and 2009, Deutsche Pfandbriefbank Group did not have any HtM financial assets.

13 Property, Plant and Equipment

Property, plant 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, plant and equipment are tested at least annually for impairment. If the value of property, plant 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 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, plant and equipment are recognised in profit or loss of the financial year in which they arose.

14 Intangible Assets

Purchased and internally generated software are the main items recognised as intangible assets. Goodwill has not been recapitalised after the complete impairment in the financial year 2008.

Software is an intangible asset with a finite useful life. Purchased software is measured at amortised cost of purchase. Deutsche Pfandbriefbank Group capitalises internally generated software if it is probable that future economic benefits will flow to the Group and the expenses can be measured reliably. Expenses eligible for capitalisation include external directly attributable costs of materials and services as well as personnel expenses for employees directly associated with an internally generated software project. 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 have to be tested for impairment at least annually and whenever there is an indication that the intangible asset may be impaired.

15 Other Assets

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

16 Liabilities

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

17 Trading Liabilities

Refinancing positions of the trading portfolio measured at fair value are recognised in trading liabilities. In addition, trading liabilities also include negative market values of trading derivatives and of standalone 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 through profit or loss.

18 Provisions

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.

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

The actuarial gains and losses are accounted by using the so-called corridor approach: A portion of actuarial gains or losses shall be recognised as income or expense in subsequent periods only if the net cumulative unrecognised gains or losses at the end of the previous reporting period exceed the greater of 10% of the present value of the earned pension entitlements and 10% of the fair value of the assets of any external benefit facility. The portion of actuarial gains or losses that has to be recognised in profit or loss is divided by the expected average remaining working lives of the employees participating in that plan.

The interest rate used for discounting defined benefit obligations is based on the long-term interest rates at balance sheet date on high class fixed-income corporate bonds.

Deutsche Pfandbriefbank AG obtained insurance against parts of the risks arising from defined-benefit pension commitments as of 1 January 2005 by taking reinsurance classified as a qualifying insurance policy under IAS 19. This reinsurance is pledged to the plan beneficiaries and constitutes plan assets under IAS 19. The pension obligations have to be netted with the plan assets by taking into account the ceiling according to IAS 19.58. A pension obligation remains after netting as of 31 December 2010.

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

19 Other Liabilities

Besides negative fair values from derivative financial instruments (hedging derivatives and derivatives hedging dFVTPL financial instruments), accruals are one of the items recognised in other liabilities. Accruals arose 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 accruals are measured 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.

20 Subordinated Capital

In the event of bankruptcy or liquidation subordinated capital may only be repaid after all non-subordinated creditors have been satisfied. Subordinated capital of Deutsche Pfandbriefbank Group encompasses subordinated liabilities, participating certificates outstanding and hybrid capital instruments. For some instruments of subordinated capital the holders participate in any net loss or 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 Deutsche Pfandbriefbank 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.

By applying the effective interest rate method an expected reduction of the interest entitlement and/or an expected loss participation of the subordinated capital led to a devaluation of the subordinated capital in the year 2009. The devaluation is recognised as an interest income in profit or loss. In the year 2010 an interest expense of € –13 million resulted from a write-up of these instruments.

21 Silent Participation

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

22 Share-based Compensation

As of 31 December 2010 and as of 31 December 2009 no company of Deutsche Pfandbriefbank Group has provided a commitment for share-based compensation.

23 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 at the individual companies in the Group are generally recognised in profit of 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 statement of changes in equity. The group of consolidated companies does not include any companies from hyperinflationary countries.

24 Taxes on Income

Taxes on income are recognised and measured in accordance with IAS 12. Apart from the exceptions defined in the standard, deferred taxes are calculated for all temporary differences for the IFRS values and the tax base 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 from IAS 12.34 et seq.

Deferred taxes are measured using the national tax rates which are expected at the time when the differences are balanced, as the concept of deferred taxes is based on the presentation of future tax assets or tax liabilities (liability method). Changes of tax rates have been taken into account. The pay-out of the corporate income tax claim which was capitalised on 31 December 2006 has begun since 1 January 2008 over a period of ten years independently of a dividend payment. The interest-free claim had to be shown with the present value. A rate of 3.7 % p.a. has been used for discounting purposes. Changes of the capitalised corporate income tax claims due to tax assessment notes for previous periods in the year 2010 were recognised accordingly in the income statement.

25 Non-current Assets Held for Sale

In accordance with IFRS 5, non-current assets held for sale or disposal group have to be measured on the balance sheet date at the lower of carrying amount and fair value less costs to sell. The assets have to be disclosed separately in the statement of financial position. As of 31 December 2010 and of 31 December 2009, Deutsche Pfandbriefbank Group did not own material non-current assets held for sale. In the published condensed interim report as of 30 June 2010 Deutsche Pfandbriefbank Group disclosed all financial instruments transferred to FMS Wertmanagement in the note disposal group.

26 Future-related Assumptions and Estimation Uncertainties

When the financial statements are being prepared, Deutsche Pfandbriefbank 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.

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

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

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

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. For practical considerations, the valuation models can only take account of quantifiable factors (e.g. cash flows and discount rates) that also require estimates. Changes in assumptions relating to these factors might have an impact on the fair values of the financial instruments.

Embedded Derivatives According to IAS 39.11, an embedded derivative has to be separated from the host contract and has to be 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. The economic risks of the host contracts and embedded derivatives are assessed on the basis of measuring methods to evaluate the existence of an obligation to separate.

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

Taxes on Income Deutsche Pfandbriefbank Group is subject to a wide range of national tax regulations with regard to the calculation of taxes on income. In order to 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 availability of such tax benefits are subject to estimation. Major losses carried forward are subject to national German tax law, and their availability also depends on the restrictions set out in section 10d EStG, 8c KStG as well as section 10a GewStG. Deferred tax assets arising from losses carried forward are recognised as far as it is likely that taxable income will be available to offset the non-utilised tax losses carried forward.

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

Segment Reporting

27 Notes to Segment Reporting by Operating Segment

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

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

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

Value Portfolio (VP) The operating segment Value Portfolio contains mainly securities issued by FMS Wertmanagement and a few selected structured products.

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

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

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

28 Income Statement, Broken Down by Operating Segment

Income/expenses in € million		PSF	REF	VP	Consolidation & Adjustments	**Deutsche Pfandbriefbank**
Operating revenues	1.1.–31.12.2010	73	571	5	3	652
	1.1.–31.12.2009	53	541	31	–64	561
	1.1.–31.12.2009[1]	125	540	33	–45	653
Net interest income and similar income	1.1.–31.12.2010	88	551	–27	–12	600
	1.1.–31.12.2009	37	646	98	4	785
	1.1.–31.12.2009[1]	114	645	101	3	863
Net commission income	1.1.–31.12.2010	–5	71	–76	–	–10
	1.1.–31.12.2009	–5	95	–150	–	–60
	1.1.–31.12.2009[1]	–11	95	–150	–	–66
Net trading income	1.1.–31.12.2010	1	–3	79	–	77
	1.1.–31.12.2009	21	–154	88	–	–45
	1.1.–31.12.2009[1]	22	–154	88	–	–44
Net income from financial investments	1.1.–31.12.2010	–9	–2	–6	–	–17
	1.1.–31.12.2009	–	–38	–5	–	–43
	1.1.–31.12.2009[1]	–	–38	–6	1	–43
Net income from hedge relationships	1.1.–31.12.2010	–	–	–	–45	–45
	1.1.–31.12.2009	–	–	–	–6	–6
	1.1.–31.12.2009[1]	–	–	–	–23	–23
Balance of other operating income/expenses	1.1.–31.12.2010	–2	–46	35	60	47
	1.1.–31.12.2009	–	–8	–	–62	–70
	1.1.–31.12.2009[1]	–	–8	–	–26	–34
Provisions for losses on loans and advances	1.1.–31.12.2010	–	422	21	–	443
	1.1.–31.12.2009	1	1,885	4	–	1,890
	1.1.–31.12.2009[1]	3	1,884	4	–	1,891
General administrative expenses	1.1.–31.12.2010	46	151	52	103	352
	1.1.–31.12.2009	38	191	55	–25	259
	1.1.–31.12.2009[1]	53	201	57	–6	305
Balance of other income/expenses	1.1.–31.12.2010	–	–	–	8	8
	1.1.–31.12.2009	–	–	–	16	16
	1.1.–31.12.2009[1]	–	–	–	18	18
Pre-tax profit	1.1.–31.12.2010	**27**	**–2**	**–68**	**–92**	**–135**
	1.1.–31.12.2009	**14**	**–1,535**	**–28**	**–23**	**–1,572**
	1.1.–31.12.2009[1]	**69**	**–1,545**	**–28**	**–21**	**–1,525**

[1] Combined

Cost-income ratio in %		PSF	REF	VP	**Deutsche Pfandbriefbank**
Cost-income ratio (based on operating revenues)	1.1.–31.12.2010	63.0	26.4	>100.0	54.0
	1.1.–31.12.2009	71.7	35.3	>100.0	46.2
	1.1.–31.12.2009[1]	42.4	37.2	>100.0	46.7

[1] Combined

29 Balance Sheet related Measures, Broken Down by Operating Segment

Balance sheet related measures, broken down by operating segment in € billion		PSF	REF	VP	Consolidation & Adjustments	**Deutsche Pfandbriefbank**
Risk-weighted assets[1]	31.12.2010	2.7	12.3	1.1	–	16.1
	31.12.2009	2.5	30.7	12.4	–	45.6
Finance volume	31.12.2010	53.3	25.8	2.2	–	81.3
	31.12.2009	63.1	54.8	10.1	–	128.0

[1] 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; according to Basle II advanced IRB approach for authorised portfolios, otherwise Basle II standardised approach; pro forma as per prepared annual financial statements 2010 and after result distribution 2010

The Management Board controls balance sheet related measures by operating segments based on 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.

30 Key Regulatory Capital Ratios (Based on German Commercial Code [HGB]), Broken Down by Operating Segment

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

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

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

if these are fulfilled on the level of the superordinated company.

31 Breakdown of Operating Revenues

Operating Revenues by Products

Operating revenues by products

in € million		Public Sector financings	Commercial Real Estate financings	Other products	**Deutsche Pfandbriefbank**
Operating revenues	1.1.–31.12.2010	571	73	8	652
	1.1.–31.12.2009	53	541	–33	561
	1.1.–31.12.2009[1)]	125	540	–12	653

[1)] Combined

Operating Revenues by Regions Deutsche Pfandbriefbank Group as of 31 December 2010 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	**Deutsche Pfandbriefbank**
Operating revenues	1.1.–31.12.2010	599	29	24	652
	1.1.–31.12.2009	470	40	51	561
	1.1.–31.12.2009[1)]	560	42	51	653

[1)] Combined

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

Notes to the Income Statement

32 Net Interest Income and Similar Income

Net interest income and similar income, broken down by categories of income/expenses in € million	2010	2009
Interest income and similar income	**4,949**	**5,256**
Lending and money-market business	3,410	3,731
Fixed-income securities and government-inscribed debt	907	1,038
Current result from swap transactions (balance of interest income and interest expenses)	632	475
Subordinated capital	–	12
Interest expenses and similar expenses	**4,349**	**4,471**
Deposits	1,261	1,038
Liabilities evidenced by certificates	2,934	3,433
Subordinated capital	154	–
Total	**600**	**785**

Total interest income for financial assets that are not at fair value through profit or loss, amount to € 4.3 billion (2009: € 4.8 billion). Total interest expenses for financial liabilities that are not at fair value through profit or loss amount to € 4.3 billion (2009: € 4.5 billion).

Net interest income and similar income includes income of € 70 million (2009: € 103 million) due to the increase in the present value of the adjusted allowances resulting over a period of time and an expense of € – 17 million (2009: € – 24 million) due to the increase in the present value of the adjusted liabilities over a period of time.

33 Net Commission Income

Net commission income in € million	2010	2009
Securities and custodial services	– 8	– 6
Lending operations and other service operations	– 2	– 54
thereof: Costs of the liquidity support	– 74	– 149
Total	**– 10**	**– 60**

Net commission income is attributable exclusively to financial assets and financial liabilities which are not designated at fair value through profit or loss. Commission income from trust activities amount to € 0 million (2009: € 0 million), with commission expenses at € 0 million (2009: € 0 million).

34 Net Trading Income

Net trading income in € million	2010	2009
From interest rate instruments and related derivatives	– 29	– 158
From credit risk instruments and related derivatives	106	113
Total	**77**	**– 45**

35 Net Income From Financial Investments

Net income from financial investments in € million	**2010**	**2009**
Income from financial investments	54	179
Expenses from financial investments	71	222
Total	**–17**	**–43**

Net income from financial investments consists of income from the sale of securities of the measurement categories AfS and LaR together with changes in the value of such instruments that are to be recognised in the income statement. HtM investments were not held in 2010 and 2009. Based on measurement categories, net income from financial investments is broken down as follows:

Net income from financial investments by IAS 39 categories in € million	**2010**	**2009**
Available-for-sale financial investments	4	–3
Loans-and-receivables financial investments	–21	–7
Result from investment properties	–	–33
Total	**–17**	**–43**

36 Net Income from Hedge Relationships

Net income from hedge relationships in € million	**2010**	**2009**
Result from fair value hedge accounting	–6	–7
Result from hedged items	–5	17
Result from hedging instruments	–1	–24
Result from dFVTPL investments and related derivatives	–37	2
Result from dFVTPL investments	–34	17
Result from derivatives related to dFVTPL investments	–3	–15
Ineffectiveness from cash flow hedge accounting affecting income	–2	–1
Total	**–45**	**–6**

37 Balance of Other Operating Income/Expenses

Balance of other operating income/expenses in € million	**2010**	**2009**
Other operating income	173	25
Other operating expenses	126	95
Balance of other operating income/expenses	**47**	**–70**

Other operating income comprises mainly an income from pbb Services GmbH for rendered services to DEPFA and HRE Holding amounting to € 65 million (2009: € 15 million) as well as an income from services for the ongoing operations of FMS Wertmanagement of € 78 million (2009: € 0 million). From those service fees € 43 million (2009: € 0 million)were transferred to sister companies. The net income of € 35 million has compensated the increase in general administrative expenses for the servicing.

