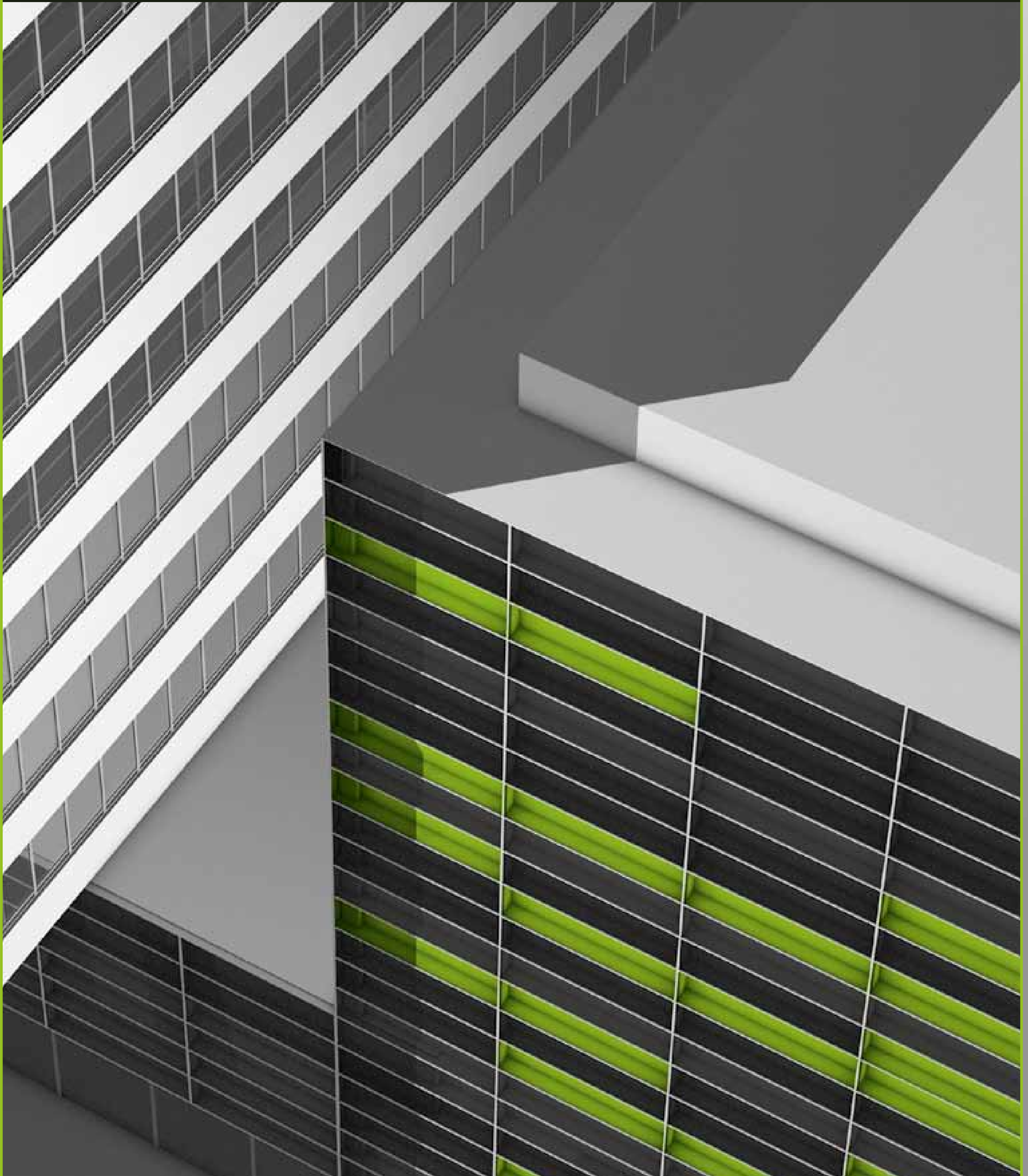
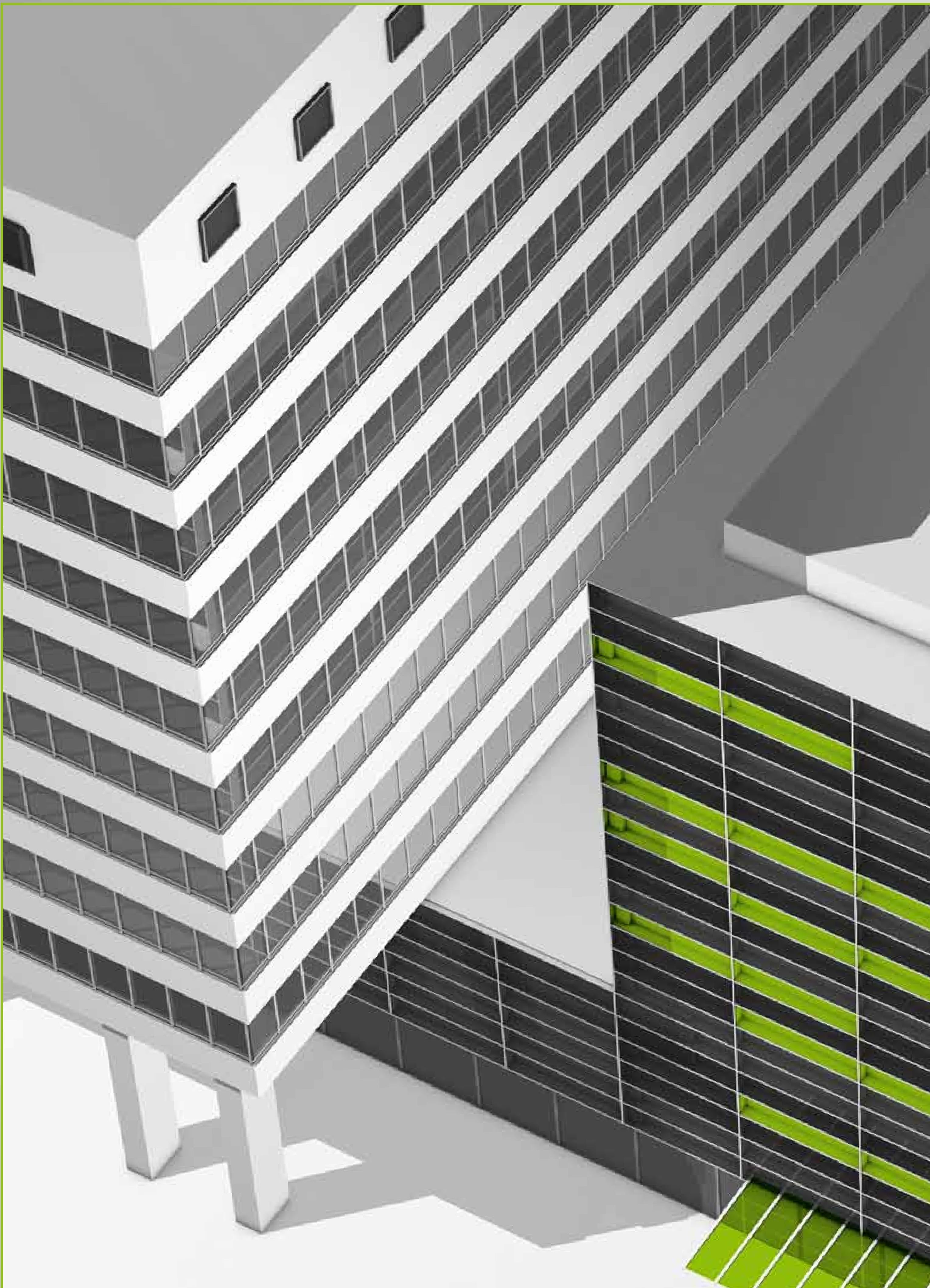
# Annual Report 2012

PUBLIC SECTOR FINANCE
REAL ESTATE FINANCE

pbb

DEUTSCHE PFANDBRIEFBANK





pbb Deutsche Pfandbriefbank is a specialist bank for commercial real estate finance and public investment finance. We are active in selected European countries; our business is focused on Germany as well as Great Britain, France and Scandinavia.

By supplying credit to the real estate sector and by financing measures for improving public sector infrastructure, we have an important economic function to perform.

## Real Estate Finance

Our services are targeted at professional national and international real estate investors. The focus is on office premises, retail, residential housing and logistics. We aim to provide mid-size to larger financing and offer local expertise as well as cross-border know-how.

## Public Investment Finance

We finance public sector infrastructure projects: public institutions, municipal housing construction, utilities/waste disposal sector, health/nursing-care properties as well as child care/educational facilities. We also provide export finance with public-sector guarantees.

# Financial Highlights
# Ratings

| Financial highlights | | 2012 | 2011 |
|---|---|---|---|
| **Operating performance according to IFRS** | | | |
| Pre-tax profit/loss | in € million | 124 | 188 |
| Net income/loss | in € million | 69 | 117 |
| **Key ratio** | | | |
| Return on equity before taxes | in % | 3.8 | 5.9 |
| Return on equity after taxes | in % | 2.1 | 3.7 |
| Cost-income ratio[1] | in % | 73.0 | 67.9 |
| **Balance sheet figures** | | **31.12.2012** | **31.12.2011** |
| Total assets | in € billion | 97.1 | 108.8 |
| Equity (excluding revaluation reserve) | in € billion | 3.3 | 3.2 |
| Equity | in € billion | 3.3 | 3.1 |
| **Personnel** | | | |
| Employees | | 1,044 | 1,032 |

[1] The cost-income ratio is the ratio of general administrative expenses and operating revenues

| Senior unsecured ratings and ratings for Pfandbriefe of pbb[1] | | 31.12.2012 | | | 31.12.2011 | | |
|---|---|---|---|---|---|---|---|
| | | Fitch Ratings | Moody's | Standard & Poor's | Fitch Ratings | Moody's | Standard & Poor's |
| **pbb** | Long-term rating | A– | Baa2 | BBB | A– | A3 | BBB |
| | Outlook | Stable | Negative | Stable | Stable | Stable | Stable |
| | Short-term rating | F1 | P–2 | A–2 | F1 | P–1 | A–2 |
| Mortgage Pfandbriefe | | –[2] | Aa1 | AA+[3][4] | AAA[3] | Aaa | AA+[5] |
| Public sector Pfandbriefe | | –[2] | Aa1[3] | AA+[3][4] | AA+ | Aa1 | AA+[5] |

[1] Ratings from mandated rating agencies
[2] After the rating mandates were terminated by the Bank, the ratings were withdrawn in February respectively in September 2012
[3] Review for downgrade
[4] The ratings were confirmed in each case in January 2013 (see events after 31 December 2012)
[5] Stable outlook

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

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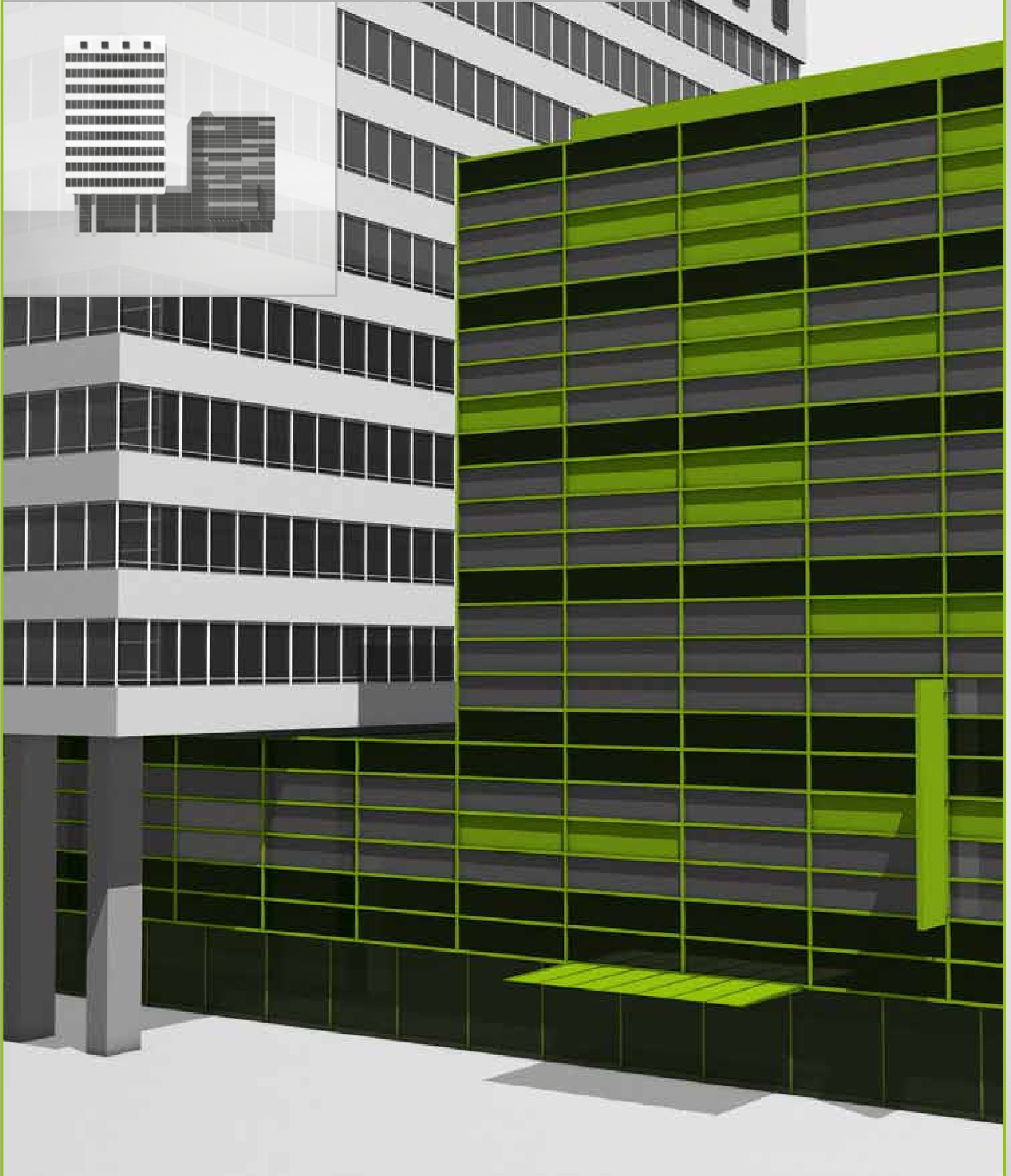
# RFR Holding GmbH Bienenkorbhaus Frankfurt

## **€ 50 million**

Acquisition financing
Germany
October 2012

pbb has provided acquisition financing of € 50 million to RFR Holding for the acquisition of the Bienenkorbhaus. The Bienenkorbhaus on the Frankfurter Zeil has commercial letting premises of around 11,000 m². With a mix of stores (3,500 m²) and office premises (7,500 m²), it is currently more than 95% let. The main tenants are the shoe trader Ludwig Görtz with a flagship store and Frankfurter Sparkasse.



# Preface of the CEO
# Report of the Supervisory Board

# Preface of the CEO

As the previous year, 2012 was shaped by the European sovereign debt crisis – even though developments during the second half of the year were more positive. pbb Deutsche Pfandbriefbank can look back on a successful financial year – in terms of new business, funding and the results of operations. Our business model is sound and profitable which is proven by our track record of ten successive profitable quarters.

Developments during the course of the year once again demonstrated the high degree of dependency between new business and funding. At the beginning of the year, all market players were faced with uncertainty concerning the scope available in the capital markets. For this reason, we throttled back our origination activities at first – our priority is on liquidity rather than on achieving target new business volumes.

However, we observed already during the first quarter of 2012 that the capital markets were sufficiently deep – a development which continued throughout the year. We were regularly active as an issuer, we placed Pfandbriefe which are our most important funding instrument as well as significant volumes of unsecured funding with medium to long terms, and overall realised continuously narrowing spreads over the course of the year.

We have accelerated our sales efforts with the success on the funding markets. On a quarterly basis, we doubled our new business in the third as well as in the fourth quarters. Particularly in the fourth quarter, we demonstrated our origination strength with the highest volume seen since we returned to the lending markets. Moreover, we concluded new business in 2012 with higher margins on average – yet at lower risk, compared to the previous year.

**Management Board of Deutsche Pfandbriefbank AG**
From left to right:
Wolfgang Groth, Dr. Bernhard Scholz, Manuela Better, Alexander von Uslar

For the year 2013, we have set ourselves the target of considerably boosting the volume of new business. Stronger market presence and further improved processes will support this goal. In 2012 and at the beginning of 2013, we opened offices in Stockholm and at three German locations; this completes our regional set-up. We will also expand our market-facing teams across all functions by around 50 staff members over the medium term.

We will also terminate servicing of the portfolio of FMS Wertmanagement in the autumn of 2013. We want to discontinue servicing because portfolio management exclusively for third parties is not part of our business model – however, we also must not continue these operations as a result of the EU ruling in the state aid proceedings. After the termination of servicing, we will be able to focus exclusively on our core business as specialists for European real estate finance and public investment finance.

In 2013, we will also establish deposit-taking business with private investors in order to expand our funding base. Term deposits and overnight deposits will complement our unsecured funding. We expect that we will be able to attract deposit volumes that will sustainably broaden our funding base without having a major impact on the competitive situation on the deposit market.

Kind regards

**Manuela Better**
CEO

# Report of the Supervisory Board



Reviewing the financial year 2012, the Supervisory Board of Deutsche Pfandbriefbank AG (pbb) reports on the key areas of its monitoring and advisory activity.

As was the case in 2011, the macro-economic environment at the beginning of 2012 again reflected considerable levels of uncertainty on the funding markets and an associated and necessary wait-and-see attitude at pbb for new business. As the funding situation improved in the course of the year, pbb was able to focus to a greater extent on new business, particularly in the field of commercial real estate financing. The Supervisory Board in its supervisory and advisory function considered in particular the business activities of pbb which followed the market development. One particular focus was providing support to the Company for the purpose of regaining its sales strength/market presence with due consideration being given to a conservative risk profile.

Preparations for terminating servicing for FMS Wertmanagement and the associated process of transferring tasks to FMS Wertmanagement were some of the further projects and changes which the Supervisory Board considered intensively; some of these are determined by EU regulations. In addition, the deliberations of the Supervisory Board regularly considered the start of the organisational and technical process of segregating the subgroups pbb and DEPFA and also the continued development of the IT landscape.

The Supervisory Board again continuously monitored the Management Board in the financial year 2012, and regularly advised the latter with regard to management of the Company.

The Supervisory Board was always able to verify the legality, purpose and adequacy of the management measures taken by the Management Board. The Management Board has complied with its notification obligations and regularly, promptly and comprehensively informed the Supervisory Board in written and verbal form of the events and measures relevant for the Company. This also comprised information concerning any variances between the actual development of business and the original budgeted forecasts. The members of the Supervisory Board always had adequate opportunity to critically assess the reports and proposed resolutions of the Management Board which were submitted in the committees and in the plenary session, and was also able to make its own recommendations.

In particular, the Supervisory Board has extensively discussed and reviewed the plausibility of all transactions which are significant for the Company on the basis of written and verbal Management Board reports.

In 2012, the Supervisory Board of pbb held six meetings and also adopted five circulation resolutions outside meetings. The Risk Management and Liquidity Strategy Committee held seven meetings, and also discussed exposures – usually in monthly telephone conferences. The Audit Committee held a total of four meetings.

In 2012, in addition to the above-mentioned issues, the Supervisory Board and Management Board in particular also discussed aspects relating to preparations for the planned reprivatisation of pbb and the associated restructuring processes within the Bank. Particular mention has to be made in this respect of the new target model of the Bank, the redistribution of Management Board divisions, the reshaping of the IT landscape and the transfer of servicing for the portfolio outsourced to FMS Wertmanagement to FMS Wertmanagement Service GmbH which was established by FMS Wertmanagement. The Supervisory Board also considered the strategy of the Group, and discussed the sovereign debt crisis of the countries which are currently the focus of attention with the resultant turmoil on the interbank market and the related consequences for funding and new business.

As a result of the continuing sovereign debt crisis in Europe, the routinely discussed issues of liquidity and funding retained their significance. Regulatory requirements were a further key aspect of deliberations. The Supervisory Board monitored the development of the Internal Control System (ICS) and, within this framework, the process for monitoring the key controls which had been set up.

The Supervisory Board also arranged to be notified of the probable impact of Basel III.

The Management Board informed the Supervisory Board regularly and promptly with regard to the economic and financial development of the pbb Group. The Management Board also reported on the risk position, risk management, the liquidity strategy, all reportable exposures as well as major events which are of considerable importance for assessing the situation and development and also for management of the Company. The Chairman of the Management Board was constantly in contact with the chairman of the Supervisory Board with regard to major developments. The following were the subject of regular discussions in the Supervisory Board: developments in lending business and lending policy as a whole, risk development, risk management, the focus of business policy as well as the developments and trends on the lending and funding markets. The Supervisory Board also concerned itself with the results of internal audit, the annual and multiple-year planning of the Bank based on the EU decision, the steering and control mechanisms in lending, security and derivative operations. The Supervisory Board assessed the necessary independence of the auditor, awarded the audit engagement to the auditor and agreed the fee with the auditor.

Moreover, on 9 March 2012, the Supervisory Board adopted again a resolution regarding the statement of compliance with the public corporate governance code of the Federal Government, which was published on pbb's website. At this point, please also refer to the compensation report of the Company, printed in this management report and also published on pbb's website.

The Supervisory Board of pbb consisted of the following persons between 1 January 2012 and 31 December 2012: Dr. Bernd Thiemann (Chairman), Dagmar Kollmann (Deputy Chairman), Dr. Günther Bräunig, Dr. Hedda von Wedel, Dr. Alexander Groß (after 1 June 2012), Dr. Ludger Schuknecht (after 1 June 2012) as well the employees' representatives Georg Kordick, Heike Theißing and Dr. Christian Gebauer-Rochholz (after 20 November 2012). Heike Theißing, previously a court-appointed member of the Supervisory Board, and Dr. Christian Gebauer-Rochholz were elected as employees' representatives on to the Supervisory Board of pbb with the election of 20 November 2012.

**Supervisory Board of Deutsche Pfandbriefbank AG**
as of 31 December 2012

| Name and place of residence | Principal activity | Function in Supervisory Board and meeting attendance | Function in committees and meeting attendance: Audit Committee | Function in committees and meeting attendance: Risk Management and Liquidity Strategy Committee |
|---|---|---|---|---|
| **Dr. Bernd Thiemann**<br>Kronberg, Germany | Former Chairman of the Management Board of DG Bank AG | Chairman<br>6 of 6 | Member<br>4 of 4 | Member<br>7 of 7 |
| **Dagmar Kollmann**<br>Bad Homburg, Germany | Chairman of the Partners Committee of Kollmann GmbH | Deputy Chairman<br>6 of 6 | Chairman<br>4 of 4 | Member<br>7 of 7 |
| **Dr. Günther Bräunig**<br>Frankfurt/Main, Germany | Member of the Management Board of KfW | Member<br>6 of 6 | Member<br>4 of 4 | Chairman<br>7 of 7 |
| **Dr. Christian Gebauer-Rochholz**<br>Hochheim, Germany | Bank employee | Workers' council representative<br>–[1] | | |
| **Dr. Alexander Groß**<br>Teltow, Germany | Head of the department I for Economic Policy in the Federal Ministry for Industry and Technology | Member<br>3 of 3[2] | | |
| **Georg Kordick**<br>Poing, Germany | Bank employee | Workers' council representative<br>6 of 6 | | |
| **Dr. Ludger Schuknecht**<br>Frankfurt/Main, Germany | Head of the department for Fundamental Issues of Financial Policy and Economics in the Federal Ministry of Finance | Member<br>3 of 3[2] | | |
| **Heike Theißing**<br>Munich, Germany | Bank employee | Workers' council representative<br>6 of 6 | | |
| **Dr. Hedda von Wedel**<br>Andernach, Germany | Retired President of the Bundesrechnungshof | Member<br>6 of 6 | Member<br>3 of 4 | |

[1] from 20 November 2012 no meeting in the year under review
[2] from 1 June 2012

## Audit Committee

With effect from 29 March 2012, the Supervisory Board of pbb also established an Audit Committee, which comprised Dagmar Kollmann (Chairman), Dr. Bernd Thiemann, Dr. Günther Bräunig and Dr. Hedda von Wedel.

In its first meeting held on 21 May 2012, the Audit Committee discussed the result of the first quarter of 2012 of pbb. Internal Audit provided its status report and informed on the progress achieved with processing the outstanding internal and external audit findings. KPMG provided an overview of the results of the ICS audit IDW PS 951 type B in connection with FMS Wertmanagement Servicing. On 29 June 2012, the committee discussed various issues, including the current issues of Internal Audit and Compliance. The Audit Committee adopted the KPMG audit plans for auditing the ICS and the audit of financial statements 2012. Reporting on the second quarter of 2012 of pbb was the main item discussed in the meeting held on 13 August 2012. Current issues of Internal Audit were reported. On 12 November 2012, the committee mainly focused on reporting for the third quarter of 2012 of pbb.

The committee again reported on the implementation of the audit plan of Internal Audit, the status of processing the internal and external findings, the ICS and also monitoring of the key controls which have been established.

After completing its own review, the Supervisory Board has not raised any objections regarding the result of the audit by the auditor. In the accounts meeting, the Supervisory Board approved the consolidated financial statements prepared by the Management Board and adopted the annual financial statements.

## Risk Management and Liquidity Strategy Committee

In the period between 1 January 2012 and 31 December 2012, the Supervisory Board of pbb had a Risk Management and Liquidity Strategy Committee (RLA), consisting of Dr. Günther Bräunig (Chairman), Dagmar Kollmann and Dr. Bernd Thiemann.

The RLA compressed the detailed control of the Supervisory Board over risk and liquidity management, monitored risk reporting of the Management Board and was integrated in the credit approval process to the extent defined in the rules of procedure. The RLA also regularly discussed the liquidity and funding situation. In 2012, it also intensively considered the changing regulatory requirements, particularly with regard to the risk-bearing capacity of pbb (ICAAP).

In its meeting of 16 January 2012, the committee also discussed the credit approval process. On 15 February 2012, the committee also discussed the risk report of the Management Board, the risk strategy of the HRE Group as well as the new business statistics 2011. On 2 May 2012, the calculation of the risk-bearing capacity and the corresponding notifications to the bank regulator were subjects discussed in the committee. On 21 May 2012, the committee discussed the risk report of the Management Board for the first quarter of 2012, the risk-bearing capacity as well as a report concerning own real estate exposures in addition to the regularly discussed issues. On 27 October 2012, the liquidity situation and planning and the stress test of the European Banking Authority (EBA) were the key items considered in the meeting. On 29 June 2012, the committee focused mainly on new business 2012, the current situation of the countries which are currently the focus of attention as well as the ICAAP. On 13 August 2012, the risk report as well as the adjustment of the risk strategy were subjects which were the particular focus of attention. On 12 November 2012, the main additional issues to be discussed were the finalisation status of MaRisk, repurchasing of hybrids at DEPFA and matching-maturity funding of the PSF portfolio.

In addition, the RLA also considered individual exposures in numerous telephone conferences. These involved regular re-submissions (if mandatory under the rules of procedure of the RLA), as well as approvals for change applications and new business.

The Supervisory Board wishes to thank the Management Board, all employees as well as the employees representatives for their major commitment and also for their work last year.

# City of Hanover Construction of eight day nurseries **€ 20 million**

Long-term financing
Germany
May 2012

Within the framework of a public-private partnership, pbb has provided finance of approximately € 20 million for the capital of Lower Saxony, namely Hanover, for building eight day nurseries. The day nurseries provide a total of 745 places, and will be constructed by mid-2013. pbb will provide the construction phase financing extended for the construction company and also the long-term end financing for the city of Hanover as the borrower.

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# Group Management Report

# Group Management Report
## Principles of the pbb Group

**Business Model of the pbb Group**

The Deutsche Pfandbriefbank Group (pbb Group) is headed by Deutsche Pfandbriefbank AG (pbb). It is a wholly owned subsidiary of Hypo Real Estate Holding AG (HRE Holding). HRE Holding is wholly owned by the Finanzmarktstabilisierungsfonds (Financial Market Stabilisation Fund), which in turn is administered by the Bundesanstalt für Finanzmarktstabilisierung (Federal Financial Market Stabilisation Institution), an institution of the Federal Republic of Germany. According to a resolution of the EU Commission in the Aid proceedings from July 2011, the Federal Republic of Germany is required to reprivatise pbb by no later than the end of 2015.

pbb is a specialist bank for commercial real estate finance and public investment finance. It is active in both areas in selected European countries; in addition to Germany, the main focus of business is to be found in Great Britain, France and Scandinavia. The core business is lending: pbb has an important role to play in supplying credit to the real estate industry and supports the public sector with financing for projects and measures designed to improve public infrastructure. The Group does not maintain a trading book with portfolios of securities with the aim of generating short-term profit. It offers derivatives to customers exclusively for the purpose of hedging risks in connection with a credit transaction.

In the field of lending business, the Group operates either as a sole lender or together with other partners, particularly in transactions with a high financing requirement. In such cases, the Group has access to a wide network of banking partners and other financing sources such as mezzanine or private equity partners with whom individual financial solutions are put together for customers. In such cases, as part of its operations pbb takes on additional functions as an arranger who puts together a syndicate for a customer comprising a group of financiers, and also acts as an agent responsible for managing the financing arrangements of syndicates. In addition, the Group also acts as an underwriter, by first providing finance on its own and then selling on parts of such loans to interested partners as part of syndication arrangements.

### Strategic Business Segments

In the field of real estate financing, the Group's range of services is targeted at professional national and international real estate investors such as real estate companies, institutional investors, real estate funds as well as SMEs and customers with a regional focus in Germany. The focus is on the less volatile real estate types, namely offices, retail properties, apartments and logistics. pbb focuses on medium- to large-scale financing arrangements, and offers its customers local expertise in the main target markets of Germany, Great Britain and France as well as other selected European regions, and also offers international know-how. By far the most significant proportion of the extended financing arrangements is attributable to investment loans, in other words loans for purchasing existing properties which generate a cash flow; development loans are of minor significance.

In the field of public investment financing, pbb finances projects for providing public sector infrastructure. In this particular field, the focus is on public sector facilities, municipal housing, utilities and the disposal industry, health, nursing-care and child-care properties as well as educational facilities. In addition to financing public sector infrastructure, pbb is also active in the field of export financing with public guarantees. The financing arrangements are provided to public sector borrowers, companies with a public sector or private legal form as well as special-purpose vehicles offering public services. The regional focus is on Germany and France, and the Group also has operations in other selected European countries.

In addition to these two strategic areas of operation, pbb also has a public budget financing portfolio. This portfolio operates on the balance sheet, and thus generates interest income. In accordance with a requirement of the EU Commission imposed as a result of the aid proceedings from 2011, pbb does not operate any new business in this particular field.

### Funding

The funding of loans which have been extended is based to a considerable extent on matching maturities, and primarily utilises the Pfandbrief market; it is complemented by unsecured funding. The Pfandbrief market is characterised by a high degree of liquidity and a broad investor base. This market is the second largest market for fixed-income securities in Germany, after the market for public sector bonds.

pbb issues mortgage Pfandbriefe and public Pfandbriefe and, measured in terms of outstanding volume, is the second-largest issuer. Issues are regularly placed on the international capital market in the benchmark format and also in the form of bilateral private placings. The Bank structures private placings in the form of bearer or registered securities, depending on the requirements of the investors; the term and rate structure are the subject of individual negotiation in this respect. In line with lending operations, the Pfandbriefe are denominated in a range of currencies, whereby the Euro is the main currency.

Unsecured funding is mainly based on borrowers' note loans and also bearer bonds.

The main investors in the bonds of pbb are banks, funds and insurers, and also central banks. Private investors have so far been of minor significance.

## Objectives and Strategies

The strategy of the Deutsche Pfandbriefbank Group focuses on long-term business success, and avoids speculative elements. The Group mainly extends medium- to long-term loans, which generally are also held on a long-term basis.

The assessment and appropriate pricing of credit risk are crucial factors for the success of new business. In order to ensure that the Group is competitive with its new business activities, it needs access to the funding markets subject to appropriate conditions. The Group operates active investor relations work in order to expand its investor base. pbb will expand its funding base by way of deposit business with private investors.

A further major factor of success is management of the existing portfolio with the aim of identifying and mitigating changing risks.

### Preparations for Reprivatising

Up to the point at which the Bank is privatised, the Management Board of pbb aims to achieve a return on equity after taxes of at least 8% for the entire bank. For this purpose, the aim is to considerably boost pre-tax profit; this is to be achieved by expanding the earnings base with new business and also by way of reducing costs. The cost base of the Bank does not yet reflect the size and focus of the Bank in all areas after the restructuring process of recent years. In particular, the costs of IT and the number

of employees will decline considerably starting in the year 2013. This reflects the conclusion of a programme for consolidating the IT landscape and also the discontinuation of services provided for third parties; the latter is to be accompanied by the transfer of staff to the provider who will render these services starting in October 2013. The Bank aims to achieve a cost-income ratio of less than 40% by the year 2015.

The year 2012 saw the start of a project with the aim of redefining the target structure. The new target structure is expected to be completely implemented by the end of 2013. With this target structure, the Management Board will develop a specialist Pfandbrief bank with a European focus – it will thus create the necessary conditions for reprivatisation, and will ensure that the Group is able to meet future challenges beyond the year 2015. The aim is to ensure that the Group is better focused on penetrating the relevant markets. The structure and size will also be brought into line with the objective of being a specialist Pfandbrief bank. The sales force was expanded with new offices in Stockholm, Berlin and Hamburg in 2012. This will be followed by an office in Düsseldorf in 2013. The Group intends to expand the number of employees in the front office teams in the course of the next few years and thus further improve its market penetration.

One aspect which is closely linked with the development of a new target model is the transfer of servicing for the portfolio of FMS Wertmanagement which the pbb Group has been operating as a service provider for FMS Wertmanagement since the end of 2010. The termination of this service is the result of a corresponding requirement of the EU Commission; it is also a necessity, because portfolio management exclusively for third parties does not form part of the business model. The transfer to a service company of FMS Wertmanagement is expected to take place on 30 September 2013; until that time, the pbb Group will continue to be responsible for servicing. Work started on preparations for transferring servicing in the year 2012.

### Projects for Optimising IT and Processes

In addition to these projects for strategic further development, projects have also been carried out for optimizing IT and processes. The project for optimising the customer-oriented primary processes which was initiated in early 2011 and which was implemented in the course of this year focused mainly on the quality and process speed in the processing of financing enquiries of our customers, with due consideration being given to the risk policy of the Bank.

The project for harmonising information technology was successfully implemented at the beginning of October 2012. The focus in this respect was on transferring the credit and collateral data from the old bank system to the new target system as well as integrating the credit management system in the new target architecture.

**Management Concept**

The management concept of pbb Group focuses on achieving long-term growth in the value of the Group. The purpose is to create the conditions necessary for successful reprivatisation. A major objective in this respect is to achieve a balanced ratio between risk and return, in order to ensure that the risks which are taken on are consistent with external and internal risk-bearing capacity guidelines, and to achieve an adequate return on the capital employed.

At pbb Group, management and measurement are based on a consistent and integrated system of parameters which provides support to members of management in their leadership of the Group. The system of parameters comprises the dimensions of profitability, growth in the strategic areas, risk and capital. Regular budget-actual comparisons with corresponding analyses show management the reasons for any variances affecting the key parameters. Current market developments, such as the level of interest rates, are also detailed. In addition to strategic planning for the overall Bank, regular medium-term extrapolations of the profitability parameters and (stress) scenario calculations also guarantee management a comprehensive overview of the future business development of the Group.

A key parameter for profitability is return on equity after taxes, in which IFRS after-tax result is divided by the average capital, excluding revaluation reserve, available in the financial year. Pre-tax profit is a further financial performance indicator and is to be increased by means of higher revenues and also by means of strict cost discipline. Cost discipline and efficiency are monitored by means of the cost-income ratio, i.e. the ratio between general administrative expenses and operating revenues.

The growth in the strategic areas for increasing revenues is measured in various ways, including the volume of new business concluded in the Real Estate Finance segment and within the Public Sector Finance segment in public sector investment financing. The volume of new business is a major factor of influence on the amount of interest-bearing assets and thus on future profitability. A cash value management approach is used for managing and calculating new business. In an economic view, and in line with overall bank management, each new business transaction should make a positive value contribution, after the deduction of all costs (in a full-cost approach), to the overall Bank success.

Risk management is based on the risk-bearing capacity analysis. This analysis states that the requirements of internal capital adequacy are satisfied as soon as the pbb Group is able to service its subordinate debt completely in a period of one year with a very high probability. The aim is to ensure that the risk cover funds exceed the necessary economic risk capital. The methods and results of the risk-bearing capacity analysis are described in detail in the risk and opportunity report.

In accordance with the waiver regulation set out in Section 2 a KWG, pbb is exempted from the requirement to meet regulatory core capital ratios at the level of the Bank. The Tier 1 ratio, as the key management parameter, is regularly determined by pbb Group on a pro forma basis. In case of the Tier 1 ratio, the core capital on the basis of the definition set out in the German Solvency Regulation is divided by the risk-weighted assets in accordance with Basel II. The implementation of Basel III will see the introduction of a minimum CET1 ratio (core equity Tier 1 ratio) as a further regulatory requirement; this is already recognised in the management system.

**pbb as an Employer**

Whereas pbb employed a total of 1,032 persons in 2011, the corresponding figure at the end of 2012 was 1,044. The adjusted fluctuation[a] again declined appreciably in the Group in 2012, to the current figure of 9.92 % (previous year: 14.96 %).

Greater focus on personnel development measures has also contributed in 2012 towards stabilising the personnel situation. The main focus was on internal training and further training for senior executives and project managers. In the «Leadership Academy», these employees were provided with continuous further training for their management and project tasks. The internal training was enhanced and improved by seminars concerning the subjects of communication and conflict strategies.

In addition to these «in-house» management seminars, the Company has also introduced specialist qualifications for international training as a real estate manager (EBS) which pbb developed in conjunction with the European Business School (Oestrich-Winkel). In the year under review, a further focus in terms of specialist qualifications was on accounts analysis and qualifications as appraisal experts.

The Bank's range of further training was enhanced and improved by external training measures concerning specialist subjects as well as aspects of social and method competence. In the year 2012, costs of € 1.16 million were incurred for internal and external qualification measures for employees of pbb.

[a] Adjusted fluctuation is defined as the level of fluctuation arising from the termination of employment agreements by members of staff or the Bank and by the expiry of temporary agreements or by the conclusion of a cancellation agreement, not including death, retirement, early retirement or Group transfer.

## Compensation Report

The individual details of compensation for the financial year 2012 for each member of the Management Board and the Supervisory Board are set out in the following. The figures which are published are the payments received by the members of the Management Board and the members of the Supervisory Board for the financial year 2012.

### Management Board

The individual details of compensation for the financial year 2012 for each member of the Management Board and the Supervisory Board are set out in the following. The figures which are published are the payments received by the members of the Management Board and the members of the Supervisory Board for the financial year 2012.

| **Group compensation to members of the Management Board of HRE Holding** | | | **2012** | | | **2011** |
|---|---|---|---|---|---|---|
| in € thousand | Monetary compensation | Benefits in kind[1] | **Total** | Monetary compensation | Benefits in kind[1] | **Total** |
| Manuela Better[2] | 500 | 15 | 515 | 500 | 14 | 514 |
| Wolfgang Groth | 500 | 42 | 542 | 500 | 39 | 539 |
| Dr. Bernhard Scholz[2] | 500 | 24 | 524 | 500 | 32 | 532 |
| Alexander von Uslar[2] | 500 | 23 | 523 | 500 | 22 | 522 |
| **Total** | **2,000** | **104** | **2,104** | **2,000** | **107** | **2,107** |

[1] Including: costs of standard benefits in kind which are taxable
[2] There are also 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 HRE Holding** | | | | **2012** | **2011** |
|---|---|---|---|---|---|
| in € thousand | Present value of pension claims vested | Interest expense | Outstanding past service cost | **DBO as of 31.12.**[1] | **DBO as of 31.12.** |
| Manuela Better, Chairperson | 84 | 140 | – | 4,235 | 2,938 |
| Dr. Bernhard Scholz | 89 | 130 | – | 3,817 | 2,741 |
| Alexander von Uslar | 76 | 111 | – | 3,680 | 2,326 |
| **Total** | **249** | **381** | **–** | **11,732** | **8,005** |

[1] The considerable increase compared with the previous year is mainly due to the reduction in the discount rate which, in accordance with IAS 19, has to be based on the long-term rate for prime fixed-income corporate bonds on the closing date

## Supervisory Board

In accordance with Section 10 (1) of the articles of incorporation, the members of the Supervisory Board of pbb receive annual compensation of € 10,000. No separate payment is made for committee activity. The entitlement to compensation relates on a pro rata basis to the period of the activity. The Bank refunds travelling expenses, no allowances are paid for attending meetings. At the Annual General Meeting held on 16 May 2012, a resolution was adopted to extend the Supervisory Board from six to nine members. As of 1 June 2012, Dr. Alexander Groß and Dr. Ludger Schuknecht were thus elected on to the Supervisory Board of pbb. In the election held on 20 November 2012, Heike Theißing and Dr. Christian Gebauer-Rocholz were elected as employees' representatives on to the Supervisory Board of pbb. Heike Theißing had previously been a court-appointed member of the Supervisory Board of pbb (since 7 July 2011).

| **Provisions Supervisory Board compensation Deutsche Pfandbriefbank AG** | | | **2012** | **2011** |
|---|---|---|---|---|
| in € | Compensation | Value added tax | **Total** | **Total** |
| Annual compensation per member | 10,000 | 19 % | | |
| Ursula Bestler[1] (until 18.5.2011) | – | – | – | 4,500 |
| Dr. Günther Bräunig | 10,000 | 1,900 | 11,900 | 11,900 |
| Dr. Christian Gebauer-Rochholz[1] (from 21.11.2012) | 1,150 | 220 | 1,370 | – |
| Dr. Alexander Groß[2] (from 1.6.2012) | 5,850 | – | 5,850 | – |
| Dagmar Kollmann | 10,000 | 1,900 | 11,900 | 11,900 |
| Georg Kordick[1] | 10,000 | 1,900 | 11,900 | 11,900 |
| Dr. Ludger Schuknecht[2] (from 1.6.2012) | 5,850 | – | 5,850 | – |
| Heike Theißing[1] (from 7.7.2011) | 10,000 | 1,900 | 11,900 | 5,950 |
| Dr. Bernd Thiemann | 10,000 | 1,900 | 11,900 | 11,900 |
| Dr. Hedda von Wedel | 10,000 | 1,900 | 11,900 | 11,900 |
| **Total** | **72,850** | **11,620** | **84,470** | **69,950** |

[1] Employees' representative
[2] The representatives of the ministries perform their activities on the Supervisory Board at the instigation of their employers; accordingly, the income from this activity is not subject to VAT.

## Employee Compensation

Compensation of employees is paid in line with the regulatory and legal requirements, and in particular also in line with the Restructuring Act. As a result of the special regulations and requirements regarding the prohibition of variable compensation, the new compensation system which was introduced in the financial year 2010 was adjusted accordingly as part of the process of implementing these requirements; however, it will continue to be maintained as the target system. Variable compensation as a component of the target system is still suspended. The prohibition of paying variable compensation imposed by the Restructuring Act means that it has again not been possible to fully take account of the regulatory requirements with regard for instance to long-term nature, sustainability and also an effect offering adequate management and behaviour incentives which have been derived from various regulations, including the Institute Compensation Ordinance. In order to maintain operational viability, a function premium has been introduced in 2011 with the involvement of the employees' representatives; this premium is considerably lower in total and in individual cases than the originally envisaged variable compensation and has been agreed with the Supervisory Board and also with the owners.

## Compensation Committee

In the year 2012, the Compensation Committee consisted of representatives of personnel, the sales units as well as Treasury/Asset Management and Portfolio Management, Risk Controlling and Management, Compliance/Corporate Governance, Finance as well as a representative of internal audit (as a member without voting rights within the framework of the relevant duties). The Compensation Committee is chaired by the HR director.

The Compensation Committee of pbb held a total of one ordinary meeting in the year 2012, and considered in particular the following issues:

- Deliberation of the proposed measures for assuring adequate compensation which is viable on the market in order to avoid considerable operational risks within the context of the Restructuring Act
- Preparation of the compensation report for 2011
- Regular performance of the risk analysis and preparation of a proposal for defining the risk takers in accordance with Section 5 of the Institutsvergütungsverordnung (Institute Compensation Ordinance) for 2012.
- Deliberation of the principles within the framework of the salary review 2012 and an assessment of adequacy, with due consideration being given to the legal and regulatory requirements

In the year 2012, the following criteria were defined for identifying the risk takers:

- All managing directors of pbb
- All second tier executives who report directly to the Management Board of pbb Holding
- Employees with a voting right in Credit Committees (CC) and/or Risk Committees (RC) and/or Risk Provisioning Committees (RPC) and/or Asset and Liability Committees (ALCO)

Accordingly, 4.95 % of the workforce in total are risk takers. The Management Board of pbb has agreed the proposal submitted by the Compensation Committee, and has adopted the corresponding resolution.

## Sustainability

Companies bear responsibility for the entire environment in which they operate: their employees, their customers and investors as well as society and the environment. The pbb Group classifies this responsibility under the term «corporate responsibility».

Responsible corporate management takes account of all aspects of corporate responsibility, and defines the highest standard for action. In the pbb Group, the principles of sustainability underpins the idea of corporate responsibility. Actions are responsible, focused on the long term and recognise the consequences for all stakeholders in the Company and also for the environment.

### Employees

The employees are the main factor of success of the Bank. The pbb Group employs men and women from a wide range of different nationalities and with a wide range of specialist backgrounds. Particular emphasis is placed on diversity.

The major potential of this diversity among employees is recognised, and specialist, professional and personal development is encouraged. Daily conduct between members of staff and also the professional actions of employees with regard to third parties are defined in a code of conduct which sets out clear rules.

### Customers and Investors

As a specialist bank, pbb finances projects of professional real estate investors and public sector infrastructure projects in its New Business division. In both areas of operation, pbb applies high standards with regard to lending operations. We finance almost exclusively investments in buildings which comply with the requirements of sustainability, or support the public sector in its tasks of providing public sector infrastructure.

As a company which is indirectly whollyowned by the public sector, pbb is subject to the Public Corporate Governance Code of the federal government. The code of good corporate management of the federal government is modelled on the positive experience with the German Corporate Governance Code, which is targeted primarily at listed companies. The Public Corporate Governance Code of the federal government also reflects the current international developments and standards of good corporate management.

### Social Responsibility

Currently, pbb demonstrated its social responsibility mainly via its two non-profit foundations, namely pbb Stiftung Deutsche Pfandbriefbank and Stiftung für Kunst und Wissenschaft.

The foundations of pbb have their own capital which is ring-fenced with regard to the Bank and which is used exclusively for fulfilling the foundation aims:

- The pbb Stiftung Deutsche Pfandbriefbank is based in Munich and supports projects for promoting art and culture; the foundation focuses particularly on providing support for young artists. In addition, it encourages the improvement of architectural culture in commercial projects in Germany with an architecture prize which enjoys nationwide recognition and which is awarded for commercial buildings which are exemplary in aesthetic and ecological terms.
- The Stiftung für Kunst und Wissenschaft (foundation for arts and science), which was established in 1968 by Württembergische Hypothekenbank, now has its legal registered offices in Munich. The foundation focuses its activities in the federal state of Baden-Württemberg, and promotes intellectual and artistic work particularly in literature, painting, sculpture, music, theatre, architecture/design, regional and cultural studies.

This commitment which is primarily cultural and academic is complemented at pbb by social commitment. In this particular field, we use our limited financial means to particularly support projects which are either related to the locations of the Company or which are already carried out on a voluntary basis by employees. We also encourage the personal commitment of employees.

Accordingly, pbb has been supporting the youth centre «JugendKulturHaus Gleis 1» at the Company's location in Unterschleißheim since 2013. Mobile youth work is being funded in an initial project.

### Environment

As a financial service provider, the focus is on the responsible deployment of resources in the Bank itself and also at the manufacturers which supply the Bank with products.

The buildings of the Group's headquarters in Unterschleißheim near Munich are extremely energy-efficient. Since April 2011, the entire power requirement of the Group's headquarters has been covered by renewable energies. Working procedures are designed to reduce the volume of paper which is used, and only paper which is certified as being environmentally friendly is used. The extensive use of video conference systems enables the number of business journeys to be reduced. Company cars must comply with the regulations regarding $CO_2$ in line with ecological compatibility. Vehicles with higher $CO_2$ emissions are classified with a negative factor, or are not even permitted to be procured.

The entire hardware equipment of the Bank complies with the «Label Green IT» requirements.

### Corporate Responsibility Rating

Institutional investors and financial services providers are increasingly using independent evaluations of the performance of an issuer in the field of corporate responsibility in their investment decisions. At present pbb complies with these investor requirements with two corporate responsibility ratings of the agencies IMUG and Oekom. IMUG rates debt instruments and, in 2011, awarded a «neutral» rating for the public Pfandbriefe, mortgage Pfandbriefe and unsecured bonds of pbb. Oekom is currently rating pbb as «prime».

## Macro-economic and Sector-specific Conditions

### Macro-economic Conditions

The global economy slowed down appreciably in 2012, and has been affected by a phase of weakness since the autumn. Real gross domestic product (GDP) in the eurozone declined by 0.5 % in 2012. The countries which have been the focus of attention for many years were particularly affected by a recession. The economic performance of Italy (– 2.3 %) and Spain (– 1.5 %) declined again following two years of recovery, whereas Greece (– 6.5 %) and Portugal (– 3.2 %) have now been in a severe recession for two years.

Although GDP growth in Germany weakened from 3.0 % in 2011 to 0.7 % in the year under review, the trend continued to point upwards. In France, real GDP has been unchanged, and only minor growth of 0.2 % has been achieved in Great Britain.

The level of interest rates has again been kept very low in order to boost the economies in all markets which are important for pbb; this did not have any major impact on inflation in the year under review. Inflation rates throughout the world have recently declined as a result of falling commodity prices. On average for 2012, the change in consumer prices in the eurozone amounted to 2.5%, and the corresponding figures for Germany are 2.1%.

The level of debt in the Eurozone again increased slightly in 2012 compared with 2011 (90 % of GDP in Q3 2012); however, net new borrowings have been declining for the past three years. For 2012, a financing deficit of 3.3% is expected to be seen, compared with a deficit of 4.1% in 2011. The decline in net new borrowings is due to the consolidation efforts which many European countries have adopted in order to return their public finances to a sustainable basis.

The central banks have responded to a recent increase in pessimism on the financial markets in the late summer of 2012. In the summer, the ECB announced the possibility of unlimited buying of the bonds of the euro countries which are currently the focus of attention. Merely the announcement of the measures and the introduction of the ESM (so-called Euro Rescue Fund) had a settling effect on the financial markets and depressed the yields for government bonds issued by the countries which are currently the focus of attention. In addition, the ECB lowered its key lending rate in July to 0.75 %, and left it unchanged at this level until the end of the year. Recent figures for the European payment system TARGET show that liabilities due to the Bundesbank of the European countries which are currently the focus of attention declined in the autumn of 2012, and that there have been no signs of any outflows of private capital since the third quarter.

Sources: Eurostat, Statistisches Bundesamt, ECB

## Sector-specific Conditions

**Overall Situation in the Banking Sector** The year 2012 has seen virtually no improvements compared with the previous year in the European banking sector. Results of operations and also the risk situation have been mixed. Particularly the first half was challenging for the sector as a result of the sovereign debt crisis which was becoming more severe, whereas the second half reported a more positive development. Overall, most investors focused on the consolidation of balance sheet risks, cost reductions and improvements to the equity situation. The banking sector has suffered in the public perception as a result of the legal aspects of resolving the financial crisis.

**Commercial Real Estate Finance** The transaction volume on the markets for commercial real estate financing in 2012 declined in most European countries. Investors continued to focus primarily on low-risk office and retail properties in good locations, with good appointments and let on a long-term basis to tenants with good creditworthiness (so-called core properties). The strong demand in this segment has meant that the attainable yields have declined further. Demand for properties which do not satisfy these criteria, or only satisfy the criteria partially, were the subject of weaker demand throughout Europe.

Optimism in the German real estate industry has strengthened again somewhat. Germany has been able to benefit from its status as a «safe haven» in Europe. With turnover of more than € 25 billion in commercial real estate investment, the volume of transactions increased by almost 10% compared with the previous year. This good development was mainly due to a strong second half with a higher level of portfolio transactions. 80% of the transaction revenues were generated in the form of individual transactions, and this was roughly in line with the corresponding previous year figure. Demand was strongest for office properties (more than 40%), followed by retail properties (approx. 30%).

The market for housing portfolios in Germany was characterised by high levels of activity in the year under review. A high number of major transactions resulted in a transaction volume considerably in excess of € 10 billion in this market. The figure reported for the previous year has accordingly more than doubled. The German housing market is still extremely attractive particularly for international investors. Prices in certain areas of this market have already risen appreciably, which means that there has been a considerable downturn in yields in some locations. A positive development has been lower vacancy rates in the year under review, particularly in the office segment. The real estate climate index, published by Deutsche Hypo, rose strongly in December alone by 4.2% to 118.5 points, after already having reported a slight increase in previous months.

The commercial real estate market in Great Britain was declining slightly until the autumn of 2012. This was mainly due to the weak performance on the investment market outside London. Properties in central locations in London produced above-average performances. This situation reflects the selective demand of investors who, despite considerably higher purchase prices, continue to prefer office and retail properties particularly in the West End and the City of London. This development was mainly due to the interest of international investors. On the other hand, less than prime locations and other regional markets were not able to attract such strong levels of interest.

In France, the decline on the investment market to a transaction volume of more than € 16.5 billion was as expected. This was due to the moderate development in the regions, whereas the greater region of Paris became more attractive compared with the previous year. In the year under review, the greater region of Paris accounted for 80% of the overall French transaction volume. In France, the office segment was predominant, and accounted for approximately two-thirds of all transactions.

In 2012, providers of real estate loans primarily financed acquisitions in the core real estate segment. For real estate of lesser quality, funding was provided on a more selective basis and more conservatively in terms of LTVs, location and lending volume. Large financing volumes were generally handled in syndicates. The realisable gross margins were better than was the case last year mainly as a result of the retirement of some competitors from the market segment of commercial real estate financing. Funding in the commercial real estate financing sector throughout Europe is to a large extent still provided by way of banks, even if insurers and credit funds are operating to a greater extent on a selective basis on the market. Overall, however, these alternative forms of debt financing provided by insurers, credit funds and real estate bonds were still of minor significance in 2012.

Sources: BNP Paribas Real Estate, Property Report, Deutsche Hypo real estate climate index, Jones Lang LaSalle investment market overview, own research

**Public Sector Finance** The reporting year was affected by the continuing uncertainty on the public investment financing market. However, there were initial signs that the situation had been stabilising since the autumn measures of the ECB mentioned above.

In municipal financing, this meant that the amount of finance provided by private banks and development banks in the countries which so far have not been very much affected by the sovereign debt crisis was sufficient to finance municipal investment projects.

However, there was no change in the course of the year to the still critical assessment, held by financing banks and investors, of the financial situation of countries which are currently the focus of attention and sub-sovereign entities, resulting in a differentiated rating assessment of municipalities and central, regional and local authorities. In the countries of Southern Europe, and in particular Spain, it was therefore necessary to take special measures to assure the liquidity of regions with major debt maturities. In most European countries, the efforts to reduce deficits at the municipal level had a negative impact on certain investment projects, and was thus reflected in lower demand for financing.

In Germany, the market provided adequate demand for finance. However, the German market was still characterised by the fact that demand focused on finance with very long maturities, and also by the fact that finance was provided by local competitors (mainly by public-sector banks and development banks) in conjunction with very low margins. The market in traditional public sector investment financing was thus very challenging.

On the other hand, the French market was less competitive and provided adequate potential for new business with attractive margins. This was due mainly to the continuing process of restructuring and the wait-and-see attitude of major competitors. Despite a large joint bond issue in which numerous municipalities participated, demand for financing was strong, and the banks which were active in the market were able to generate adequate new business. For this reason, it was possible to conduct new business in France with very good risk/reward profiles.

In Italy and Spain, most of the market for public-sector investment financing was covered by public-sector institutions.

With regard to budget financing, there has been a wide range of developments in risk premiums in the individual countries. In Germany, premiums on the secondary market have risen again slightly from their all-time lows. In Italy, Spain and Portugal, risk premiums have narrowed appreciably towards the end of 2012, and are now a long way off their all-time highs.

**Funding Markets** Whereas the beginning of 2012 was characterised by a high degree of uncertainty on the capital market, the situation improved considerably in the further course of the year. The sovereign debt crisis affecting the countries on the periphery of Europe was reflected in the first half of the year, and resulted in a downturn in market sentiment and a wait-and-see attitude among investors which had a negative impact on the funding possibilities for credit institutions. With the two 3-year funding facilities at the end of 2011 and in February 2012 as well as the announcement for purchasing government bonds in September, the ECB was able to institute specific measures for facilitating the funding of banks. This overall scenario enabled the German Pfandbrief to emerge as a winner in the second half of the year. Whereas Pfandbriefe at the beginning of the year were considered to be expensive compared with other European covered bonds, they have increasingly been the subject of investor demand. This «flight to quality» resulted in a strong secondary market performance and considerably lower risk premiums than was the case at the beginning of the year.

In conjunction with the low level of interest rates and the search for yields, the risk appetite of investors picked up again, and the feared shortage affecting unsecured bank funding failed to materialise. Whereas only a small number of players entered the market at reasonable levels with public transactions in the first few months of the year, there was a strong increase in demand and a reduction in risk premiums in the further course of the year. Also small private placing of borrowers' note loans and unsecured securities were well received by German investors.

## Business Performance

The success achieved with the restructuring process and the reduction of complexity in new financing business, in the portfolio-optimising process and also with regard to the issuing respectively redemption of secured and unsecured instruments are reflected in the income statement. With pre-tax profit of € 124 million (2011: € 188 million), pbb Group has not only underlined its profitability; it has also met its target forecasts: The pre-tax profit was in the mid-range of the target of € 100 million to € 140 million forecast at the beginning of the year. Return on equity after taxes amounted to 2.1 %, and was lower than the originally budgeted figure of 2.8 %.

Compared with the budget, the positive development in provisions for losses on loans and advances and general administrative expenses on the one hand and the lower operating revenues on the other cancelled each other out. pbb Group benefited from successful restructurings, as a result of which it was possible for a total of € –4 million to be reversed from provisions for losses on loans and advances. General administrative expenses (€ 341 million) were also lower than budget as a result of strict cost discipline. The fact that operating revenues were lower than the originally budgeted figure (€ 467 million) was reflected mainly in the lower net interest income (€ 296 million), which was affected by risk-reducing measures with which pbb Group responded in a flexible manner to the market climate. The exposure to some Southern European countries has also been reduced. This strategy and the deliberate expansion as well as the changed composition of liquidity holdings, combined with a low level of interest rates for investing own funds were factors behind lower contributions to net interest income. Because operating revenues declined to a greater extent than general administrative expenses, the cost-income ratio of 73.0 % was higher than the originally budgeted figure of 66.0 %.

New business activity was deliberately reduced in the first half of 2012 in response to the uncertain climate on the funding markets and also the uncertainty affecting the overall market. New business activity was significantly increased in the second half of 2012 after the uncertainty on the markets declined appreciably in the course of the year. The volume of new business amounted to a total of € 5.6 billion, and was lower than the originally budgeted figure of € 8.0 billion. However, the resultant negative impact on profitability was partially offset by the positive development in margins. The new-business margins were higher than the originally budgeted margins and also the average margins of existing business.

## Development in Earnings

### pbb Group

Pre-tax profit is stated as € 124 million; this is lower than the corresponding previous year figure, which was very much affected by exceptional factors. The development in results in 2012 compared with the previous year is detailed in the following:

| **Key financials pbb Group** | | **2012** | **2011** | △ in € million |
|---|---|---|---|---|
| **Operating performance** | | | | |
| Operating revenues | in € million | 467 | 526 | –59 |
| Net interest income and similar income | in € million | 296 | 371 | –75 |
| Net commission income | in € million | 23 | 32 | –9 |
| Net trading income | in € million | 10 | –8 | 18 |
| Net income from financial investments | in € million | 13 | 3 | 10 |
| Net income from hedge relationships | in € million | –6 | –56 | 50 |
| Balance of other operating income/expenses | in € million | 131 | 184 | –53 |
| Provisions for losses on loans and advances | in € million | –4 | –12 | 8 |
| General administrative expenses | in € million | 341 | 357 | –16 |
| Balance of other income/expenses | in € million | –6 | 7 | –13 |
| Pre-tax profit/loss | in € million | 124 | 188 | –64 |
| Income taxes | in € million | 55 | 71 | –16 |
| Net profit/loss | in € million | 69 | 117 | –48 |
| **Key ratios** | | | | |
| Cost-income ratio | in % | 73.0 | 67.9 | |
| Return on equity before taxes | in % | 3.8 | 5.9 | |
| Return on equity after taxes | in % | 2.1 | 3.7 | |

**Operating Revenues** Operating revenues amounted to € 467 million (2011: € 526 million). The decline was mainly due to the effects of the lower level of market interest rates for investing own funds and liquidity items as well as measures taken to reduce risk in response to the uncertain market situation. Moreover, holdings of interest-bearing assets also declined in 2012, due to various factors, including the reduction of risks and also as a result of lower one-off effects attributable to the redemption of liabilities ahead of maturity. The bank levy also had a negative impact on operating revenues.

The net interest income of € 296 million for 2012 was lower than the corresponding previous year figure (2011: € 371 million). This development was mainly due to declining one-off effects, the reduced average holdings of interest-bearing assets and a lower level of market interest rates compared with the previous year. One-off effects have been mainly attributable to repayments of receivables and redemptions of liabilities ahead of maturity. These transactions were carried out at the request of customers and can only be influenced to a limited extent by pbb Group. In the financial year 2012, such one-off revenues of € 17 million were lower than the corresponding previous year figure (2011: € 43 million). The average holdings of interest-bearing assets declined in 2012. This decline was due to various factors, including the strategy of reducing high-risk but high-interest holdings as part of the risk-reducing measures. In addition, redemptions also reduced the exposure to countries which are currently the focus of attention, such as Italy and Portugal. The liquidity holdings were expanded despite the associated costs in order to prevent risks in relation to future funding. As a result of the lower level of market interest rates, the own funds to be invested generated lower contributions to net interest income. Margins generated by new business were higher than the margins generated by existing business; this had a positive impact, but was only partially able to compensate for the negative factors.

The net commission income amounted to € 23 million (2011: € 32 million). The main reason for the decline was lower fees generated by credit and other service business (2012: € 25 million; 2011: € 35 million).

Net trading income amounted to € 10 million (2011: € –8 million). The main reason for the positive result was an effect of € 7 million attributable to the extension of the value shown for secured derivatives in the context of changed market conditions. The extended valuation now recognises the credit risk of the counterparty and also the Bank's own default risk (so-called bilateral credit value adjustment). pbb Group again did not have any portfolios with the aim of generating short-term profits (trading book).

The net income from financial investments of € 13 million (2011: € 3 million) included net income of € 20 million (2011: € 5 million) from the sale of securities. This resulted in capital gains being realised as part of the process of adjusting the liquidity holdings. These were opposed by costs of € –6 million (net) for portfolio-based allowances of securities in the IFRS valuation category LaR (2011: € –1 million).

The net income from hedge relationships in the financial year of € –6 million was much less negative than was the case in the previous year (2011: € –56 million). A positive valuation result of € 2 million (2011: € –37 million) was attributable to dFVTPL assets in conjunction with the related hedges. In the first quarter of 2012, pbb Group sold three securities in the valuation category dFVTPL which had been issued by the Republic of Portugal. The volatility of this position has declined considerably as a result of the disposals. As of the balance sheet date, pbb Group has only one financial instrument of this valuation category in its portfolio; this matures in the second quarter of 2013. Expenses of € –8 million was also recognised in relation to hedge inefficiencies (2011: € –19 million); this was mainly due to different interest rate fixing dates. Inefficiencies were also attributable to the interest rate hedging of underlyings which were concluded below the no-risk funding rate (so-called sub-Libor effect).

The balance of other operating income/expenses declined in the financial year 2012 to € 131 million (2011: € 184 million). This was due mainly to the bank levy of € –24 million payable for the current and previous periods (2011: € –2 million). The balance of other operating income/expenses which is attributable to services for the ongoing operation of FMS Wertmanagement and which corresponded to general administrative expenses, amounted to € 106 million, and was thus lower than the corresponding previous year figure (2011: € 109 million). Because the transferred portfolio declined further in the year under review, the volume of necessary services has declined accordingly. In accordance with the requirement of the European Commission, Servicing has to be completely discontinued by the end of September 2013. The net income from IT services provided to the affiliated company DEPFA was € 40 million (2011: € 35 million). Currency translation has resulted in income of € 3 million (2011: € 7 million). Further income was attributable to rental income generated from real estate of € 7 million (2011: € 3 million).

**Provisions for Losses on Loans and Advances** The improved economic situation of individual financing arrangements and successful restructuring resulted in a net reversal of provisions for losses on loans and advances of € – 4 million in the year under review (2011: € – 12 million). This positive development is also reflected in the decline in problem loans, which fell from € 1.3 billion to € 1.1 billion.