Apart from the effects of the transfer of servicing income from FMS Wertmanagement (€ 43 million, 2009: € 0 million) other operating expenses contain foreign currency translation effects (in particular US-Dollar) amounting to € 13 million (2009: € 52 million). Moreover, other operating expenses include additions to provisions concerning the transfer of positions to FMS Wertmanagement amounting to € 21 million (2009: € 0 million).

38 Provisions for Losses on Loans and Advances

Provisions for losses on loans and advances in € million	2010	2009
Provisions for losses on loans and advances	425	1,889
Additions	742	2,019
Releases	–317	–130
Provisions for contingent liabilities and other commitments	21	3
Additions	24	4
Releases	–3	–1
Recoveries from write-offs of loans and advances	–3	–2
Total	**443**	**1,890**

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

39 General Administrative Expenses

General administrative expenses in € million	2010	2009
Personnel expenses	94	112
Wages and salaries	71	92
Social security costs	15	13
Pension expenses and related employee benefit costs	8	7
Other general administrative expenses	242	131
Depreciation/amortisation	16	16
On software and other intangible assets excluding goodwill	11	11
On property, plant and equipment	5	5
Total	**352**	**259**

Cost-income ratio in %	2010	2009
Cost-income ratio	54.0	46.2

40 Balance of Other Income/Expenses

Balance of other income/expenses in € million	2010	2009
Other income	16	26
thereof: Releases of restructuring provisions	16	26
Other expenses	8	10
thereof: Additions to restructuring provisions	8	10
Balance of other income/expenses	**8**	**16**

41 Taxes on Income

Breakdown in € million	2010	2009
Current taxes	18	41
Deferred taxes	32	–43
thereof: Deferred taxes on capitalised losses carried forward	11	3
Total	**50**	**–2**

Current taxes contain a current tax expense of € 18 million (2009: current tax expense € 41 million). The current taxes contain tax income for prior years of € 3 million.

The change of € –26 million (2009: € 19 million) for deferred taxes has been netted with the AfS reserve and € –383 million (2009: € –163 million) have been netted with the cash flow hedge reserve. The netting of deferred taxes with other equity was € –107 million (2009: € 0 million). The recognition of deferred taxes in other equity in the financial year affects mainly the disposal of net income affecting deferred taxes due to the transfer of positions to FMS Wertmanagement.

Reconciliation in € million	2010	2009
Net income/loss before taxes	−135	−1,572
Applicable (legal) tax rate vin %	15.83	15.83
Expected (computed) tax expense	−21	−249
Tax effects		
arising from foreign income	4	1
arising from tax rate differences	13	−9
arising from losses	–	−1
arising from tax-free income	−1	−7
arising from deductible and non-deductible items	54	75
arising from valuation adjustments and the non-application of deferred taxes	3	166
arising from the write-down of deferred taxes	–	2
arising from prior years and other aperiodical effects	−2	27
from other differences	–	−7
Accounted taxes on income	**50**	**−2**
Group tax ratio in %	**−36.9**	**0.1**

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

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

The effects from tax rate differences include the trade tax burden (current and deferred in accordance with IFRS) which exists in Germany additionally to German corporation tax and solidarity surcharge.

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

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

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

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

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

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

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

Deferred tax liabilities/assets in € million	2010	2009
Loans and advances to other banks/customers (including loan loss allowances)	–	1
Financial investments	193	396
Trading assets	287	57
Other assets/liabilities	811	2,602
Liabilities to other banks/to customers	108	577
Others	44	72
Deferred tax liabilities	**1,443**	**3,648**
Loans and advances to other banks/customers (including provisions for losses on loans and advances)	202	683
Financial investments	125	121
Provisions	23	26
Other assets/liabilities	607	2,822
Losses carried forward	157	168
Liabilities evidenced by certificates	6	265
Trading liabilities	361	117
Others	–	32
Deferred tax assets	**1,481**	**4,234**

For the domestic companies, the deferred taxes are calculated using the uniform rate of corporation tax of 15.0% plus the 5.5% solidarity surcharge payable on this and the locally applicable collection rate for municipal trade tax (the current basic rate is 3.5%). Due to the relocation to Unterschleißheim the tax rate for the valuation of deferred taxes for Deutsche Pfandbriefbank AG is 26.84%.

On the reporting date, there are unused losses carried-forward totalling € 3,519 million (2009: € 3,910 million) at corporate tax level and € 3,717 million (2009: € 4,043 million) at trade tax level. Deferred tax assets have been stated as € 564 million (2009: € 625 million) at corporate tax level and € 611 million (2009: € 625 million) at trade tax level, because the criteria for recognition in accordance with IAS 12.34 et seq. were satisfied. The loss carried-forward can be utilised for an unlimited period of time. Additionally temporary differences of € 60 million (2009: € 61 million) were not recognised with deferred tax assets.

Domestic deferred tax assets on loss carryforwards and temporary differences has been statet in the amount of € 50 million, although the respective associated companies generated in the prior year tax losses. The reason is that the Group expects future tax profits and the losses were generated by one-off effects (financial crisis).

From the origination and reversal of temporary differences a deferred tax income arised of € 21 million (2009: € 55 million). Deferred tax assets of € 11 million (2009: € 3 million) on loss carryforwards has been resolved.

The current tax expense was reduced by the use of previously unrecognised tax losses of € 0.5 million (2009: € 0 million).

On differences associated with investments in subsidiaries, deferred tax liabilities in the amount of € 480 million (2009: € 530 million), has not been stated because it is the ability and the intention to invest profits permanently in these subsidiaries.

42 Net Gains/Net Losses

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

Net gains/net losses in € million	**2010**	**2009**
Loans and receivables	−382	−1,853
Available for sale	4	−3
Held for trading	77	−45
Designated at fair value through P&L	−37	2
Financial liabilities at amortised cost	−9	144

Notes to the Balance Sheet (Assets)

43 Cash Reserve

Cash reserve in € million	31.12.2010	31.12.2009
Balance with central banks	224	618
Total	**224**	**618**

Cash in hand as of 31 December 2010 amounts to less than €1 million as was the case in the previous year.

44 Trading Assets

Trading assets in € million	31.12.2010	31.12.2009
Positive fair values from derivative financial instruments	764	360
Stand-alone derivatives (bank book)	15,404	1,075
Total	**16,168**	**1,435**

The increase of the stand-alone derivatives (bank book) compared to the prior year resulted from the transfer of risks and rewards of positions to FMS Wertmanagement by back-to-back derivatives.

45 Loans and Advances to Other Banks

Loans and advances to other banks, broken down by type of business in € million	31.12.2010	31.12.2009
Loans and advances	12,118	77,967
Public sector loans	6,391	9,126
Real estate loans	28	42
Other loans and advances	5,699	68,799
Investments	3,072	184
Total	**15,190**	**78,151**

Loans and advances to other banks, broken down by maturities in € million	31.12.2010	31.12.2009
Repayable on demand	4,365	4,167
With agreed maturities	10,825	73,984
up to 3 months	4,698	63,858
from 3 month to 1 year	720	3,142
from 1 year to 5 years	2,226	2,502
from 5 years and over	3,181	4,482
Total	**15,190**	**78,151**

46 Loans and Advances to Customers

Loans and advances to customers, broken down by type of business in € million	31.12.2010	31.12.2009
Loans and advances	72,900	91,221
Public sector loans	36,856	36,277
Real estate loans	35,941	54,303
Other loans and advances	103	641
Investments	59,940	–
Total	**132,840**	**91,221**

Loans and advances to customers, broken down by maturities in € million	31.12.2010	31.12.2009
Unspecified terms	–	1
With agreed maturities	132,840	91,220
up to 3 months	65,419	6,539
from 3 months to 1 year	8,091	10,765
from 1 year to 5 years	28,409	35,814
from 5 years and over	30,921	38,102
Total	**132,840**	**91,221**

47 Volume of Lending

Volume of lending in € million	31.12.2010	31.12.2009
Loans and advances to other banks	12,118	77,967
Loans and advances to customers	72,900	91,221
Contingent liabilities	102	689
Total	**85,120**	**169,877**

48 Allowances for Losses on Loans and Advances

Development in € million	Individual allowances on loans and advances	Portfolio-based allowances	Total
Balance at 1.1.2009	**1,402**	**439**	**1,841**
Changes affecting income	1,662	114	1,776
Gross additions	1,895	126	2,021
Releases	– 130	–	– 130
Increase of the present value due to passage of time (unwinding)	– 103	–	– 103
Release model reserve	–	– 12	– 12
Changes not affecting income	– 288	– 3	– 291
Addition and disposals in the group of consolidated companies	–		–
Use of existing loan-loss allowances	– 357	– 3	– 360
Reclassifications	3	–	3
Effects of currency translations and other changes not affecting income	66	–	66
Balance at 31.12.2009	**2,776**	**550**	**3,326**
Balance at 1.1.2010	**2,776**	**550**	**3,326**
Changes affecting income	464	– 110	354
Gross additions	741	1	742
Releases	– 207	– 110	– 317
Increase of the present value due to passage of time (unwinding)	– 70	–	– 70
Release model reserve	–	– 1	– 1
Changes not affecting income	– 2,780	– 339	– 3,119
Addition and disposals in the group of consolidated companies	5	–	5
Use of existing loan-loss allowances	– 704	– 1	– 705
Reclassifications	13	–	13
Effects of currency translations and other changes not affecting income	113	– 1	112
Change due to transfer to FMS Wertmanagement	– 2,207	– 337	– 2,544
Balance at 31.12.2010	**460**	**101**	**561**

In total € 695 million of the gross additions relate to the period from 1 January to 30 September 2010.

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

Breakdown in € million	31.12.2010	31.12.2009
Individual allowances for losses on loans and advances to other banks	36	30
Individual allowances for losses on loans and advances to customers	424	2,746
Portfolio-based allowances	101	550
Total	**561**	**3,326**

Loan loss ratio in € million	31.12.2010	31.12.2009
Loan losses	705	361
Use of existing loan-loss allowances	706	360
Use of allowances for losses on guarantees and indemnities	2	3
Recoveries from written-off loans and advances	–3	–2
Total volume of lending	85,120	169,877
Loan loss ratio[1] in %	**0.83**	**0.21**

[1] Loan losses/total volume of lending

Ratio of allowances to total lendings in € million	31.12.2010	31.12.2009
Total allowances	595	3,337
Allowances for losses on loans and advances	561	3,326
Allowances for contingent liabilities and other commitments	34	11
Total volume of lending	85,120	169,877
Provision rate[1] in %	**0.70**	**1.96**

[1] Total allowances/total volume of lending

49 Financial Investments

Breakdown in € million	31.12.2010	31.12.2009
AfS financial investments	2,293	2,811
Shares in non-consolidated subsidiaries	2	2
Participating interests	–	7
Debt securities and other fixed-income securities	2,289	2,799
Equity securities and other variable-yield securities	2	3
dFVTPL financial investments	317	925
Debt securities and other fixed-income securities	317	925
LaR financial investments	13,735	27,178
Debt securities and other fixed-income securities	13,735	27,178
Total	**16,345**	**30,914**

Financial investments, broken down by maturities in € million	31.12.2010	31.12.2009
Unspecified terms	4	12
With agreed maturities	16,341	30,902
Up to 3 months	787	736
From 3 months to 1 year	804	2,682
From 1 year to 5 years	6,132	9,549
From 5 years and over	8,618	17,935
Total	**16,345**	**30,914**

Breakdown of debt securities and other fixed-income securities in € million	31.12.2010	31.12.2009
Bonds and debt securities	16,341	30,902
by public issuer	10,218	14,409
by other issuer	6,123	16,493
Total	**16,341**	**30,902**

The carrying amounts of the LaR financial investments were reduced by portfolio-based allowances amounting to € 5 million (2009: € 33 million).

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

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

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

Since the date of reclassification, financial assets with a (reclassified) carrying amount of around € 7.7 billion became due. The carrying of the financial assets transferred to FMS Wertmanagement amounted to € 8.9 billion.

In the financial year 2010 securities with a reclassified carrying amount of € 0.5 billion (2009: € 1.3 billion) were sold due to the decided reduction of portfolios. Thereby a net loss of € – 2 million (2009: € – 103 million) was realised.

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

The following tables summarise the carrying amounts and fair values as of 31 December 2010 as well as fair value gains and losses that would have been recognised in 2010 if the financial assets had not been reclassified.

Reclassifications 2010		into: Financial investment loans and receivables (LaR)		Effect in reporting period if no assets would have been reclassified (1.1. – 31.12.2010)	
			31.12.2010		
	Date	Carrying amount in € billion	Fair value in € billion	Income statement in € million	AfS reserve (after taxes) in € million
out of:					
Financial investments available for sale (AfS)	1.7.2008	12.7	12.4	–16	– 20

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

Securities listed on the stock exchange		**31.12.2010**		**31.12.2009**
in € million	listed	unlisted	listed	unlisted
Debt securities and other fixed-income securities	15,030	1,311	26,826	4,076
Equity securities and other variable-yield securities	–	2	–	3
Total	**15,030**	**1,313**	**26,826**	**4,079**

Deutsche Pfandbriefbank Group cannot determine reliably a fair value for some shares in companies for which there is no market value available and which are not fully consolidated or are not accounted for using the equity method due to considerations of materiality. These companies in the legal form of limited or private are not traded in an active market. Therefore, the investments are measured at amortised cost. The carrying amount of these financial investments amounted to €2 million as of 31 December 2010 (2009: €9 million). In financial year 2010, financial investments, for which it is not possible for the fair value to be reliably established, were derecognised for €7 million (2009: €0 million). As in the previous year, this did not result in a profit.