The net additions to individual allowances amounted to € 23 million (2011: € 21 million) and are attributable to a small number of individual cases. As was the case in the previous year, no specific provision had to be created in relation to public sector financing including exposures in countries which are currently in the focus of attention. pbb Group did not have any exposure to Greek counterparties.

Portfolio-based allowances are created only for receivables for which there have not been any indications of an individual impairment. Portfolio-based allowances of € – 22 million (net) were reversed in the financial year 2012 (2011: € – 23 million). These reversals were mainly attributable to the successful restructuring of financing arrangements with a less positive rating, for which there were no criteria for recognising an individual allowance. The reduced portfolio also had an impact.

In addition, in the financial year 2012 it was possible for provisions for contingent liabilities and other obligations of € – 4 million (net) to be reversed (2011: € – 9 million). This was mainly due to a payment in relation to commitments for which an impairment had been recognised.

**General Administrative Expenses** In the financial year 2012, general administrative expenses declined by € 16 million to € 341 million (2011: € 357 million), mainly due to lower non-staff expenses of € 210 million (2011: € 228 million). This was mainly attributable to lower IT costs of € 102 million (2011: € 121 million). This development reflects the successful conclusion of IT projects in previous years and in 2012. Compared with the previous year, personnel expenses of € 131 million remained more or less constant (2011: € 129 million). General administrative expenses also include the expenses which correspond to the balance of other operating income/expenses from the services for ongoing operation of FMS Wertmanagement. Because operating revenues declined to a greater extent than general administrative expenses, the cost-income ratio increased to 73.0 % (2011: 67.9 %).

**Balance of Other Income/Expenses** The balance of other income/expenses of € – 6 million (2011: € 7 million) is mainly attributable to changes in the restructuring provisions. Additions were necessary after the future headcount will be adjusted as part of the process of further specifying the target structure. There have also been updates following the validations of the parameters included in the calculation process.

**Pre-tax Profit/Loss** The profit before tax amounted to € 124 million (2011: € 188 million). Return on equity before taxes amounted to 3.8 % (2011: 5.9 %).

**Taxes on Income** Income of € – 8 million from actual taxes (2011: € 18 million), and the expenses of € 63 million for deferred taxes (2011: € 53 million) combine to form a total tax expense of € 55 million (2011: € 71 million).

**Net Profit/Loss** The profit/loss after tax of pbb Group amounted to € 69 million (2011: € 117 million). Return on equity after taxes amounted to 2.1 % (2011: 3.7 %).

## Operating Segment Real Estate Finance (REF)

| Key financials Real Estate Finance | | 2012 | 2011 | Δ in € million |
|---|---|---|---|---|
| **Operating performance** | | | | |
| Operating revenues | in € million | 264 | 274 | –10 |
| Net interest income and similar income | in € million | 227 | 245 | –18 |
| Net commission income | in € million | 25 | 37 | –12 |
| Net trading income | in € million | 2 | –11 | 13 |
| Net income from financial investments | in € million | 16 | 1 | 15 |
| Net income from hedge relationships | in € million | –3 | –7 | 4 |
| Balance of other operating income/expenses | in € million | –3 | 9 | –12 |
| Provisions for losses on loans and advances | in € million | –5 | –1 | –4 |
| General administrative expenses | in € million | 139 | 138 | 1 |
| Balance of other income/expenses | in € million | –3 | 3 | –6 |
| Pre-tax profit/loss | in € million | 127 | 140 | –13 |
| **Key ratio** | | | | |
| Cost-income ratio | in % | 52.7 | 50.4 | |

The Real Estate Finance segment comprises all commercial real estate financing arrangements of pbb Group. As originally forecast at the beginning of the year, most of the Group profit was generated by the segment Real Estate Finance (REF). The budgeted figure was exceeded as a result of the lower risk provisioning requirement. However, the pre-tax profit of the segment (€127 million) was lower than the corresponding previous year figure (2011: €140 million) due to the negative impact of the bank levy.

At the beginning of 2012, new real estate financing business was concluded only on a very selective basis in view of the high level of uncertainty on the funding markets. New business activity increased significantly when this uncertainty declined appreciably in the course of the year. However, despite a strong fourth quarter, in which new business of €2.4 billion was concluded, the full-year volume of €4.9 billion failed to meet the new business target and the previous year figure (€6.3 billion). New business margins in 2012 were higher than the margins achieved in the previous year and also higher than the margins achieved in the existing portfolio.

**Operating Revenues** In the reporting year, operating revenues in the REF segment declined to €264 million (2011: €274 million); this was due mainly to lower net interest income as well as lower net commission income. The net interest income of €227 million (2011: €245 million) was affected particularly by lower one-off factors mainly in the form of repayments of receivables and redemptions of liabilities before maturity and also the reduced average holdings of interest-bearing assets. In addition, the lower level of market interest rates resulted in lower contributions to net interest income generated by the liquidity holdings and own funds to be invested. Net commission income of €25 million was lower than the corresponding previous year figure of €37 million and is due mainly to charges in lending business which were lower compared with the previous year. Net trading income improved to €2 million in the financial year 2012 (2011: €–11 million). The valuation of the secured derivatives (including credit risk of the counterparty and the Bank's own default risk) had a positive impact. Capital gains from the sale of securities as part of the process of adjusting the liquidity holdings resulted in net income from financial investments of €16 million (2011: €1 million). The net income from hedge relationships of €–3 million (2011: €–7 million) was attributable to hedge inefficiencies. The balance of other operating income/expenses was slightly negative at €–3 million (2011: €9 million);

this was mainly attributable to the allocation of the expenses of the bank levy over the operating segments (2012: € – 9 million; 2011: € 0 million).

**Provisions for Losses on Loans and Advances** A figure of € – 5 million (net) was reversed for provisions for losses on loans and advances (2011: € – 1 million). This was due to the improved economic situation applicable for some financing arrangements as well as successful restructurings, which also resulted in a decline in the problem loans. The net additions to individual allowances amounted to € 24 million (2011: € 15 million) and were attributable to a small number of individual cases. On the other hand, a figure of € – 26 million was reversed from portfolio-based allowances as a result of successful restructuring and the associated repayment of a problem loan. In the previous year, portfolio-based allowances of € – 29 million were reversed mainly as a result of improved ratings of financing arrangements.

**General Administrative Expenses** General administrative expenses at € 139 million were in line with the corresponding previous year figure (2011: € 138 million). Because operating revenues declined in conjunction with almost constant general administrative expenses, the cost-income ratio increased to 52.7 % (2011: 50.4 %).

## Operating Segment Public Sector Finance (PSF)

| Key financials<br>Public Sector Finance | | 2012 | 2011 | Δ in € million |
|---|---|---|---|---|
| **Operating performance** | | | | |
| Operating revenues | in € million | 47 | 63 | – 16 |
| Net interest income and similar income | in € million | 58 | 109 | – 51 |
| Net commission income | in € million | – 1 | – 3 | 2 |
| Net trading income | in € million | 8 | – 3 | 11 |
| Net income from financial investments | in € million | – 2 | 5 | – 7 |
| Net income from hedge relationships | in € million | – 3 | – 48 | 45 |
| Balance of other operating income / expenses | in € million | – 13 | 3 | – 16 |
| Provisions for losses on loans and advances | in € million | 4 | – | 4 |
| General administrative expenses | in € million | 53 | 54 | – 1 |
| Balance of other income / expenses | in € million | – 1 | 2 | – 3 |
| Pre-tax profit / loss | in € million | – 11 | 11 | – 22 |
| **Key ratio** | | | | |
| Cost-income ratio | in % | >100.0 | 85.7 | |

The Public Sector Finance segment comprises the financing arrangements of the public sector. The segment comprises public-sector investment finance arrangements, in which pbb Group operates new business, as well as expiring budget financing. In the year under review, the pre-tax profit of the segment (€ – 11 million) was lower than the corresponding previous year figure (2011: € 11 million) as a result of lower operating revenues in conjunction with a constant cost base; it was also lower than the original forecast, which predicted a slightly positive result. In the PSF segment, operating revenues declined (€ 47 million; 2011: € 63 million) as a result of various factors, including the negative impact of the bank levy.

New business in the PSF segment amounted to € 0.7 billion, and was thus lower than the original forecast and the previous year figure (2011: € 1.7 billion). New business was concluded only on a very selective basis mainly in view of the uncertainty on the overall market (sovereign debt crisis). The regional focus of new business in 2012 was France and Germany, as pbb Group responded to the debt crisis in some countries. However, the margins of new business in the year under review were higher than the corresponding previous year figures, and were also higher than the average margins of existing business.

**Operating Revenues** Operating revenues in the PSF segment declined to € 47 million, mainly due to lower net interest income (2011: € 63 million). Net interest income in the year under review amounted to € 58 million, compared with € 109 million in the previous year. This is due to lower contributions to net interest income resulting from repayments of receivables and redemptions of liabilities as well as from liquidity holdings and own funds to be invested. The latter declined as a result of the lower level of market interest rates. In addition, net interest income was also affected by the reduced average holdings of interest-bearing assets. Net commission income includes cost of the security and custodial business, and at € – 1 million was roughly in line with the previous year figure (2011: € – 3 million). The net trading income of € 8 million (2011: € – 3 million) reflects the positive impact of the valuation of the secured derivatives (including credit risk of the counterparty and the Bank's own default risk). The net income from financial investments of € – 2 million (2011: € 5 million) was mainly attributable to portfolio-based allowances of financial investments of the IFRS valuation category LaR. Following the reduction of risks resulting from the sale of Portuguese securities which were allocated to the IFRS valuation category dFVTPL, the net income from hedge accounting was much less volatile than was the case in the previous year, and amounted to € – 3 million (2011: € – 48 million). The balance of other operating income/expenses was negative in the financial year 2012 at € – 13 million (2011: € 3 million); this was mainly attributable to the allocation of the costs of the bank levy over the operating segments (2012: € – 15 million; 2011: € 0 million).

**Provisions for Losses on Loans and Advances** Provisions for losses on loans and advances amounted to € 4 million in the reporting period (2011: € 0 million). It was not necessary to create any further individual allowances with regard to other public issuers, because there were no objective indications of an impairment in accordance with IAS 39.59. The downgrading of the creditworthiness of Spain and Portugal has resulted in an increase of € 4 million in the volume of watchlist loans and additions to the portfolio-based allowances in the year under review (2011: € 0 million).

pbb Group did not have any exposure to Greek counterparties.

**General Administrative Expenses** General administrative expenses at € 53 million were in line with the corresponding previous year figure (2011: € 54 million). Approximately one-third of the general administrative expenses of pbb Group (exclusive servicing of FMS Wertmanagement) is attributable to the PSF segment. Because operating revenues declined in conjunction with virtually constant general administrative expenses, the cost-income ratio increased to more than 100.0 % (2011: 85.7 %).

## Operating Segment Value Portfolio (VP)

| Key financials Value Portfolio | | 2012 | 2011 | Δ in € million |
|---|---|---|---|---|
| **Operating performance** | | | | |
| Operating revenues | in € million | 147 | 168 | –21 |
| Net interest income and similar income | in € million | 1 | – | 1 |
| Net commission income | in € million | –1 | –2 | 1 |
| Net trading income | in € million | – | 6 | –6 |
| Net income from financial investments | in € million | –1 | –3 | 2 |
| Net income from hedge relationships | in € million | – | –1 | 1 |
| Balance of other operating income/expenses | in € million | 148 | 168 | –20 |
| Provisions for losses on loans and advances | in € million | –3 | –11 | 8 |
| General administrative expenses | in € million | 148 | 159 | –11 |
| Balance of other income/expenses | in € million | –2 | 2 | –4 |
| Pre-tax profit/loss | in € million | – | 22 | –22 |
| **Key ratio** | | | | |
| Cost-income ratio | in % | >100.0 | 94.6 | |

The Value Portfolio segment mainly comprises the income and expenses attributable to the services of pbb Group for the ongoing operation of FMS Wertmanagement as well as IT services provided to the affiliated company DEPFA. The segment also comprises non-strategic portfolios, for instance selected structured products. In the year under review, pre-tax profit for the segment broke even and was roughly in line with the original forecast. Lower income for the servicing of FMS Wertmanagement was the reason for the decline in the result compared with the previous year. Because the transferred portfolio declined further in the year under review, the volume of necessary services has declined accordingly.

**Operating Revenues** In the year under review, operating revenues in the Value Portfolio segment declined to € 147 million (2011: € 168 million). Net interest income amounted to € 1 million (2011: € 0 million), and was mainly attributable to non-strategic investments. Net commission income was slightly less negative, at € –1 million (2011: € –2 million). The net trading income and the net income from hedge relationships both roughly broke even in the financial year 2012 (compared with € 6 million respectively € –1 million in 2011). The net income from financial investments (€ –1 million; 2011: € –3 million) also almost broke even. The balance of other operating income/expenses declined to € 148 million (2011: € 168 million). The balance of other operating income/expenses which is attributable to services for the ongoing operation of FMS Wertmanagement and which corresponded to general administrative expenses, amounted to € 106 million, and was thus lower than the corresponding previous year figure (2011: € 109 million). The income from IT services provided to the affiliated company DEPFA increased, however (2012: € 40 million; 2011: € 35 million).

**Provisions for Losses on Loans and Advances** Provisions for losses on loans and advances totalling € –3 million were reversed in the year under review as a result of defaults being absorbed by third parties (2011: € –11 million).

**General Administrative Expenses** General administrative expenses are stated as € 148 million, and are thus lower than the corresponding previous year figure (2011: € 159 million) because fewer expenses were incurred for servicing of FMS Wertmanagement. Because operating revenues declined to a greater extent than general administrative expenses, the cost-income ratio increased to more than 100.0 % (2011: 94.6 %).

## Consolidation & Adjustments

| Key financials Consolidation & Adjustments | | 2012 | 2011 | Δ in € million |
|---|---|---|---|---|
| **Operating performance** | | | | |
| Operating revenues | in € million | 9 | 21 | −12 |
| Net interest income and similar income | in € million | 10 | 17 | −7 |
| Net commission income | in € million | – | – | – |
| Net trading income | in € million | – | – | – |
| Net income from financial investments | in € million | – | – | – |
| Net income from hedge relationships | in € million | – | – | – |
| Balance of other operating income/expenses | in € million | −1 | 4 | −5 |
| Provisions for losses on loans and advances | in € million | – | – | – |
| General administrative expenses | in € million | 1 | 6 | −5 |
| Balance of other income/expenses | in € million | – | – | – |
| Pre-tax profit/loss | in € million | 8 | 15 | −7 |

In Consolidation & Adjustments, the sum of the segment results is reconciled with the consolidated results. This column contains consolidations as well as certain expenses and income which do not fall under the scope of the various operating segments.

Pre-tax profit in Consolidation & Adjustments was positive (€ 8 million; 2011: € 15 million). The net interest income was generated primarily as a result of the equity which was not allocated to the segments.

## Development in Assets

| Assets<br>in € million | 31.12.2012 | 31.12.2011 | in € million |
|---|---|---|---|
| Cash reserve | 1,937 | 323 | 1,614 |
| Trading assets | 3,325 | 9,818 | −6,493 |
| Loans and advances to other banks | 7,995 | 7,632 | 363 |
| Loans and advances to customers | 49,590 | 55,236 | -5,646 |
| Allowances for losses on loans and advances | −325 | −477 | 152 |
| Financial investments | 25,572 | 28,677 | −3,105 |
| Property, plant and equipment | 2 | 3 | −1 |
| Intangible assets | 39 | 35 | 4 |
| Other assets | 7,235 | 6,058 | 1,177 |
| Income tax assets | 1,686 | 1,474 | 212 |
| Current tax assets | 53 | 55 | −2 |
| Deferred tax assets | 1,633 | 1,419 | 214 |
| **Total assets** | **97,056** | **108,779** | −11,723 |

**General Development in Assets** The total assets of pbb Group amounted to € 97.1 billion, and were thus € 11.7 billion (10.8 %) lower than the corresponding figure at the end of the previous year (2011: € 108.8 billion). The decline was mainly attributable to effects which occurred during the process of transferring positions to FMS Wertmanagement. In addition, the total assets also declined as a result of the process of streamlining some portfolios in line with overall strategy, for instance portfolios in public sector budget financing. Market-related factors had the effect of boosting total assets. In particular, the lower level of long-term interest rates has led to an increase in the market values of derivatives and the underlyings shown in fair value hedge accounting. In addition, total assets have increased as a result of higher levels of cash held with central banks and also investments. The increase in this item is due to various factors, including an increase in the liquidity reserve. The funds are also used for future new business in commercial real estate financing and public sector investment financing.

**Effects from Transfer of Positions to FMS Wertmanagement** The process of transferring positions to FMS Wertmanagement has resulted in effects which initially increased total assets in the course of 2010, but which have gradually declined over a period of time. These effects were mainly attributable to the transmission of liquidity for FMS Wertmanagement, the synthetic transfer of market risks by means of so-called back-to-back derivatives as well as synthetically transferred cover fund holdings. These effects have developed as follows in the financial year 2012:

> The back-to-back derivatives were to a certain extent replaced by direct business relations between FMS Wertmanagement and the external customers (novation of derivatives). This has resulted in a decline in the positive market values of the back-to-back derivatives which are shown as trading assets and also the corresponding external derivatives as of 31 December 2012 to € 1.0 billion (2011: € 7.4 billion).

> The balance sheet holdings of synthetically transferred cover fund holdings, shown under loans and advances to customers, declined from € 9.0 billion at the end of the previous year to € 7.5 billion as of 31 December 2012 as a result of maturities.

In addition, the decline of € 0.5 billion in the investment at the central bank of liquidity not required for FMS Wertmanagement (2011: € 0.7 billion) had the effect of slightly reducing total assets in loans and advances to other banks.

**Covenants Relating to the Total Assets** As of the balance sheet date, pbb Group complied with all covenants relating to the total assets which had been imposed by the European Commission in connection with the approval of state aid. Accordingly, the total assets adjusted by certain opposite effects attributable to the transfer of positions transferred to FMS Wertmanagement amounted to € 95.4 billion as of 31 December 2012 (2011: € 100.6 billion), and were thus lower than the prescribed maximum limit of € 105.0 billion (2011: € 107.0 billion). The strategic total assets adjusted by the holdings of synthetically transferred mortgage cover funds and the holdings of pure budget financing amounted to € 59.8 billion (2011: € 58.7 billion), and were also lower than the prescribed maximum limit of € 71.0 billion (2011: € 67.0 billion). The increase in the adjusted strategic total assets compared with the previous year is attributable to the market-related effects and the higher cash reserve as well as the higher cash investments.

**Investments** The purpose of pbb Group is the operating of bank business and in particular lending business. Investments in property, plant and equipment and intangible assets are of minor significance in this respect. Nevertheless, pbb Group invested in these areas in 2012. These activities focused on the further development of the IT landscape, which has an impact on all segments. The process of transferring lending business to a standard IT system was successfully completed as of 1 October 2012. In 2013, the process of segregating the IT systems from FMS Wertmanagement is also currently ongoing within the framework of a further project; this has an impact on the Value Portfolio segment. The process of unbundling from the affiliated DEPFA was also continued. The additions of purchased and self-created software amounted to € 18 million in the year under review (2011: € 8 million).

Within the framework of restructuring, pbb Group occasionally acquires real estate. In the year 2012, a property in Japan was acquired in the Real Estate Finance segment (€ 102 million). The purchase price corresponded to the carrying amount of the receivable after provisions for losses on loans and advances; this means that the acquisition did not have any impact on the result.

pbb Group acquires financial investments mainly for portfolio optimisation purposes, for instance for investing liquidity positions and own funds.

## Development in the Financial Position

| **Equity and liabilities**<br>in € million | **31.12.2012** | **31.12.2011** | △ in € million |
|---|---|---|---|
| Liabilities to other banks | 7,797 | 8,223 | –426 |
| Liabilities to customers | 11,895 | 12,363 | –468 |
| Liabilities evidenced by certificates | 52,550 | 55,038 | –2,488 |
| Trading liabilities | 3,192 | 9,903 | –6,711 |
| Provisions | 164 | 163 | 1 |
| Other liabilities | 14,438 | 16,123 | –1,685 |
| Income tax liabilities | 1,698 | 1,373 | 325 |
| Current tax liabilities | 64 | 82 | –18 |
| Deferred tax liabilities | 1,634 | 1,291 | 343 |
| Subordinated capital | 1,993 | 2,501 | –508 |
| **Financial liabilities** | **93,727** | **105,687** | –11,960 |
| **Financial equity** | **3,329** | **3,092** | 237 |
| **Total equity and liabilities** | **97,056** | **108,779** | –11,723 |

## Liabilities

Total Group liabilities as of 31 December 2012 amounted to € 93.7 billion, compared with € 105.7 billion as of the same date in the previous year. The change was mainly attributable to the decline in the effects which occurred in connection with the process of transferring positions to FMS Wertmanagement. The negative market values of the back-to-back derivatives with FMS Wertmanagement and the corresponding derivatives with external third parties were reduced from € 7.4 billion last year to € 1.0 billion as of 31 December 2012, by way of novations.

In addition to the reducing effects attributable to the process of transferring positions to FMS Wertmanagement, the lower funding requirement due to the process of streamlining some portfolios on the assets side of the balance sheet in line with overall strategy also resulted in a reduction in the volume of liabilities shown on the balance sheet.

The decline in investments of transmitted funds of FMS Wertmanagement at the central bank resulted in a slight reduction in loans and advances to other banks.

Market-related factors had the effect of increasing the balance sheet total, because the market values of the derivatives and the underlyings measured at fair value increased primarily in fair value hedge accounting as a result of the lower level of long-term interest rates.

## Capital

**Development of Financial Equity** The equity attributable to shareholders has developed as follows:

| Financial position equity in accordance with IFRS<br>in € million | 31.12.2012 | 31.12.2011 | Δ in € million |
|---|---|---|---|
| **Equity attributable to equity holders** | **3,329** | **3,092** | 237 |
| Subscribed capital | 380 | 380 | – |
| Silent participation | 999 | 999 | – |
| Additional paid-in capital | 5,036 | 5,036 | – |
| Retained earnings | –3,166 | –3,277 | 111 |
| Foreign currency reserve | –29 | –34 | 5 |
| Revaluation reserve | 40 | –129 | 169 |
| AfS reserve | –360 | –549 | 189 |
| Cash flow hedge reserve | 400 | 420 | –20 |
| Consolidated profit/loss 1.1.–31.12. | 69 | 117 | –48 |
| **Total financial position equity** | **3,329** | **3,092** | 237 |

Equity amounted to € 3.3 billion as of the reporting date (2011: € 3.1 billion). No capital increases or capital reductions were carried out in the financial years 2012 and 2011. There have been major changes only in the positions of the revaluation reserve. The AfS reserve as of 31 December 2012 was less negative than was the case in the previous year, mainly as a result of closer credit spreads of Italian securities (€ –0.4 billion; 2011: € –0.5 billion). Disposals of AfS securities had a slightly opposite impact. The cash flow hedge reserve has declined as of the balance sheet date by € 20 million. This mainly reflected the expiry of derivative holdings, which more than compensated for the increases in market value due to the lower level of interest rates.

**Capital Measures** The subscribed capital of pbb amounted to € 380,376,059.67 as of 31 December 2012, and also as of 31 December 2011, and comprises 134,475,308 no-par-value bearer shares each with a theoretical interest of € 2.83 in the subscribed capital. Finanzmarktstabilisierungsfonds-FMS is the sole shareholder of pbb. There was no contingent or authorised capital as of 31 December 2012.

No specific capital measures are planned at present. However, within the framework of the approval decision in the aid proceedings, the European Commission has specified that pbb will have to be reprivatised as quickly as possible, and by no later than as of the end of 2015.

**Regulatory Indicators According to German Solvency Regulation** In accordance with the waiver rule set out in Section 2 a KWG, pbb is exempted from the requirement to establish the equity and core capital ratios at the level of the institution. pbb Group voluntarily discloses these figures on a pro-forma basis.

The regulatory capital of pbb Group in accordance with the Solvency Regulation (Solvabilitätsverordnung; SolvV) on a pro forma basis is as follows:

| **Own funds**[1)]<br>in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| Core capital (Tier I) | 2,898 | 2,762 |
| Supplementary capital (Tier II) | 1,179 | 1,383 |
| **Equity capital** | **4,077** | **4,145** |
| Tier III capital | – | – |
| **Total** | **4,077** | **4,145** |

1) Consolidated pursuant to section 10 a German Banking Act (KWG); pro forma as per prepared annual financial statements and after result distribution

The capital ratios have been determined on the basis of the definition of shareholders' equity in accordance with SolvV and also using risk-weighted assets in accordance with Basel II. On a pro forma basis, the capital ratios are as follows:

| **Key capital ratios**[1)]<br>in % | 31.12.2012 | 31.12.2011 |
|---|---|---|
| Core capital ratio[2)] | 18.9 | 16.3 |
| Equity capital ratio[3)] | 26.7 | 24.5 |
| Own funds ratio (overall indicator)[2)] | 26.6 | 24.4 |

1) Pro forma as per prepared annual financial statements and after result distribution
2) Including risk-weighted credit risk positions as well as the capital requirements for market risk positions and operational risks scaled with the factor 12.5
3) Including risk-weighted credit risk positions as well as the capital requirements for operational risks scaled with the factor 12.5

Capital is managed on the basis of the Solvency Regulation (Solvabilitätsverordnung; SolvV) and the requirements of section 10 of the German Banking Act (Kreditwesengesetz; KWG). Accordingly, the equity ratio (equity/risk-weighted assets) is not permitted to fall below 8.0 %; in addition, the percentage of core capital in relation to shareholders' equity must be at least 50%, which means that the core capital ratio must be at least 4.0 %. At the same time, it is necessary to comply with the own-fund ratio of min. 8.0 % calculated on the basis of the ratio between the own funds and the total of risk-weighted assets and the multiple of 12.5 times the amounts recognised for market risk positions. These requirements were satisfied throughout the whole of 2011 and 2012.

## Liquidity

**Principles and Objectives of the Liquidity and Financial Management** The primary objective of financial management of pbb Group is to assure and manage liquidity of pbb and its subsidiaries in such a way that their financing and funding capability is guaranteed at all times. In pbb Group, Treasury is responsible for central liquidity management by way of raising and investing liquidity on the money and capital markets and the interbank money market as well as with central banks and other liquidity sources. On the other hand, the liquidity risk strategy forms part of the risk strategy of HRE.

**Maturities** Management of the balance sheet structure of pbb Group is the responsibility of the Group Asset and Liability Committee (ALCO) of HRE, which simultaneously operates for pbb Group. The ALCO is chaired by the member of the Management Board responsible for Treasury and Asset Management and comprises the CRO, the CFO and the heads of Treasury and Asset Management, Finance, Risk Management and Control. It meets on a monthly basis. The remaining terms of the assets and liabilities are compared in the following:

| Maturity structure of financial position | 31.12.2012 | | 31.12.2011 | |
|---|---|---|---|---|
| in € million | Assets | Equity and liabilities | Assets | Equity and liabilities |
| **Total** | **97,056** | **97,056** | **108,779** | **108,779** |
| up to 3 months | 14,831 | 10,425 | 10,771 | 10,323 |
| 3 months to 1 year | 6,702 | 6,278 | 6,936 | 6,972 |
| 1 year to 5 years | 30,607 | 28,786 | 32,345 | 30,203 |
| 5 years and over | 32,954 | 28,746 | 41,816 | 30,627 |
| Other assets[1]/equity and liabilities[2] | 11,962 | 22,821 | 16,911 | 30,654 |

[1] Trading assets, allowances for losses on loans and advances, property, plant and equipment, intangible assets, other assets, income tax assets
[2] Trading liabilities, provisions, other liabilities, income tax liabilities, equity

**Liquidity Management** Within pbb Group, liquidity management is the central responsibility of the Treasury function of pbb. The sales entities receive internal one-to-one funding when new business is concluded. This means that the interest, currency and loan default risks are pooled and managed centrally. At pbb, the liquidity ratio is calculated at the level of the individual bank in accordance with the Liquidity Regulations, and amounted to 2.28 (31 December 2011: 2.34). It was thus considerably higher than the legal minimum limit of 1.0. The requirement of monitoring international regulations for operating facilities in relation to the liquidity ratio is also complied with, if this is demanded by local regulatory authorities.

**Funding** Pfandbriefe are the main funding means of pbb Group. pbb Group also raises unsecured funding. At the request of customers, most issues are carried out on a fixed-income basis. On the other hand, new business on the assets side of the balance sheet is mainly concluded on a floating interest basis, whereby the interest rate risk of the borrower is hedged where appropriate with a customer derivative. Open interest rate positions of the Group are regularly hedged by swapping fixed interest rates for variable interest rates. In the financial year 2012, pbb Group underlined its activity on the funding markets by way of five benchmark issues (four covered and one unsecured) and also by way of topping up four issues. The issues and topping-up activities, which are shown in the following table, replaced expiring securities, where necessary.

**Benchmark issues**

| ISIN | Announcement | Settlement | Maturity | Coupon | Volume | Issue price | Currency |
|---|---|---|---|---|---|---|---|
| DE000A1K0RS7 (mortgage Pfandbrief) | 10.1.2012 | 18.1.2012 | 18.1.2016 | 2.250% | 500 million | 99.970% | EUR |
| DE000A1EWJU1 (1st tap)[1] | 22.2.2012 | 29.2.2012 | 6.10.2016 | 2.625% | 100 million | 102.579% | EUR |
| DE000A1K0RS7 (1st tap) | 7.3.2012 | 14.3.2012 | 18.1.2016 | 2.250% | 175 million | 101.904% | EUR |
| DE000A1MLUW0 (mortgage Pfandbrief) | 24.5.2012 | 1.6.2012 | 3.6.2019 | 2.125% | 500 million | 99.800% | EUR |
| DE000A1PGTJ2 (mortgage Pfandbrief) | 27.6.2012 | 4.7.2012 | 4.7.2017 | 1.625% | 500 million | 99.658% | EUR |
| DE000A1MLUW0 (1st tap) | 23.7.2012 | 30.7.2012 | 3.6.2019 | 2.125% | 200 million | 102.806% | EUR |
| DE000A1PG3A3 (unsecured benchmark issue) | 4.9.2012 | 11.9.2012 | 11.9.2015 | 2.500% | 500 million | 99.852% | EUR |
| DE000A1PG3A3 (1st tap) | 19.9.2012 | 24.9.2012 | 11.9.2015 | 2.500% | 250 million | 100.603% | EUR |
| DE000A1PG3M8 (mortgage Pfandbrief) | 6.11.2012 | 12.11.2012 | 20.11.2019 | 1.875% | 250 million | 99.641% | GBP |

[1] Tap of an issue of originally €500 million of 6 October 2011

**Ratings** The following table summarises pbb's senior unsecured ratings and Pfandbrief ratings:

| **Senior unsecured ratings and ratings for Pfandbriefe of pbb**[1] | | 31.12.2012 | | | 31.12.2011 | | |
|---|---|---|---|---|---|---|---|
| | | Fitch Ratings | Moody's | Standard & Poor's | Fitch Ratings | Moody's | Standard & Poor's |
| **pbb** | Long-term rating | A– | Baa2 | BBB | A– | A3 | BBB |
| | Outlook | Stable | Negative | Stable | Stable | Stable | Stable |
| | Short-term rating | F1 | P–2 | A–2 | F1 | P–1 | A–2 |
| Public sector Pfandbriefe | | –[2] | Aa1 | AA+[3][4] | AAA[3] | Aaa | AA+[5] |
| Mortgage Pfandbriefe | | –[2] | Aa1[3] | AA+[3][4] | AA+ | Aa1 | AA+[5] |

[1] Ratings from mandated rating agencies
[2] After the rating mandates were terminated by the Bank, the ratings were withdrawn in February respectively in September 2012
[3] Review for downgrade
[4] The ratings were confirmed in each case in January 2013 (see events after 31 December 2012)
[5] Stable outlook

The Rating Agencies may alter or withdraw their ratings at any time. For the evaluation and usage of ratings, please refer to the Rating Agencies' pertinent criteria and explanations and the relevant terms of use are to be considered. Ratings should not substitute individual analysis. Ratings do not constitute any recommendation to purchase, hold or sell securities issued by pbb.

The development of ratings is currently heavily driven by exogenous factors such as the ongoing sovereign debt crisis or changes to rating methodologies and parameters applied by the rating agencies, and reflects only to a limited extent the successfully implemented restructuring process and the business success of pbb.

Despite a more critical view towards the banking sector, the senior unsecured ratings assigned by Standard & Poor's and Fitch Ratings remained unchanged in the financial year 2012. Moody's downgraded the senior unsecured rating in December from A3 to Baa2 with a negative outlook; this move followed a comprehensive review of bank ratings using revised criteria in the course of which Moody's downgraded numerous ratings particularly in the European banking sector in the first half of the year.

pbb terminated the rating for public sector Pfandbriefe by Fitch Ratings also in view of changes to its covered bonds rating methodology which, in the Bank's opinion, would have resulted in excessive overcollateralisation requirements. As the methodologies applied by the rating agencies increasingly differ from one another and thus make cover pool management more difficult, pbb has also terminated the rating by Fitch Ratings for mortgage Pfandbriefe. pbb has taken suitable measures to limit the impact of the changes to the methodology introduced by Standard & Poor's in the year under review. Following Moody's downgrade of the senior unsecured rating, the rating agency also downgraded the rating of the public sector Pfandbriefe from Aaa to Aa1 in December, whereas the review for downgrade continued for the rating of mortgage Pfandbriefe at the end of the financial year.

**Off-balance-sheet Obligations** The irrevocable loan commitments constitute most of the off-balance-sheet obligations, and declined from € 1,137 million as of 31 December 2011 to € 1,035 million as of 31 December 2012 as a result of drawings and reductions of lines. The contingent liabilities arising from guarantees and warranty agreements amounted to € 75 million as of the balance sheet date (2011: € 38 million).

## Summary

pbb Group closed the financial year 2012 with a pre-tax profit of € 124 million, and was thus profitable for a tenth quarter in succession. The pre-tax profit was lower than the figure for the corresponding previous year period, which was particularly affected by one-off factors; however, it is in the mid-range of the target corridor of € 100 million to € 140 million forecast at the beginning of the year. The fact that pbb Group has been able to meet its objective in terms of pre-tax profit despite its conservative strategy in view of the troublesome market climate illustrates the sustainable success of the Group with its refocusing. The decline in assets and liabilities is mainly attributable to lower opposite effects from the transfer of positions to FMS Wertmanagement. The requirements regarding the regulatory capital ratios in accordance with the Solvency Regulation were satisfied throughout the whole of 2012. These are determined voluntarily by pbb Group on a pro forma basis.

# Events after 31 December 2012



After 31 December 2012 the following events occurred without any material impacts on assets, financial position and earnings.

At the beginning of January 2013, the Credit Watch negative initiated by Standard & Poor's in November 2012 for the two Pfandbrief programmes of pbb were resolved. Both ratings were confirmed at AA+/A–1+. The outlook for the long-term rating of both programs is stable.

pbb Group had participated in the three-year tenders of the European Central Bank of December 2011 and March 2012. pbb Group utilised the first repayment dates in January respectively February 2013 in order to completely repay the liquidity which had been raised.

On 17 January 2013, pbb Group issued an unsecured benchmark bond with a volume of € 500 million at an issue price of 99.587 %. In view of strong investor demand, this was topped up by a further € 360 million on 14 February, and now has a total volume of € 860 million. The bond had a coupon of 2.0 % and a term of three and a half years, and is due to expire on 19 July 2016.

On 23 January 2013, there was a further issue of a mortgage Pfandbrief of € 500 million with a coupon of 0.875 %, an issue price of 99.785 % and a term of four years (due upon final maturity on 30 January 2017).

# Risk and Opportunity Report

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

## Organisation and Principles of Risk and Capital Management

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

### Organisation and Committees

The principles, methods and processes of the risk management system of HRE Group are specified centrally by risk management and controlling of HRE Holding and are applied in pbb Group. The committees detailed in the following have been set up at the HRE Group level with the involvement of the respective decision makers of pbb Group.

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

The following are major components of the risk management system for which the Management Board is responsible:

- Defining, updating and communicating business and risk strategies as the basis of business activities and risk acceptance for all units in pbb Group
- Defining and improving organisation structures within pbb 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 within pbb Group
- Taking decisions regarding (portfolio) management measures outside the competences which have been transferred

The Management Board of Deutsche Pfandbriefbank AG notifies the Supervisory Board of Deutsche Pfandbriefbank AG with regard to significant changes in the business and risk strategies as well as the risk profile of pbb Group. The Risk Management and Liquidity Strategy Committee (RLA) of the Supervisory Board is mainly responsible for controlling the overall risk situation and for monitoring, establishing and improving an efficient risk management system, and is also responsible for the liquidity management and assurance of pbb Group and resolves upon necessary credit approvals for credit decisions. The Management Board notifies this committee of all increases to 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 **Group Risk Committee (RC)** of HRE, acting simultaneously for Deutsche Pfandbriefbank AG, consists of the Chief Risk Officer (CRO; Chairman) and the Chief Financial Officer (CFO) of HRE Holding acting as CRO and CFO of Deutsche Pfandbriefbank AG simultaneously as well as the Chief Risk Officer (CRO) of DEPFA Bank plc and the Chief Credit Officer (CCO) of Deutsche Pfandbriefbank AG as well as the Head of Risk Management & Control. In general, the committee meets on a monthly basis and discusses the risk development of the Bank, adopts guidelines/policies, methods for risk measurement, the related parameters as well as methods of monitoring all risk types. The Risk Committee is responsible for the development of standard guidelines of risk management and risk controlling across the Group and also monitors the development of the risk-bearing capacity, economic capital, the risk cover funds as well as the credit portfolio and the compliance with limits. The Risk Committee discusses the portfolios of HRE Group and hence of pbb Group.

The **Group Asset and Liability Committee (ALCO)** of HRE, acting simultaneously for Deutsche Pfandbriefbank AG, is chaired by the member of the Management Board responsible for Treasury and Asset Management and comprises the CRO, the CFO 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 pbb 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 respectively Deutsche Pfandbriefbank AG.

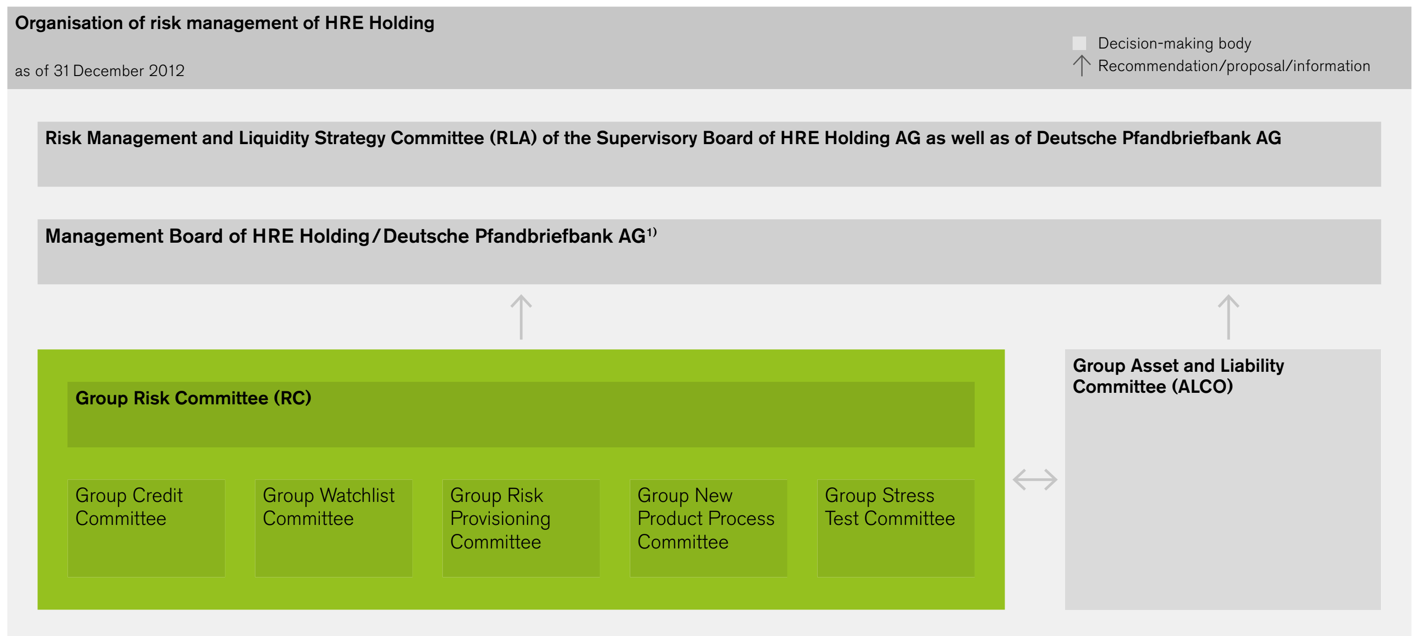
The **Group Credit Committee** of HRE, acting simultaneously for Deutsche Pfandbriefbank AG, comprises the CRO (Chairman), the Chief Credit Officers (CCOs) of the operating segments, the Senior Credit Executives as well as representatives of the front office. The front office representatives have a voting right as part of front office responsibility. 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 are in the responsibility of the Management Board of Deutsche Pfandbriefbank AG and which have to be approved by the RLA. The Credit Committee ensures that the credit decisions are consistent with the prevailing business and risk strategy.

The **Group Watchlist Committee** of HRE, acting simultaneously for Deutsche Pfandbriefbank AG, meets every month. All exposures of pbb Group identified by the early warning system are discussed and, if appropriate, individual measures are decided there; these measures have to be subsequently implemented by the relevant departments. Where necessary, the committee takes decisions regarding the need to transfer exposures to 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.

If there are any indications of an objective impairment of an exposure, the extent of the impairment is first determined and the result is presented in the **Group Risk Provisioning Committee.** The committee takes decisions within the framework of a predefined set of allocated powers and in line with the IFRS regulations, 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.

The **Group New Product Process Committee** ensures that, before business commences with new products or in new markets, the resultant risks as well as the related impact on processes, controls and the infrastructure are systematically analysed and addressed. Operations with new products or in new markets are only commenced when they have been approved by the New Product Process Committee.

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




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

**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 pbb Group is included:

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

- The entity Risk Management & Control, which is also responsible for monitoring and managing market, credit, operational and liquidity risks as well as the risk-bearing capacity of pbb Group and which is also responsible for Group-wide uniform risk measuring methods, risk reports and credit processes
- The entities Credit Officer Real Estate I & Public Sector pbb of pbb Group, who are each responsible for portfolio management and the analysis of new business. The entity CRM Real Estate I & Public Sector pbb also comprises the entity Global Workout Real Estate I, which is responsible for the restructuring and workout of all critical exposures in the real estate financing segment, and the Credit Secretary which in particular is responsible for the organisation of the Credit Committee.

In the period under review Property Analysis & Valuation, which is responsible for the analysis and uniform valuation of the collateral properties using market and loan-to-value methods, was under the control of the CEO in the reporting period. In addition to the CRO function, the Compliance/Corporate Governance entity and the Group Internal Audit entity (independent) extend the risk management system of pbb Group. The area of responsibility of Group Internal Audit comprises the regular as well as the event-driven audit of processes and systems as well as significant transactions. This also includes the revision of the risk management system. Risk management is also supported by the Legal department.

## Risk Strategy and Policies

The risk strategy of pbb Group is based on the business strategy, risk inventory and the results of the Group-wide financial planning process. It is applicable for the operating segments and legal entities of pbb Group. The risk strategy was revised in February 2012, adopted by the Management Board of Deutsche Pfandbriefbank AG and presented to the Risk Management and Liquidity Strategy Committee of the Supervisory Board of Deutsche Pfandbriefbank AG and afterwards to the Supervisory Board plenum to be noted. In July 2012, the risk strategy was updated in order to take account of the modified risk-bearing capacity concept, which is also detailed in the sub-chapters «Economic Capital and Monitoring the Risk-bearing Capacity» as well as «Result of Risk-bearing Capacity Analysis».

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

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

## Risk Reporting

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

### Risk Quantification and Risk Management

The credit risk, market risk, business risk, property risk and operational risk in particular are quantified and backed with available financial resources as part of the risk-bearing capacity analysis. The liquidity risk is quantified on the basis of the liquidity position. The individual calculation methods are described in detail in the risk report in the chapters «Result of Risk-bearing Capacity Analysis» respectively «Liquidity Risk».

Further risk types which are considered to be major as part of the regular internal risk inventory, such as regulatory risks as well as risks which are considered to be immaterial, are not measured quantitatively; instead, they are managed and limited by way of regular detailed reports, clear specifications, e.g. the regulations concerning compliance and corporate governance.

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

1. Monitoring the risk-bearing capacity on the basis of comparing economic capital and the available financial resources of pbb Group.
2. Monitoring of the risk-weighted assets (RWA) of pbb Group at the portfolio level by means of stress tests which are intended to ensure that the core Tier 1 ratio does not fall below 10%.
3. Operational risk management via
   - the use of Basel-II-compliant risk parameters in lending business of pbb Group. The Basel-II-compliant management approach shows the average expected loss at the borrower level, and is therefore a major component for the early recognition of risks and ongoing profitability monitoring. The parameters are reviewed and recalibrated annually.
   - A limit system for counterparty and issuer risks on the basis of a standard application which has been tested in the market with a risk measurement method that is uniform throughout the Group.
   - Intensive monitoring and management of individual exposures.
   - Monitoring the risk of losses by way of appropriate impairment triggers in accordance with IAS 39.
4. Daily monitoring of market risk.
5. Daily monitoring of liquidity risk.
6. Monitoring of operational risk.

### Economic Capital and Monitoring the Risk-bearing Capacity

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

pbb Group has implemented an Internal Capital Adequacy Assessment Process (ICAAP). This is based on the concept of economic capital.

Economic capital is defined as the quantity of capital required by a bank in order to cover the largest potential total loss with a defined probability (the confidence level) over a time horizon of one year. There have been the following enhancements in 2012.

A going-concern approach has been developed as the primary steering approach for demonstrating the risk-bearing capacity of pbb Group; this has been completely integrated in the ICAAP. Unlike the previous gone-concern approach, this steering approach does not focus on the theoretical event of the institute being liquidated; instead, it focuses explicitly on the going-concern assumption and also assumes that the regulatory minimum capital ratios are met. In addition to protecting regulatory minimum

capitalisation, the going-concern approach also comprises an extensive early warning system which generates corresponding early warning signals a long time before the minimum ratios are attained.

The process of determining economic capital for market risks was adjusted in 2012 in order to meet the new regulatory ICAAP requirements regarding the quantification of credit spread risks of securities in the banking book. In addition, a regular validation process carried out in the credit portfolio model has seen the introduction of a further developed correlation model which is adapted specifically to the new focus of the Company and the current developments on the markets. In addition to market, credit, business and operational risks, the risk inventory in 2012 has shown that due to foreclosed assets the Bank's own real estate portfolio increased so that the valuation risk for real estate has now to be considered to be material. It has therefore been included and capitalised as an independent risk type in the ICAAP.

The previous gone-concern approach has been further developed in two complementary perspectives which support in parallel the leading going-concern approach. Firstly, there is the instantaneous liquidation perspective which, in a theoretical liquidation case, does not assume opportunistic winding up of the portfolios unlike demanded by the German Pfandbrief Act and instead is based on the assumption of the immediate sale of, inter alia, the securities of the banking book. According to this assumption and in addition to the above-mentioned major risks the instantaneous liquidation perspective also takes account of credit spread risks arising from securities in the banking book for calculating the economic capital and deducts the hidden losses attributable to these securities for determining the available financial resources. Secondly, pbb Group has developed a strategic gone-concern perspective which focuses on strategic business for calculating the economic capital. Risks from the Budget Finance portfolio and the Value Portfolio which are earmarked for being streamlined are covered by way of a buffer. For these two perspectives, the confidence level has been adjusted to 99.91% (99.95% in the gone-concern approach at the end of 2011). This adjustment is based on the change in the average probability of default of companies which have been awarded good long-term credit ratings by external rating agencies, namely A– at Standard & Poor's and A–/A3 at Fitch Ratings and Moody's, and is consistent with the fundamentally conservative parameters in the risk models. The methods of calculating the economic capital for the individual risk types as well as current parameters are described in greater detail in the chapter «Result of Risk-bearing Capacity Analysis». No economic capital is calculated for the liquidity risk. This risk type is subject to specific organisational and operational arrangements.

In order to assess the adequate capitalisation of the capital backing of pbb Group in the relevant approach, the amount of economic capital is compared with the respective available financial resources. For instance in the leading going-concern perspective, the available risk cover funds essentially comprise the core capital in accordance with HGB less the capital which is maintained for assuring the regulatory minimum ratios. The remaining core capital is suitable for absorbing potential losses and for maintaining a corresponding risk buffer. For determining the available financial resources, the gone-concern approach takes account of IFRS equity as well as subordinate positions with a maturity of more than one year and of hidden losses of bonds. In order to verify the risk-bearing capacity, the economic capital must be completely covered by the available financial resources.

In addition to the presentation of risk-bearing capacity in the going-concern approach, the economic capital is analysed in the instantaneous liquidation perspective and the strategic gone-concern perspective.

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

**Major Risk Types**

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

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

**Credit Risk**

**Definitions**

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

The counterparty risk comprises the credit risk, counterparty default risk, replacement risk, repayment risk, issuer risk, country risk, concentration risk and fulfilment risk which are defined as follows:
> Credit risk is defined as the risk which considers loans and traditional credit products as such. A major factor determining the credit risk is the ability of the borrower to fulfil his financial obligations as well as the value of collateral in the case of a borrowers' default. Declines in the fair value as a result of rating changes are taken into consideration for calculating the credit risk.
> Counterparty default risk is defined as the risk of a potential unexpected default or decline in the fair value of a claim or a derivative. This is due to a deterioration in the creditworthiness of a counterparty or a deterioration of the hedging situation. The counterparty default risk includes the replacement risk and the repayment risk.
> Issuer risk is defined as the risk in relation to bonds and other securities. In particular, it refers to the ability of the issuer to meet his financial obligations and also relates to the value of collateral in the event of the default of an issuer. Declines in the fair value as a result of rating changes are taken into consideration for calculating the issuer risk.
> Country risk arises from changes in the values of international exposures due to country-specific political and economic conditions. It essentially comprises the risk that arises in connection with business activities in certain countries. The country risk includes the conversion risk, transfer risk and sovereign default risk.
> Concentration risk is defined as the risk of cluster formation in relation to a risk factor or counterparties, or a strongly correlated group of risk factors or counterparties.
> Fulfilment risk is defined as the risk that the Bank makes a payment or delivers an asset which has been sold to a counterparty but does not receive a payment or the purchased asset.

## Credit Risk Strategy and Principles

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

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

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

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

## Credit Risk Reports

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

- The Group Risk Report contains the development in volumes as well as relevant credit risk management indicators such as the development of the expected loss as well as the unexpected loss via value at risk (VaR). The report shows the credit risk at HRE Group level and also at the level of pbb Group in the context of the overall bank risk and the risk-bearing capacity, it reports limit utilisations and violations of existing limits, and also identifies risk concentrations. Key indicators, such as the development of the exposure at default (EaD), the expected loss (EL) and the credit value at risk (Credit VaR) are integrated in this report and are discussed by the Management Board; the report is also submitted to the Risk Management and Liquidity Strategy Committee (RLA) of the Supervisory Board to be noted.
- The Credit Risk Report contains details concerning the portfolio and risk parameters at the HRE Group level and also at the level of pbb Group.
- For decisions relating to new business and adjustments of terms, major parameters, contents and analyses are presented to the Credit Committee and discussed.
- In the active business, further regular reports support operational management with regard to the management and timely recognition of risks at the sub-portfolio level.
- Unusual developments which might result in a major deterioration in the risk position of an individual exposure are reported to a wider group 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 risk VaR) pbb Group uses a credit portfolio model which is described in greater detail in the section «Result of Risk-bearing Capacity Analysis».

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

In addition to the stress tests for economic capital, there are also RWA reverse stress tests. They investigate the extent to which a certain risk parameter (e.g. rating, loss-given default (LGD), currency) can change before the minimum Tier 1 ratio of 10% is no longer met. Tolerance change levels have been defined for all tested risk parameters; these levels must not be violated if the test of pbb Group is to be successfully completed.

**Credit Risk Quantification According to Basel II** pbb 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 final result of the regulatory audit for the introduction of the Advanced IRBA at former DEPFA Deutsche Pfandbriefbank AG is expected in 2013.

### Credit Risk Management and Monitoring

**Credit Risk Management** At the portfolio level, the intended portfolio structure is defined in the risk strategy by means of structure components. The limits are also based on the available financial resources, and include for pbb Group for example:
> Limiting of country risks
> Definition of strategic risk parameters (e.g. 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:
> Analysis of portfolio developments of HRE Group and therefore as well for pbb Group in the Group Risk Committee
> Determining the credit risk VaR at the portfolio level by way of a credit portfolio model and partly limiting at the segment level; analysis of concentration risks and various stress tests
> Central Group-wide monitoring of risk concentrations by way of special, regular and ad hoc evaluations, such as regional or product-specific evaluations
> Continuous analysis of the portfolio and the relevant markets by the local Credit Risk Management units
> Regular evaluation of the collateral
> Special reports for exposures which are potentially at risk (e.g. «credit issue notes»)
> Calculation of a risk-adjusted margin using a defined Ra RoC for new business

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

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

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

The credit risk management entities (Credit Officer Real Estate I & Public Sector pbb and Credit Officer Public Sector, Financial Institutions & Value Portfolio) carry out the initial risk analysis for new business and annual risk analysis for existing business. Probability of default (PD) and loss given default (LGD) rating tools, which are developed by Credit Risk as part of Risk Management and Control (RMC) and annually validated and calibrated, are used for valuation purposes and for preparing the credit decision in new and prolongation business. Property Analysis & Valuation Germany/Property Analysis Europe provides support for analysing and valuing the securities.

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

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

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

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

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

### Hedging and Minimising Risk by Collateral

In the Real Estate Finance segment, financing arrangements are backed by property charges. On the occasion of the regular credit reports for existing financing arrangements or as part of the decision-making process in the case of new financing, the LTVs (loan-to-value) as well as the property (micro and macro location, rental situation, condition of property) and market circumstances are regularly discussed and are also taken into consideration as part of the assessment process for individual loans. On average, the loss-given default (LGD) is 17 % for commercial real estate financing arrangements which have not defaulted (December 2011: 21%). For the entire real estate finance portfolio, the LGD average is 18 % (December 2011: 22 %). To a certain extent, these declines in the average parameter values are also due to portfolio disposals or other changes in the case of major individual transactions.

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

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

a) When the loan is initially granted:
> For all real estate security, an internal report (property report) is prepared in the course of the loan decision-making process, and an external appraisal is generally obtained (this is always the case outside Germany) – before the loan is paid out. The procedures ensure that two views of the property are taken into consideration in the decision-making process. The first view is external and focuses solely on the property (as a complete market and lending value appraisal). The second view is internal within the framework of the financing arrangement; it compares the property risks with the financing structure.
> All internally prepared reports and appraisals are consistent with the four-eye principle. At least one senior property analyst (with MRICS and/or HypZert qualifications) is responsible for the report or the appraisal.
> Every market and lending value is established or at least reviewed by a senior property analyst with the HypZert(F) or (outside Germany) with the HypZert (MLV) qualification.
> When an order is placed for external appraisals, the MRICS and/or HypZert qualifications are also required as minimum standards. Other appraisals or comments are not recognised.
> In addition, the choice of external service providers in the field of real estate valuation is subject to strict selection criteria which are constantly monitored by the Bank and which are demonstrably checked every year.
> Every externally engaged appraisal, which has to be prepared in line with the four-eye principle, is again checked by an internal senior appraisal expert with the above qualifications before the data are entered into the Bank's internal system.

b) During on-going monitoring by the property analysis department:
> As part of the credit monitoring process, the economic value of the security is generally reviewed annually; this included an assessment of the main factors which influence the real estate value (rental income, market changes, changes in the building condition). A new market value is established at least every three years. Differences in the values or the security are immediately recognised in the bank systems for risk assessment purposes.
> In the three-year market value calculation process, the quality standards which are applied are the same as those applied in the new business process. Again, the MRICS and/or HypZert qualifications are the minimum qualifications required for preparing appraisals or comments.

c) General:
> The procedures for ensuring the personal quality standards for the property analysts or engaged external appraisal experts in line with the prevailing regulations (HypZert/MRICS) is carried out by the respective monitoring authorities independently of the Bank; these processes are internationally recognised. Corresponding evidence is actively demanded by the Bank.
> The process of engaging external services is carried out independently of the actual valuation management process in order to ensure maximum independence. Externally prepared appraisals or comments in which there is a suspicion that the person preparing the appraisal or comment might not be neutral are not recognised in any way and are also not used for the Bank's own internal purposes for the further process of preparing an appraisal.

> External appraisals are internally checked and are subject to quality assurance measures.
> Development financing arrangements are constantly monitored by our specialists (control of building status and costs). In addition, well-known external specialist companies are also involved in construction controlling (technical control, cost control) on an ad-hoc basis in the case of complex development financing.

In the Public Sector Finance field and especially in Public Investment Finance other financial securities and guarantees in particular are also accepted as collateral (e.g. credit insurances, contractual guarantees from public authorities, fixed-income securities, purchase of receivables, etc.). Additionally, in Public Investment Finance there exist legal framework requirements as the maintenance obligation, which allow recourse on a public sector entity.

## Credit Portfolio

The entire credit portfolio of pbb Group was calculated by using a standard method in line with the Basel-II-compliant exposure at default (EaD).

The EaD recognises the current utilisation as well as pro rata credit interest in relation to which a borrower may default before an exposure is defined as having defaulted (max. 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 € 76.2 billion as of 31 December 2012 (EaD 31 December 2011: € 87.7 billion). This figure includes the EaD with respect to FMS Wertmanagement which is not considered to be part of the core exposure of the pbb Group, and which declined from € 4.9 billion as of the end of 2011 to € 0.2 billion. This amount is attributable to so-called back-to-back transactions. Background is that 2010 for most of the derivatives earmarked to be transferred to FMS Wertmanagement, it was not possible initially to arrange the transfer of beneficial ownership, which meant that the market price risks of the derivatives were transferred to FMS Wertmanagement by way of concluding derivatives with identical conditions between pbb Group and FMS Wertmanagement. Because of realised novations this amount was clearly reduced in the year under review.

In addition, the credit portfolio EaD of € 76.2 billion also included assets with an EaD of € 0.7 billion (31 December 2011: € 0.8 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. In 2010, the credit risks of these assets was transferred by means of guarantees provided by FMS Wertmanagement, so that HRE ultimately retains a counterparty risk with regard to FMS Wertmanagement in connection with these positions.

To properly reflect the actual economic risk in HRE Group, the above-mentioned EaDs which are not considered as core exposure and which are attributable to back-to-back transactions with FMS Wertmanagement as well as the positions guaranteed by FMS Wertmanagement have been detailed merely for information purposes in the following overviews of the portfolio development and structure by means of footnotes.

Bonds in the portfolio of pbb subgroup with an EaD of € 2.2 billion (EaD as of 31 December 2011: € 3.0 billion) which were issued by FMS Wertmanagement and which were provided by FMS Wertmanagement in connection with the pro rata compensation demand for the transferred assets and liabilities have for the first time been treated as core exposure of HRE Group and are therefore included in the respective

tables for EaD distribution instead of showing them for information only by means of footnotes. In order to permit a better comparison with the figures as of the end of 2011 the core exposure to FMS Wertmanagement is alternatively shown as well in the tables for EaD distribution for the previous year.

Considering the above-mentioned restrictions the EaD for the total exposure of pbb Group amounted to € 75.3 billion as of 31 December 2012 (31 December 2011: € 82.0 billion).

**Overview of the Total Exposure of pbb Group: € 75.3 billion EaD** The credit portfolio is broken down into the following segments:
> Real Estate Finance (REF)
> Public Sector Finance (PSF)
> as well as the non-strategic segment Value Portfolio (VP) which is earmarked for being wound down

In addition to the internal reconciliation and consolidation positions, «Consolidation & Adjustments» in 2012 shows for the first time the EaD for transactions which are not directly attributable to the operating segments. These are basically asset positions for asset and liability management. Previously, the EaD of these asset items was disclosed in the Public Sector Finance segment. In order to permit better comparability with the figures as of the end of 2011, the exposure which is not directly attributable to the operating segments will be attributed to «Consolidation & Adjustments» in the following EaD splits for 31 December 2011, in line with the procedure as of 31 December 2012.

As of 31 December 2012, 88 % of the EaD in «Consolidation & Adjustments» was attributed to the rating classes AAA to AA– and 11% of the EaD was attributed to the rating classes A+ to A–. Only 1% of the EaD was in the rating classes BBB+ and worse.

**Total portfolio: EaD according to business segments**

| in € billion | 31.12.2012[1] | 31.12.2011[2] | Δ in € bn | 31.12.2011[3] |
|---|---|---|---|---|
| Real Estate Finance | 23.7 | 25.2 | – 1.5 | 25.2 |
| Public Sector Finance | 38.9 | 45.7 | – 6.8 | 52.1 |
| Value Portfolio | 0.3 | 1.7 | – 1.4 | 1.7 |
| Consolidation & Adjustments | 12.4 | 9.4 | + 3.0 | 0.03 |
| **Total** | **75.3** | **82.0** | – 6.7 | **79.0** |

[1] In addition € 0.9 billion EaD with regard to the counterparty FMS Wertmanagement including guaranteed positions of € 0.7 billion (C&A: € 0.0 billion; PSF: € 0.2 billion; VP: € 0.7 billion)
[2] Basis of figures: Annual Report of pbb Group as of 31 December 2011; in addition the EaD which is not directly attributable to the operating segments has been classified under «Consolidation & Adjustments», and the so-called core exposure to FMS Wertmanagement has been shown in the tables whereas previously it had been shown as a footnote; in addition € 5.7 billion EaD with regard to the counterparty FMS Wertmanagement including guaranteed positions of € 0.8 billion (C&A: € 3.9 billion; PSF: € 1.3 billion; VP: € 0.5 billion)
[3] Basis of figures: Annual Report of pbb Group as of 31 December 2011; in addition € 8.7 billion EaD with regard to the counterparty FMS Wertmanagement including guaranteed positions of € 0.8 billion (C&A: € 6.9 billion; PSF: € 1.3 billion; VP: € 0.5 billion)

As of 31 December 2012 the total exposure at default (EaD) of pbb Group decreased compared to year-end 2011 by € 6.7 billion to € 75.3 billion. Overall, the percentage in the Real Estate Finance segment remained stable (31%; previous year: 31%) whereas there were slight percentage decreases in the Public Sector Finance segment (52 %; previous year: 56 %) and the Value Portfolio (0.4 %; previous year: 2 %). On the other hand, the percentage attributable to Consolidation & Adjustments increased from 11% to 17 %.

The portfolio of the Public Sector Finance segment (PSF) had an EaD of € 38.9 billion as of 31 December 2012 (31 December 2011: € 45.7 billion); of this figure € 8.4 billion was attributable to the strategic Public Investment Finance portfolio. From the remaining portfolio an EaD of € 28.6 billion was related to the non-strategic portfolio of budget financing earmarked for streamlining. The residual amount was attributable to netting positions with financial institutions.

Risk Parameters **Expected Loss** The expected loss (EL), which is calculated on the basis of the annual probability of default (PD), the loss-given default (LGD) and the exposure at default (EaD), is stated as € 125 million as of 31 December 2012 using the parameters defined under Basel II (31 December 2011: € 181 million). The decline in the expected loss is mainly due to recalibration of the model for estimating the LGD for international real estate financing as well as repayments.

The expected loss for a time period of one year is calculated for the entire exposure, with the exception of trading book positions and non-performing loans for which an individual allowance has already been recognised. The figure was split to the segments as follows:

**Total exposure: expected loss according to business segments**

| in € million | 31.12.2012 | 31.12.2011 | Δ in € million |
|---|---|---|---|
| Real Estate Finance | 103 | 140 | −37 |
| Public Sector Finance | 21 | 24 | −3 |
| Consolidation & Adjustments | 1 | 13 | −12 |
| Value Portfolio | – | 4 | −4 |
| **Total** | **125** | **181** | −56 |

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

**Economic Credit Risk Capital** The economic capital for credit risk – calculated with the credit portfolio model – amounted to € 226 million (31 December 2011: € 343 million) for a confidence level of 95 % and a period of one year thus considering the going-concern approach, disregarding diversification effects to other risk types. Details regarding the calculation are set out in the section «Result of Risk-bearing Capacity Analysis».

Regional Breakdown of the Portfolio At the reporting date, the main focus of the exposure of pbb Group was unchanged on Western Europe. Germany continued to account for most of the overall exposure, with 49% (€36.7 billion). The main items in the category «Other Europe», which accounted for approximately 14% (€10.5 billion) of the overall portfolio, were Austria (€6.3 billion; 31 December 2011: €7.0 billion) and Sweden (€1.6 billion; 31 December 2011: €1.3 billion) followed by Belgium (€0.5 billion; 31 December 2011: €0.7 billion).

Compared with the end of 2011, the exposure in Italy has declined by €1.8 billion to €3.4 billion as a result of the final maturity of securities. The reduction of the exposure in Portugal was due to the early redemption of a promissory note loan and the sale respectively the maturity of bonds in the amount of €0.5 billion. In Spain the decline of the exposure in the amount of €0.4 billion was mainly due to the maturity of bonds. The reduction of the exposure in the category «Other Europe» was mainly due to a reduction of the exposure in Austria (€6.3 billion; end of previous year: €7.0 billion). Compared with the previous year the percentage of the category «Emerging Markets» in accordance with the IMF definition remained stable and mainly comprised Poland with €2.0 billion (31 December 2011: €2.1 billion) and Hungary with €0.7 billion (31 December 2011: €0.7 billion).