50 Property, Plant and Equipment

Breakdown in € million	31.12.2010	31.12.2009
Plant and operating equipment	5	10
Total	**5**	**10**

Development of property, plant and equipment in € million	2010	2009
Plant and operating equipment		
Acquisition/production costs		
Balance at 1.1.	**32**	**36**
Changes in the group of consolidated companies	–8	15
Changes from foreign currency translation	1	–
Additions	1	3
Disposals	–5	–22
Balance at 31.12.	**21**	**32**
Amortisation/depreciation and write-ups		
Balance at 1.1.	**22**	**24**
Changes in the group of consolidated companies	–7	11
Changes from foreign currency translation	–	–
Scheduled amortisation/depreciation	5	5
Unscheduled amortisation/depreciation	–	–
Write-ups	–	–
Reclassifications	–	–
Disposals	–4	–18
Balance at 31.12.	**16**	**22**
Carrying amounts		
Balance at 31.12.	**5**	**10**

51 Intangible Assets

Breakdown in € million	31.12.2010	31.12.2009
Software acquired	8	23
Internally generated software	17	3
Advance payments	7	2
Total	**32**	**28**

Development of intangible assets in € million	Software acquired	Internally generated software	Advance payments	2010 Total	2009 Total
Acquisition/production costs					
Balance at 1.1.	**86**	**4**	**2**	**92**	**70**
Changes in the group of consolidated companies	–	–	–	–	10
Additions	9	2	6	17	11
Reclassifications	−21	21	−1	−1	6
Disposals	–	–	–	–	5
Balance at 31.12.	**74**	**27**	**7**	**108**	**92**
Amortisation/depreciation and write-ups					
Balance at 1.1.	**63**	**1**	**–**	**64**	**47**
Changes in the group of consolidated companies	–	–	–	–	9
Scheduled amortisation/depreciation	5	6	–	11	11
Unscheduled amortisation/depreciation	1	–	–	1	1
Reclassifications	−3	3	–	–	–
Disposals	–	–	–	–	−3
Balance at 31.12.	**66**	**10**	**–**	**76**	**64**
Carrying amounts					
Balance at 31.12.	**8**	**17**	**7**	**32**	**28**

The amortisation/depreciation of intangible assets is part of general administrative expenses.

52 Other Assets

Other assets in € million	31.12.2010	31.12.2009
Positive fair values from derivative financial instruments	4,607	11,389
Hedging derivatives	4,607	11,389
Micro fair value hedge	3,630	2,884
Cash flow hedge	977	8,505
Salvage acquisitions	86	108
Other assets	313	285
Deferred charges and prepaid expenses	29	19
Total	**5,035**	**11,801**

The salvage acquisitions initially recognised in 2010 are described in the note consolidation. The impairments on salvage acquisitions amounted to € 2 million in the financial year 2010 (2009: € 37 million) and the losses from sales to € 0 million (2009: € 5 million).

53 Income Tax Assets

Income tax assets in € million	31.12.2010	31.12.2009
Current tax assets	64	131
Deferred tax assets	1,481	4,234
Total	**1,545**	**4,365**

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

54 Subordinated Assets

The following balance sheet items contain subordinated assets:

Subordinated assets in € million	31.12.2010	31.12.2009
Loans and advances to other banks	–	510
Loans and advances to customers	70	66
Financial investments	–	20
Total	**70**	**596**

55 Repurchase Agreements

As a pledgor of genuine repurchase agreements, Deutsche Pfandbriefbank Group has pledged assets with a book value of € 1.8 billion (2009: € 1.2 billion). The securities are not derecognised. The considerations which have been received amount to € 0.1 billion (2009: € 0.1 billion) and are recognised under liabilities and thereof mainly come under liabilities to other banks. Assets in repurchase agreements are the only transferable assets the acquirer can sell or repledge in the absence of default according to IAS 39.37 (a).

56 Securitisation

As of 31 December 2010 Deutsche Pfandbriefbank Group has the synthetic securitisation Estate UK-3 with a maturity of 15 years and a total volume of lending of € 521 million in the portfolio. The issuer of the transaction with commercial mortgage loans is Deutsche Pfandbriefbank AG.

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

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

Securitisation programmes usually provide for a small part of the risks being retained in the form of a first loss piece or interest sub-participation on the part of the pledgor. For the programme mentioned above, first loss pieces amount to € 17 million (2009: € 92 million). Thereof risks are neither held by interest sub-participations (2009: € 43 million) nor by purchase of own junior tranches (2009: € 32 million).

Overall a reduction of risk-weighted assets according to Basel II of € 17 million (2009: € 220 million) was achieved with the above-mentioned synthetic securitisation programme.

Notes to the Balance Sheet (Equity and Liabilities)

57 Liabilities to Other Banks

Liabilities to other banks by maturities in € million	31.12.2010	31.12.2009
Repayable on demand	15	895
With agreed maturities	62,572	66,730
Up to 3 months	59,499	57,608
From 3 months to 1 year	1,199	7,034
From 1 year to 5 years	1,465	1,158
From 5 years and over	409	930
Total	**62,587**	**67,625**

58 Liabilities to Customers

Liabilities to customers by maturities in € million	31.12.2010	31.12.2009
Repayable on demand	3,464	53
With agreed maturities	13,920	12,325
Up to 3 months	1,240	205
From 3 months to 1 year	1,529	1,572
From 1 year to 5 years	4,885	3,809
From 5 years and over	6,266	6,739
Total	**17,384**	**12,378**

59 Liabilities Evidenced by Certificates

Liabilities evidenced by certificates, broken down by type of business in € million	31.12.2010	31.12.2009
Debt securities in issue	40,344	84,626
Mortgage bonds	8,494	11,569
Public sector bonds	26,346	40,254
Other debt securities	5,218	32,789
Money market securities	286	14
Registered notes in issue	23,502	24,567
Mortgage bonds	7,144	8,230
Public sector bonds	15,318	15,323
Other debt securities	1,040	1,014
Total	**63,846**	**109,193**

Liabilities evidenced by certificates, broken down by maturities in € million	31.12.2010	31.12.2009
With agreed maturities		
Up to 3 months	2,621	8,225
From 3 months to 1 year	8,959	39,141
From 1 year to 5 years	26,071	31,664
From 5 years and over	26,195	30,163
Total	**63,846**	**109,193**

60 Trading Liabilities

Trading liabilities in € million	31.12.2010	31.12.2009
Negative fair values from derivative financial instruments	871	452
Other trading liabilities	2	2
Stand-alone derivatives (bank book)	15,421	1,418
Total	**16,294**	**1,872**

The increase of the stand-alone derivatives (bank book) compared to the prior year resulted from the transfer of risks and rewards of positions to FMS Wertmanagement by back-to-back derivatives.

61 Provisions

Breakdown in € million	31.12.2010	31.12.2009
Provisions for pension and similar obligations	5	5
Restructuring provisions	83	100
Provisions for contingent liabilities and other commitments	34	11
Other provisions	54	37
thereof: Long-term liabilities to employees	3	4
Total	**176**	**153**

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

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

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

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

Discount rates and valuation parameters in %	31.12.2010/ 1.1.2011	31.12.2009/ 1.1.2010
Discount rate	4.75	5.25
Expected return from plan assets	4.25	4.50
Rate of increase in pension obligations	2.00	2.00
Rate of increase in future compensation and vested rights	2.50	2.50
Rate of increase over career	0–1.50	0–1.50

The rate of increase over career amounts for members of the Management Board 0%, for directors and non-pay-scale staff 1.5% and for pay-scale staff 0.5%.

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

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

Funding status in € million	31.12.2010	31.12.2009	31.12.2008	31.12.2007	31.12.2006
Present value of unfunded pension claims cested	–	–	–	–	–
Present value of partly funded pension obligations	217	204	143	116	130
Fair value of plan assets	– 198	– 198	– 195	– 156	– 153
Funding status	**19**	**6**	**– 52**	**– 40**	**– 23**
Outstanding actuarial profit (+)/loss (–)	– 14	– 1	–	–	– 17
Outstanding past service cost	–	–	–	–	–
Net of balance sheet value	**5**	**5**	**– 52**	**– 40**	**– 40**
thereof: Capitalised excess cover of plan assets	–	–	52	40	40
Pensions provisions recognised	5	5	–	–	–

The 10 % corridor of the higher amount originating from the present value of the pension claims vested and the fair value of plan assets was not exceeded as of 31 December 2010 and as of 31 December 2009. Movements in pension obligations are shown below:

Development of pension obligations in € million	2010	2009
Balance at 1.1.	**204**	**143**
Changes in the group of consolidated companies	–	63
Transfer of staff	–	1
Pensions claims vested	1	1
Interest expense	10	11
Actuarial profit (–)/loss (+)	13	– 2
Payments to beneficiaries	– 11	– 13
Balance at 31.12.	**217**	**204**

The experience-based adjustment of pension claims (profit [–]/loss [+]) amounts to 0 % (2009: – 2 %; 2008: 0 %, 2007: 1 %) of the corresponding present value of pension claims vested as of 31 December 2010.

Pension expenses are broken down as follows:

Breakdown of pension expenses in € million	2010	2009
Present value of pension claims vested	1	1
Interest expense	10	11
Expected return from plan assets	– 9	– 9
Past service cost	–	–
Actuarial losses recognised as expense	–	–
Total	**2**	**3**

The pension expenses are part of general administrative expenses.

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

Development of plan assets in € million	2010	2009
Balance at 1.1.	**198**	**195**
Changes in the group of consolidated companies	–	1
Transfer of staff	–	3
Expected return from plan assets	9	9
Outstanding actuarial profit (+)/loss (–)	–	– 3
Payments to beneficiaries	–9	– 7
Balance at 31.12.	**198**	**198**

The actual return from the plan assets amounts to € 9 million (2009: € 6 million).

Development of provisions in € million	Restructuring provisions	Provisions for contingent liabilities and other commitments	Other provisions
Balance at 1.1.2010	**100**	**11**	**37**
Changes in the group of consolidated companies	–	–	–
Change due to transfer to FMS Wertmanagement	–	−3	−6
Changes due to foreign currency translation	–	–	–
Additions	8	29	38
Reversals	−16	−3	−2
Increase of the present value due to passage of time (unwinding)	2	–	–
Amounts used	−11	−1	−4
Reclassifications	−1	1	−1
Intra-group transfers	1	–	−8
Balance at 31.12.2010	**83**	**34**	**54**

On 19 December 2008 the Management Board and Supervisory Board of the Deutsche Pfandbriefbank 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 2010 € 11 million (2009: € 29 million) were used of this provision. The provision will be completely utilised until 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 in connection with town planning agreements of € 9 million (2009: € 9 million) and provisions for long-term liabilities with regard to employees of € 3 million (2009: € 4 million).

In connection with the transfer of positions to FMS Wertmanagement provisions amounting to € 21 million are included in other provisions.

Legal and Arbitration Proceedings As a result of the nature and global scope of its activities, Deutsche Pfandbriefbank Group is involved in court, arbitration and regulatory proceedings in numerous countries. For the uncertain liabilities arising from these proceedings, Deutsche Pfandbriefbank Group creates provisions if the potential outflow of resources is sufficiently likely and if it is possible for the extent of the obligation to be estimated. The probability of the outflow of resources depends to a considerable extent on the outcome of the proceedings, which, however, normally cannot be estimated with any certainty. The assessment of probability and the quantification of the uncertain liability essentially depend on estimates. The actual liability may differ considerably from this estimate. With regard to the accounting treatment of the individual cases, the Group relies on its own expertise, appraisals prepared by external advisors, in particular legal advisors, developments in the individual proceedings as well as developments in equivalent proceedings, experience within the Group and also the experience of third parties in equivalent cases, depending on the importance and difficulty of the specific case.

In March 2009, a credit broker who previously had been acting for Deutsche Pfandbriefbank Group in France initiated legal action against Deutsche Pfandbriefbank at the Landgericht Stuttgart, claiming damages of at least € 20 million due to the suspension of the cooperation contract.

The decision of the Management Board not to pay any discretionary variable compensation for the year 2008 has since resulted in several labour court proceedings with staff in Germany which are either pending or which have been threatened. The question as to whether, and if so to what extent, bonus claims for employees exist for the year 2008 is a question of contract interpretation; in particular the interpretation of reasonableness as well as the application of the Law of General Terms and Conditions in each individual case. So far, six verdicts of the first instance have been issued against the Bank and two verdicts of the first instance have been issued against pbb Services regarding the bonus for the year 2008. In seven cases, the respective company has already appealed against the verdicts which have (partially) allowed the litigation regarding the bonuses, and intends to do so in the further proceedings. However, in the meantime, four verdicts of the first instance have also been allowed in favour of the Bank; in each of these cases, the litigation regarding the bonuses of the staff has been completely denied. Two of the plaintiffs have already appealed, and one verdict is now legally binding. In three cases in which the labour court had allowed bonus claims to the staff, the court of appeal has now decided in favour of the Bank (2) or pbb Services (1). One decision (in favour of pbb Services) is already legally binding.

It is possible that bonus claims for 2008 will be enforced successfully by additional employees; however, the decisions of the labour courts in Munich and Stuttgart as well as the regional labour court in Munich which have been issued in favour of the Bank show that the courts are also able to use their discretion to fully reject the litigation.

Employees have also enforced claims for bonuses for the year 2009, in court in certain cases. The Management Board has also decided not to pay any discretionary variable compensation throughout the Group for the year 2009. An offer was made for a payment with a different purpose, a different content and of a different amount in 2010 as part of the process of determining the replacement solution for 2009; this offer also involved the aims of reducing the operational risks and also of achieving a legal settlement. So far, two verdicts of the first instance have been issued against the Bank and one verdict of the first instance has been issued against pbb Services with regard to the bonus for the year 2009. In all three cases, the respective company has already appealed against the verdict which has allowed the bonus claims (partially). Two verdicts of the first instance have been issued in favour of the Bank; these verdicts have each completely rejected the bonus claims of the employees. One of the plaintiffs has already appealed. In two cases in which the labour court had allowed bonus claims to the employees, the court of appeal has now decided in favour of the Bank (1) or in favour of pbb Services (1). The decision (in favour of pbb Services) is already legally binding. Again, it is possible that further employees may successfully enforce bonus claims for 2009. However, we are assuming that, as a result of the voluntary one-off payment offered within the framework of the substitute solution for the non-payment of discretionary variable compensation for 2009 (in Germany in return for a waiver), it is likely that litigation in relation to payment of discretionary compensation for 2009 will probably be the exception.

62 Other Liabilities

Other liabilities in € million	31.12.2010	31.12.2009
Negative fair values from derivative financial instruments	4,316	13,087
Hedging derivatives	4,293	13,020
Micro fair value hedge	3,578	3,784
Cash flow hedge	715	9,236
Derivatives hedging dFVTPL financial instruments	23	67
Other liabilities	14,518	451
Deferred income	49	97
Total	**18,883**	**13,635**

Other liabilities include amongst others liabilities from the offsetting of results and also accruals pursuant to IAS 37. Accruals in particular include accounts payable in respect of invoices still outstanding, short-term liabilities to employees and other accruals in respect of commission, interest, operating expenses, etc. The largest single item of other liabilities is a liability to FMS Wertmanagement as compensation for assets which were not transferred for legal reasons.