**Total portfolio: EaD according to regions**

| in € billion | 31.12.2012[1] | 31.12.2011[2] | Δ in € bn | 31.12.2011[3] |
|---|---|---|---|---|
| Germany | 36.6 | 37.2 | −0.6 | 34.2 |
| Other Europe[4] | 10.5 | 12.0 | −1.5 | 12.0 |
| France | 7.6 | 7.7 | −0.1 | 7.7 |
| Spain | 4.6 | 5.0 | −0.4 | 5.0 |
| Great Britain | 3.9 | 4.0 | −0.1 | 4.0 |
| Italy | 3.4 | 5.2 | −1.8 | 5.2 |
| Emerging markets[5] | 3.0 | 3.1 | −0.1 | 3.1 |
| Other | 2.2 | 2.2 | – | 2.2 |
| Portugal | 1.6 | 2.1 | −0.5 | 2.1 |
| Japan | 1.1 | 1.5 | −0.4 | 1.5 |
| USA | 0.7 | 1.0 | −0.3 | 1.0 |
| Ireland | 0.1 | 1.0 | −0.9 | 1.0 |
| **Total** | **75.3** | **82.0** | −6.7 | **79.0** |

[1] In addition €0.8 billion EaD with regard to the counterparty FMS Wertmanagement including guaranteed positions of €0.7 billion, the figures without guaranteed positions were fully attributable to Germany (€0.2 billion), the guaranteed positions related to Germany (54%, €0.4 billion) and Italy (46%, €0.3 billion)
[2] Basis of figures: Annual Report of pbb Group as of 31 December 2011; in addition the EaD which is not directly attributable to the operating segments has been classified under «Consolidation & Adjustments», and the so-called core exposure to FMS Wertmanagement has been shown in the tables whereas previously it had been shown as a footnote; in addition €5.7 billion EaD with regard to the counterparty FMS Wertmanagement including guaranteed positions of €0.8 billion; the figures without guaranteed positions were fully attributable to Germany (€4.9 billion), the guaranteed positions related to Germany (59%, €0.5 billion) and Italy (41%, €0.3 billion)
[3] Basis of figures: Annual Report of pbb Group as of 31 December 2011; in addition €8.7 billion EaD with regard to the counterparty FMS Wertmanagement including guaranteed positions of €0.8 billion; the figures without guaranteed positions were fully attributable to Germany (€7.9 billion), the guaranteed positions related to Germany (59%, €0.5 billion) and Italy (41%, €0.3 billion)
[4] Comprises among others Austria, Belgium, Switzerland, Sweden, Denmark, Finland and the Netherlands
[5] Emerging markets in accordance with the IMF definition

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

**Issuer Risk** The bonds, borrowers' note loans and structured loans in the portfolio are broken down according to region for the purpose of classifying the EaD according to issuer risk. The EaD is attributed on the basis of the domicile of the issuer. The EaD according to issuer risk amounted to € 43.5 billion as of 31 December 2012, and was thus lower than the corresponding figure at the end of 2011 (€ 49.5 billion). Western Europe accounted for most of the exposure, whereby Germany accounted for the highest figure (namely € 18.3 billion). The main country under «Other Europe» was Austria (€ 6.2 billion), followed by Belgium with € 0.5 billion.

**Total portfolio: issuer risk according to regions**

| in € million | 31.12.2012[1] | 31.12.2011[2] | Δ in € bn |
|---|---|---|---|
| Germany | 18.3 | 20.3 | − 2.0 |
| Other Europe[3] | 7.5 | 8.8 | − 1.3 |
| France | 5.0 | 4.7 | + 0.3 |
| Spain | 4.0 | 4.5 | − 0.5 |
| Italy | 3.1 | 4.9 | − 1.8 |
| Other | 2.0 | 2.0 | – |
| Portugal | 1.6 | 2.0 | − 0.4 |
| Emerging markets[4] | 1.2 | 1.2 | – |
| Japan | 0.5 | 0.6 | − 0.1 |
| Great Britain | 0.3 | 0.3 | – |
| Ireland | – | 0.2 | − 0.2 |
| **Total** | **43.5** | **49.5** | − 6.0 |

[1] In addition €0.4 billion EaD with regard to the counterparty FMS Wertmanagement representing guaranteed positions which were fully attributable to Germany
[2] Basis of figures: database for the Annual Report of pbb Group as of 31 December 2011; in addition the EaD which is not directly attributable to the operating segments has been classified under «Consolidation & Adjustments», and the so-called core exposure to FMS Wertmanagement has been shown in the tables whereas previously it had been shown as a footnote;
in addition € 0.5 billion EaD with regard to the counterparty FMS Wertmanagement representing guaranteed positions which were fully attributable to Germany
[3] Comprises among others Austria, Belgium, Switzerland, Sweden, Denmark, Finland and the Netherlands
[4] Emerging markets in accordance with the IMF definition

The largest decline in the portfolio in terms of the issuer risk broken down according to regions was seen in Germany, and is due to the repayment of promissory note loans and bonds which fell due (€ − 2.0 billion). In «Other Europe», the main decline was attributable to Austria, also due to bonds which fell due or the repayment of promissory note loans (€ − 1.2 billion). The decrease in the portfolio of Italy (€ − 1.8 billion) was mainly due to the repayment of two promissory note loans in the amount of € 1.6 billion. There was also a decline in Spain (€ − 0.5 billion) and Portugal (€ − 0.4 billion), in Portugal due to the early redemption of a promissory note loan and the sale respectively the maturity of bonds, in Spain mainly due to the maturity of bonds.

With regard to the breakdown of issuer risk according to segments, the Public Sector Finance segment accounted for 85 % of the EaD at the end of 2012 (December 2011: 85 %) and Consolidation & Adjustments accounted for 15 % (December 2011: 15 %).

**Real Estate Finance: € 23.7 billion EaD** Portfolio Development and Structure The EaD of the Real Estate Finance portfolio of the pbb Group declined by € 1.5 billion compared with 31 December 2011. The customer derivatives included in the portfolio reported an EaD of € 0.7 billion as of 31 December 2012 compared with an EaD of € 0.8 billion at the end of 2011.

Whereas the absolute figure for Great Britain increased slightly compared with the previous year reference date, there was a decline in the absolute figure for Germany as well as for most of the other reported countries. Only the exposure of Spain and the countries of the category Emerging Markets, namely Hungary, Poland and Rumania, remained stable.

| **Real Estate Finance: EaD according to regions[1)]** in € billion | **31.12.2012[2)]** | **31.12.2011[3)]** | Δ in € bn | **31.12.2011[4)]** |
|---|---|---|---|---|
| Germany | 12.1 | 13.1 | −1.0 | 13.1 |
| Great Britain | 3.4 | 3.0 | +0.4 | 3.0 |
| Other Europe[5)] | 2.8 | 3.0 | −0.2 | 3.0 |
| France | 2.2 | 2.5 | −0.3 | 2.5 |
| Emerging markets[6)] | 1.9 | 1.9 | – | 1.9 |
| Spain | 0.5 | 0.5 | – | 0.5 |
| Japan | 0.6 | 0.8 | −0.2 | 0.8 |
| Italy | 0.2 | 0.3 | −0.1 | 0.3 |
| Portugal[7)] | 0.0 | 0.1 | −0.1 | 0.1 |
| **Total** | **23.7** | **25.2** | −1.5 | **25.2** |

1) In the Real Estate Finance segment, there was no exposure to the counterparty FMS Wertmanagement
2) Breakdown including customer derivatives of approx. € 0.7 billion
3) Basis of figures: Annual Report of pbb Group as of 31 December 2011; in addition the EaD which is not directly attributable to the operating segments has been classified under «Consolidation & Adjustments» and the so-called core exposure to FMS Wertmanagement has been shown in the tables whereas previously it had been shown as a footnote; breakdown including customer derivatives of approx. € 0.8 billion
4) Basis of figures: Annual Report of pbb Group as of 31 December 2011; breakdown including customer derivatives of approx. € 0.8 billion
5) Comprises among others Austria, Belgium, Switzerland, Sweden, Denmark, Finland and the Netherlands
6) Emerging markets in accordance with the IMF definition
7) In Portugal € 0.03 billion EaD in the segment Real Estate Finance

The breakdown of the portfolio according to property types as of 31 December 2012 changed only slightly compared with the end of 2011. The main items were the property types «Office buildings» with € 7.5 billion EaD or 32 % of the overall REF portfolio (31 December 2011: 36 %) and «Retail» with € 6.9 billion EaD or 29 % of the REF portfolio (31 December 2011: 28 %). The percentage of properties with residential use remained more or less stable at 21% in compared to the end of 2011 (20 %). Worth mentioning is also the percentage of 12 % of the property type «Logistics/Storage» (31 December 2011: 9 %).

**Real Estate Finance: EaD according to property type[1]**

| in € billion | 31.12.2012 | 31.12.2011[2] | Δ in € bn | 31.12.2011[3] |
|---|---|---|---|---|
| Office buildings | 7.5 | 8.9 | −1.4 | 8.9 |
| Retail | 6.9 | 7.1 | −0.2 | 7.1 |
| Housing construction | 5.0 | 5.1 | −0.1 | 5.1 |
| Logistics/storage | 2.8 | 2.4 | +0.4 | 2.4 |
| Other | 1.2 | 1.4 | −0.2 | 1.4 |
| Hotel/leisure | 0.3 | 0.3 | – | 0.3 |
| **Total** | **23.7** | **25.2** | −1.5 | **25.2** |

[1] In the Real Estate Finance segment there was no exposure to the counterparty FMS Wertmanagement
[2] Basis of figures: Annual Report of pbb Group as of 31 December 2011; in addition the EaD which is not directly attributable to the operating segments has been classified under «Consolidation & Adjustments» and the so-called core exposure to FMS Wertmanagement has been shown in the tables whereas previously it had been shown as a footnote
[3] Basis of figures: Annual Report of pbb Group as of 31 December 2011

At the end of the year 2012 the portfolio was still dominated by investment financing (94 %; 31 December 2011: 93 %). Higher risk construction projects in the building phase (building finance) only accounted for 3 % of the EaD (31 December 2011: 4 %). Real Estate Finance for which the capital is serviced mainly out of the current property cash flow is shown under investment financing.

**Real Estate Finance: EaD according to loan type[1]**

| in € billion | 31.12.2012 | 31.12.2011[2] | Δ in € bn | 31.12.2011[3] |
|---|---|---|---|---|
| Investment financing | 22.3 | 23.3 | −1.0 | 23.3 |
| Customer derivatives | 0.7 | 0.8 | −0.1 | 0.8 |
| Construction financing | 0.6 | 1.0 | −0.4 | 1.0 |
| Other | 0.1 | 0.1 | – | 0.1 |
| **Total** | **23.7** | **25.2** | −1.5 | **25.2** |

[1] In the Real Estate Finance segment there is no exposure to the counterparty FMS Wertmanagement
[2] Basis of figures: Annual Report of pbb Group as of 31 December 2011; in addition the EaD which is not directly attributable to the operating segments has been classified under «Consolidation & Adjustments» and the so-called core exposure to FMS Wertmanagement has been shown in the tables whereas previously it had been shown as a footnote
[3] Basis of figures: Annual Report of pbb Group as of 31 December 2011

Risk Parameters Using the parameters defined under Basel II, the expected loss for the Real Estate Finance portfolio was € 103 million as of 31 December 2012 (31 December 2011: € 140 million). The considerable decline is mainly due to the recalibration of the model for estimating the LGD for international real estate financing.

**Public Sector Finance: € 38.9 billion EaD** Portfolio Development and Structure The portfolio of the Public Sector Finance segment (PSF) had an EaD of € 38.9 billion as of 31 December 2012 (31 December 2011: € 45.7 billion); of this figure, € 8.4 billion were attributable to the strategic portfolio of Public Investment Finance. From the remaining portfolio an EaD of € 28.6 billion was related to the non-strategic portfolio of budget financing earmarked for streamlining.

Most of the exposure was reported for Western Europe with an emphasis on Germany. The percentage of the countries in this segment remained stable with smaller exceptions. The major part of «Other Europe» represented Austria with € 5.9 billion (31 December 2011: € 6.6 billion). The EaD in Italy, Portugal and Spain decreased significantly due to a reduction of deals in these countries. The exposure in the USA related almost entirely to financial institutions located in the USA.

**Public Sector Finance: EaD according to regions**

| in € billion | 31.12.2012[1] | 31.12.2011[2] | Δ in € bn | 31.12.2011[3] |
|---|---|---|---|---|
| Germany | 13.8 | 16.4 | −2.6 | 20.6 |
| Other Europe[4] | 7.2 | 8.4 | −1.2 | 8.9 |
| France | 5.0 | 4.6 | −0.4 | 5.1 |
| Spain | 4.1 | 4.5 | −0.4 | 4.5 |
| Italy | 3.1 | 4.9 | −1.8 | 4.9 |
| Portugal | 1.6 | 2.0 | −0.4 | 2.0 |
| Other | 1.5 | 1.4 | −0.1 | 2.1 |
| Emerging markets[5] | 1.1 | 1.2 | −0.1 | 1.2 |
| Great Britain | 0.5 | 0.6 | −0.1 | 0.6 |
| USA | 0.5 | 0.6 | −0.1 | 0.8 |
| Japan | 0.4 | 0.4 | – | 0.5 |
| Ireland | 0.1 | 0.7 | −0.6 | 0.9 |
| **Total** | **38.9** | **45.7** | −6.8 | **52.1** |

[1] In addition € 0.2 billion EaD with regard to the counterparty FMS Wertmanagement, which was fully attributable to Germany; including guaranteed positions of € 0.01 billion
[2] Basis of figures: Annual Report of pbb Group as of 31 December 2011; in addition the EaD which is not directly attributable to the operating segments has been classified under «Consolidation & Adjustments» and the so-called core exposure to FMS Wertmanagement has been shown in the tables whereas previously it had been shown as a footnote;
in addition € 1.3 billion EaD with regard to the counterparty FMS Wertmanagement, which was fully attributable to Germany; including guaranteed positions of € 0.5 billion
[3] Basis of figures: Annual Report of pbb Group as of 31 December 2011;
in addition € 1.3 billion EaD with regard to the counterparty FMS Wertmanagement, which was fully attributable to Germany; including guaranteed positions of € 0.5 billion
[4] Comprises among others Austria, Belgium, Switzerland, Sweden, Denmark, Finland and the Netherlands
[5] Emerging markets in accordance with the IMF definition

The position «Public Sector Borrowers» included receivables due from sovereigns (30 %), public sector enterprises (30 %) and municipalities (40 %).

| **Public Sector Finance: EaD according to counterparty structure**<br>in € billion | 31.12.2012[1] | 31.12.2011[2] | Δ in € bn | 31.12.2011[3] |
|---|---|---|---|---|
| Public sector borrowers | 27.3 | 35.0 | − 7.7 | 40.3 |
| Financial institutions[4]/insurance companies | 8.2 | 9.4 | − 1.2 | 10.5 |
| State-regulated companies[5] | 3.4 | 1.3 | + 2.1 | 1.3 |
| **Total** | **38.9** | **45.7** | − 6.8 | **52.1** |

[1] In addition € 0.2 billion EaD with regard to the counterparty FMS Wertmanagement, which was fully attributable to Germany; including guaranteed positions of € 0.01 billion
[2] Basis of figures: Annual Report of pbb Group as of 31 December 2011; in addition the EaD which is not directly attributable to the operating segments has been classified under «Consolidation & Adjustments» and the so-called core exposure to FMS Wertmanagement has been shown in the tables whereas previously it had been shown as a footnote; in addition € 1.3 billion EaD with regard to the counterparty FMS Wertmanagement, which was fully attributable to Germany; including guaranteed positions of € 0.5 billion
[3] Basis of figures: Annual Report of pbb Group as of 31 December 2011; in addition € 1.3 billion EaD with regard to the counterparty FMS Wertmanagement, which was fully attributable to Germany; including guaranteed positions of € 0.5 billion
[4] Financial institutions with a state background or state guarantee
[5] Water utilities, power supply utilities, etc.

As of the reporting date, the PSF segment again included a high proportion of public sector borrowers, which is reflected in the rating. 58 % (31 December 2011: 74 %) of the EaD was attributable to the rating classes AAA to AA–. The rating classes A+ to A– accounted for 14 % of the EaD (31 December 2011: 17 %). The proportion of BBB+ positions and positions with worse ratings increased from 9 % in December 2011 to 28 % in December 2012 mainly as a result of the downgrading of Italy and Spain as well as further internal reclassifications.

| **Public Sector Finance: EaD according to internal ratings**<br>in € billion | 31.12.2012[1] | 31.12.2011[2] | Δ in € bn | 31.12.2011[3] |
|---|---|---|---|---|
| AAA to AA– | 22.5 | 33.8 | − 11.3 | 39.4 |
| A+ to A– | 5.5 | 7.7 | − 2.2 | 8.3 |
| BBB+ and worse | 10.9 | 4.2 | + 6.7 | 4.4 |
| **Total** | **38.9** | **45.7** | − 6.8 | **52.1** |

[1] In addition € 0.2 billion EaD to the counterparty FMS Wertmanagement, which was fully attributable to the rating classes AAA to AA–
[2] Basis of figures: Annual Report of pbb Group as of 31 December 2011; in addition the EaD which is not directly attributable to the operating segments has been classified under «Consolidation & Adjustments» and the so-called core exposure to FMS Wertmanagement has been shown in the tables whereas previously it had been shown as a footnote; in addition € 1.3 billion EaD (including positions of € 0.5 billion guaranteed by FMS Wertmanagement) to the counterparty FMS Wertmanagement, which was fully attributable to the rating classes AAA to AA–
[3] Basis of figures: Annual Report of pbb Group as of 31 December 2011; in addition € 8.2 billion EaD (including positions of € 0.5 billion guaranteed by FMS Wertmanagement) to the counterparty FMS Wertmanagement, which was fully attributable to the rating classes AAA to AA–

Risk Parameters The expected loss for the portfolio of the Public Sector Finance segment was € 21 million over the one-year period (31 December 2011: € 24 million). There were two effects which partially compensated for each other with the rating downgrades of Italy, Spain, Portugal and the rating improvement of an Italian financing arrangement.

**Value Portfolio: € 0.3 billion EaD** Portfolio Development and Structure The Value Portfolio comprises non-strategic portfolios of pbb Group as well as a part of the transactions which exist with the counterparty FMS Wertmanagement. The portfolio structure is inter alia affected by derivative business with financial institutions. 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.

The strategic decline of € 1.4 billion in the exposure as of 31 December 2012 compared with 31 December 2011 was mainly attributable to the decrease of the exposure of almost all countries – especially of Germany and the USA. In the remaining portfolio as of 31 December 2012 the regional focus was also on these two countries.

| **Value Portfolio: EaD according to regions** in € billion | **31.12.2012[1]** | **31.12.2011[2]** | Δ in € bn | **31.12.2011[3]** |
|---|---|---|---|---|
| Germany | 0.2 | 0.5 | −0.3 | 0.5 |
| USA | 0.1 | 0.5 | −0.4 | 0.5 |
| Great Britain[4] | – | 0.2 | −0.2 | 0.2 |
| Other[4] | – | 0.1 | −0.1 | 0.1 |
| Other Europe[4][5] | – | 0.1 | −0.1 | 0.1 |
| France[4] | – | 0.1 | −0.1 | 0.1 |
| Italy | – | 0.1 | −0.1 | 0.1 |
| Ireland[4] | – | 0.1 | −0.1 | 0.1 |
| **Total** | **0.3** | **1.7** | −1.4 | **1.7** |

[1] In addition € 0.7 billion EaD to the counterparty FMS Wertmanagement, which were fully guaranteed; the guaranteed positions related to Germany (54 %) and Italy (46 %)
[2] Basis of figures: Annual Report of pbb Group as of 31 December 2011; in addition the EaD which is not directly attributable to the operating segments has been classified under «Consolidation & Adjustments» and the so-called core exposure to FMS Wertmanagement has been shown in the table whereas previously it had been shown as a footnote; in addition € 0.5 billion EaD to the counterparty FMS Wertmanagement, including guaranteed positions amounting to € 0.3 billion, the non-guaranteed exposure was fully attributable to Germany, the guaranteed positions were fully attributable to Italy
[3] Basis of figures: Annual Report of pbb Group as of 31 December 2011; in addition € 0.5 billion EaD to the counterparty FMS Wertmanagement, including guaranteed positions amounting to € 0.3 billion, the non-guaranteed exposure was fully attributable to Germany, the guaranteed positions were fully attributable to Italy
[4] Because of the rounding of the first position after the decimal point the following exposure is not shown in the table: exposure against Great Britain: € 0.01 billion; Other: € 0.001 billion; Other Europe: € 0.01 billion; France: € 0.001 billion; Ireland: € 0.01 billion
[5] Comprises among others Austria, Belgium, Switzerland, Sweden, Denmark, Finland and the Netherlands

| **Value Portfolio: EaD according to counterparty structure** in € billion | **31.12.2012[1]** | **31.12.2011[2]** | Δ in € bn | **31.12.2011[3]** |
|---|---|---|---|---|
| Financial institutions / insurance companies | 0.18 | 1.55 | −1.37 | 1.55 |
| Companies | 0.07 | 0.09 | −0.02 | 0.09 |
| Public sector borrowers | 0.05 | 0.05 | – | 0.05 |
| **Total** | **0.3** | **1.7** | −1.4 | **1.7** |

[1] In addition € 0.7 billion EaD to the counterparty FMS Wertmanagement, which were fully guaranteed; the guaranteed positions related to Germany (54 %) and Italy (46 %)
[2] Basis of figures: Annual Report of pbb Group as of 31 December 2011; in addition the EaD which is not directly attributable to the operating segments has been classified under «Consolidation & Adjustments» and the so-called core exposure to FMS Wertmanagement has been shown in the tables whereas previously it had been shown as a footnote; including exposure to the affiliated institution DEPFA Bank plc of € 0.1 billion as of 31 December 2011
[3] Basis of figures: Annual Report of pbb Group as of 31 December 2011; including exposure to the affiliated institution DEPFA Bank plc of € 0.1 billion as of 31 December 2011

Risk Parameters The expected loss for the value portfolio amounted to € 0.2 million as of 31 December 2012 using the parameters defined under Basel II (31 December 2011: € 4 million). Among other things the decline is due to repayments.

### Structured Products

pbb Group's residual holdings in fully state-guaranteed collateralised debt obligations had a notional value of € 0.8 billion as of 31 December 2012 (31 December 2011: € 0.8 billion) and an actual fair value of € 0.7 billion (31 December 2011: € 0.7 billion).

The residual holdings of pbb Group of non-state-guaranteed structured securities, namely credit-linked investments in the form of collateralised debt obligations (CDOs in the narrower sense of the term), remained stable in comparison with the end of the year 2011 with a notional value of € 0.1 billion. The fair value of these securities which securitise credit risks amounted to € 8 million as of 31 December 2012 (31 December 2011: € 10 million).

The valuation of assets was essentially based on market values.

### Consolidated Special-purpose Vehicle without Capital Share in pbb Group

The special-purpose vehicle is an ABS structure which has been completely written down so that no further risks can result for pbb Group from this special-purpose vehicle (31 December 2012: nominal € 0.4 billion, 31 December 2011: nominal € 0.5 billion). The consolidation of the special-purpose vehicle had resulted in particular in a balance sheet extension of € 0.4 billion (31 December 2011: € 0.4 billion). However, from the risk point of view, there had not been an increase in the volume. Accordingly, the volume exposed to risk was € 0.4 billion lower (31 December 2011: € 0.4 billion).

### Watchlist and Non-performing Loans: € 2.6 billion

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

Watchlist and non-performing loans (restructuring and workout loans) are defined as follows:

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

### Development of Watchlist and Non-performing Loans of pbb Group

| Watchlist and non-performing loans of pbb Group | | | | 31.12.2012 | | | | 31.12.2011 | |
|---|---|---|---|---|---|---|---|---|---|
| EaD in € million | REF | PSF | VP | Total | REF | PSF | VP | Total | Δ in € million |
| Workout loans | 11 | – | – | 11 | 10 | – | 15 | 25 | –14 |
| Restructuring loans[1] | 1,076 | – | 3 | 1,079 | 1,273 | 35 | – | 1,308 | –229 |
| **Non-performing loans[1]** | **1,087** | **–** | **3** | **1,090** | **1,283** | **35** | **15** | **1,333** | –243 |
| Watchlist loans | 857 | 641 | – | 1,498 | 648 | – | – | 648 | +850 |
| **Total** | **1,944** | **641** | **3** | **2,588** | **1,931** | **35** | **15** | **1,981** | +607 |

[1] In addition € 6 million EaD as of 31 December 2011 and as of 31 December 2012 in the segment «Consolidation & Adjustments»

The watchlist and non-performing loans increased by a total of € 607 million.

The watchlist loans increased by € 1,142 million (gross) or € 850 million (net). The main driver behind the increase, with € 641 million, was the downgrading of the creditworthiness of Spain and Portugal in the PSF segment. In the REF segment, the watchlist volume increased by € 501 million; this included two loans totalling € 369 million. The increase is opposed by restructurings and repayments of € 261 million; this figure included one loan totalling € 162 million. Only € 31 million had to be transferred from the watchlist to non-performing-loan support.

The non-performing loans declined by € 368 million (gross) or € 243 million (net) due to various factors, including restructurings and repayments as well as one loan where the Bank has taken over the property into its own books.

### Impairments and Provisions

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

Portfolio-based allowances are calculated using risk parameters which are compliant with Basel 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 Group Risk Provisioning Committee.

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

### Coverage for Non-performing Loans

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

The non-performing loans of pbb Group were covered by 35 % as of 31 December 2012 (31 December 2011: 38 %). The decline was mainly attributable to repayments of loans for which loan loss provisions had been booked for the full amount or the major part of the exposure and after selling the collateral.

The non-performing loans in the Real Estate Finance segment were covered by 30 % (31 December 2011: 33 %). There were no non-performing loans in the Public Sector Finance segment as of 31 December 2012. In the Value Portfolio the non-performing loans were covered by 92 % (31 December 2011: 90 %).

### Opportunities

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

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

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

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

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

According to the given structure of maturities of the existing portfolio in the Public Sector Finance segment a decline in EaD of € 0.3 billion can be expected for the financial year 2013 with regard to Ireland, Italy, Portugal and Spain. This reduction in exposure means that there is an opportunity of being less affected by potential further rating downgrades in the above-mentioned countries.

## Market Risk

### Definition

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

### Market Risk Strategy

pbb Group follows the following fundamental principles in relation to market risks:
> Transactions may be conducted only in financial instruments which 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 transactions are subject to daily income statement and risk monitoring by Risk Management & Control.

### Organisation of Market Risk Management

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

### Market Risk Reports

Risk Management & Control daily prepares extensive market risk reports at Group level for various recipients:
> The daily market risk report is addressed particularly to the CRO and the member of the Management Board responsible for Treasury of pbb 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 also made available to the CRO and the member of the Management Board responsible for Treasury.

### Measurement and Limiting of Market Risk

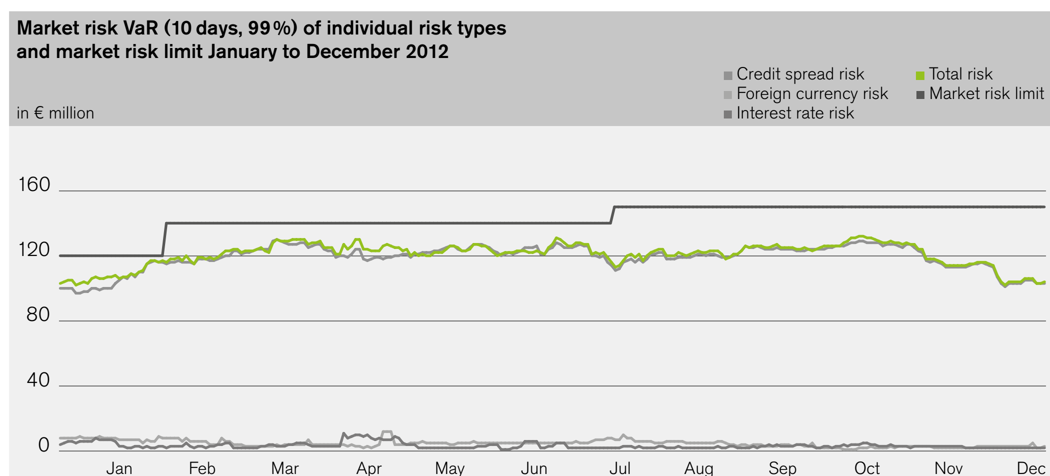
**Market Risk Value at Risk** Risk Management & Control uses a variance-covariance approach to calculate the market risk VaR at the overall and sub-portfolio level on a daily basis. All positions are taken into account, whereby the credit spread VaR from positions which are included in the IFRS category Loans & Receivables is not taken into consideration. Details are not broken down by business segments.
> 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 an overall VaR, which constitutes the basis for the limit monitoring, the historically observed correlations are used.

On 31 December 2012 the market risk VaR amounted to € 104 million. The comparison figure as of 31 December 2011 was € 103 million. In the period under review there were no limit violations. In view of changed market conditions (in particular, higher VaRs resulted from increased credit spread volatilities), the Management Board adopted a resolution in February 2012 to increase the market risk limit from € 120 million to € 140 million. In July, according to the risk strategy, the market risk limits were adjusted slightly, resulting in a further increase of € 10 million to € 150 million.

In 2012 the development in the market risk VaR was mainly affected by the change in credit spread volatilities. Whereas the market risk VaR increased in the first half of 2012 mainly as a result of higher credit spread volatilities, the decline in the second half is mainly due to lower credit spread volatilities.

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

**Market risk VaR (10 days, 99 %) of individual risk types and market risk limit January to December 2012**




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

**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 of the net present value of positions because of changes of the respective credit spreads. Risk measuring systems for the calculation of credit spread risks exist for all relevant positions of pbb Group. The major part of the credit spread risk is attributable to eligible assets for covered bonds.

**Stress Testing** Whereas the VaR measurement simulates the market risk under «normal» market conditions and cannot be used as a measure for a potentially maximum loss stress scenarios show the market risk under extreme conditions. At pbb Group hypothetical stress scenarios are calculated on a monthly basis for all major key risk drivers such as credit spreads, interest rates and exchange rates. In addition historical stress scenarios are simulated. For example, a parallel shift of 200 basis points upwards in the interest rate curve for all positions of pbb Group (including equity books) would have resulted in a loss of approximately € 208 million as of 31 December 2012. The corresponding market value loss for the end of 2011 was € 125 million. The higher market value loss in the stress testing case is mainly due to an increase in the portfolio and the maturities in the equity books. An opposite parallel shift of 200 basis points downwards in the interest rate curve would have resulted in a market value gain of € 87 million. The Management Board and the corresponding executive bodies are regularly notified 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 for the going-concern approach is calculated for a period of one year and for a confidence level of 95 %. The economic capital for market risks of pbb Group, disregarding diversification effects for other risk types, amounted to € 171 million as of 31 December 2012 (31 December 2011: € 132 million). The method of calculating the economic market risk capital was adjusted in 2012 as described in the chapter «Result of Risk-bearing Capacity Analysis».

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

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

## Market Risk Management, Monitoring and Reduction

pbb Group uses a three-pillar approach for managing and monitoring the market risk:
> Management of the position in Treasury
> Risk measurement and monitoring compliance with limits by Risk Management & Control
> Escalation processes across all decision-making committees right through to the Management Board

For all positions market risk is monitored by a combination of value-at-risk (VaR) limits and monitoring of sensitivities by Risk Management & Control.

## Outlook

As defined in the risk strategy of pbb, foreign currency and interest rate risks further have to be kept at a low level or have to be reduced if market risks arise as a result of new business. Credit spread risks are due to the assets in the cover pools for the German Pfandbrief and are thus an inherent factor in the business model of pbb. They will continue to be the predominant type of market risk.

**General Interest Rate Risk** The total general interest rate risk of pbb Group amounted to €2 million as of 31 December 2012. It was thus lower than the corresponding figure of 31 December 2011 (€5 million). On average, the interest rate risk for 2012 amounted to €3 million (max. €11 million; min. €1 million) which was again at a low level (average VaR for 2011 €20 million; max. €39 million; min. €2 million).

For the first time non-linear interest risks from capital-market operations were calculated on a daily basis in 2012 and were integrated into the market risk VaR. They were insignificant as in the year before.

**Credit Spread Risk** Most of the credit spread risk was 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.

Therefore credit spread VaR of AFS and FVtPL stocks accounted for €103 million as of the end of December 2012 (year end 2011: €98 million).

**Foreign Currency Risk and Other Market Risks** The foreign currency risk which is calculated as a present value amounted to €3 million as of 31 December 2012; the corresponding figure at the end of 2011 was €8 million. The general strategy aims to hedge foreign currency risks as far as possible.

There are no share price risks and commodity risks and inflation risks are essentially hedged. A VaR has also been calculated for Vega risks since December 2012. The Vega risk is defined as the negative change in the present value of a non-linear product due to a change in the volatility of the underlying. The Vega risks have since that time also been included in the total market risk VaR. The Vega VaR on 31 December 2012 was €0.5 million.

Financial derivatives are mainly used for hedging purposes.

## Opportunities

As detailed above, the sensitivities result in a VaR, i.e. a possible future (economic) loss in the event of an unfavourable market development. It has to be mentioned that these sensitivities may also result in economic gains in the event of a positive market development.

Accordingly, the assets of the cover pools for instance result in high negative credit spread sensitivities which pose a risk. In the event of a reduction of the relevant credit spreads, these credit spread sensitivities result in economic profits, which again constitute an opportunity.

Within the framework of the hypothetical stress scenarios of pbb Group an opposite parallel shift of 200 basis points downwards in the interest rate curve would comprise the opportunity for a market value gain of €87 million.

## Liquidity Risk

### Definition

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

### Liquidity Risk Strategy

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

### Organisation of Liquidity Risk Management

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

### Liquidity Risk Report

The liquidity management reports are prepared daily and reported to the entire Management Board as well as to the Deutsche Bundesbank and to the Bundesanstalt für Finanzdienstleistungsaufsicht. The reports contain the daily liquidity situation as well as projections on the basis of contractual cash flows and assumptions made in relation to future events which will influence the probable liquidity development.

### Measuring and Limiting Liquidity Risk

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

The liquidity position resulting from the contractual and optional cash flows is measured in different scenarios. In this context different liquidity positions are calculated on a daily basis. The three liquidity positions assume:

> Constant market and refinancing conditions (base scenario)
> Risk scenario (modified (historic) stress scenario)
> Liquidity stress ((historic) stress scenario)

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

For the liquidity risk for the various liquidity scenarios a limit for a period of 12 months respectively a trigger of 24 months (base scenario) has been defined.

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

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

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

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

The requirements relating to the maintenance of liquidity reserves were implemented in the context of enhancing liquidity risk measurement and in line with the requirements for risk management (MaRisk) as of December 2010. Therefore the stress scenario has been extended to include various parameters specified in MaRisk.

## Liquidity Risk Monitoring and Management

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

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

## Hedging and Reduction of Liquidity Risk

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

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

### Development of the Risk Position of pbb Group

The development of the liquidity position in 2012 exceeded expectations in spite of the continuing stress situation on the capital markets mainly in the first half of the year.

The cumulative liquidity position (liquid assets as well as expected net cash flows) calculated as part of the liquidity risk measurement as of 31 December 2012 amounted to € 5.5 billion for a 12-month horizon in the base scenario. There was a slight decrease by € 0.2 billion in comparison with the previous year. Because of a higher unsecured funding this decrease was below the planned change of liquidity.

The liquidity ratio in accordance with the Liquidity Ordinance amounted to 2.28 at Deutsche Pfandbriefbank AG as of 31 December 2012; it was thus higher than the statutory minimum of 1.0.

### Funding

For funding purposes covered and unsecured issues are available to pbb Group. Pfandbriefe are the main funding instrument. Because of their high quality and acceptance on international capital markets, Pfandbriefe are comparatively less affected by market fluctuations than many other funding sources.

Whereas the beginning of 2012 was characterised by a high degree of uncertainty on the capital market, the situation improved considerably in the further course of the year. The sovereign debt crisis facing the countries on the periphery of Europe was the main factor in the first half of the year, and resulted in a downturn in sentiment and a wait-and-see attitude among investors, thus making it more difficult for credit institutions to find funding opportunities. With the two three-year refinancing facilities at the end of 2011 and in February 2012 as well as the announcement for purchasing government bonds in September, the ECB was able to institute specific measures for assuring the refinancing of banks. The trend involving «flight to quality» mainly benefited the German Pfandbrief. The strong demand for this instrument offered issuers the opportunity of covered funding at much lower levels. In this climate, pbb issued a total of three benchmark issues and three top-up issues in the form of mortgage Pfandbriefe denominated in euros. In addition, pbb was also able to launch a GBP mortgage Pfandbrief benchmark and thus to further expand its funding base. With regard to unsecured funding a public transaction with a benchmark format was also successfully placed in 2012. Moreover, pbb Group was able to cover a considerable share of the funding needs via private placements. In addition to public transactions private placements are a significant funding vehicle for the Bank and due to their usually smaller amounts they help to improve the granularity of the funding structure.

### Forecast Liquidity Requirement

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

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

### Funding Risk

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

### Market Liquidity Risk

With regard to financial instruments which are measured at fair value, quantitative details for a better assessment of the market liquidity risk can be obtained from the presentation of the three levels of the fair value hierarchy in note 73. Generally there is no intention to sell LaR holdings for liquidity management purposes, as liquidity for these holdings can mainly be generated by way of including them in the cover pool, refinancing opportunities of the central bank or repo transactions.

### Opportunities

The cumulative liquidity position of €5.5 billion in the base scenario over a horizon of 12 months which is detailed in the section «Development of the Risk Position of the pbb Group" as of 31 December 2012 opens up the opportunity of being able to provide a flexible response particularly with regard to possible new business.

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

The trend to «flight to quality» described in the section «Funding» mainly benefited the German Pfandbrief. The strong demand offered the issuers and thus also Deutsche Pfandbriefbank the opportunity of covered funding at much lower levels. If the trend continued this would ceteris paribus have a positive impact on future earnings.

## Operational Risk

### Definition

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

### Strategy for Operational Risks

The overriding aims of pbb Group are the early recognition, recording, assessment as well as monitoring, prevention and limiting of operational risks as well as early and meaningful management reporting. pbb Group does not attempt to completely preclude the possibility of risk; instead, it aims to minimise potential losses. The approach is to ensure that there is sufficient information to make informed decisions about risk mitigation.

### Organisation of Operational Risk Management

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

### Risk Reports, Monitoring and Management of Operational Risks

Operational risks are monitored by means of a network of controls, procedures, reports and responsibilities. Within pbb Group, each individual business area and management level takes on responsibility for its own operational risks, and provides appropriate resources and processes for limiting such risks. The focus of the operational risk department is the proactive identification, management and mitigation of risks rather than on just risk monitoring, measurement, and reaction to risk.

The consolidated information is used in order to determine the operational risk profile of pbb Group and any required measures in relation to mitigation of identified risks.

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

## Risk Measurement

The economic capital for operational risk in the going-concern perspective amounted to € 14 million as of 31 December 2012 (31 December 2011: € 14 million). Details of the calculation are set out in the chapter «Result of Risk-bearing Capacity Analysis».

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, was € 82 million as of 31 December 2012 (31 December 2011: € 86 million).

## Major Operational Risks of pbb Group

Major operational risks result from the continuing enhancements at HRE Group and therefore also at pbb Group. This also comprises the process of rendering services for FMS Wertmanagement as well as ongoing changes in the IT environment. Operational risks are furthermore attributable in particular to the high number of manual processes and controls.

Until the consolidation process has been completed and the servicing of FMS Wertmanagement cease, there will be a constant level of susceptibility to errors with regard to the manual processes and controls which are carried out for ensuring data consistency and integrity.

In addition to assessing own portfolios, pbb Group also managed services for FMS Wertmanagement, the extent of which is governed in service level agreements. This insourcing arrangement involves a fulfilment risk for pbb Group; if certain requirements are not met, this might result in claims for damages against FMS Wertmanagement. This risk will cease on 1 October 2013.

There is also a significant reliance on key personnel who on the one hand are dealing with the continuing enhancements and on the other, dealing with operating daily business including the servicing of FMS Wertmanagement.

pbb Group suffered losses of € 3.3 million in total from operational risks in 2012 (31 December 2011: € 0.2 million). The operational loss was distributed to the segment Real Estate Finance with 88% and to the segment Public Sector Finance with 12 %.

## Opportunities

The operational risk profile of pbb Group has continued to improve over that past couple of years due to the successful implementation of various IT projects. However, operational risk still exists due to key man risk and the ceasing of the servicing of FMS Wertmanagement in October 2013. Once these changes have been implemented, it is possible that the operational risk profile of pbb Group will continue to improve in regards to key man risk.

### Result of Risk-bearing Capacity Analysis

## Going-Concern

| Going-Concern<br>in € million | 31.12.2012 | 31.12.2011[1] | Δ in € million |
|---|---|---|---|
| Credit risk | 226 | 343 | –117 |
| Market risk | 171 | 132 | 39 |
| Operational risk | 14 | 14 | – |
| Business risk | – | 78 | –78 |
| Property risk | 11 | – | 11 |
| **Total before diversification effects** | **422** | **567** | –145 |
| **Total after diversification effects** | **375** | **513** | –138 |
| Available financial resources (free capital) | 1,660 | 1,764 | –104 |
| Excess capital/capital shortfall | 1,285 | 1,251 | 34 |

[1] The pro forma figures as of 31 December 2011 have been shown for comparison purposes

The newly developed going-concern perspective explicitly focuses on the protection of regulatory minimum capitalisation, and thus focuses on the continuation of business activities of pbb Group in periods of difficult economic downturns. In order to prove the risk-bearing capacity the first step is to calculate the economic capital at a confidence level of 95%. This includes the risk types which we define to be of a material nature, namely credit risk, market risk, operational risk, funding risk as part of the business risk and property risk. This is opposed by the so-called free capital as available financial resources, comprising core Tier 1 capital less the Tier 1 capital necessary for covering the regulatory minimum ratios and a buffer for risks which are minor and are not quantifiable or only partially quantifiable. In accordance with the principle of prudence, an additional charge in relation to the risk-weighted assets is taken into account in order to determine the Tier 1 capital necessary for covering the regulatory minimum ratios. The amount of free capital as of the reference date was €1.7 billion (31 December 2011: €1.8 billion).

Excluding the diversification effects between the individual risk types, the economic capital of pbb Group in the newly developed going-concern perspective amounted to €422 million (31 December 2011: €567 million). If these effects are taken into account, it was €375 million (31 December 2011: €513 million). The most significant risk type on the basis of the ICAAP (measured in terms of the economic capital) was the credit risk, which accounted for approximately 54% of the undiversified economic capital.

Accordingly, the resulting excess capital as of 31 December 2012 amounted to €1.3 billion for the given period of one year (31 December 2011: €1.3 billion); it is further proof of the risk-bearing capacity of pbb Group in the leading going-concern perspective.

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

| **Economic capital according to segments**<br>in € million | **31.12.2012** |
|---|---|
| Real Estate Finance | 127 |
| Public Sector Finance | 250 |
| Value Portfolio | 3 |
| Consolidation & Adjustments | 29 |
| **Total** | **375** |

On 7 December 2011, BaFin detailed key aspects of the regulatory appraisal in its letter «Regulatory appraisal of bank-internal risk-bearing capacity concepts». The going-concern approach used by pbb Group satisfies the requirements of this regulatory assessment for a going-concern approach.

### Gone-Concern (Instantaneous Liquidation Perspective)

In order to fully comply with the new regulatory requirements with regard to banks' internal risk-bearing capacity concepts pbb Group has revised the existing gone-concern approach (liquidation perspective) and has implemented it as an additional, parallel steering approach. The purpose of the so-called instantaneous liquidation perspective is to guarantee protection of the senior lender in a theoretical liquidation scenario with a very high probability. pbb Group has selected a confidence level of 99.91% which is based on the average probability of default of companies which have been awarded good long-term credit ratings by external rating agencies, namely A– from Standard & Poor's, A–/A3 from Fitch Ratings and Moody's. However, this liquidation scenario does not assume an opportunistic winding up of portfolios as postulated by the German Pfandbrief Act, and instead assumes an immediate sale at stressed market values of the assets and securities in the investment book recognised at fair value. According to this assumption the instantaneous liquidation perspective besides the already mentioned major risks takes account of credit spread risks arising from securities in the investment book for calculating the economic capital, and deducts simultaneously the hidden losses attributable to these securities for determining the available financial resources.

| Gone-Concern (instantaneous liquidation perspective) | | | |
|---|---|---|---|
| in € million | 31.12.2012 | 31.12.2011[1] | Δ in € million |
| Credit risk | 1,446 | 1,685 | –239 |
| Market risk | 1,143 | 619 | 524 |
| Operational risk | 86 | 103 | –17 |
| Business risk | 42 | 41 | 1 |
| Property risk | 20 | – | 20 |
| **Total before diversification effects** | **2,737** | **2,448** | 289 |
| **Total after diversification effects** | **2,383** | **2,247** | 136 |
| Available financial resources before hidden losses | 3,953 | 4,173 | –220 |
| Hidden losses | 1,394 | –[2] | – |
| **Available financial resources** | **2,559** | **4,173** | **–** |
| Excess capital/capital shortfall | 176 | 1,926 | – |

[1] Positions in accordance with the risk-bearing capacity concept valid as of 31 December 2011. Differences are explained in the chapter «Method Used for the Individual Risk Types»; no comparability to the figures as of 31 December 2012
[2] Methodically not included are hidden losses in the amount of €1.8 billion

In the instantaneous liquidation perspective, the economic capital without diversification effects amounted to € 2.7 billion as of 31 December 2012 (31 December 2011: € 2.4 billion); if these effects are taken into consideration, it amounted to € 2.4 billion (31 December 2011: € 2.2 billion). The main drivers in this respect are the credit risk (€ 1.4 billion) and the market risk (€ 1.1 billion). The significant increase of the market risk by € 524 million was mostly caused by the credit spread risk attributable to securities in the investment book which was newly added in the reporting year. This effect overcompensated the opposite effect from the reduction of the confidence level compared to 31 December 2011. Most of the market risk is attributable to the sub-portfolios of budget financing and the Value Portfolio – both are non-strategic and earmarked for being streamlined – due to the fact that the volatility of credit spreads is still increased for certain areas of the European Economic Area. This effect can also be seen in the following table of economic capital according to segments where an increase in the segments Public Sector Finance and Value Portfolio is shown. The credit risk decreased by € 239 million, mainly because of further enhancements of the credit portfolio model which help to represent more precisely the correlations between rating migrations and defaults from borrowers. The property risk was classified as material in the first half of 2012 as part of the risk inventory process due to an increase of the Bank's own property portfolio as a result of one rescue acquisition. It was thus quantified for the first time as of 30 June 2012.

The available financial resources in the instantaneous liquidation perspective initially amounted to € 4.0 billion (31 December 2011: € 4.2 billion); this figure was reduced to € 2.6 billion after the hidden losses attributable to the securities in the investment portfolio were deducted. Hidden losses have been recognised in the available financial resources for the first time with the introduction of the new risk-bearing capacity concept in 2012.

The distribution of the economic capital according to segments in the instantaneous liquidation perspective is as follows:

| Economic capital according to segments in € million | 31.12.2012 | 31.12.2011[1] |
|---|---|---|
| Real Estate Finance | 633 | 1,186 |
| Public Sector Finance | 1,702 | 1,201 |
| Value Portfolio | 10 | 46 |
| Consolidation & Adjustments | 134 | n/a |
| **Total** | **2,383** | **2,247** |

[1] The numbers as of 31 December 2011 cannot be compared directly with the numbers as of 31 December 2012.
As of 31 December 2011 the economic capital of C&A was allocated to the three segments REF, PSF and VP and not shown separately

## Strategic Gone-Concern (Strategic Liquidation Perspective)

In addition to the instantaneous liquidation perspective described above, pbb Group has also developed a so-called strategic gone-concern perspective. In this perspective, the risk calculation is adjusted by the budget finance portfolio which has been earmarked for streamlining and the Value Portfolio in order to focus on management of the strategic core business of real estate finance and public investment finance. All risk types which have been defined as being significant, including the credit spread risk for securities in the investment book, are taken into consideration, aggregated to form an economic capital and are then limited. In the strategic gone-concern perspective, the economic capital amounted to € 1.2 billion and the hidden losses of the strategic portfolio amounted to around € 0.7 billion. Because this perspective had been introduced for the first time in 2012, no comparison figures as of 31December 2011 were available.

## Opportunities

The results of the risk-bearing capacity analysis in the so-called instantaneous liquidation view are still very much affected by the relatively high volume of hidden losses of the securities in the investment book which has to be considered as a deduction from the available financial resources. This is due to a considerable extent to the credit spreads of some Southern European countries, regions and municipalities which still had been widened as of the reference date as a result of the European sovereign debt crisis. The volatility of credit spreads of some European countries is also still higher compared with the period before the crisis, and puts a strain on the result of the risk-bearing capacity statement as a result of a correspondingly higher market risk. The downgrades observed in 2012 have resulted in an increased credit risk.

Although it is still clearly too soon to speak of a turnaround in the European sovereign debt crisis in 2013, we have observed a stabilisation of the European bond markets in recent months as a result of the crisis management of the ECB. Overall, the ICAAP-relevant hidden losses of pbb Group for securities in the investment book have declined by approximately € 0.7 billion since June 2012. A continuation of this trend would result in a further expansion of the excess capital in the ICAAP liquidation approach of pbb Group in 2013.

If there is a comprehensive recovery of trust in the European public finances, systematic rating improvements of public sector issuers could lead to a significant reduction of risk and therefore as well to a further increase of the excess capital in the ICAAP.

### Method Used for the Individual Risk Types

The economic capital for each risk type is determined using a quantitative approach and is aggregated to form an overall bank risk with due consideration being given to specific correlations. In line with the common market standard, the risk types are calculated for a period of one year and in relation to a defined confidence level (99.91% in the gone-concern, 95% in the going-concern). For the gone-concern confidence level, the Bank uses the average figure for long-term default rates of companies with very good external ratings (A– at Standard & Poor's and Fitch Ratings, A3 at Moody's). This confidence level is slightly lower than was the case at the end of 2011 (99.95%).

The method of calculating the economic capital for the individual material risk types for 2012 is explained in the following.

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

In addition adjustments of the parameterisation of the correlation within the credit portfolio model had been implemented in 2012. Target of these adjustments was the optimal alignment of the credit portfolio model to the business model of pbb Group with simultaneous consideration of the conservative regulatory requirements on the modelling of diversification effects.

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

**Operational Risk** The calculation of economic capital for operational risks includes the result of the calculation using the standard approach in accordance with Basel II. For the purposes of the capital adequacy procedure, the regulatory capital requirement is scaled to the corresponding lower confidence level (from 99.9% to 95%). In the gone-concern approach it is scaled to the higher confidence level of 99.91%).

**Business Risk** In pbb Group, the business risk is generally defined as the risk of reductions in profit due to changes in the external business environment which affect the economic conditions of the Bank. These include non-quantifiable risks such as regulatory risk, reputation risk and strategic risk as well as risks such as funding costs arising from an unexpected funding gap and earning risks. The calculation of economic capital for the business risk comprises an assumed increase in funding costs

as a result of an increase in funding needs in conjunction with a simultaneous increase in the unsecured funding rate. As part of the liquidity risk measurement process, the increased funding needs which would occur in conjunction with certain market events is simulated every month in the stress scenario. An increase in the Bank's own rating to the historical maximum of credit spreads observed on the market is simulated for the unsecured funding rate. It is conservatively assumed that both events will occur simultaneously. Because pbb Group is fully funded for a period of one year in the 95% scenario, this risk is equal to zero. A further element of business risk is the risk that planned income from new business is not completely realised. Nevertheless, this risk is already taken into account by not considering the potential earnings as part of the available financial resources.

**Property Risk** In addition to market, credit, business and operational risks, the risk inventory in 2012 has shown that the valuation risk for real estate has to be considered as being of a material nature. It has therefore been included in the ICAAP and capitalised as an independent risk type. It describes the risk of a valuation loss of the real estate portfolio of pbb Group.

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

## Stress Tests

In the recent past stress tests have successively gained greater importance in the regulatory view as well as in the context of internal bank management which is inter alia due to the European sovereign debt crisis. Within the Stress Test Committee, which directly reports to the Group Risk Committee, all activities, developments and decisions with reference to stress testing are concentrated. A major enhancement in 2012 was the definition and impact analysis of so-called macro-economic stress scenarios with a time horizon of several years and a focus on a continuing or aggravating sovereign debt crisis. The impact analysis of these scenarios was carried out in the third quarter in an integrated approach which included all major risks as well as the available financial resources with consideration of stressed market parameters.

Stress tests in relation to the economic capital are further used in order to obtain a better understanding of the sensitivity of the risk-bearing capacity with regard to adverse movements of the risk parameters. Moreover, so-called inverse stress tests are calculated on a regular basis which describe as a result certain parameter constellations where the capitalisation is still sufficient. In addition to institutionalised stress tests, ad hoc queries on behalf of the Management Board regarding potential rating changes and loss ratios have played an important role throughout the year. The focus was particularly on the crisis situations of some Southern European countries.

### Regulatory Indicators According to German Solvency Regulation

In accordance with the waiver regulation set out in Section 2a KWG, pbb is exempted from the requirement to establish the equity and core capital ratios at the level of the institution.

The waiver regulation set out in Section 2a KWG states that a credit institution or financial services institution which has its registered offices within Germany and which is part of a regulated group of institutions or financial holding group does not have to comply with the following regulations if these regulations are complied with at the level of the ultimate parent company:
> Regulations regarding solvency (equity in relation to risk-weighted assets)
> Regulations regarding large loans (equity in relation to loans extended to individual borrower units)
> Regulations set out in Section 25a (1) Clause 3 No. 1 KWG for establishing and assuring risk-bearing capacity, defining strategies, setting up processes for identifying, assessing, managing, monitoring and communicating risks.

pbb Group voluntarily discloses these figures on a pro forma basis.

The regulatory capital of pbb Group in accordance with the Solvency Regulation (SolvV) on a pro forma basis was as follows:

| **Own funds**[1]<br>in € million | **31.12.2012** | **31.12.2011** |
|---|---|---|
| Core capital (Tier I) | 2,898 | 2,762 |
| Supplementary capital (Tier II) | 1,179 | 1,383 |
| **Equity capital** | **4,077** | **4,145** |
| Tier III capital | – | – |
| **Total** | **4,077** | **4,145** |

[1] Consolidated pursuant to section 10a German Banking Act (KWG); pro forma as per prepared annual financial statements and after result distribution

The risk-weighted assets, the operational risks and the market risk positions on a pro forma basis were as follows:

| **Risk-weighted assets**[1]<br>in € billion | **31.12.2012** | **31.12.2011** |
|---|---|---|
| Risk-weighted assets | 15.3 | 17.0 |

[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 Basel II advanced IRB approach for authorised portfolios, otherwise Basel II standardised approach; pro forma as per prepared annual financial statements and after result distribution

| **Operational risks**<br>in € million | **31.12.2012** | **31.12.2011** |
|---|---|---|
| Total | 86 | 80 |

| **Market risk positions**<br>in € million | **31.12.2012** | **31.12.2011** |
|---|---|---|
| Currency risks | 6 | 6 |
| Interest rate risks | – | – |
| **Total** | **6** | **6** |

The capital ratios have been determined on the basis of the equity definition in accordance with SolvV and also using risk-weighted assets in accordance with Basel II. On a pro forma basis, the capital ratios are as follows:

| **Key capital ratios**[1)]<br>in % | **31.12.2012** | **31.12.2011** |
|---|---|---|
| Core capital ratio[2)] | 18.9 | 16.3 |
| Equity capital ratio[3)] | 26.7 | 24.5 |
| Own funds ratio (overall indicator)[2)] | 26.6 | 24.4 |

[1)] Pro forma as per prepared annual financial statements and after result distribution
[2)] Including risk-weighted credit risk positions as well as the capital requirements for market risk positions and operational risks scaled with the factor 12.5
[3)] Including risk-weighted credit risk positions as well as the capital requirements for operational risks scaled with the factor 12.5

## Recapitalisation Survey

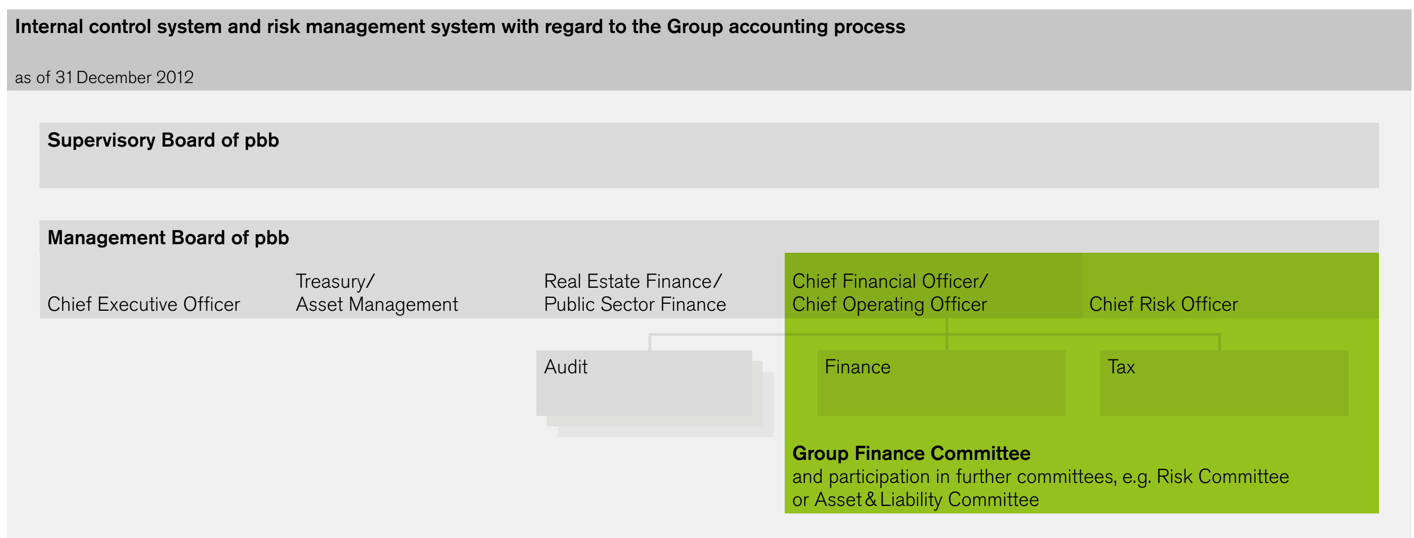
pbb Group was involved in the recapitalisation survey with European banks which was carried out in the second half of 2011 by the European Banking Authority (EBA). The reference date for compliance with the minimum ratio of core Tier 1 capital specified by the EBA was 30 June 2012. HRE Group more than matched the minimum ratio for core Tier 1 capital specified by the EBA on the occasion of the preliminary survey in the second half of 2011 and also as of the reference date 30 June 2012, and accordingly did not report any recapitalisation requirement due to EBA perspective.

## Internal Control System 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. It 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 pbb 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 (GFC).




The Management Board of pbb is required to prepare consolidated financial statements and a Group management report. In conjunction with the obligation to introduce a Group-wide internal control and risk management system, the central Management Board of pbb 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. In addition, the Supervisory Board also has audit obligations and reporting obligations. To support its activities the Supervisory Board implemented an Audit Committee. In accordance with section 100 (5) AktG, at least one member of the Supervisory Board must have specialist knowledge of accounting and auditing.

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

The CFO was amongst others also responsible for managing Finance, Tax and Audit in the year 2012. 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 pbb 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 accounting software. In addition, the data is checked for plausibility, analysed and consolidated.

The Group Finance Committee on HRE level provides 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 pbb 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 (ALCO).

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

pbb 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 of HRE Holding also form the Management Board of pbb.

There is clear functional segregation within the CFO department, which is for instance reflected in separate departments for preparation of figures and reporting. The GFC 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 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 pbb Group is protected against unauthorised access by a clearly regulated administration and release of authorisations.

In addition to the system-based measures, pbb Group has also implemented manual respectively 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.

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 reports 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, pbb Group takes measures designed to avert fraudulent actions and deliberate violations to the detriment of pbb Group. Examples of fraudulent actions to the detriment of pbb Group are theft, embezzlement or misappropriation. With regard to the accounting process, deliberately incorrect accounting is also defined as a fraudulent action. pbb 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

pbb 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 GFC 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 pbb 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 pbb Group and individual employees.

pbb 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.

The IT landscape of pbb Group is of a heterogeneous nature mainly due to numerous acquisitions of companies in the past. In recent years within the framework of the New Evolution project, the systems and the processes have therefore been standardised as far as possible. The process of transferring lending business to a standard IT system was successfully completed as of 1 October 2012. The standardisation of the sub-ledgers has reduced the complexity of the Group accounting process.

### 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 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. The Audit department is neither 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. Some accounting issues are audited every two years, whereas others are audited every three years.

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 Supervisory Board also interrogates division managers directly. 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 consolidated financial statements and the Group financial review. The Supervisory Board approves the consolidated financial statements and Group financial review 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 pbb Group Audit Committee, and reports on the material results of the audit, amongst others material weaknesses of the internal control and internal risk management system with regard to the accounting process. If relevant, 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.

# Forecast Report



## Macro-economic Forecast

The forecasts for the year 2013 are based on three fundamental assumptions. Firstly, the economy in Europe will not be affected in the period covered by the forecast by a further increase in the level of uncertainty resulting from the European sovereign debt crisis. Secondly, fiscal policy in the USA will only implement part of the consolidation program. And thirdly, monetary policy in the industrialised countries will continue to be expansionary in 2013.

On the basis of these assumptions, the global economy will achieve moderate growth this year. GDP in the eurozone will probably report minimal contraction, and GDP of the EU will expand slightly. The German economy is likely to report the same level of growth as in this year, and Great Britain will probably achieve slight growth. Italy will probably continue to be in recession, and France will approximately stagnate. Greece, Portugal and Spain will probably again produce less than in the previous year.

Inflation in the period covered by the forecast will probably increase somewhat more slowly in most regions than was the case last year due to the still weak development of demand. However, inflation risks might become more significant in future if the economies continue to be supplied with central bank money at rates close to zero.

Source: Council of Experts for Assessing the Macro-economic Development

## Sector-specific Conditions

### Overall Situation of the Banking Sector

As a result of the planned introduction of Basel III, the improvement in the equity situation will continue to be right at the top of the agenda. Because the sovereign debt crisis still has not been completely overcome, the need to maintain liquidity will continue to be extremely important. Due to the misdeeds of individual players, the entire sector will continue to be affected by a negative public image in 2013; this is likely to result in further regulatory measures.

### Real Estate Finance

Despite the downturn in the economic climate and the uncertainty regarding the sovereign debt crisis which has still not been overcome, real estate as an asset class will continue to be one of the main investment categories in 2013.

In particular, demand in the preferred core markets of Germany, France, Great Britain and Scandinavia, will probably continue to be relatively robust. The top six locations in Germany (Berlin, Frankfurt, Hamburg, Cologne, Munich and Stuttgart), Paris, London and also Stockholm will continue to be the European «magnets». Positive developments are also possible in some Eastern European countries such as Poland. The office and retail segments will probably continue to dominate events on the market.

It is likely that many institutional investors such as insurers or pension funds would like to increase the percentage of real estate assets in relation to their overall capital investments. However, in the currently uncertain climate of the financial crisis, they have so far moved quite close to the relatively limited core property segment. If investors, however, wish to achieve further growth, they will have to abandon their strong focus on the core property segment. Because of the record low yields in this segment, demand for properties outside the «core universe» might gradually pick up again with regard to criteria such as countries, location and condition of the property. For Germany, we expect that the volume of trans-

actions in the calendar year will be roughly in line with the level seen in the previous year. If the economy and real estate market in some southern European countries bottom out, these countries might reappear on the radar of opportunist investors.

The year 2013 is also not likely to experience a credit crunch, although the disappearance of some competitors and the effects of Basel III will probably result in more difficult financing conditions in terms of LTVs, equity requirements and size categories. We are assuming that there will be an increase in alternative forms of finance in the calendar year and that financiers might expand their exposure; however, these sources in 2013 will continue to be available only on a selective basis.

Sources: BNP Paribas Real Estate, Property Report, Jones Lang LaSalle Investment market overview, own research

### Public Sector Finance

There will continue to be considerable changes in state finance in general and public sector finance in particular. In addition to more stringent transparency requirements for public sector borrowers, the individual limits per borrower will probably decline. Banks will increasingly diversify the financing risks at the municipal level on the basis of investment purpose and regionality, and will carry out their analyses of creditworthiness more intensively and on the basis of a higher number of criteria.

Under these conditions, some market players – if they have not already done so – will restrict their financing activities or withdraw from the markets.