63 Income Tax Liabilities

Income tax liabilities in € million	31.12.2010	31.12.2009
Current tax liabilities	83	85
Deferred tax liabilities	1,443	3,648
Total	**1,526**	**3,733**

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

64 Subordinated Capital

Breakdown in € million	31.12.2010	31.12.2009
Subordinated liabilities	2,480	3,626
Participating certificates outstanding	15	13
Hybrid capital instruments	271	256
Total	**2,766**	**3,895**

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

Subordinated capital, broken down by maturities in € million	31.12.2010	31.12.2009
With agreed maturities		
Up to 3 months	215	32
From 3 months to 1 year	113	217
From 1 year to 5 years	1,193	1,353
From 5 years and over	1,245	2,293
Total	**2,766**	**3,895**

The appreciation of some instruments of subordinated capital led to an expense of € – 13 million in the year 2010 (2009: income of € 138 million).

Participating Certificates Outstanding Issued participatory capital comprises the following issues:

Participating certificates outstanding Issuer	Year of issue	Type	in € million	Nominal amount in %	Interest rate Maturity
Deutsche Pfandbriefbank AG	1989	Registered participation certificate	10	8,000	2014
Deutsche Pfandbriefbank AG	2001	Registered participation certificate	21	7,100	2011
Deutsche Pfandbriefbank AG	2001	Registered participation certificate	5	7,130	2011
Deutsche Pfandbriefbank AG	2001	Bearer participation certificate	13	6,750	2010
Deutsche Pfandbriefbank AG	2001	Bearer participation certificate	50	7,000	2011
Deutsche Pfandbriefbank AG	2002	Bearer participation certificate	50	7,000	2012

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

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

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

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

65 Equity

Subscribed capital equals the maximum liability of the shareholder for the liabilities of the corporation to its creditors. Additional paid-in capital includes premiums from the issue of shares and the contribution of SoFFin to reserves. 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.

The subscribed capital as of 31 December 2010 and during the entire financial year 2010 amounts to € 380,376,059.67 which is divided into 134,475,308 ordinary bearer shares representing a rounded interest of € 2.83 in the share capital as of 31 December 2009 and as of the whole year 2009. HRE Holding holds 100 % of the share capital of the bank. SoFFin is the only shareholder of HRE Holding.

In the fourth quarter 2009 SoFFin provided Deutsche Pfandbriefbank AG with a silent participation of € 1.0 billion. The silent participation participates in the cumulative loss calculated in accordance with the regulations of commercial law to the same extent that the silent participation is related to the total carrying amount of all liable capital shares which participate in the cumulative loss. The total loss of the silent partner in relation to the cumulative loss under commercial law is limited to its silent contribution. The cumulative loss which is attributable to the year 2008 is not used for calculating the loss participation. At the end of the year, the silent contribution was reduced by € 318 million to € 285 million (2009: by € 397 million to € 603 million) in the commercial law financial statements of Deutsche Pfandbriefbank AG. Deutsche Pfandbriefbank AG has a replenishment obligation.

66 Foreign-currency Assets and Liabilities

Foreign-currency assets and liabilities in € million	**31.12.2010**	**31.12.2009**
Foreign-currency assets	19,948	36,722
thereof: US$	8,358	20,779
JP¥	2,499	3,536
CHF	3,247	2,670
SEK	1,237	2,123
HK$	76	6
GB£	3,699	6,310
Others	832	1,298
Foreign-currency liabilities (excluding equity)	20,975	36,146
thereof: US$	8,391	20,434
JP¥	2,267	3,429
CHF	3,267	2,651
SEK	1,809	1,963
HK$	83	–
GB£	4,256	6,364
Others	902	1,305

67 Trust Business

The following tables show the volume of fiduciary business not shown in the consolidated balance sheet.

Trust assets in € million	**31.12.2010**	**31.12.2009**
Loans and advances to customers	22	25
Total	**22**	**25**

Trust liabilities in € million	**31.12.2010**	**31.12.2009**
Deposits from other banks	15	20
Amounts owed to other depositors	7	5
Total	**22**	**25**

Notes to the Cash Flow Statement

68 Notes to the Items in the Cash Flow Statement

The cash flow statement shows the cash flows of the financial year broken down into cash flows attributable to operating activities, investing activities and financing activities. Cash and cash equivalents correspond to the balance sheet item cash reserve, and include cash in hand and credit balances at central banks.

Operating activities are defined broadly, and correspond to operating result. Cash flow from operating activities includes payments (inflows and outflows) attributable to loans and advances to other banks and customers as well as securities attributable to trading assets and other assets. Inflows and outflows attributable to liabilities to other banks and customers, liabilities evidenced by certificates and other liabilities are also included under operating activities. The interest and dividend payments resulting from operating activities are shown under cash flow from operating activities.

Cash flow from investing activities comprises payments for investment and security holdings as well as for property, plant and equipment.

Cash flow from financing activities comprises inflows from capital increases, payments into reserves and silent participations as well as inflows and outflows for subordinated capital.

In 2010, no company was purchased or sold.

Notes to the Financial Instruments

69 Derivative Transactions

The following tables present the respective nominal amounts and fair values of OTC derivatives and derivatives traded on a stock exchange.

In order to minimise (reduce) both the economic and the regulatory credit risk arising from these instruments, master agreements (bilateral netting agreements) have been concluded. By means of such netting agreements, the positive and negative fair values of the derivatives contracts included under the master agreement can be offset against one another, and the future regulatory risk add-ons for these products can be reduced. Through this netting process, the credit risk is limited to a single net claim on the party to the contract.

For both regulatory reports and the internal measurement and monitoring of the credit commitments, such risk-reducing techniques are utilised only if they are considered to be enforceable under the respective legal system in the event that the business associate becomes insolvent. Legal advice was taken in order to check enforceability.

Similar to the master agreements, Deutsche Pfandbriefbank Group concludes collateral agreements with its business associates to collateralise the net claim or liability remaining after netting (obtained or pledged collateral). As a rule, this collateral management reduces credit risk by means of prompt measurement and adjustment exposure to customers.

Fair values appear as the sum of positive and negative amounts per contract, from which no pledged collateral has been deducted and no netting agreements have been taken into consideration. By definition, no positive fair values exist for put options.

Volume of derivatives at 31.12.2010	Nominal amount				Fair value	
	Remaining maturities					
in € million	Less than 1 year	1 to 5 years	More than 5 years	**Total**	positive	negative
Interest-based transactions						
OTC products	51,010	203,584	161,525	416,119	19,534	19,205
Forward rate agreements	–	–	–	–	–	–
Interest rate swaps	47,802	198,532	161,466	407,800	19,490	19,140
Interest rate options	3,208	5,052	59	8,319	44	65
Call options	1,605	2,514	–	4,119	35	9
Put options	1,603	2,538	59	4,200	9	56
Other interest rate contracts	–	–	–	–	–	–
Total	**51,010**	**203,584**	**161,525**	**416,119**	**19,534**	**19,205**
Foreign-currency-based transactions						
OTC products	10,427	16,065	2,278	28,770	1,241	1,160
Spot and forward currency transactions	6,971	286	–	7,257	111	143
Interest rate/currency swaps	3,456	15,779	2,278	21,513	1,130	1,017
Total	**10,427**	**16,065**	**2,278**	**28,770**	**1,241**	**1,160**
Other transactions						
OTC products	–	60	183	243	–	243
Credit derivatives	–	60	183	243	–	243
Total	–	**60**	**183**	**243**	–	**243**
Total	**61,437**	**219,709**	**163,986**	**445,132**	**20,775**	**20,608**

Use made of derivative transactions at 31.12.2010		Fair value	
in € million	Nominal amount	positive	negative
Interest-based transactions			
Fair value hedge accounting	70,692	3,629	3,539
Cash flow hedge accounting	17,162	772	660
Derivatives hedging dFVTPL financial instruments	315	–	23
Stand-alone derivatives	327,950	15,133	14,983
Total	**416,119**	**19,534**	**19,205**
Foreign-currency-based transactions			
Fair value hedge accounting	240	1	39
Cash flow hedge accounting	1,425	205	55
Stand-alone derivatives	27,105	1,035	1,066
Total	**28,770**	**1,241**	**1,160**
Other transactions			
Stand-alone derivatives	243	–	243
Total	**243**	**–**	**243**
Total	**445,132**	**20,775**	**20,608**

Volume of derivatives at 31.12.2009	Nominal amount				Fair value	
	Remaining maturities					
in € million	Less than 1 year	1 to 5 years	More than 5 years	**Total**	positive	negative
Interest-based transactions						
OTC products	57,860	143,189	132,625	333,674	12,251	14,032
Forward rate agreements	1,000	–	–	1,000	–	–
Interest rate swaps	53,364	136,412	131,837	321,613	12,185	13,901
Interest rate options	3,496	6,777	778	11,051	66	129
Call option	1,610	3,426	146	5,182	53	13
Put options	1,886	3,351	632	5,869	13	116
Other interest rate contracts	–	–	10	10	–	2
Total	**57,860**	**143,189**	**132,625**	**333,674**	**12,251**	**14,032**
Foreign-currency-based transactions						
OTC products	19,644	7,453	2,398	29,495	573	520
Spot and forward currency transactions	17,133	136	–	17,269	45	326
Interest rate/currency swaps	2,511	7,317	2,398	12,226	528	194
Total	**19,644**	**7,453**	**2,398**	**29,495**	**573**	**520**
Other transactions						
OTC products	–	55	488	543	–	405
Credit derivatives	–	55	488	543	–	405
Total	**–**	**55**	**488**	**543**	**–**	**405**
Total	**77,504**	**150,697**	**135,511**	**363,712**	**12,824**	**14,957**

Use made of derivative transactions at 31.12.2009		Fair value	
in € million	Nominal amount	positive	negative
Interest-based transactions			
Fair value hedge accounting	75,485	2,879	3,764
Cash flow hedge accounting	238,549	7,938	8,795
Derivatives hedging dFVTPL financial instruments	876	–	67
Stand-alone derivatives	18,764	1,434	1,406
Total	**333,674**	**12,251**	**14,032**
Foreign-currency-based transactions			
Fair value hedge accounting	528	5	20
Cash flow hedge accounting	26,132	567	441
Stand-alone derivatives	2,835	1	59
Total	**29,495**	**573**	**520**
Other transactions			
Stand-alone derivatives	543	–	405
Total	**543**	**–**	**405**
Total	**363,712**	**12,824**	**14,957**

Counterparties in € million	31.12.2010 Fair value positive	31.12.2010 Fair value negative	31.12.2009 Fair value positive	31.12.2009 Fair value negative
OECD banks	11,848	14,354	11,314	14,228
OECD financial institutions	8,432	5,983	217	318
Other companies and private individuals	495	271	1,293	411
Total	**20,775**	**20,608**	**12,824**	**14,957**

70 Cash Flow Hedge Accounting

The cash flows of the hedged items shown in cash flow hedge accounting are expected to occur in the following periods:

Cash flow hedge: periods of hedged items when cash flows are expected to occur in € million	31.12.2010	31.12.2009
Up to 1 month	8	12
From 1 month to 3 months	–5	5
From 3 months to 1 year	3	117
From 1 year to 2 years	27	130
From 2 years to 5 years	84	656
From 5 years and over	388	1,838
Total	**505**	**2,758**

It is expected that the cash flows will affect the income statement in the period of occurrence.

The development of the cash flow hedge reserve is shown in the statement of changes in equity.

71 Undiscounted Cash Flows of Financial Liabilities

The contractual undiscounted cash flows from derivative and non-derivative financial instruments of the financial liabilities according to IFRS 7.39 are split up into the following remaining maturities as of 31 December 2010:

Contractual undiscounted cash flows of the financial liabilities according to IFRS 7.39 in € billion	31.12.2010	31.12.2009
Up to 3 months	65	75
From derivative financial instruments	2	4
From non-derivative financial instruments	63	71
From 3 months to 1 year	19	65
From derivative financial instruments	4	10
From non-derivative financial instruments	15	55
From 1 year to 5 years	56	56
From derivative financial instruments	12	11
From non-derivative financial instruments	44	45
From 5 years and over	70	55
From derivative financial instruments	8	3
From non-derivative financial instruments	62	52

In conformity with the requirements, the contractual undiscounted cash flow maturities are presented in accordance with the worst-case scenario, meaning that if there are options or terminations rights involved the most unfavourable case from a liquidity perspective is assumed. This presentation does not reflect the economic management which is based on expected cash flows. The liquidity risk strategy and management of Deutsche Pfandbriefbank Group is described in the Risk Report.

72 Assets Assigned or Pledged as Collateral for Own Liabilities

The following assets and received collaterals were assigned or pledged as collateral:

Liabilities in € million	31.12.2010	31.12.2009
Liabilities to other banks	59,132	56,906
Total	**59,132**	**56,906**

The following assets were pledged as collateral for the above liabilities:

Assets pledged in € million	31.12.2010	31.12.2009
Loans and advances to other banks	196	214
Loans and advances to customers	8,658	5,476
Financial investments	1,413	5,842
Total	**10,267**	**11,532**

The assets pledged mainly resulted from repurchase agreements. The transactions were carried out at the normal standard terms for repurchase transactions. The amount of the previous year additionally includes collaterals which had not be released until 31 December 2009 for the liquidity support from a syndicate from the German finance sector and the Bundesbank with the participation of the German Federal Government as well as from SoFFin.

73 Collaterals Permitted to Resell or Repledge

The fair value of collaterals that may be resold or repledged in the absence of default amounted to € 62.3 billion as of 31 December 2010 (2009: € 0 billion). Deutsche Pfandbriefbank Group received the collaterals as part of repurchase agreements and is principally obliged to return the collaterals to the grantor. The majority of collaterals which can be sold or repledged in the absence of default results from collaterals of FMS Wertmanagement which are pledged for funding at central banks or in bilateral repo. The funding is transferred to FMS Wertmanagement which does not have direct access to ECB funding due to its missing banking status. The fair value of the transferred collaterals amounts to € 62.3 billion (2009: € 0 billion).

74 Fair Values of Financial Instruments

The recognised fair values of financial instruments according to IFRS 7 correspond to the amounts at which, in the opinion of Deutsche Pfandbriefbank Group, an asset could be exchanged on the balance sheet date between willing, competent business partners or the amount at which a liability could be settled between such business partners. The fair values were determined as of the balance sheet date based on the market information available and on valuation methods described in note financial instruments.

As per the amendment to IFRS 7 Financial Instruments: Disclosures issued in March 2009 all financial assets and liabilities of HRE that are measured at fair value should be grouped into the fair value hierarchies.

The three-level hierarchy is based on the degree to which the input for the fair value measurement is observable:

> Level 1 – quoted priced (unadjusted) in active markets for identical financial assets or financial liabilities.
> Level 2 – inputs that are observable either directly or indirectly, other than quoted prices included within Level 1.
> Level 3 – valuation techniques that include inputs that are not based on observable market data (unobservable inputs).

The following tables show financial assets and financial liabilities measured at fair value grouped into the fair value hierarchy:

Fair value hierarchy at 31.12.2010

in € million	**Total**	Level 1	Level 2	Level 3
Assets				
Financial assets at fair value through P&L	20,115	317	19,772	26
Trading assets	16,168	–	16,160	8
dFVTPL financial investments	317	317	–	–
Hedging derivatives	3,630	–	3,612	18
Financial assets at fair value not affecting P&L	3,268	2,291	944	33
AfS financial investments[1]	2,291	2,291	–	–
Cash flow hedge derivatives	977	–	944	33
Total	**23,383**	**2,608**	**20,716**	**59**
Liabilities				
Financial liabilities at fair value through P&L	19,895	–	19,635	260
Trading liabilities	16,294	–	16,041	253
Hedging derivatives	3,578	–	3,571	7
Derivatives hedging dFVTPL financial instruments	23	–	23	–
Financial liabilities at fair value not affecting P&L	715	–	715	–
Cash flow hedge derivatives	715	–	715	–
Total	**20,610**	–	**20,350**	**260**

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

Fair value hierarchy at 31.12.2009

in € million	**Total**	Level 1	Level 2	Level 3
Assets				
Financial assets at fair value through P&L	5,244	871	4,346	27
Trading assets	1,435	–	1,426	9
dFVTPL financial investments	925	871	54	–
Hedging derivatives	2,884	–	2,866	18
Financial assets at fair value not affecting P&L	11,307	2,792	8,467	48
AfS financial investments[1]	2,802	2,792	10	–
Cash flow hedge derivatives	8,505	–	8,457	48
Total	**16,551**	**3,663**	**12,813**	**75**
Liabilities				
Financial liabilities at fair value through P&L	5,723	–	5,480	243
Trading liabilities	1,872	–	1,636	236
Hedging derivatives	3,784	–	3,777	7
Derivatives hedging dFVTPL financial instruments	67	–	67	–
Financial liabilities at fair value not affecting P&L	9,236	–	9,218	18
Cash flow hedge derivatives	9,236	–	9,218	18
Total	**14,959**	**–**	**14,698**	**261**

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

The current reporting period was characterised by the transfer of positions to FMS Wertmanagement, which took place on 1 October 2010 and which resulted in a considerable change in the presented figures.

During the current financial year there have been neither reclassifications from Level 1 into Level 2, nor reclassifications from Level 2 into Level 1.

The following tables present the changes in Level 3 instruments for the business year:

Changes in Level 3 financial assets	Financial assets at fair value through P&L		Financial assets at fair value not affecting P&L	
in € million	Trading assets	Hedging derivatives	Cash flow hedge derivatives	**Total**
Balance at 1.1.2009	**5**	**12**	**34**	**51**
Comprehensive income				
Income statement	4	15	–	19
AfS reserve	–	–	14	14
Purchases	–	–	–	–
Sales	–	–	–	–
Issues	–	–	–	–
Settlements	–	–9	–	–9
Transfers into Level 3	–	–	–	–
Transfers out of Level 3	–	–	–	–
Balance at 31.12.2009	**9**	**18**	**48**	**75**
Balance at 1.1.2010	**9**	**18**	**48**	**75**
Comprehensive income	–1	6	–	5
Income statement	–	–	–	–
AfS reserve	–	–	–	–
Purchases	–	–	–	–
Sales	–	–	–	–
Changes due to transfer to FMS Wertmanagement	–	–	–15	–15
Issues	–	–	–	–
Settlements	–	–	–	–
Reclassification into Level 3	–	–	–	–
Reclassification out of Level 3	–	–6	–	–6
Balance at 31.12.2010	**8**	**18**	**33**	**59**

Changes in Level 3 financial liabilities

in € million	Financial liabilities at fair value through P&L		Financial liabilities at fair value not affecting P&L	
	Trading liabilities	Hedging derivatives	Cash flow hedge derivatives	**Total**
Balance at 1.1.2009	**–610**	**–35**	**–15**	**–660**
Comprehensive income				
Income statement	–14	28	–	14
AfS reserve	–	–	–3	–3
Purchases	–2	–	–	–2
Sales	–	–	–	–
Issues	–	–	–	–
Settlements	390	–	–	390
Transfers into Level 3	–	–	–	–
Transfers out of Level 3	–	–	–	–
Balance at 31.12.2009	**–236**	**–7**	**–18**	**–261**
Balance at 1.1.2010	**–236**	**–7**	**–18**	**–261**
Comprehensive income				
Income statement	78	–	–	78
AfS reserve	–	–	2	2
Purchases	–	–	–	–
Sales	–	–	–	–
Changes due to transfer to FMS Wertmanagement	85	–	16	101
Issues	–	–	–	–
Settlements	–	–	–	–
Reclassifications into Level 3	–180	–	–	–180
Reclassifications out of Level 3	–	–	–	–
Balance at 31.12.2010	**–253**	**–7**	**–**	**–260**

The position Change due to transfer to FMS Wertmanagement shows Level 3 transactions which meet the derecognition criteria in accordance with IAS 39.14 et seq. and which have been transferred either physically or synthetically.

Of the total gains or losses for the year 2010 recognised in income statement amounting to €83 million relates to FVTPL assets and FVTPL liabilities held in Level 3 on the balance sheet date. Gains or losses from FVTPL assets (thereof €–1 million trading assets and €6 million hedging derivatives) are included in net trading income (€–1 million) and net income from hedge relationships (€6 million). Gains or losses from FVTPL liabilities are mainly included in net trading income (€78 million).

The changes recognised in equity (€2 million) mainly relate to cash flow hedge derivatives held on the balance sheet date. Those changes were recognised in cash flow hedge reserve.

In the year 2010, Deutsche Pfandbriefbank Group reclassified financial instruments from Level 2 into Level 3 (€180 million) and from Level 3 into Level 2 (€6 million).

Although Deutsche Pfandbriefbank Group believes that its estimates of fair value 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 2010 which have been quantified on the basis of the specified valuation parameters taking account of scenarios usual in the market:

Sensitivities of Level 3 instruments at 31.12.2010 in € million	Favourable changes	Unfavourable changes
Assets		
Financial assets at fair value through P&L		
Hedging derivatives	4.8	–5.5
Total	**4.8**	**–5.5**
Liabilities		
Financial liabilities at fair value through P&L		
Trading liabilities	0.4	–0.5
Hedging derivatives	0.2	–0.3
Total	**0.6**	**–0.8**

Sensitivities of Level 3 instruments at 31.12.2009 in € million	Favourable changes	Unfavourable changes
Assets		
Financial assets at fair value through P&L		
Hedging derivatives	5.3	–5.1
Total	**5.3**	**–5.1**
Liabilities		
Financial liabilities at fair value through P&L		
Hedging derivatives	0.3	–0.4
Total	**0.3**	**–0.4**

The 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.

The methods and valuation techniques used for the purpose of measuring fair value are unchanged compared to the previous period. In the following the valuation methods on the level of product classes are described in detail:

The fair values of certain financial instruments reported at notional values are almost identical to their carrying amounts. These include, for example, cash reserve, loans and advances and liabilities without fixed interest rates or maturity respectively mature in the short term. For these financial instruments the carrying amount is used for fair value measurement because the difference is not material.

Quoted market prices are applied for market securities and derivatives as well as for quoted debt instruments. The fair value of the non-derivative debt instruments for which no active market price is available is determined as the present value for future expected cash flows on the basis of related benchmark interest curves and credit spreads.

The fair value of interest and interest rate/currency swaps and also interest rate based forward transactions are determined on the basis of discounted future expected cash flows. The market interest rates applicable for the remaining maturity of the financial instruments are used for the purpose of the calculation. The fair value of forward currency transactions is determined on the basis of current forward rates. Options are measured using exchange prices or accepted models for determining option prices. For common European options, the current Black-Scholes models (currency and index-related instruments) or lognormal models (interest rate related instruments) are used as the valuation models. In the case of exotic instruments, the interest rates are simulated via one- and multidimensional term structure models with use of the current interest rate structure as well as caps or swaption volatilities as parameters relevant for valuation purposes. One- and multifactor models are used for interest rate/currency products.

Generally accepted standard models are used for credit derivatives, e.g. credit default swaps. As is the case concerning interest rate and currency derivatives, the counterparty solvency is taken into account for measurement purposes.

Gaussian copula models which are usual in the market and appropriate adjustments thereof are used for determining fair values for structured credit products. In parallel the expected loss of the respected papers was calculated on the basis of the underlyings and the subordination. A detailed separate credit analysis was performed for the tranches being held in case of significant expected losses. Counterparty risk adjustments are taken into account for the measurement of customer derivatives.

Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost according to IAS 39.46.

Fair values of financial instruments		**31.12.2010**		**31.12.2009**
in € million	Carrying amounts	Fair value	Carrying amounts	Fair value
Assets	**184,813**	**183,904**	**210,402**	**208,237**
Cash reserve	224	224	618	618
Trading assets (HfT)	16,168	16,168	1,435	1,435
Loans and advances to other banks[1]	15,154	14,973	78,121	77,891
Category LaR	15,154	14,973	78,121	77,891
Loans and advances to customers[1]	132,315	132,117	87,925	87,323
Category LaR	132,315	132,117	87,925	87,323
Financial investments	16,345	15,815	30,914	29,581
Category AfS	2,293	2,293	2,811	2,811
Category dFVTPL	317	317	925	925
Category LaR	13,735	13,205	27,178	25,845
Other assets	4,607	4,607	11,389	11,389
thereof: Hedging derivatives	4,607	4,607	11,389	11,389
Liabilities	**181,388**	**181,312**	**208,197**	**207,341**
Liabilities to other banks	62,587	62,628	67,625	67,654
Liabilities to customers	17,384	17,490	12,378	12,248
Liabilities evidenced by certificates	63,846	63,603	109,193	108,518
Trading liabilities (HfT)	16,294	16,294	1,872	1,872
Other liabilities	18,511	18,511	13,234	13,234
thereof: Hedging derivatives	4,293	4,293	13,020	13,020
Derivatives hedging dFVTPL financial instruments	23	23	67	67
Subordinated capital	2,766	2,786	3,895	3,815
Other items	**892**	**863**	**3,338**	**3,156**
Contingent liabilities	102	102	689	689
Irrevocable loan commitments	790	761	2,649	2,467

[1] Reduced by allowances for losses on loans and advances

The change in hidden reserves or hidden charges of Deutsche Pfandbriefbank Group is mainly attributable to the transfer of positions to FMS Wertmanagement which took place as of 1 October 2010.

In the case of certain positions which had not been physically transferred to FMS Wertmanagement but which had been synthetically transferred to FMS Wertmanagement by way of a financial guarantee as of the balance sheet date, the hidden reserves and hidden charges are as follows:

The above table has taken account of the financial guarantees for calculating the fair values (economic view). If these financial guarantees were to be disregarded, the item loans and advances to customers would show a fair value which was € 35 million lower, and a contingent receivable from the financial guarantee of € 35 million would have to be shown.

The carrying amounts reflect the maximum on balance sheet exposure to credit risk of the assets and the maximum amount the entity could have to pay of the other items according to IFRS 7.

Asset and liabilities according to measurement categories and classes in € million	31.12.2010	31.12.2009
Assets	**184,813**	**210,402**
Loans and receivables (LaR)	161,204	193,224
Held to maturity (HtM)	–	–
Available for sale (AfS)	2,293	2,811
Held for trading (HfT)	16,168	1,435
dFVTPL assets (dFVTPL)	317	925
Cash reserve	224	618
Positive fair values from hedging derivatives	4,607	11,389
Liabilities	**181,388**	**208,197**
Held for trading (HfT)	16,294	1,872
Financial liabilities at amortised cost	160,778	193,238
Negative fair values from hedging derivatives	4,316	13,087

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 2010 and as of 31 December 2009. However, no individual impairment provision was made against these assets respectively the collaterals underlying these assets as Deutsche Pfandbriefbank Group does not consider that there is any issue regarding their recoverability. Such timing issues in receipts of payments due occur regularly (up to three months) in the normal course of business and do not, by themselves, impair the quality of the asset. The total investment in relation to the past due amounts have also been disclosed to put the size of the amounts in question into context.

LaR Assets

LaR assets: past due but not impaired (total investments) in € million	31.12.2010	31.12.2009
Up to 3 months	134	761
From 3 months to 6 months	18	288
From 6 months to 1 year	4	205
From 1 year and over	8	222
Total	**164**	**1,476**

Carrying amounts LaR assets in € billion	31.12.2010	31.12.2009
Carrying amount of LaR assets that are neither impaired nor past due	161.0	192.1
Carrying amount of LaR assets that are past due but not impaired (total investment)	0.2	1.5
Carrying amount of individually assessed impaired LaR assets (net)	0.4	2.4
Balance of portfolio-based allowances	0.1	0.6
Total	**161.7**	**196.6**
thereof: Loans and advances to other banks (including investments)	15.2	78.2
Loans and advances to customers (including investments)	132.8	91.2
Financial investments (gross)	13.7	27.2

The carrying amount of assets that would otherwise be past due or impaired and whose terms have been renegotiated amounts to €0 million (2009: €0 million).