Loans will continue to be the traditional instrument of financing at the municipality and regional level. There is an increasing number of initiatives which are designed to provide easier access to capital markets at this level. In future, there will be further market players, e.g. institutional investors, who wish to obtain direct access to the markets either directly or via credit funds. The current core markets of Germany and France should overall perform in line with last year. The German market will continue to be dominated by the public sector banks and development banks in conjunction with a simultaneously low level of margins. On the other hand, the range of municipal financing arrangements in France will increase strongly as new players enter the market. Accordingly, competition will become more intense, and this will be reflected in the conditions. However, there will continue to be good opportunities in France for concluding business with attractive risk-reward profiles.

### Funding Markets

In the year 2013, credit institutions will have to face the challenge posed by markets affected by political considerations. If further stabilisation measures can be attained at the political level and also at the level of budgets in the eurozone, this should have a further positive impact on the markets and enable central bank support to be reduced.

At present, it remains to be seen what the effects of regulatory changes will be. However, covered bonds in particular should be able to benefit from this aspect. A declining supply of new issues on the one hand and strengthened supply of liquidity on the other should continue to have a positive impact on the funding possibilities of the credit institutions for Pfandbriefe. The low level of interest rates means that investor demand should continue to be strong for unsecured issues.

## Business Projections

The forecasts regarding the future development of pbb Group constitute estimates which have been taken on the basis of the information available at present. If the assumptions underlying these forecasts fail to materialise, or if risks and opportunities occur to an extent which has not been calculated, the actual results may differ considerably from the results which are currently expected.

### Future Development in Assets, Financial Position and Earnings

pbb Group closed the year 2012 with pre-tax profit of € 124 million. Accordingly, the pre-tax profit was in the mid-range of the earnings expectations of € 100 million to € 140 million forecast at the beginning of the year. In addition, pbb Group has demonstrated its continuing profitability with positive results reported for the past ten quarters in succession.

pbb Group is also predicting a pre-tax profit for the forecast period, namely the year 2013. In specific terms, the Management Board is anticipating pre-tax profit of at least € 100 million for 2013. Return on equity after taxes will probably be roughly in line with the corresponding previous year level (2012: 2.1%).

It is forecasted that net interest income will increase compared with the year 2012. Success in meeting the new business targets is the essential requirement for this positive development. The volume of new business for commercial real estate financing (Real Estate Finance segment) and public investment financing (part of the Public Investment Finance segment) is expected to increase strongly compared with the new business concluded in 2012 (€ 5.6 billion). These figures include prolongations with a maturity of more than one year which are carried out if pbb Group expects to achieve economic benefits in this way. Because new business will probably exceed repayments, holdings of real estate financing will probably increase slightly. The volume of public investment financing should increase in the Public Sector Finance segment, but is expected to be offset by the decline in budget financing which is consistent with overall strategy.

In addition to net interest income, the balance of other operating income/expenses, general administrative expenses and provisions for losses on loans and advances in particular will probably change compared with 2012. The balance of other operating income/expenses will decline because servicing of FMS Wertmanagement will be terminated in September 2013. On the other hand, termination of servicing will result in lower general administrative expenses, as there are plans for a transfer of employees to FMS Wertmanagement Service GmbH. However, this positive impact on general administrative expenses as a result of fixed costs and dyssynergy-related factors will not directly completely offset the downturn in revenues. In addition, additional costs of IT projects will continue to affect general administrative expenses in 2013. Higher expenses will also be necessary for implementing regulatory requirements, in particular Basel III and IFRS 9. It is expected that provisions for losses on loans and advances will return to a normal level in relation to lending business in 2013, whereas reversals were possible for individual exposures in 2012.

In line with market conventions, pbb Group is constantly further developing its valuation models. An adjustment of the valuation models and the parameters will mean that earnings will become increasingly volatile in future, and this might burden results. In particular, changes in the Bank's own credit risk as a result of the valuation of the derivatives with the bilateral credit value adjustment have an impact on the market values of the instruments. In addition, results are expected to be affected negatively in 2013 if derivatives are valued using overnight interest rate curves.

As a financial performance indicator for efficiency, the cost-income ratio will improve as a result of the lower general administrative expenses; however, it will also be negatively affected by the lower operat-

ing revenues and will improve slightly compared with the previous year (2012: 73.0%). It has to be borne in mind that servicing of FMS Wertmanagement in 2013 will still have a negative impact on the cost-income ratio.

Due to a covenant in line with the principle of burden sharing required by the European Commission, profits generated before reprivatisation will be used for repaying the silent participation of Finanzmarktstabilisierungsfonds-FMS.

As was the case in 2012, the Real Estate Finance segment will account for a greater proportion of Group profit. A slightly positive pre-tax result is expected to be generated in the Public Sector Finance segment. The Value Portfolio segment, which accounts for less than 1 % of the balance sheet total without the assets of FMS Wertmanagement, will probably also make slightly positive contributions to earnings.

Assurance of risk-bearing capacity is a significant ancillary condition for attaining the earnings and profitability objectives of pbb Group. With regard to the going-concern perspective, it is probable that the risk-covering potential will be considerably higher than the necessary economic risk capital. In the gone-concern perspective, it is expected that the minimum limits will be complied with. This is based on the assumption that there will not be a considerable increase in the hidden liabilities.

The core capital ratios will probably decline slightly as a result of expected higher risk assets in the portfolio and in new business in 2013, but it will be considerably higher than the regulatory limits and also higher than the CET1 ratio (core equity Tier 1 ratio under Basel III) of 11% which is the objective of pbb. If it is assumed that Basel III will be introduced in 2013, the risk assets would also be increased by mark ups due to the extension of the valuation of the secured derivatives to include the credit risk of the counterparty and the Bank's own default risk. As part of the Basel III implementation process, the accounting standard relevant for regulatory purposes will be changed over from HGB to IFRS. Tier 1 capital will increase particularly as a result in the change in the way in which the silent participation is recognised. However, this effect will be reduced by restrictions regarding the extent to which certain capital instruments can be recognised. The capital ratios would be at roughly the same high level as on the balance sheet date.

Total assets declined in 2012 due to various factors, including the further decline in the effects attributable to the transfer of positions to FMS Wertmanagement. The extent of the transfer effects will probably continue to decline in future, for instance as a result of derivative novations. In addition, the volume of budget financing and other portfolios in which pbb Group does not operate any new business will decline further. This means that the total volume of assets will probably also decline in 2013. In consequence, the funding requirement will also decline, which means that the liabilities are expected to decline.

**Opportunities** pbb Group has reported positive pre-tax profit for the last ten quarters. This development illustrates the positive trend at pbb Group which will result in the following opportunities in future:

- Whereas in recent years the focus has been on the restructuring and strategic refocusing of the Group and the conclusion of the EU aid proceedings, pbb Group was able to concentrate on processing its markets in 2012. pbb Group has taken advantage of this initial basis and has concluded attractive new business. pbb Group has thus created the opportunity of continuing its successful development and of boosting profitability in its core areas of business of commercial real estate finance and public investment finance with the aim of achieving growth.
- pbb Group will only continue to provide services for operating FMS Wertmanagement until September 2013. The discontinuation of these activities which no longer form part of core business will open up a further opportunity of focusing to an even greater extent on the relevant customer markets in the field of commercial real estate finance and public investment finance; this would have a positive impact on the volume of new business and the new business margins, and would thus also have a positive impact on net assets and results of operations.

- There is strong demand for financing on the markets which are relevant for pbb Group. At the same time, some competitors have withdrawn from markets. In this context, pbb Group considers that the market climate in commercial real estate finance and public investment finance will be attractive in the long term; this would have a positive impact on the volume of new business and the new business margins, and would thus also have a positive impact on the net assets and results of operations.
- Even in recent years which have been affected by market uncertainty, the Pfandbrief has continued to be a sound investment with a tried-and-tested market infrastructure; this was also reflected by the strong demand of investors in 2012. pbb Group has established a wide range of experience in the Pfandbrief market, and is able to utilise existing customer relations. This enabled pbb to successfully sell several issues last year. pbb Group will therefore use a capital market instrument which is still in demand, which had a positive effect on the financial position.
- In 2012, pbb Group has issued an unsecured issue with a longer maturity, reflecting the resurgent investor confidence. This source of funding, as well as possible and previously unutilised alternatives of raising funds, is a possibility of diversifying its funding base and responding in a flexible manner to market opportunities. This will have a positive impact on liquidity and the financial position.
- In the year 2012, the strategy of pbb Group was to significantly reduce high-risk holdings, such as exposures to Portuguese and Italian counterparties. Depending on the developments of the markets, there may be further opportunities to reduce risk in future in the Public Sector Finance segment and in the other segments, which will mean that the volatility of earnings and equity will decline.
- In 2012, further progress was achieved with regard to separating the two groups pbb and DEPFA which are part of HRE. This process, which will be continued in the course of 2013, increases the chances of a successful reprivatisation of pbb Group.
- pbb Group has become much more attractive on the labour market, supported by new personnel development measures which have been introduced. These encourage the loyalty of efficient and highly qualified staff and senior executives who are able to support pbb Group in its aim of meeting its ambitious targets.
- A further opportunity is provided by the strict cost focus of pbb Group. The reduced general administrative expenses in 2012 demonstrate the success already achieved. The respective status of processes will be continuously questioned and analysed in future in order to enable appropriate improvement measures to be identified. This also involves a project for defining the target model of pbb Group after the disposal of Servicing of FMS Wertmanagement. Following these transactions, pbb Group will considerably reduce its cost base and will become more lean and more efficient so that profitability will increase.
- In addition, pbb Group has already achieved significant success in harmonising its IT systems. For instance, the process of transferring lending business to a standard IT system as of 1 October 2012 was successfully completed. This will result in additional efficiency gains. Due to the harmonisation of the IT systems, the process optimisation as well as the establishment of specialist teams, it will be possible for customer needs to be met more rapidly and for customer satisfaction to be boosted accordingly; this would have a positive impact on the volume of new business and the new business margins and would thus also have a positive impact on net assets and results of operations.

**Risks** However, there is also the possibility of future problems facing the net assets, financial position and results of operations. The extent of potential problems is influenced particularly by the occurrence or non-occurrence of the following risks, or the extent to which such risks might occur:

- Some European countries in the financial year 2012 were only able to fund their operations with the support of international aid programmes. Holders of Greek government bonds have had to waive their entitlement to some of their claims, although the pbb Group was not directly affected. If the debt crisis facing some countries becomes more serious and if it becomes necessary to waive claims to the bonds of other countries, or if public sector debtors become insolvent, pbb Group would also be facing considerable impairments in relation to receivables and securities. These impairments might increase if, due to the interconnected nature of markets or turmoil affecting markets, the crisis affecting some countries spreads to other countries which are currently considered to be solvent.
- In 2011 and 2012, write-downs were necessary only for a small number of individual exposures as a result of various factors, including the successful portfolio management of pbb Group. Nevertheless, it is still possible in future that significant write-downs will have to be recognised in relation to receivables. These write-downs depend primarily on the economic situation of the financed properties. However, this might also depend on a general crisis of individual markets such as the real estate markets in various countries.
- The situation on the funding markets and particularly on the Pfandbrief markets has improved in the year under review, and pbb Group has taken advantage of this situation by way of stepping up issuing activity. Nevertheless, the funding markets are still sensitive for failures. The debt crisis facing some European countries may for instance result in a major loss of confidence and significantly lower sales on the issuing markets or the interbank market. If the funding markets are affected by such problems, there might be a negative impact on the liquidity situation of pbb Group despite the existence of a cushion. A further consequence might be a specific reduction in the volume of new business.
- Within the framework of the approval decision in the aid proceedings, the European Commission specified that pbb would have to be reprivatised as quickly as possible, and by no later than 31 December 2015. If the reprivatisation process has not been completed by 31 December 2015, an appointed disposal trustee will sell pbb to a purchaser, without a minimum price being specified, if the Commission has approved the purchaser and the final binding purchase agreement. The sale or alternative considerations of the shareholder with the approval of the EU Commission may have a positive and also a negative impact on the net assets, financial position and results of operations of pbb Group.
- The methods for valuing financial instruments are constantly being improved on the market. For instance, the market conventions for valuing derivatives are changing, in that overnight interest rate curves in particular are used. Such adjustments may have a negative impact on results of operations for pbb Group in 2013.
- Rating agencies continue to adapt their methodologies and models in order to assess, amongst other factors, the changing macro-economic environment and the potential impact of the European sovereign debt crisis. This, alongside with the specific rating drivers for pbb and its Pfandbriefe, could lead to rating changes. A change in the Bank's ownership structure might also result in rating changes. Downgrades of the ratings of pbb and/or its Pfandbriefe could have a negative impact particularly on the Bank's funding conditions and hence on its development in earnings and its financial position.
- The risk-bearing capacity concept is being constantly improved. The further development might have an impact on the risk-bearing capacity analysis in the going-concern approach and also in the gone-concern approach. The development in the market values of the assets and liabilities is a further factor which has an impact on the risk-bearing capacity in the gone-concern approach. If the hidden liabilities increase as a result of changes in market values, the cover capital might fall below the necessary economic capital.
- Membership in the HRE Group has had a negative impact on the image of pbb Group in recent years. Even if success has already been achieved in terms of re-entering the markets, it is possible that there may be negative consequences for achieving the objectives of pbb Group.

> Litigation which is currently pending and which might become pending in future might have a considerably negative impact on the results of pbb Group.
> As part of the conclusion of EU aid proceedings, complete termination of servicing provided by pbb Group for FMS Wertmanagement as of 30 September 2013 was imposed as a requirement. When the cooperation agreement is terminated, the activities in the field of servicing will be handled by FMS Wertmanagement itself or FMS Wertmanagement Service GmbH. As a result of the contractual agreements, FMS Wertmanagement may also enforce claims which might have an impact on the net assets, financial position and results of operations of pbb Group even after servicing has been terminated.
> pbb Group is exposed to operational risks, resulting for instance from technology risks due to the large number of accounting systems. Although pbb Group has already successfully completed some projects for optimising processes and the IT infrastructure, the operational risks may result in significant losses. The risks can also become relevant for the ongoing operation of FMS Wertmanagement for the service obligations taken on from pbb Group.
> A further operational risk results from the reliance on employees who are owners of positions which are exposed to risk. As a result of the restructuring process and the planned transfer of employees to FMS Wertmanagement Service GmbH, some members of staff in key positions might leave. This might have an impact on the net assets, financial position and results of operations.
> The ongoing development of national and international regulatory requirements may have an impact on the structure of assets and liabilities, and may thus also affect the results of operations. For instance, the modified obligations presented by the Basel Committee on Banking Supervision (Basel III) regarding more stringent liquidity requirements might have a negative impact on profitability, or profitability might be reduced by more stringent capital requirements. In addition, there might also be an impact on existing regulatory and economic parameters, requiring for instance a change in capital backing.
> The possibility of introducing a tax on financial-market transactions is planned in most of the countries in the European Union. The aim is to introduce a tax on purchases and sales of transferable securities or options and other financial instruments. Such a tax might have a negative impact on the result of pbb Group and might mean that some business might be unprofitable.

### Summary

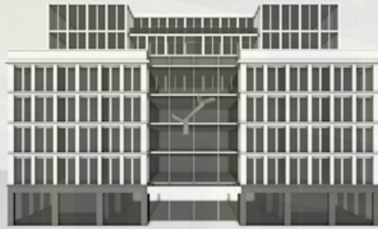
The positive development of pbb Group seen in recent years will result in numerous opportunities for boosting profitability in future. However, this assessment is based on the assumption that risks which for instance result from factors which cannot be influenced, such as the government debt crisis, do not become relevant. Overall, giving due consideration to the opportunities and risks for 2013, pbb Group is anticipating pre-tax profit of at least €100 million for the year 2013.

# Plaza Global Real Estate Partners Prime Office Building

## GBP 106 million

Acquisition refinancing
Great Britain
December 2012

pbb has provided a GBP 106 million facility to Plaza Global Real Estate Partners, the joint venture created between Quantum Global Real Estate and LaSalle Investment Management. The loan will allow Plaza Global Real Estate Partners to refinance part of the initial acquisition of an awarded office building in the West End of London comprising nearly 9,270 m². The space is let to a high-end gallery and several financial companies.



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# Consolidated Financial Statements

# Consolidated Financial Statements
## Consolidated Income Statement

| **Income/expenses** in € million | Notes | **2012** | **2011** | Δ in € million |
|---|---|---|---|---|
| **Operating revenues** | | 467 | 526 | –59 |
| Net interest income and similar income | 31 | 296 | 371 | –75 |
| Interest income and similar income | | 2,879 | 3,691 | –812 |
| Interest expenses and similar expenses | | 2,583 | 3,320 | –737 |
| Net commission income | 32 | 23 | 32 | –9 |
| Commission income | | 27 | 38 | –11 |
| Commission expenses | | 4 | 6 | –2 |
| Net trading income | 33 | 10 | –8 | 18 |
| Net income from financial investments | 34 | 13 | 3 | 10 |
| Net income from hedge relationships | 35 | –6 | –56 | 50 |
| Balance of other operating income/expenses | 36 | 131 | 184 | –53 |
| Provision for losses on loans and advances | 37 | –4 | –12 | 8 |
| General administrative expenses | 38 | 341 | 357 | –16 |
| Balance of other income/expenses | 39 | –6 | 7 | –13 |
| **Pre-tax profit/loss** | | **124** | **188** | –64 |
| Taxes on income | 40 | 55 | 71 | –16 |
| **Net income/loss** | | **69** | **117** | –48 |
| **attributable to:** Equity holders (consolidated profit/loss from the parent company) | | 69 | 117 | –48 |

# Consolidated Statement of Comprehensive Income

| Consolidated statement of comprehensive income | | | 2012 | | | 2011 |
|---|---|---|---|---|---|---|
| in € million | Before tax | Tax | Net of tax | Before tax | Tax | Net of tax |
| **Net income/loss** | **124** | **55** | **69** | **188** | **71** | **117** |
| Additional paid-in capital | – | – | – | – | – | – |
| Retained earnings | –6 | – | –6 | –3 | – | –3 |
| Foreign currency reserve | 5 | – | 5 | 1 | – | 1 |
| AfS reserve | 260 | 71 | 189 | –406 | –116 | –290 |
| Cash flow hedge reserve | –26 | –6 | –20 | –121 | –27 | –94 |
| Total other comprehensive income of the period | 233 | 65 | 168 | –529 | –143 | –386 |
| **Total comprehensive income of the period** | **357** | **120** | **237** | **–341** | **–72** | **–269** |
| **attributable to:** Equity holders (consolidated profit/loss from the parent company) | 357 | 120 | 237 | –341 | –72 | –269 |

| Disclosure of components of consolidated comprehensive income | | |
|---|---|---|
| in € million | 2012 | 2011 |
| **Net income/loss** | **69** | **117** |
| Additional paid-in capital | – | – |
| Unrealised gains/losses | – | – |
| Retained earnings | –6 | –3 |
| Unrealised gains/losses | –6 | –3 |
| Foreign currency reserve | 5 | 1 |
| Unrealised gains/losses | 5 | 1 |
| AfS reserve | 189 | –290 |
| Unrealised gains/losses | 177 | –294 |
| Reclassification adjustments for gains/losses included in profit or loss | 12 | 4 |
| Cash flow hedge reserve | –20 | –94 |
| Unrealised gains/losses | 47 | 393 |
| Reclassification adjustments for gains/losses included in profit or loss | –67 | –487 |
| Total other comprehensive income of the period | 168 | –386 |
| Total unrealised gains/losses | 223 | 97 |
| Total reclassification adjustments for gains/losses included in profit or loss | –55 | –483 |
| **Total comprehensive income of the period** | **237** | **–269** |

# Consolidated Statement of Financial Position

**Assets**

| in € million | Notes | 31.12.2012 | 31.12.2011 | Δ in € million | 1.1.2011 |
|---|---|---|---|---|---|
| Cash reserve | 8, 42 | 1,937 | 323 | 1,614 | 224 |
| Trading assets | 9, 43 | 3,325 | 9,818 | −6,493 | 16,168 |
| Loans and advances to other banks | 10, 44 | 7,995 | 7,632 | 363 | 12,128 |
| Loans and advances to customers | 10, 45 | 49,590 | 55,236 | −5,646 | 118,642 |
| Allowances for losses on loans and advances | 11, 46 | −325 | −477 | 152 | −561 |
| Financial investments | 12, 47 | 25,572 | 28,677 | −3,105 | 33,605 |
| Property, plant and equipment | 13, 48 | 2 | 3 | −1 | 5 |
| Intangible assets | 14, 49 | 39 | 35 | 4 | 32 |
| Other assets | 15, 50 | 7,235 | 6,058 | 1,177 | 5,035 |
| Income tax assets | 24, 51 | 1,686 | 1,474 | 212 | 1,545 |
| Current tax assets | | 53 | 55 | −2 | 64 |
| Deferred tax assets | | 1,633 | 1,419 | 214 | 1,481 |
| **Total assets** | | **97,056** | **108,779** | −11,723 | **186,823** |

**Equity and liabilities**

| in € million | Notes | 31.12.2012 | 31.12.2011 | Δ in € million | 1.1.2011 |
|---|---|---|---|---|---|
| Liabilities to other banks | 16, 55 | 7,797 | 8,223 | −426 | 62,587 |
| Liabilities to customers | 16, 56 | 11,895 | 12,363 | −468 | 17,384 |
| Liabilities evidenced by certificates | 16, 57 | 52,550 | 55,038 | −2,488 | 63,846 |
| Trading liabilities | 17, 58 | 3,192 | 9,903 | −6,711 | 16,294 |
| Provisions | 18, 59 | 164 | 163 | 1 | 176 |
| Other liabilities | 19, 60 | 14,438 | 16,123 | −1,685 | 18,883 |
| Income tax liabilities | 24, 61 | 1,698 | 1,373 | 325 | 1,526 |
| Current tax liabilities | | 64 | 82 | −18 | 83 |
| Deferred tax liabilities | | 1,634 | 1,291 | 343 | 1,443 |
| Subordinated capital | 20, 62 | 1,993 | 2,501 | −508 | 2,766 |
| **Liabilities** | | **93,727** | **105,687** | −11,960 | **183,462** |
| **Equity attributable to equity holders** | | 3,329 | 3,092 | 237 | 3,361 |
| Subscribed capital | 63 | 380 | 380 | – | 380 |
| Silent participation | 21, 63 | 999 | 999 | – | 999 |
| Additional paid-in capital | 63 | 5,036 | 5,036 | – | 5,036 |
| Retained earnings | 63 | −3,166 | −3,277 | 111 | −3,089 |
| Foreign currency reserve | 23 | −29 | −34 | 5 | −35 |
| Revaluation reserve | 7 | 40 | −129 | 169 | 255 |
| AfS reserve | | −360 | −549 | 189 | −259 |
| Cash flow hedge reserve | | 400 | 420 | −20 | 514 |
| Consolidated profit/loss 1.1.–31.12. | | 69 | 117 | −48 | −185 |
| **Equity** | | **3,329** | **3,092** | 237 | **3,361** |
| **Total equity and liabilities** | | **97,056** | **108,779** | −11,723 | **186,823** |

# Consolidated Statement of Changes in Equity

| Consolidated statement of changes in equity | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Equity attributable to equity holders | | | | | | | | |
| | | | | | | Revaluation reserve | | | |
| in € million | Subscribed capital | Silent participation | Additional paid-in capital | Retained earnings | Foreign currency reserve | AfS reserve | Cash flow hedge reserve | Consolidated profit/loss | **Equity** |
| **Equity at 1.1.2011** | **380** | **999** | **5,036** | **−3,089** | **−35** | **−259** | **514** | **−185** | **3,361** |
| Capital increase | – | – | – | – | – | – | – | – | – |
| Transaction costs of capital measures | – | – | – | – | – | – | – | – | – |
| Treasury shares | – | – | – | – | – | – | – | – | – |
| Distribution | – | – | – | – | – | – | – | – | – |
| Total comprehensive income for the year | – | – | – | −3 | 1 | −290 | −94 | 117 | −269 |
| Transfer to retained earnings | – | – | – | −185 | – | – | – | 185 | – |
| Changes in the group of consolidated companies | – | – | – | – | – | – | – | – | – |
| **Equity at 31.12.2011** | **380** | **999** | **5,036** | **−3,277** | **−34** | **−549** | **420** | **117** | **3,092** |
| **Equity at 1.1.2012** | **380** | **999** | **5,036** | **−3,277** | **−34** | **−549** | **420** | **117** | **3,092** |
| Capital increase | – | – | – | – | – | – | – | – | – |
| Transaction costs of capital measures | – | – | – | – | – | – | – | – | – |
| Treasury shares | – | – | – | – | – | – | – | – | – |
| Distribution | – | – | – | – | – | – | – | – | – |
| Total comprehensive income for the year | – | – | – | −6 | 5 | 189 | −20 | 69 | 237 |
| Transfer to retained earnings | – | – | – | 117 | – | – | – | −117 | – |
| Changes in the group of consolidated companies | – | – | – | – | – | – | – | – | – |
| **Equity at 31.12.2012** | **380** | **999** | **5,036** | **−3,166** | **−29** | **−360** | **400** | **69** | **3,329** |

# Consolidated Statement of Cash Flows



| Consolidated statement of Cash Flows[1]<br>in € million | 2012 | 2011[2] |
|---|---|---|
| **Net income/loss** | **69** | **117** |
| Write-downs, provisions for losses on, and write-ups of, loans and advances and additions to provisions in lending business | 4 | –10 |
| Write-downs and depreciation less write-ups on non-current assets | 19 | 75 |
| Change in other non-cash positions | 163 | 432 |
| Result from the sale of non-current assets | –18 | –4 |
| Other adjustments | –241 | –300 |
| **Subtotal** | **–4** | **310** |
| | | |
| 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 | –235 | –31 |
| Loans and advances to other banks | –546 | 3,974 |
| Loans and advances to customers | 5,837 | 63,712 |
| Other assets from operating activities | –108 | 87 |
| Liabilities to other banks | –493 | –54,449 |
| Liabilities to customers | –545 | –5,156 |
| Liabilities evidenced by certificates | –3,433 | –9,902 |
| Other liabilities from operating activities | –2,276 | –4,470 |
| Interest income received | 2,493 | 3,158 |
| Dividend income received | 1 | – |
| Interest expense paid | –2,267 | –3,042 |
| Taxes on income paid | –17 | –10 |
| **Cash flow from operating activities** | **–1,593** | **–5,819** |
| | | |
| Proceeds from the sale of non-current assets | 4,290 | 10,420 |
| Payments for the acquisition of non-current assets | –533 | –4,142 |
| Proceeds from the sale of investments | – | – |
| Payments for the acquisition of investments | – | – |
| **Cash flow from investing activities** | **3,757** | **6,278** |
| | | |
| Payments of subordinated capital | –550 | –360 |
| **Cash flow from financing activities** | **–550** | **–360** |
| | | |
| Cash and cash equivalents at the end of the previous period | 323 | 224 |
| +/– Cash flow from operating activities | –1,593 | –5,819 |
| +/– Cash flow from investing activities | 3,757 | 6,278 |
| +/– Cash flow from financing activities | –550 | –360 |
| +/– Effects of exchange rate changes and non-cash valuation changes | – | – |
| **Cash and cash equivalents at the end of the period** | **1,937** | **323** |

[1] Explanations in Note 66 «Notes to the Items in the Statement of Cash Flows»
[2] Adjusted, see Note 3 «Consistency»

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## 1 General Information

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

**Accounting Policies**

## 2 Principles

pbb has prepared its Group financial statements for the period ended 31 December 2012 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. pbb 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 pbb prepared these consolidated financial statements on 19 March 2013 under the going-concern assumption.

**Initially Adopted Standards, Interpretations and Amendments** Amendments to IFRS 7 Financial Instruments: Disclosures – Transfer of Financial Assets require disclosing in a separate note the relationships between financial assets, which were not derecognised in their entirety, and the associated financial liabilities as well as the nature and the risks of the continuing involvement in derecognised assets. A separate note Transfer of Financial Assets was added to these consolidated financial statements of ppb.

### Endorsed Standards, Interpretations and Amendments, Which Are Not Yet Mandatorily Applicable

The following standards, interpretations and amendments are endorsed until 31 December 2012, are not mandatorily applicable and were not adopted earlier:

- Amendments to IFRS 1 – Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters
- Amendments to IAS 12 Income Taxes – Deferred Tax: Recovery of Underlying Assets
- IFRS 10 Consolidated Financial Statements and Amendments to IAS 27 Separate Financial Statements
- IFRS 11 Joint Arrangements and Amendments to IAS 28 Investments in Associates and Joint Ventures
- IFRS 12 Disclosure of Interests in Other Entities
- IFRS 13 Fair Value Measurement
- Amendments to IAS 1 Presentation of Items of Other Comprehensive Income
- IAS 19 (revised 2011) Employee Benefits
- IFRIC Interpretation 20: Stripping Costs in the Production Phase of a Surface Mining
- Amendments to IAS 32 Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities and Amendments to IFRS 7 Financial Instruments: Disclosure – Offsetting Financial Assets and Financial Liabilities

Amendments to IFRS 1 concern solely IFRS first-time adopters. Because pbb Group is not an IFRS first-time adopter, there were no impacts on these consolidated financial statements.

Amendments to IAS 12 repeal the interpretations of SIC-12 and regulate the nature of realisation of specific assets in conjunction with deferred tax measurement for investment properties, property, plant and equipment measured at fair value. On these consolidated financial statements there were no impacts because pbb Group did not own such assets.

IFRS 10 supersedes the requirements of IAS 27 and SIC-12 regarding control and consolidation. IFRS 10 implements the control concept as consolidation model. According to this, parent-subsidiary relationships will not only depend on voting rights, but also on other contractual commitments. IAS 27 was renamed in Separate Financial Statements and is solely applicable to separate financial statements, SIC-12 was cancelled. The new standards are originally applicable for financial years beginning on or after 1 January 2013, but were endorsed in European Law with an effective date of 1 January 2014. IFRS 10 will probably result in impacts on the group of consolidated companies of pbb, especially in connection with structured entities.

IFRS 11 supersedes IAS 31 and cancels the proportionate consolidation option of joint ventures. In the future, the equity method is applicable according to IAS 28. The new standards are originally applicable for financial years beginning on or after 1 January 2013, but were endorsed in European Law with an effective date of 1 January 2014. Impacts on future consolidated financial statements will depend on whether or not joint arrangements and at equity investments exist in pbb Group. Presently, this is not the case.

In IFRS 12 the IASB consolidated the disclosure requirements concerning subsidiaries, joint arrangements and associates as well as non-consolidated structured entities. The new standard was originally applicable for financial years beginning on or after 1 January 2013, but was endorsed in European Law with an effective date of 1 January 2014. Due to the requirements of IFRS 12 pbb Group expects extended disclosures regarding its interests in other entities.

The regulations for all assets and liabilities concerning fair value measurement were summarised in IFRS 13. Material new requirements of IFRS 13 Fair Value Measurement concern, for example, the definition of fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between independent market participants (exit price). For measuring financial instruments applying bid price respectively asking price is permitted for assets respectively debts, if these prices represent the fair value in the best way. IFRS 13 expands the disclosure requirements regarding the fair value hierarchy. IFRS 13 is applicable to financial years beginning on or after 1 January 2013. The standard is applicable prospectively. Impacts on consolidated financial statements of pbb will be due to the amended methods to measure fair value and the extended disclosures.

According to Amendments to IAS 1 Presentation of Items of Other Comprehensive Income (OCI), positions of other comprehensive income have to be grouped whether or not they could be recycled into the income statement. Amendments to IAS 1 is applicable for periods beginning on or after 1 July 2012. pbb Group will adjust its disclosures accordingly.

Due to IAS 19 (revised 2011) the corridor approach of recognising actuarial gains or losses is prohibited. Instead, such effects have to be recognised directly in equity. Past service costs have to be recognised in the period of the plan changes instead of allocating the expenses over the period until the claims become vested. The interest rate for discounting the defined benefit obligation is also used for the expected return on plan assets. In addition, sensitivity analysis of pension plans and the average duration of the defined benefit obligation have to be disclosed in the notes. Furthermore, an amendment of the accounting of bonus feature elements («Aufstockungsbeträge») in connection with semi-retirement contracts results from IAS 19 (revised 2011). IAS 19 (revised 2011) is applicable for periods beginning on or after 1 January 2013. The Amendments will generally have impacts on employee benefits accounting and disclosure of pbb Group. In particular, the cancellation of the corridor approach will increase equity volatility. Using the measurement parameters available at the end of 2012 would result in an equity reducing effect of approx. € 46 million. The pre-tax profit will benefit by approx. € 1 million. The cancellation of the amortisation of actuarial losses if the corridor is exceeded is widely compensated by the changed return on plan assets in income statement. Furthermore, notes disclosures will increase.

IFRIC 20 includes requirements concerning stripping costs of a surface mine. The interpretation is applicable for financial years beginning on or after 1 January 2013. pbb Group is not impacted by IFRIC 20.