The fair value of collaterals for the impaired financial assets amounts to approx. €0.4 billion (2009: €2.0 billion). The collaterals mainly consist of lands charges.

AfS Assets As of 31 December 2010 and as of 31 December 2009 Deutsche Pfandbriefbank Group has neither past due and not impaired nor impaired AfS financial investments in the portfolio.

Other Notes

76 Contingent Liabilities and Other Commitments

Contingent liabilities and other commitments in € million	31.12.2010	31.12.2009
Contingent liabilities	**102**	**689**
Guarantees and indemnity agreements	102	689
Loan guarantees	14	39
Performance guarantees and indemnities	88	650
Other commitments	**821**	**2,691**
Irrevocable loan commitments	790	2,649
Book credits	25	558
Guarantees	52	60
Mortgage and public sector loans	713	2,031
Other commitments	31	42
Total	**923**	**3,380**

The former Hypo Real Estate Bank International AG, a predecessor institute of Deutsche Pfandbriefbank AG, has overtaken with the announcement as of 2 January 2006 irrevocable and unconditional guarantees to fulfil all liabilities of Hypo Public Finance Bank, Dublin. By the fact that all shares of Hypo Public Finance Bank, Dublin, were sold, the commitment was limited according the guarantee contract to all liabilities, which existed until the date of sale.

As of 3 July 2008, the former Hypo Real Estate Bank International AG guaranteed DEPFA Bank plc the loss of AAA-rated CMBS with an amount up to US$0.9 billion. This guarantee was assigned by DEPFA Bank plc to its subsidiary Hypo Public Finance Bank. The guarantee is constituted in a contingency, which arose at year end in accordance with the sale of Hypo Public Finance Bank puc to DEPFA Bank plc. Since the CMBS have been transferred to FMS Wertmanagement the guarantee does not exist anymore.

Deutsche Pfandbriefbank AG obligated itself to Hypo Real Estate Bank International LLC I, and to Hypo Real Estate Capital Hong Kong Corporation Limited, Hong Kong, to support these companies in such a way that the companies are in a position to satisfy their financial obligations.

Positions have been transferred to FMS Wertmanagement primarily by way of the granting of sub-participations, trust agreements or risk transfers (guarantees). Section 8 of the Framework Agreement specifies that FMS Wertmanagement can demand a review of the complete real transfer. Specifically, FMS Wertmanagement can demand the transfer if the transferring party does not suffer any economic disadvantage or if it provides compensation for such a disadvantage. The direct costs of the transfer are not considered to be a disadvantage for the purposes of this regulation. If an economic disadvantage were to arise, the Finanzmarktstabilisierungsanstalt would make a binding decision as to whether a transfer is nevertheless to take place. The Finanzmarktstabilisierungsanstalt can also specify a transfer if FMS Wertmanagement fails to provide compensation for the disadvantages. The costs of the transfer are borne by the transferring legal entity. The above passages therefore comprise the following possible cost components:

1. Costs of the audit
2. Costs of the transfer
3. Compensation for economic disadvantages

Within the context of the transfer of positions to FMS Wertmanagement, the FMSA reserves the right to impose a payment condition for the stabilisation measure in accordance with Section 8a (4) No. 8 FMStFG against HRE for payment to FMS Wertmanagement; this figure must not exceed € 1.59 billion. The purpose of this payment condition is to restore neutrality in terms of competition. The payment condition can also be fixed in several notices. However, the extent of the payment condition must be fixed in such a way that, after the condition has been fixed, the regulatory core capital ratio of the bank entities within the HRE sub-groups Deutsche Pfandbriefbank and DEPFA do not fall below 15 % in each case as of 31 March 2011. In addition, the fixing of the payment condition must not result in the sub-groups respectively their parent companies

a) becoming insolvent, illiquid or result in a negative going concern assumption,
b) relevant regulatory capital ratios, major credit limits or other legal or regulatory requirements being violated,
c) their rating falling below investment grade, or
d) the purchase price, taking account of the payment condition, falling below the market value of the transferred assets.

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 the Financial Market Stabilisation Act, Deutsche Pfandbriefbank AG 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.

Deutsche Pfandbriefbank Group is a lessor within the framework of operating lease agreements. Non-terminable operating lease agreements for land and buildings as well as for operating and business equipment existed as of 31 December 2010. The minimum obligations arising from non-terminable leasing arrangements will result in costs of € 7 million in 2011, € 21 million in total in the years 2012 to 2015 and € 56 million in total for 2016 and beyond. In the previous year the non-terminable operating lease agreements were as follows: for financial year 2010: € 12 million, in financial years 2011 to 2014 € 41 million in total and for 2015 and beyond € 53 million in total.

For Deutsche Pfandbriefbank Group irrevocable loan commitments form the largest part of other commitments. Irrevocable loan commitments comprise all commitments of a creditor which can grant a loan and advance at a later date and which can cause a credit risk. These are mainly credit commitments which are not fully drawn by the customer.

77 Key Regulatory Capital Ratios (Based on German Commercial Code)

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

The Management Board of HRE Holding manages regulatory capital on the basis of the German Solvency Regulation (SolvV) in connection with section 10 German Banking Act (KWG). According to these standards the total equity capital ratio (equity capital/risk-weighted assets) may not go below 8.0%. In addition, the core capital (Tier I) must consist of at least 50% of equity capital (core capital and supplementary capital), so that the core capital ratio may not be lower than 4.0%. At the same time, the own funds ratio, which is calculated by dividing the own funds by the total risk-weighted assets, must be not lower than 8.0%. The total risk-weighted assets are determined by multiplying the capital requirements for market risk positions and operational risks by 12.5 and adding the resulting figures to the sum of risk-weighted assets for credit risk. These regulatory capital requirements have been met throughout the entire year 2010.

78 Group Auditors' Fee

Group auditors' fee in € thousand	31.12.2010	31.12.2009
Audit	3,361	3,732
Other assurance services	2,251	148
Tax advisory services	2	116
Other non-audit services	5,588	1,248
Total	**11,202**	**5,244**

79 Relationship with Related Parties

According to IAS 24 (Related-Party Disclosures), a party is related to an entity if, directly, or indirectly through one or more intermediaries, the party controls or is controlled by the reporting entity, has an interest in the entity that gives it significant influence over the entity or has joint control over the entity as well as associates and joint ventures.

In addition to the subsidiaries included in the consolidated financial statements, Deutsche Pfandbriefbank AG also directly or indirectly maintains relations with non-consolidated subsidiaries and other related entities in the course of exercising its normal business operations. Transactions with related parties are carried out on an arm's length basis, until the application of section 7 (d) FMStBG, by considering the specifics of section 311 ff AktG (German Stock Corporation Act).

As of 31 December 2010 Deutsche Pfandbriefbank Group had liabilities netted by loans to its parent company HRE Holding of € 0.9 billion (2009: € 0.4 billion). Deutsche Pfandbriefbank Group had loans to its sister company DEPFA netted by liabilities of € 0.3 billion (2009: € 62.7 billion), thereof € 0 billion subordinated loans netted with subordinated liabilities (2009: € 0.7 billion). These loans mainly resulted from the passed liquidity supports. In addition, there were contingent liabilities of Deutsche Pfandbriefbank Group to sister companies which are described in the note contingent liabilities and other commitments in the consolidated financial statements.

Loans and advances to non-consolidated subsidiaries amounted to € 5 million as of 31 December 2010 (2009: € 16 million) whereas liabilities to non-consolidated subsidiaries amounted to € 1 million (2009: € 4 million).

In financial year 2010 Deutsche Pfandbriefbank Group had a net interest income of € 85 million (2009: € 944 million) and a net commission income of € 310 million (2009: € 586 million) from DEPFA. These net income mainly resulted from the passed liquidity supports. There was a net interest income of € 6 million (2009: € 43 million) to HRE Holding.

As a result of HRE Holding and hence of Deutsche Pfandbriefbank AG being controlled by SoFFin, a special estate of the German Federal Government according to § 2 section 2 FMStFG, Deutsche Pfandbriefbank AG is a state-controlled entity and a related party with other enterprises which are subject to the control, joint control or significant influence of the Federal Republic of Germany (so-called government-related entities). Business relations with public sector entities are carried out on an arm's length basis.

The securities which are guaranteed by the SoFFin and which had been issued by Deutsche Pfandbriefbank AG for obtaining liquidity reported a total volume of € 124 billion by the end of September 2010 and were completely hand over to HRE respectively to other subsidiaries. These guarantees were transferred completely to FMS Wertmanagement as part of the portfolio transfer process. There are no longer any guarantees of the SoFFin for HRE. Since that time, Deutsche Pfandbriefbank AG has been refinanced primarily by way of outstanding Pfandbriefe, covered bonds and unsecured issues. The following conditions were applicable for all liquidity guarantees which HRE received from the SoFFin: Deutsche Pfandbriefbank AG paid to the SoFFin a proportionately calculated commitment commission of 0.1% per annum in relation to that part of the guarantee framework which was not utilised. A commission of 0.5% or 0.8% per annum was incurred for guarantees which were issued.

HRE received various recapitalisation measures in 2010. Deutsche Pfandbriefbank AG did not profit by this. The SoFFin has provided an undertaking to pay a further € 0.45 billion in the form of a contribution to the additional paid-in capital of HRE Holding or Deutsche Pfandbriefbank AG. This obligation depends on various factors, including conditions under aid law. Evidence that the criteria have been satisfied can be provided by 31 December 2011, and the claim to the contributions will then expire.

Deutsche Pfandbriefbank Group has various relationships with the sister company FMS Wertmanagement for example due to the fulfillment of funding function for FMS Wertmanagement or due to the synthetic transfer of positions. The relationships are described in Note 5.

Apart from the above there have been no other material relationships with related companies.

During the financial year Deutsche Pfandbriefbank AG did not pay neither fixed remuneration (2009: € 149 thousand) nor severance payments (2009: € 1,327 thousand) to the Management Board.

The overall remuneration paid to former members of the Management Board and their surviving dependants for the year 2009 amounted to € 5,156 thousand (2009: € 3,616 thousand).

The Supervisory Board remuneration for the reporting period amounted to € 71 thousand (2009: € 76 thousand). This figure was composed exclusively of fixed remuneration.

Remuneration paid to persons with key function in the Group (Senior Management)[1]			2010	2009
in € thousand	Remuneration[2]	Severance payments	Total	Total
Total	7,511	361	**7,872**	**8,089**

[1] Members of the second management level of Deutsche Pfandbriefbank AG and managing directors of subsidiaries of Deutsche Pfandbriefbank AG
[2] Reporting follows the so-called «vested principle». The components of compensation which were earned (vested) in the relevant period 2010 are reported. In this connection, it needs to be stated that the alternative payment for discretionary variable compensation for 2009 which was paid out in 2010 is thus not included in the compensation for 2010. The alternative payment for 2010 for the group of persons relevant for reporting purposes amounted to a total of € 3,305 thousand. Members of the Management Board of HRE Holding have not received an alternative payment for 2009

Pension obligations to persons with key function in the Group (Senior Management)		
in € thousand	31.12.2010	31.12.2009
Total[1]	**67,406**	**67,343**

[1] Thereof € 61,891 thousand (2009: € 60,519 thousand) for pensioners and surviving dependants

80 Employees

Average number of employees	2010	2009
Employees (excluding apprentices)	923	858
Apprentices	2	6
Total	**925**	**864**

81 Summary of Quarterly Financial Data

Deutsche Pfandbriefbank Group				2010
in € million	1st quarter	2nd quarter	3rd quarter	4th quarter
Operating performance				
Operating revenues	121	99	241	192
Net interest income and similar income	166	164	161	109
Net commission income	–7	–1	–12	10
Net trading income	–12	–36	110	15
Net income from financial investments	–13	–4	–1	1
Net income from hedge relationships	–17	–22	–2	–4
Balance of other operating income/expenses	4	–2	–15	60
Provisions for losses on loans and advances	226	175	17	25
General administrative expenses	73	98	105	76
Balance of other income/expenses	1	–1	–	8
Pre-tax profit/loss	–177	–175	119	98

82 Members of the Supervisory Board and of the Management Board

Supervisory Board

Dr. Bernd Thiemann
Kronberg, Self-employed management consultant
(Chairman of the Supervisory Board)

Dagmar Kollmann
Bad Homburg, Chairperson of the Partners Committee of Kollmann GmbH
(Deputy Chairperson of the Supervisory Board)

Ursula Bestler
Munich, Bank employee
(Workers' Council Representative)

Dr. Günther Bräunig
Frankfurt, Member of the Management Board of KfW
(Member of the Supervisory Board)

Georg Kordick
Poing, Bank employee
(Workers' Council Representative)

Dr. Hedda von Wedel
Andernach, Retired President of the Bundesrechnungshof
(Member of the Supervisory Board)

Management Board

Manuela Better
Munich
(Member of the Management Board,
Chairperson of the Management Board since 25 March 2010)

Wolfgang Groth
Tawern
(Member of the Management Board since 1 January 2011)

Dr. Bernhard Scholz
Regensburg
(Member of the Management Board since 1 January 2010)

Alexander Freiherr von Uslar-Gleichen
Gruenwald

Dr. Axel Wieandt
Koenigstein
(Member of the Management Board to 25 March 2010,
Chairman of the Management Board to 25 March 2010)

Dr. Kai Wilhelm Franzmeyer
Bad Homburg
(Member of the Management Board to 6 December 2010)

Frank Krings
Hofheim
(Member of the Management Board to 6 December 2010)

83 Holdings of Deutsche Pfandbriefbank AG

Holdings of Deutsche Pfandbriefbank AG as of 31.12.2010 Name and place of business	Interest in % Total Sec 16 (4) Stock Corp. Act	of which held indirectly	Currency	Total assets in thousands	Equity in thousands	Net income/loss in thousands	Alternative financial year
Subsidiaries							
Consolidated subsidiaries							
Banks and financial institutions							
Foreign banks and financial institutions							
Hypo Real Estate Capital Hong Kong Corporation Ltd. i.L., Hong Kong	100.00	–	HK$	7,197	6,831	135	–
Hypo Real Estate Capital India Corporation Private Ltd. i.L., Mumbai	100.00	–	INR	337,975	337,975	23,108	1.4.2009–31.3.2010
Hypo Real Estate Capital Singapore Corporation Private Ltd. i.L., Singapore	100.00	–	SG$	3,043	2,620	600	–
Other consolidated subsidiaries							
House of Europe Funding I Ltd., Grand Cayman[1]	–	–	€	540,176	1	–	–
Hypo Real Estate Capital Japan Corp., Tokyo	100.00	–	JP¥	132,837,386	30,424,435	435,659	–
Hypo Real Estate International LLC I, Wilmington	100.00	–	€	350,109	350,109	–5	1.1.–31.12.2009
Hypo Real Estate International Trust I, Wilmington	100.00	–	€	350,057	350,057	–	1.1.–31.12.2009
IMMO Immobilien Management GmbH & Co. KG, Munich	94.00	–	€	4,290	–7,535	–1,216	–
Little Britain Holdings (Jersey) Ltd., Jersey	100.00	–	GB£	73,420	–4,045	–4,045	–
pbb Services GmbH, Munich (former: Hypo Real Estate Systems GmbH)	100.00	–	€	37,203	3,020	2,888[2]	–
Ragnarök Vermögensverwaltung AG & Co. KG, Munich	94.00	–	€	3,914	–1,703	–256[3]	–

Holdings of Deutsche Pfandbriefbank AG as of 31.12.2010 Name and place of business	Interest in % Total Sec 16 (4) Stock Corp. Act	of which held indirectly	Currency	Total assets in thousands	Equity in thousands	Net income/loss in thousands	Alternative financial year
Non-consolidated subsidiaries							
Other non-consolidated subsidiaries							
DEPFA Finance N.V., Amsterdam	100.0	–	€	1,231,196	3,848	551	–
Frappant Altona GmbH, Munich	88.40	88.40	€	1,373	25	–444[4]	–
FUNDUS Gesellschaft für Grundbesitz und Beteiligungen mbH, Munich	94.00	–	€	1,267	904	–125[2]	–
GfI-Gesellschaft für Immobilienentwicklung und -verwaltung mbH i.L., Stuttgart	100.00	–	€	11	11	–	1.1.–31.12.2009
Immo Immobilien Management Beteiligungsgesellschaft mbH, Munich	100.00	–	€	31	28	–4	–
IMMO Invest Real Estate GmbH, Munich	100.00	–	€	3,453	28	84[2]	–
IMMO Trading GmbH, Munich	100.00	–	€	848	525	–864[2]	–
Meridies Grundbesitz- und Bebauungsgesellschaft mbH, Munich	94.00	–	€	529	78	–470[2]	–
WestHyp Immobilien Holding GmbH, Munich	100.00	–	€	679	392	–142	1.1.–31.12.2009
Associated companies							
Associated companies valued using the equity method							
Archplan Projekt Dianastraße GmbH, Munich	33.20	33.20	€	325	–214	–99	1.1.–31.12.2009
SANO Grundstücks-Vermietungsgesellschaft mbH & Co. Objekt Dresden KG, Duesseldorf	33.33	–	€	12,936	–4,422	–147	1.1.–31.12.2009
SOMA Grundstücks-Vermietungsgesellschaft mbH & Co. Objekt Darmstadt KG, Duesseldorf	33.33	–	€	35,757	–9,197	–705	1.1.–31.12.2009
Wisus Beteiligungs GmbH & Co. Zweite Vermietungs-KG, Munich	33.00	–	€	10,087	–2,780	214	–

[1] Special purpose entity without capital investment consolidated according to SIC-12
[2] Profit transfer by shareholders on the basis of profit and loss transfer agreement
[3] General partner liability (Komplementärhaftung) of Deutsche Pfandbriefbank AG
[4] Profit transferred by Meridies Grundbesitz- und Bebauungsgesellschaft mbH, Munich, on the basis of profit and loss transfer agreement

Exchange rates 1 € equates to		**31.12.2010**
Great Britain	GB£	0.86075
Hong Kong	HK$	10.38560
India	INR	59.75800
Japan	JP¥	108.65000
Singapore	SG$	1.71360

Munich, 23 March 2011

Deutsche Pfandbriefbank Aktiengesellschaft
The Management Board

Manuela Better

Wolfgang Groth

Dr. Bernhard Scholz

Alexander von Uslar

Responsibility Statement

To the best of our knowledge, and in accordance with the applicable reporting principles, the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group, and the Group management report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the principal opportunities and risks associated with the expected development of the Group.

Munich, 23 March 2011

Deutsche Pfandbriefbank Aktiengesellschaft
The Management Board

Manuela Better

Wolfgang Groth

Dr. Bernhard Scholz

Alexander von Uslar

Auditor's Report

We have audited the consolidated financial statements prepared by Deutsche Pfandbriefbank AG, Munich – the balance sheet, the income statement, the statement of comprehensive income, statement of changes in equity, cash flow statement and notes to the consolidated financial statements – together with the group management report for the business year from 1 January to 31 December 2010. 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 Deutsche Pfandbriefbank Group in accordance with these requirements. The group management report is consistent with the consolidated financial statements and as a whole provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development.

Without qualifying this opinion we refer to the passages in the group management report concerning «Risks threatening the existence» [«Bestandsgefährdende Risiken»] as well as to note 2. There it is disclosed that the ability of Deutsche Pfandbriefbank AG and its subsidiaries to continue as a going concern is dependent upon the European Commission approving the support measures which have been implemented by the German Financial Market Stabilisation Fund [«Sonderfonds Finanzmarktstabilisierung»]. In addition, it is necessary that the approval by the European Commission imposes only such conditions which are realisable within an economically sustainable business plan and in particular do not peril the regulatory effectiveness induced by the capital support measures.

Munich, 24 March 2011

KPMG AG
Wirtschaftsprüfungsgesellschaft
[original German version signed by:]

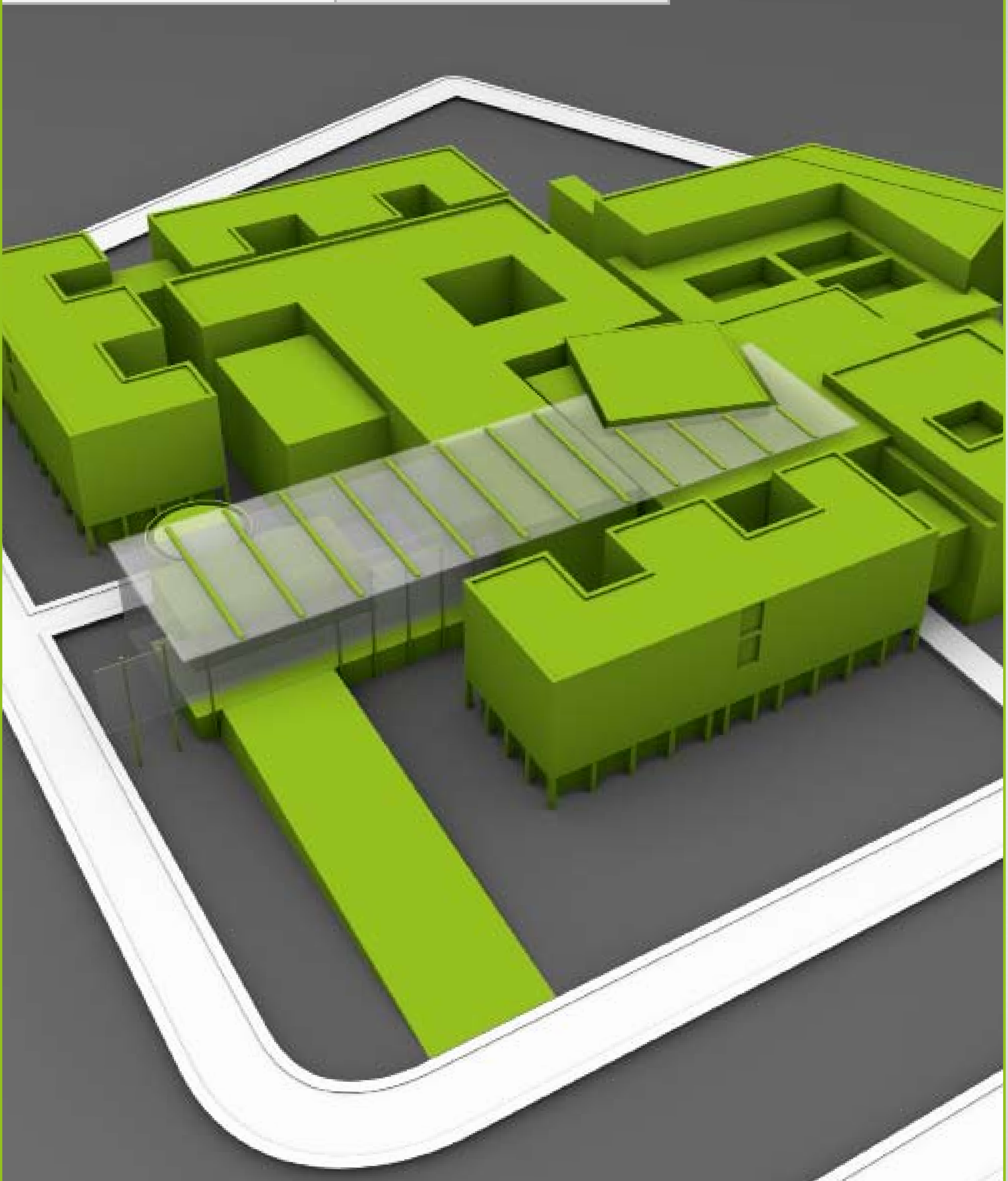
Wiechens	Muschick
Wirtschaftsprüfer	Wirtschaftsprüfer
[German Public Auditor]	[German Public Auditor]

Nouvel Hôpital du Centre Hospitalier Régional Metz-Thionville

€ 100 million

Funding of an investment programme
Bilateral loan
Public Sector Finance, Paris, December 2010

pbb funded together with two other banks an investment programme to finalise the construction of the new hospital with 87,000 m² and 640 beds on the site of Mercy, which will gather all medical activities in Metz apart from geriatry. Additionally the loan funds the construction of a maternity hospital in a separate building.



Service Chapter

Glossary

Advanced approach Under the advanced approach method, a bank with a sufficiently developed internal capital allocation procedure (strict criteria in terms of methodology and disclosure) is permitted to use its internal assessments regarding the credit standing of a debtor when assessing the lending risk within its portfolio.
There are specialised analysis procedures for different types of loan commitments – e.g. loans to companies and retail customers – that exhibit different loss characteristics.

Asset/liability management Measures by a bank to control the balance sheet structure and to limit the risks resulting from differences in time periods and insufficient liquidity.

Asset-backed security A bond or note that is based on pools of assets.

Assets book Risk-carrying positions that are not allocated to the >> trading book.

Asset finance Asset finance is funding to acquire additional assets to drive a business forward. Virtually any asset can be financed including IT, software, refurbishment, machinery, etc.

Available-for-sale assets Financial assets that are available for the Company to sell and that do not relate to loans, financial instruments held for trading or >>held-to-maturity financial instruments. Available-for-sale financial instruments include in particular fixed-income securities that cannot or should not be held to maturity and also equity instruments with no final maturity.

Basel II The term Basel II stands for a new capital adequacy framework, which was presented by the Basel Committee on Banking Supervision in summer 2004. The committee meets on a regular basis at the Bank for International Settlements (BIS) and is formed by representatives of the central banks and banking supervisors of the major developed nations. It gives general strategic recommendations on the framework and standards for banking supervision. In comparison to the first capital adequacy framework (Basel I) from 1988, Basel II will define new general conditions for the measurement of risk-weighted assets and the minimum capital requirements for credit institutions.

BIS Bank for International Settlements headquartered in Basel; as the central bank of the central banks, it is in particular responsible for cross-border banking supervision and for the establishment of internationally valid equity capital requirements for supraregionally operating banks.

BIS equity funds Equity capital that is recognised for regulatory purposes and complies with the Recommendation on Equity issued by the Basel Committee for Banking Supervision in July 1988 (last amended in January 1996) for financial institutes operating on the international stage. It comprises liable equity capital (core capital and supplementary capital) and Tier III capital:
> Core capital or Tier I capital largely subscribed capital, reserves and certain hybrid capital instruments.
> Supplementary capital or Tier II capital includes in particular participatory capital, long-term subordinated liabilities, unrealised gains from listed securities and other valuation adjustments for inherent risks.
> Tier III capital mainly comprises short-term subordinated liabilities and surplus supplementary capital.

Bonds Term used in English-speaking countries for fixed-income securities and/or debentures.

Calculated mortgage lending value, also: loan-to-value (LTV) Relationship between the funds loaned to the borrower and the value of the collateral.

Capacity to meet interest payments Degree to which the rental income from a financed building must, in long-term financing, at least cover the interest service payments. Ratio: DSC (debt service coverage).

Cash flow Equals cash receipts minus cash payments over a given period of time.

Cash-flow hedge Security against the risk of loss of future interest payments under a variable-interest balance sheet transaction obtained by means of a >> swap.

Collateralised Debt Obligation (CDO) Collateralised Debt Obligations (CDOs) represent a segment of >>asset-backed securities. It represents a debenture bond that is secured by a diversified debt portfolio. A collateralised debt obligation is usually divided into different slices of varying creditworthiness. Usually CDOs are classified according to the object of their investment. If debenture bonds are sold, then one is dealing with so-called cash CDOs – if, however, instead of real bonds their risks alone are sold, these are called synthetic CDOs.

Commercial mortgage-backed security (CMBS) A type of >>mortgage-backed security (MBS) on commercial real estate.

Commercial paper (CP) Money market instruments in the form of bearer instruments that do not have standardised maturities but can be geared to individual investment requirements and are paid on a discount basis. Their maturities vary between 1 and 270 days. They are issued on the money market by debtors with an irreproachable credit standing, usually first-class industrial corporations; they are issued in high amounts and with high minimum nominal values.

Concentration risk Risk resulting from concentration of the credit risk on a single party (counterparty, issuer, country or borrowing customer) in the portfolio or among a group of parties that over a period of time exhibit a parallel development in terms of probability of default caused, for example, by similar economic dependencies. Synonym: cluster risk.

Corporate governance Corporate governance refers to the legal and factual framework for managing and monitoring companies. The recommendations of the Corporate Governance Code create transparency and are intended to strengthen confidence in a good and responsible management; they are primarily aimed at protecting shareholders.

Cost-income ratio Relationship between general administrative expenses and the total of net interest income and similar income, net commission income, net trading income, net income from investments and balance of other operating income/expenses; a low cost-income ratio indicates high productivity.

Counterparty risk Risk that, as a result of default on the part of a contracting partner, it will no longer be possible to collect an unrealised profit from outstanding interest and currency-related derivative and futures transactions. The counterparty risk is differentiated according to performance risk (from the value date until performance) and exchange/pre-settlement risk (from the date of conclusion until the value date).

Country risk Risk that a business partner in a certain country will be unable to fulfil his contractually agreed obligations due to political or social unrest, nationalisation or expropriation, non-recognition by governments of foreign debts, currency controls or a devaluation of the national currency.

Credit default swap (CDS) Financial contract where the risk of a credit event that is specified in advance (e.g. insolvency or deterioration in credit standing) is transferred by an assignee to a guarantor. Irrespective of whether or not the credit event materialises, the guarantor receives a regular premium payment from the assignee for assuming the lending risk.

Credit derivatives Derivative financial instruments that allow one party to the transaction (assignee) to transfer the lending risk relating to a loan or a security to another party (guarantor) against payment of a premium. The risk purchaser therefore bears the lending risk relating to the loan or security without actually having to purchase it (e.g. >>credit default swap, >> total return swap or >>credit-linked note).

Credit-linked notes (CLN) A note issued by an assignee that is only repaid at the nominal value on maturity if a previously specified credit event does not materialise on the side of the debtor. If the credit event does actually occur, the credit-linked note is repaid after deducting the agreed compensatory amount. In contrast to credit default swaps and total return swaps, the guarantor receives his monetary payment in advance from the assignee.

Credit risk Credit risks include the loan default risk, counterparty risk, issuer risk and country risk; they refer to the potential loss that could result from the default or deterioration in credit ratings of loan customers, of issuers of borrowers' note loans, promissory notes and debt securities, or of counterparties in money market, securities and derivatives transactions.

Debt service coverage margin Relationship between the net income that can be earned from a property and the debt service applicable to the property in question.

Default probability Expected average probability that a business partner will fail to fulfil his obligations, based on statistical analyses of historic default patterns.

Default risk Risk of partial or total loss of a loan.

Deferred compensation An arrangement in which a portion of the wage is paid out at a date after which that income is actually earned.

Deferred taxes Taxes on income that are payable or receivable at a future date and that result from different carrying amounts being shown in the financial and commercial balance sheets. On the reporting date, they do not yet represent actual receivables or liabilities vis-à-vis tax authorities.

Developer Developers develop and execute real estate projects (generally large commercial projects) with the aim of securing a swift sale.

Earnings per share Indicator comparing the net income for the year after taxes with the average number of ordinary shares.

Fair value Amount at which an asset would be exchanged or a debt settled between expert, independent, willing business partners; often identical with the market price.

Fair-value hedge Hedging of a fixed-income balance sheet position (e.g. a receivable or a security) against the market risk by means of a >>swap; it is valued at market value (>>fair value).

Financial Market Stabilisation Act (FMStG) This was fast-tracked through Parliament on 17 October 2008. The act enables a package of measures to be implemented for stabilising the financial market. The main component of the act is the establishment of the financial market stabilisation fund.

Financial market stabilisation fund (SoFFin) This was created by the Financial Market Stabilisation Act on 17 October 2008. The aim of the fund is to stabilise the German financial system, to overcome the liquidity shortages and to strengthen the capital base of financial companies. The range of services provided by the fund includes the provision of guarantees (up to € 400 billion) as well as recapitalisation and risk acceptance (up to € 70 billion).

Financial instruments This term is in particular used to summarise credits and loans extended, interest-bearing securities, shares, participating interests, liabilities and derivatives.

Forward transactions The purchase/sale of financial instruments on a fixed date and at a fixed price; a distinction is made between contingent forward transactions (>>options) and unconditional forward transactions (>>futures). In contrast to spot transactions, the date when the contract is concluded and the date of performance for the contract are different.

Futures Contracts that are standardised in terms of volume, quality and settlement date under which a trading item belonging to the money market, investment market, precious metals market or currency market is to be delivered or purchased on a specific future date at the specified market price. In many cases, a balancing payment has to be effected in place of delivering or purchasing securities.

German Minimum Requirements for the Conduct of Lending Business (MaK) Minimum requirements that must be met by all lending institutes in order to limit risks from lending business, taking into account the respective type and extent of business conducted.

German Minimum Requirements for the Conduct of Trading Operations (MaH) Minimum requirements that must be complied with by all financial institutes in order to secure solvency and must be supplemented/specified in more detail in internal instructions, taking into account the respective type and extent of trading activities. They include requirements with regard to risk control and risk management, the organisation of trading operations and auditing, as well as regulations for specific transaction types. They were issued in October 1995 by the Federal Banking Supervisory Office (BaKred), which is now known as the Federal Financial Supervisory Office (BaFin).

Goodwill Amount that a purchaser of a company pays in excess of the >>fair value of the individual assets after deducting debts (= intrinsic value), taking into account future expected earnings (= net income value).

Hedge accounting Depiction of contrary developments in the values of a hedging transaction (e.g. an interest rate swap) and an underlying transaction (e.g. a loan). Hedge accounting aims to minimise the impact on the income statement of the valuation and the recording of valuation results from derivative transactions where such valuation and recording affects net profit or loss.

Hedging Transactions aimed at protecting against the risk of unfavourable price trends (e.g. currency and interest rate risks). A matching position is set up for each position, so that the risk is offset either in whole or in part.

Held to maturity (HtM) Financial assets acquired by third parties that have a fixed maturity and fixed or determinable payments, where the holder intends or is able to hold the asset until final maturity.

Hybrid capital instruments Investment instruments that are characterised by profit-related interest payments. Where interest payments that have not been made when losses have occurred are not paid at a later date (noncumulative hybrid capital instruments) and the instruments do not have a fixed maturity date and/or cannot be terminated by the creditor, then in accordance with regulatory requirements such instruments belong to the core capital. In all other cases, they must be allocated to the supplementary capital (e.g. cumulative hybrid capital instruments).

International Accounting Standards (IAS) Accounting standards issued by the IASC (International Accounting Standards Committee), a specialist international organisation backed by professional associations that deal with accounting issues. The aim is to develop transparent and comparable international accounting systems.

International Financial Reporting Standards (IFRS) The IFRS include the present International Accounting Standards (>>IAS) and the interpretations of the Standing Interpretations Committee as well as all standards and interpretations issued in future by the IASB (International Accounting Standards Board).

Issuer risk Losses of own-portfolio securities due to a deterioration in the credit standing of or default on the part of an issuer.

Lending risk Risk that a business partner will not fulfil his contractual payment obligations. The lending risk includes >>default, >>country and settlement risks.

Liquidity facility The obligation to provide liquidity to a contract partner. The purpose of the liquidity facility is to ensure that the payments are forwarded smoothly and on time. It provides a cushion for the risk if any payment problems arise. Regulatory conditions are attached to the drawing of a liquidity facility.

London Interbank Offered Rate – LIBOR Benchmark rate in interbank operations, which is determined daily by the main international banks of the British Banker's Association in London. Banks are able to raise funds or be offered funds from other banks on the basis of the rates.

Loss-given default (LGD) LGD is the fraction of exposure at default that will not be recovered following default.

Market risk Results from uncertainty surrounding changes in market prices and rates (including interest rates, share prices, exchange rates and commodity prices) and also from the correlations between them and their levels of volatility.

Market risk position The market risk position pursuant to Principle I includes foreign currency, commodity and options risks as well trading-book risk positions such as risks relating to interest rates and share prices as well as >>credit risks pertaining to the trading book.

Mezzanine finance Term used to describe forms of finance that have characteristics of both debt and equity.

Monoliner A monoline insurer, in the context of financial markets, guarantees the repayment of bonds.

Mortgage-backed securities (MBS) Securitisation of mortgage loans for precise control and reduction of lending risks. MBS are securities whose interest and redemption payments are linked to the payment performance of a pool of loans secured by real estate liens.

On-balance-sheet lender A loan creditor who is able to incur risks on his own balance sheet.

Operational risk The risk of direct or indirect losses resulting from the inappropriateness or failure of human beings, technical systems, internal procedures or external events (definition pursuant to Basel II).
Operational risks are not usually entered into consciously; such risks are not subject to diversification and are difficult to narrow down.
Examples: human error, faulty management processes, criminal actions, fraud, natural disasters (fire, etc.), technical failures, departure of key employees.

Option An option grants the purchaser the right to purchase (= purchase option or call) or sell (= put option or put) a specific quantity of the item underlying the option (e.g. a security or currency) from or to a contracting partner (option writer) at a price determined when the contract is concluded (= strike). The option can be exercised either on a date specified in advance or during a period specified in advance; the purchaser pays an option premium for this right.

Participation certificate Certification of participatory rights issued by companies of all legal forms and admitted to official (stock exchange) trading. Under certain circumstances, participatory certificates may be allocated to liable equity capital.

Rating Risk rating of a debtor (internal) and/or assessment of the credit standing of an issuer and its debt instruments by specialised agencies (external).

Repo transaction Short-term money-trading transaction backed by securities.

Return on equity Ratio showing the relationship between the net income for the year, or a pre-tax performance measure (e.g. pre-tax profit), and average equity capital; indicates the return on the capital put to work by the company or its owners.

Risk assets To be able to map the assets book ≫ credit risks resulting from the differing credit standings of issuers and/or business partners in accordance with regulatory requirements, balance sheet assets, off-balance-sheet transactions (e.g. warranties and guarantees for balance sheet assets) as well as ≫ forward transactions, ≫swaps and ≫option rights are weighted with respect to risk using rate-weighting factors that depend on the rating category of the issuers and/or business partners. Under Principle I, these risk-weighted assets must be backed by 8% liable equity capital.

Risk control Risk Control is responsible for implementing the risk policy prescribed by the Management Board, for the neutral monitoring of lending, market and operational risks, as well as for analysing and reporting on the current and future risk situation. Risk Control is also responsible for specifying measurement and evaluation methods as well as for subsequently carrying out measurements and evaluations of risk and risk results and/or limit controls.

Risk management The taking of business decisions at operational level, portfolio management and/or optimisation of risks in the widest sense of the word on the basis of risk/reward factors (e.g. assignment of lines for credit risks, credit derivatives, etc.) within the strategic framework defined by the Management Board and in accordance with the authorisations issued by the Management Board bestowing direct responsibility for risks and results.

Secondary risk Risk that any losses in rental income on the part of the borrower may jeopardise the capacity to meet interest payments.

Securitisation Securities-based collateralisation and/or conversion of loans (e.g. through bonds) to procure funds. The prime aim is to make the loans tradable on organised investment markets (e.g. stock exchanges). The supplier of capital (= creditor) and therefore the purchaser of the securitised loan assumes the risk of fluctuations in market prices and of loan losses; the borrower (= debtor) must provide regular public proof of his credit standing by means of regular reporting and/or of the highest possible rating by a rating agency.

Segment reporting Breakdown of the total consolidated values by individual segments, e.g. by areas of activity (divisions) or geographical characteristics (regions); this enables conclusions to be drawn regarding performance in individual segments and their contribution to the consolidated result.

Self-assessment Self-assessment is a process whereby the operational risks and the measures taken to minimise risks are regularly identified and evaluated by procedure officers, i.e. by those individuals who are best able to assess the strengths and weaknesses of procedures.
In addition to identifying and evaluating risks, self-assessment also provides the basis for drawing up an action plan to open up opportunities for improvement, as well as for the development of risk awareness at all levels within the Bank.

Senior lender Financer of first priority loans.

Solvency The extent to which an insurer or credit institution is provided with own funds. Own funds back the claims of policy holders or creditors. The greater the solvency, the greater is the backing for these claims.

Standard risk costs Average risk costs and/or valuation adjustments due to loan losses that are expected within a given year.

Swap In principle, an exchange of payment flows: an exchange of fixed and variable interest payment flows in the same currency (= interest rate swap) and/or exchange of payment flows in different currencies (= currency swap).

Tier I ratio This ratio is also referred to as the BIS core capital ratio and represents the ratio of a company's risk assets determined in accordance with the provisions of the Bank for International Settlements (BIS) plus its market risk positions to its core capital (see also BIS equity funds).

Total return swap Swap between the assignee and the guarantor with respect to the income from and changes in valuation of the underlying financial instruments. In addition to the lending risk, the guarantor also assumes the price risk resulting from the underlying financial instrument, in return for a corresponding interest payment.

Trading book Banking regulatory term for positions in financial instruments, interests and tradable loans that are held by a financial institute for the purpose of short-term resale, benefiting from price and interest rate fluctuations. This also includes transactions that are closely related to trading-book positions (e.g. for hedging purposes). Risk-carrying positions that do not belong in the trading book are assigned to the ≫ assets book.

Treasury Division pooling the areas of refinancing and liquidity control, asset/liability management, fixed-income and own-account trading.

Vacancy rate Average percentage of all real estate space that is not used or rented out.

Value at risk Method for quantifying risk; measures the potential future losses that with a certain degree of probability will not be exceeded within a specified period of time.

Financial Calendar

Financial Calendar	
24 March 2011	Publication of the results for the year 2010
14 April 2011	Publication of the Annual Report 2010
20 May 2011	Publication of the results for the first quarter of 2011
11 August 2011	Publication of the results for the second quarter of 2011
15 November 2011	Publication of the results for the third quarter of 2011

Future-oriented Statements
Internet Service

Future-oriented Statements

This report contains future-oriented statements in the form of intentions, assumptions, expectations or forecasts. These statements are based on the plans, estimates and predictions currently available to the management of Deutsche Pfandbriefbank AG. Future-oriented statements therefore only apply on the day on which they are made. We do not undertake any obligation to update such statements in light of new information or future events. By their nature, future-oriented statements contain risks and factors of uncertainty. A number of important factors can contribute to actual results deviating considerably from future-oriented statements. Such factors include the condition of the financial markets in Germany, Europe and the USA, the possible default of borrowers or counterparties of trading companies, the reliability of our principles, procedures and methods for risk management as well as other risks associated with our business activity.

Internet Service

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