The IASB revised the regulations regarding the netting of financial assets and financial liabilities and published the revision in the form of Amendments to IAS 32 and Amendments to IFRS 7. To allow the comparison between financial statements under IFRS and under US accounting principles, Amendments to IFRS 7 requires materially extended notes disclosures. Besides a qualitative description, comprehensive quantitative disclosure becomes necessary, e.g. the gross amount before netting, the net amount after netting and the fair value of financial instruments, which have been received or granted as collaterals. Amendments to IAS 32 and Amendments to IFRS 7 are retrospectively applicable for financial years beginning on or after 1 January 2013 (IFRS 7) respectively on or after 1 January 2014 (IAS 32). pbb Group expects extended notes disclosures.

**Published Standards, Interpretations and Amendments Which Are Not Yet Endorsed** The following published standards, interpretations and Amendments were not yet endorsed in European Law:

- IFRS 9 Financial Instruments and Subsequent Amendments (also concerned is IFRS 7 Financial Instruments: Disclosures)
- Amendments to IFRS 10, IFRS 11 and IFRS 12: Transition Guidance
- Amendments to IFRS 1: Government Loans
- Amendments to IFRS 10, IFRS 12 and IAS 27: Investment Entities
- Improvement to IFRSs (2009–2011)

The IASB is replacing the standard IAS 39 by IFRS 9 in several project phases. For the first project phase Classification and Measurement the IASB published new policies in 2009 and 2010, which presumably will be amended again. On the other hand, finally adopted standard parts are not yet available for the two other project phases Impairment Methodology and Hedge Accounting. The Classification and Measurement will probably provide the following measurement categories:
> at fair value through profit or loss
> at fair value through other comprehensive income
> 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 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 own credit risk have to be recognised directly in equity. The initial application of the new standard IFRS 9, which is envisaged for financial years beginning on or after 1 January 2015, will probably have a material impact for pbb Group financial statement. 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 the entire impacts on pbb Group when all parts of IFRS 9 have been completely published.

Amendments to IFRS 10, IFRS 11 and IFRS 12: Transition Guidance clarify the retrospective application of the concerned standards and have to be initially adopted along with IFRS 10, IFRS 11 and IFRS 12 for financial years beginning on or after 1 January 2014.

Amendments to IFRS 10, IFRS 12 and IAS 27: Investment Entities is not relevant for pbb Group, because according to its business model, the Group is not an investment entity. Thereof, future consolidated financial statements of pbb will presumably not be impacted. The amendments have to be initially adopted for financial years beginning on or after 1 January 2014.

In the course of the process to slightly amend several standards and interpretations, the IASB published the further amendment standard Improvements to IFRS 2009–2011. The Improvements to IFRS 2009–2011 are applicable for the financial year beginning on or after 1 January 2013 and will presumably result in immaterial impacts on future consolidated financial statements of pbb Group.

**Statement of Compliance for the Public Corporate Governance Code of the Federation (PCGK-B)**
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 PCGK-B 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 PCGK-B 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 20, which was already initially adopted in the reporting year 2012 on a voluntarily basis. It comprises a report on the principles of the Group, a financial report, a report of significant events after 31 December 2012, and a forecast report as well as a risk and opportunities report. The risk and opportunities report contains information which, under IFRS 7, is required to be disclosed. Events after the balance sheet date are described in the report of events after 31 December 2012.

## 3 Consistency

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

In 2011 there was a change in the way of recognising the bonds which were allocated to the measurement category loans and receivables. In the past, some of these bonds which were recognised as loans and receivables were disclosed as loans and advances to other banks and as loans and advances to customers. Since 2011 these instruments are disclosed completely as financial investments. In the statement of cash flows of the Group financial statements 2011 the disclosure change of the bonds was disclosed as a cash valuation change. This disclosure was adjusted according to IAS 8.42 and disclosed as a non-cash valuation change in the Group financial statements 2012. Therefore in the statement of cash flows 2012, the previous year comparison figures for cash flow from operating activities have been decreased by € –17.3 billion and cash flow from investing activities have been increased by € 17.3 billion respectively. There was no impact on cash and cash equivalents.

Apart from above, as of 31 December 2012 pbb Group applied the equal accounting and measurement principles as in the consolidated financial statements as of 31 December 2011.

## 4 Uniform Consolidated Accounting

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

## 5 Transfer of Positions to FMS Wertmanagement

With economic effect from 1 October 2010, pbb Group transferred positions to FMS Wertmanagement (established on 8 July 2010), an organisationally and economically independent public law institution with partial legal capacities. The positions had been transferred at the respective carrying amount of the transferred company in line with the accounting principles which were applicable for the separate financial statements of the respective company. The amount of the compensation claims which pbb Group received from FMS Wertmanagement was calculated as the difference between the carrying amount of the assets transferred by the respective companies and the transferred equity and liabilities.

The transfer has resulted in the derecognition of non-derivative assets with an IFRS balance sheet value of € 41.3 billion, provisions for losses on loans and advances of € – 2.5 billion, derivatives of € 9.8 billion and (previously HRE-internal) refinancing of € 76.1 billion. For pbb Group there were no gains or losses resulting from the transfer of positions to FMS Wertmanagement. The effects which reduced total assets were partially compensated for by opposite effects and are disclosed in the note relationship with related parties. pbb Group fulfils the servicing for FMS Wertmanagement and receives compensation on an arm's-length basis.

## 6 Consolidation

| pbb 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** |
| **1.1.2011** | **12** | **4** | **10** | **2** | **22** |
| Additions | – | – | – | – | – |
| Disposals | – | – | – | – | – |
| Mergers | – | – | –3 | – | –3 |
| **31.12.2011** | **12** | **4** | **7** | **2** | **19** |
| **1.1.2012** | **12** | **4** | **7** | **2** | **19** |
| Additions | 1 | 1 | – | – | 1 |
| Disposals | –2 | – | –1 | –1 | –3 |
| Mergers | –1 | – | –1 | – | –2 |
| **31.12.2012** | **10** | **5** | **5** | **1** | **15** |

| Associated companies and other investments | Associated companies | Other investments | **Total** |
|---|---|---|---|
| **1.1.2011** | **4** | **6** | **10** |
| Additions | – | – | – |
| Disposals | – | – | – |
| **31.12.2011** | **4** | **6** | **10** |
| **1.1.2012** | **4** | **6** | **10** |
| Additions | – | – | – |
| Disposals | –1 | –2 | –3 |
| **31.12.2012** | **3** | **4** | **7** |

These consolidated 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 individual financial statements for the period ended 31 December 2012.

The effects of the contractual relations between the Group companies and the subsidiaries which are not consolidated are set out in the consolidated financial statements. The pooled results of the subsidiaries, which have not been consolidated in view of their minor significance, are less than €2 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 less than 0.1% of the Group total assets. The shares in the non-consolidated companies are shown as AfS financial investments.

pbb holds 100% of the interest in DEPFA Finance N.V., Amsterdam. As the majority of risks and rewards is held Group-externally pbb has not to consolidate the special-purpose entity.

In 2012, pbb Group has simplified the corporate structure. Primarily for this reason it came to the following changes in consolidation:

The company Hypo Real Estate Capital Singapore Corp. Private Ltd. (in liquidation), Singapore, a previously consolidated 100 % subsidiary of pbb, was liquidated effective 2 March 2012. The liquidation did not result in any impacts on the development in earnings, assets and financial position of pbb Group because the subsidiary had no assets or liabilities on the date of liquidation.

The special-purpose vehicle Hayabusa GK, Tokyo, was initially consolidated on 2 July 2012. The wholly owned subsidiary of Hypo Real Estate Capital Japan Corp., Tokyo, acquired a salvage acquisition for € 102 million in Japan on 31 August 2012. The carrying amount of the salvage acquisition was € 89 million as at the balance sheet date. The planned-sale is part of a hands-free process, in which pbb Group relies on its business relations or an arranger.

pbb Services GmbH, Munich, a previously fully consolidated subsidiary of pbb, was merged with the parent company as a result of the merger agreement of 7 August 2012. The merger has not had any impact on the net assets, financial position and results of operations of the pbb Group.

Hypo Real Estate Capital Hong Kong Corp. Ltd. i.L., Hong Kong, a previously fully consolidated wholly owned subsidiary of pbb, was liquidated with effect from 17 October 2012. The liquidation has not had any impact on the net assets, financial position and results of operations of the pbb Group, because the Company did not have any assets and liabilities at the time of the liquidation.

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

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

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

## 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** pbb 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.

The purchases or sales of financial instruments are recognised on the trade date. Premiums and discounts are recognised in accordance with the accrual concept 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 pbb 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.

Collaterals with the same counterparty and same conditions (e.g. ISDA frame contract) are netted according to IAS 32.34 and thus disclosed as a net amount.

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

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

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

Held-for-trading financial instruments are measured at fair value. Changes in fair value are recognised in profit or loss. Held-for-trading financial instruments are disclosed as trading assets and trading liabilities. Interest and dividend income as well as the refinancing costs for the held-for-trading instruments are recognised in net 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. In the financial years 2012 and 2011 there were no material day one profits.

Designated at Fair Value through Profit or Loss (dFVTPL) If certain conditions are satisfied, financial assets or liabilities can be classified as a financial asset respectively a financial liability at fair value through profit or loss when they are initially recognised. A designation can be made if the use of the measurement category means that a recognition and measurement inconsistency is either avoided or considerably reduced, and management and performance measurement of a portfolio of financial instruments are based on the fair values or if the instrument contains a separable embedded derivative. pbb Group classifies financial assets under the dFVTPL category only for the first case. As of 31 December 2012, only the fixed-income security is held in the category dFVTPL. Financial receivables and 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 into the category dFVTPL will avoid inconsistency in terms of measurement. As a result of the designation of fixed-income securities, the opposite movements relating to the hedged risk in the income statement cancel each other to a large extent. The accounting treatment is accordingly consistent with risk management and the investment strategy.

dFVTPL financial instruments are measured at fair value. Changes in fair value are recognised in profit or loss. Because financial liabilities are not designated into the category dFVTPL, pbb 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. Interest income from the securities 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 that an entity has the positive intention and ability to hold to maturity. HtM financial investments are measured at amortised cost. In financial years 2012 and 2011, no financial assets were classified as HtM at pbb Group.

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

Loans and receivables are recognised in the positions loans and advances to banks, loans and advances to customers and financial investments, and are measured at amortised cost. Interest income from loans and receivables is recognised in net interest 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. pbb Group only classifies securities as AfS but not loans and advances.

AfS financial assets are measured at fair value. Changes in fair value are recognised in a separate item of equity (AfS reserve) not affecting profit or loss until the asset is sold, withdrawn or otherwise disposed 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. In the statement of financial position, stand-alone derivatives are disclosed as trading assets and trading liabilities. Hedging derivatives are disclosed as other assets and other liabilities.

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

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

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

**Impairment** According to IAS 39.58 a financial asset must be tested for impairment. At each balance sheet date pbb Group assesses on a case-by-case basis whether there is objective evidence for impairment. The criteria used to determine if there is such objective evidence included:
> significant financial difficulties of the borrower
> overdue contractual payments of either principal or interest or other breaches of contract
> becoming probable that the borrower will enter bankruptcy or other financial reorganisation
> renegotiations due to economic problems
> the market price of the asset if available

Loans with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position, where the Group has made concessions. Loans, which have been restructured with renegotiated terms, due to deterioration in the borrower's financial position, the Group has partly granted special conditions by agreeing to terms and conditions that are more favourable for the borrower than the Group has provided initially. The Group implements a forbearance policy, respectively restructuring agreements in order to maximise collection opportunities and minimise the risk of default. Under the Group's forbearance policy respectively restructuring agreement, loan forbearance or loan extension is granted on a selective basis in a situation where the debtor is currently in default on its debt, or where there is a high risk of default, there is evidence that the debtor made all reasonable effort to pay under the original contractual terms and it is expected to be able to meet the revised terms. The revised terms usually include extending maturity, changing timing of interest payments and amendments to the terms of loan covenants.

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.

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

To measure the impairment loss, the following factors are especially considered:
> pbb Group's aggregate exposure to the customer
> the amount and timing of expected interest and redemption payments
> the realisable value of collateral and likelihood 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.

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

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

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

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

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

The effective portion of the hedging instrument is recognised in a separate item of equity without any impact on profit or loss (cash flow hedge reserve). The inefficient portion of the hedging instrument is recognised in profit or loss in the net income from 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 is 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. At this point, the gains or losses have to be recognised in profit or loss. pbb Group uses a macro approach for cash flow hedge accounting.

Hedge of a Net Investment in a Foreign Operation A net investment hedge is a hedge of the foreign currency exposure on a net investment in a foreign operation. Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. pbb Group did not hedge a net investment in a foreign operation in the financial years 2012 and 2011.

## 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. 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. As of 31 December 2012, and as of 31 December 2011, pbb Group did not have loans and advances which are classified as AfS or dFVTPL.

Additions to allowances for losses on loans and advances are disclosed as a separate item provisions for losses in profit or loss. 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 (Risk Provisions)

Allowances for losses on loans and advances are recognised if there is objective evidence that it will not be possible for the entire amount which is due in accordance with the original contractual conditions to be recovered. Allowances for loans and advances are measured mainly on the basis of expectations with regard to loan defaults, the structure and quality of the loan portfolio as well as macroeconomic parameters on an 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 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 in economical hedge relationships and are recognised in net income from hedge relationships and disclosed in the 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 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 2012 and 2011, pbb 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**<br>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, brand names and customer relations are not activated.

Software is an intangible asset with a finite useful life. Purchased software is measured at amortised cost. pbb 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 annually or 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. Premiums and discounts are recognised on a pro rata basis. Interest-free liabilities are recognised with their present value. pbb Group has not designated any liabilities into the category dFVTPL. Changes in value resulting from hedge relationships are disclosed under net income from hedge relationships. 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 with an interest rate that reflects the current assessments of the time value of money and the risks specific to the liability.

Provisions for defined benefit plan 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.

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

In 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. The expected actuarial rate of return from plan assets derives from the expected long-term viability of reinsurances.

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

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

## 21 Silent Participation

Finanzmarktstabilisierungsfonds-FMS provided pbb with a silent participation of €1.0 billion deducted by transaction costs in 2009. The silent participation has an indefinite life. The silent shareholder participates in a cumulative loss to the extent of its silent deposit expressed as a percentage of the total carrying amount of all liability capital shares of the Bank which participate in a cumulative loss. The extent to which the silent shareholder participates in the cumulative loss is limited to its silent deposit. The cumulative loss attributable to the year 2008 is not taken into consideration for calculating the participation in the loss. The silent 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 2012 and as of 31 December 2011 no company of pbb 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 of the affiliated companies' single financial statements into the functional currency are generally recognised in profit or loss in balance of other operating income/expenses.

In this consolidated financial statement, balance sheet items of the subsidiaries, if they do not prepare financial statements in euros, are translated using the closing rates at the balance sheet date. For translating the expenses and income of these subsidiaries, the average rates are used. Differences resulting from the translation of the financial statements of the subsidiaries do not affect profit or loss and are disclosed in the 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 payout 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. An unchanged 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 2012 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 2012 and of 31 December 2011 pbb Group did not own non-current assets held for sale.

## 26 Accounting Estimates and Assumptions

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

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

**Allowances** The portfolio of pbb 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. Moreover, the methods for measurement of financial instruments are developed further on the market on a continuous basis. For example, in the financial year 2012, the measurement of secured derivatives was extended to include the bilateral credit value adjustment. This extended valuation now takes account of the credit risk of the respective counterparty and also the credit risk of pbb Group for the secured derivatives. The conversion process has resulted in an effect of €7 million recognised in the income statement. In addition, the methods for measuring financial instruments are continuously enhanced. For example, market conventions change for the measurement of derivatives especially by using overnight interest rate swap curves. Such adjustments can have negative effects on the income of pbb Group in 2013.

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

**Taxes on Income** pbb 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 10 d EStG, 8 c KStG as well as section 10 a 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.

## Segment Reporting

### 27 Notes to Segment Reporting by Operating Segment

pbb Group operates in the three operating segments Real Estate Finance, Public Sector Finance and Value Portfolio, which are used as the basis for managing the Group.

The presentation of the segments of pbb Group is based on internal reporting which is prepared in accordance with IFRS. Income and expenses are allocated to the segments in line with the principle of causation. The external net interest income of the Group is calculatively allocated to the segments.

**Real Estate Finance (REF)** The operating segment Real Estate Finance comprises all commercial real estate financing arrangements of the Group. New business focuses on financing existing properties with a conservative refinancing strategy. The customers are professional investors. Adequate batch sizes and loan-to-values commensurate for the level of risk involved are essential for independent operations. Strategic partnerships are agreed with other institutions with the aim of permitting higher loan-to-values and larger volumes for customers by means of syndications and syndicated financing arrangements.

**Public Sector Finance (PSF)** The operating segment Public Sector Finance comprises the financing arrangements for the public sector which are eligible as cover funds in accordance with German law. pbb Group will generate new business in public investment finance. No new business will be realised by pbb Group in public sector finance as pure budget financing. Concentrating on public investment finance is the aim. The target group for these activities are profitable customer segments with a commensurate risk level: regions, cities and municipalities as well as state-guaranteed public corporations and guaranteed public-private partnerships.

**Value Portfolio (VP)** The operating segment Value Portfolio mainly presents income and expenses from services of pbb Group to ongoing operation of FMS Wertmanagement as well as for IT services to its sister company DEPFA. Furthermore, the segment comprises non-strategic portfolios, e.g. selected structured products.

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

## 28 Income Statement, Broken Down by Operating Segment

| **Income/expenses**<br>in € million | | REF | PSF | VP | Consolidation & Adjustments | **pbb Group** |
|---|---|---|---|---|---|---|
| Operating revenues | 2012 | 264 | 47 | 147 | 9 | 467 |
| | 2011 | 274 | 63 | 168 | 21 | 526 |
| Net interest income and similar income | 2012 | 227 | 58 | 1 | 10 | 296 |
| | 2011 | 245 | 109 | – | 17 | 371 |
| Net commission income | 2012 | 25 | –1 | –1 | – | 23 |
| | 2011 | 37 | –3 | –2 | – | 32 |
| Net trading income | 2012 | 2 | 8 | – | – | 10 |
| | 2011 | –11 | –3 | 6 | – | –8 |
| Net income from financial investments | 2012 | 16 | –2 | –1 | – | 13 |
| | 2011 | 1 | 5 | –3 | – | 3 |
| Net income from hedge relationships | 2012 | –3 | –3 | – | – | –6 |
| | 2011 | –7 | –48 | –1 | – | –56 |
| Balance of other operating income/expenses | 2012 | –3 | –13 | 148 | –1 | 131 |
| | 2011 | 9 | 3 | 168 | 4 | 184 |
| Provisions for losses on loans and advances | 2012 | –5 | 4 | –3 | – | –4 |
| | 2011 | –1 | – | –11 | – | –12 |
| General administrative expenses | 2012 | 139 | 53 | 148 | 1 | 341 |
| | 2011 | 138 | 54 | 159 | 6 | 357 |
| Balance of other income/expenses | 2012 | –3 | –1 | –2 | – | –6 |
| | 2011 | 3 | 2 | 2 | – | 7 |
| **Pre-tax profit** | 2012 | **127** | **–11** | – | **8** | **124** |
| | 2011 | **140** | **11** | **22** | **15** | **188** |

| **Cost-income ratio**[1)]<br>in % | | REF | PSF | VP | **pbb Group** |
|---|---|---|---|---|---|
| Cost-income ratio (based on operating revenues) | 2012 | 52.7 | >100.0 | >100.0 | 73.0 |
| | 2011 | 50.4 | 85.7 | 94.6 | 67.9 |

[1)] The cost-income ratio is the ratio of general administrative expenses and operating revenues

## 29 Balance-sheet-related Measures, Broken Down by Operating Segment

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

| **Balance-sheet-related measures, broken down by operating segment** in € billion | | REF | PSF | VP | Consolidation & Adjustments | **pbb Group** |
|---|---|---|---|---|---|---|
| Equity[1] | 31.12.2012 | 1.0 | 1.4 | 0.0 | 0.9 | 3.3 |
| | 31.12.2011 | 1.2 | 1.0 | 0.1 | 0.9 | 3.2 |
| Risk-weighted assets[2][3] | 31.12.2012 | 9.6 | 5.0 | 0.2 | 0.5 | 15.3 |
| | 31.12.2011 | 11.8 | 4.1 | 0.5 | 0.6 | 17.0 |
| | 31.12.2011 | 12.1 | 4.3 | 0.6 | – | 17.0 |
| Financing volumes | 31.12.2012 | 22.1 | 35.4 | 0.9 | – | 58.4 |
| | 31.12.2011 | 23.5 | 44.0 | 1.1 | – | 68.6 |

[1] Excluding revaluation reserve
[2] Including risk-weighted credit risk positions as well as the capital requirements for market risk positions and operational risks scaled with the factor 12.5; according to Basel II advanced IRB approach for authorised portfolios, otherwise Basel II standardised approach; pro forma as per prepared annual financial statements and after result distribution
[3] The segmentation of risk-weighted assets was changed in the year 2012. In the new segmentation Consolidation & Adjustments contains risk-weighted assets of the asset liability management. The figures of the year 2011 are disclosed according to the new and former segmentation pursuant to IFRS 8.29

## 30 Breakdown of Operating Revenues

**Operating Revenues by Products** Operating revenues from other products mainly contained a balance of other operating income/expenses for the servicing for the ongoing operation of FMS Wertmanagement and for IT services to the sister company DEPFA totalling €146 million (2011: €144 million).

| **Operating revenues by products** in € million | | Commercial real estate financing | Public sector financing | Other products | **pbb Group** |
|---|---|---|---|---|---|
| Operating revenues | 2012 | 264 | 47 | 156 | **467** |
| | 2011 | 274 | 63 | 189 | **526** |

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

| **Operating revenues by regions** in € million | | Germany | Rest of Europe | America/Asia | **pbb Group** |
|---|---|---|---|---|---|
| Operating revenues | 2012 | 473 | 17 | –23 | 467 |
| | 2011 | 488 | 38 | – | 526 |

**Operating Revenues by Customers** A balance of other operating income/expenses of €106 million (2011: €109 million) recognised in the Value Portfolio segment resulted from services for the ongoing operation of FMS Wertmanagement. Because this position accounts for more than 10% of all operating revenues of pbb Group, FMS Wertmanagement is a major client in accordance with IFRS 8.34. The balance of other operating income/expenses compensates for the expenses of the pbb Group incurred in connection with servicing.

## Notes to the Consolidated Income Statement

### 31 Net Interest Income and Similar Income

| Net interest income and similar income, broken down by categories of income/expenses<br>in € million | 2012 | 2011 |
|---|---|---|
| **Interest income and similar income** | **2,879** | **3,691** |
| Lending and money-market business | 1,557 | 2,141 |
| Fixed-income securities and government-inscribed debt | 869 | 971 |
| Investments | 2 | – |
| Current result from swap transactions (balance of interest income and interest expenses) | 451 | 579 |
| **Interest expenses and similar expenses** | **2,583** | **3,320** |
| Liabilities to other banks and customers | 604 | 1,014 |
| Liabilities evidenced by certificates | 1,884 | 2,182 |
| Subordinated capital | 95 | 124 |
| **Total** | **296** | **371** |

Total interest income for financial assets that are measured at amortised cost, amount to € 2.4 billion (2011: € 3.1 billion). Total interest expenses for financial liabilities that are not measured at fair value through profit or loss amount to € 2.6 billion (2011: € 3.3 billion).

### 32 Net Commission Income

| Net commission income<br>in € million | 2012 | 2011 |
|---|---|---|
| Securities and custodial services | −2 | −3 |
| Lending operations and other service operations | 25 | 35 |
| **Total** | **23** | **32** |

Net commission income is attributable exclusively to financial assets and financial liabilities which are not designated at fair value through profit or loss.

## 33 Net Trading Income

| Net trading income<br>in € million | 2012 | 2011 |
|---|---|---|
| From interest rate instruments and related derivatives | 8 | –12 |
| From credit risk instruments and related derivatives | – | 6 |
| From foreign currency instruments and related derivatives | 2 | –2 |
| **Total** | **10** | **–8** |

## 34 Net Income From Financial Investments

| Net income from financial investments<br>in € million | 2012 | 2011 |
|---|---|---|
| Income from financial investments | 22 | 10 |
| Expenses from financial investments | 9 | 7 |
| **Total** | **13** | **3** |

Net income from financial investments consists of income from the sale of securities of the measurement categories AfS and LaR together with changes in the value of such instruments that are to be recognised in profit or loss. HtM investments were not held in 2012 and 2011. Based on measurement categories, net income from financial investments is broken down as follows:

| Net income from financial investments by IAS 39 categories<br>in € million | 2012 | 2011 |
|---|---|---|
| AfS financial investments | 14 | 3 |
| LaR financial investments | –1 | – |
| **Total** | **13** | **3** |

## 35 Net Income from Hedge Relationships

| **Net income from hedge relationships**<br>in € million | **2012** | **2011** |
|---|---|---|
| Result from fair value hedge accounting | –6 | –19 |
| Result from hedged items | –450 | 169 |
| Result from hedging instruments | 444 | –188 |
| Result from dFVTPL investments and related derivatives | 2 | –37 |
| Result from dFVTPL investments | – | –39 |
| Result from derivatives related to dFVTPL investments | 2 | 2 |
| Ineffectiveness from cash flow hedge accounting affecting income | –2 | – |
| **Total** | **–6** | **–56** |

## 36 Balance of Other Operating Income/Expenses

| **Balance of other operating income/expenses**<br>in € million | **2012** | **2011** |
|---|---|---|
| Other operating income | 277 | 315 |
| Other operating expenses | 146 | 131 |
| **Balance of other operating income/expenses** | **131** | **184** |

The balance of other operating income/expenses from services for the ongoing operation of FMS Wertmanagement amounted to € 106 million (2011: € 109 million). Income from IT services to sister company DEPFA amounted to € 40 million (2011: € 35 million). Income from services for ongoing operation of FMS Wertmanagement compensated the corresponding general administrative expenses. In the financial year 2012, the bank levy resulted in expenses of € 24 million (2011: € 2 million), including a calculated annual contribution for 2012, as well as the subsequent amount. Net income resulting from foreign currency translation amounted to € 3 million (2011: € 7 million).

## 37 Provisions for Losses on Loans and Advances

| Provisions for losses on loans and advances<br>in € million | 2012 | 2011 |
|---|---|---|
| Provisions for losses on loans and advances | 1 | −2 |
| Additions | 66 | 68 |
| Releases | −65 | −70 |
| Provisions for contingent liabilities and other commitments | −4 | −9 |
| Additions | 4 | 2 |
| Releases | −8 | −11 |
| Recoveries from written-off loans and advances | −1 | −1 |
| **Total** | **−4** | **−12** |

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

## 38 General Administrative Expenses

| General administrative expenses<br>in € million | 2012 | 2011 |
|---|---|---|
| Personnel expenses | 131 | 129 |
| Wages and salaries | 104 | 101 |
| Social security costs | 19 | 19 |
| Pension expenses and related employee benefit costs | 8 | 9 |
| Non-personnel expenses | 210 | 228 |
| Other general administrative expenses | 197 | 215 |
| Consulting expenses | 57 | 50 |
| IT expenses | 102 | 121 |
| Office and operating expenses | 14 | 14 |
| Other administrative expenses | 24 | 30 |
| Depreciation/amortisation | 13 | 13 |
| On software and other intangible assets excluding goodwill | 12 | 11 |
| On property, plant and equipment | 1 | 2 |
| **Total** | **341** | **357** |

| Cost-income ratio<br>in % | 2012 | 2011 |
|---|---|---|
| Cost-income ratio | 73.0 | 67.9 |

## 39 Balance of Other Income/Expenses

| Balance of other income/expenses<br>in € million | 2012 | 2011 |
|---|---|---|
| Other income | 5 | 9 |
| thereof:<br>Releases of restructuring provisions | 5 | 9 |
| Other expenses | 11 | 2 |
| thereof:<br>Additions to restructuring provisions | 11 | 2 |
| **Balance of other income/expenses** | **–6** | **7** |

## 40 Taxes on Income

| Breakdown<br>in € million | 2012 | 2011 |
|---|---|---|
| Current taxes | –8 | 18 |
| Deferred taxes | 63 | 53 |
| thereof:<br>Deferred taxes on capitalised losses carried forward | 7 | 15 |
| **Total** | **55** | **71** |

Current taxes contain tax income for prior years of € –20 million (2011: € –5 million).

The following overview shows the development of the deferred taxes recognised in the financial statement.

| Development of deferred taxes<br>in € million | 2012 | 2011 |
|---|---|---|
| Deferred taxes recognised in the statement of financial position | –1 | 128 |
| Difference to prior year | –129 | 90 |
| thereof:<br>Recognised in income statement | –63 | –53 |
| Recognised in AfS reserve | –71 | 116 |
| Recognised in cash flow hedge reserve | 5 | 27 |

| Reconciliation<br>in € million | 2012 | 2011 |
|---|---|---|
| Net income/loss before taxes | 124 | 188 |
| Applicable (legal) tax rate in % | 15.83 | 15.83 |
| Expected (computed) tax expense | 20 | 30 |
| **Tax effects** | | |
| arising from foreign income | – | 3 |
| arising from tax rate differences | 26 | 23 |
| arising from tax-free income | – 1 | – |
| arising from deductible and non-deductible items | 15 | 16 |
| arising from valuation adjustments and non-application of deferred taxes | 7 | 3 |
| arising from prior years and other aperiodical effects | – 12 | – 5 |
| arising from other differences | – | 1 |
| **Reported taxes on income** | **55** | **71** |
| **Group tax ratio** in % | **44.3** | **37.7** |

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 currently 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 and dividends 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 periodical losses. We recognised no impairments on deferred tax assets which have been recorded last year on the basis of existing losses carried forward.

The item effects from previous years 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 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**<br>in € million | **2012** | **2011** |
|---|---|---|
| Loans and advances to other banks/customers (including loan loss allowances) | 27 | 11 |
| Financial investments | 13 | 39 |
| Trading assets | 536 | 192 |
| Other assets/liabilities | 1,041 | 1,031 |
| Others | 17 | 18 |
| **Deferred tax liabilities** | **1,634** | **1,291** |
| Loans and advances to other banks/customers (including loan loss allowances) | 9 | 6 |
| Financial investments | 144 | 225 |
| Provisions | 69 | 81 |
| Other assets/liabilities | 802 | 780 |
| Trading liabilities | 472 | 183 |
| Liabilities evidenced by certificates | 3 | 3 |
| Losses carried forward | 134 | 141 |
| **Deferred tax assets** | **1,633** | **1,419** |

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%). For pbb the tax rate for the valuation of deferred taxes is 28.00% (2011: 27.80%).

On the reporting date, there are unused losses carried forward totalling €3,649 million (2011: €3,560 million) at corporate tax level and €3,747 million (2011: €3,712 million) at trade tax level. Deferred tax assets have been stated as €447 million (2011: €481 million) at corporate tax level and €519 million (2011: €545 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 €3 million (2011: €5 million) were not recognised with deferred tax assets.

From the origination and reversal of temporary differences a deferred tax expense arose of €56 million (2011: €39 million).

A deferred tax income of €–1 million (2011: €–5 million) resulted from tax rate changes.

The current tax expense was not reduced by the use of previously unrecognised tax losses (2011: €0.2 million).

On differences associated with investments in subsidiaries, deferred tax liabilities in the amount of €173 million (2011: €634 million) has not been stated because it is the ability and the intention to invest profits permanently in these subsidiaries.

## 41 Net Gains/Net Losses

The income statement contains the following net gains/net losses recognised in profit or loss according to IFRS 7.20 (a):

| **Net gains/net losses**<br>in € million | **2012** | **2011** |
|---|---|---|
| Loans and receivables | 10 | 15 |
| Available for sale | 14 | 3 |
| Held for trading | 10 | –8 |
| Designated at fair value through profit or loss | – | –39 |
| Financial liabilities at amortised cost | 6 | 31 |

## Notes to the Consolidated Statement of Financial Position (Assets)

### 42 Cash Reserve

| Cash reserve<br>in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| Balance with central banks | 1,937 | 323 |
| **Total** | **1,937** | **323** |

Cash in hand as of 31 December 2012 amounts to less than € 1 million as was the case in the previous year.

### 43 Trading Assets

| Trading assets<br>in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| Positive fair values from derivative financial instruments | 3,325 | 9,818 |
| **Total** | **3,325** | **9,818** |

### 44 Loans and Advances to Other Banks

| Loans and advances to other banks, broken down by type of business<br>in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| Loans and advances | 5,092 | 6,886 |
| Public sector loans | 2,231 | 2,602 |
| Real estate loans | 52 | – |
| Other loans and advances | 2,809 | 4,284 |
| Investments | 2,903 | 746 |
| **Total** | **7,995** | **7,632** |

| Loans and advances to other banks, broken down by maturities<br>in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| Repayable on demand | 2,736 | 293 |
| With agreed maturities | 5,259 | 7,339 |
| up to 3 months | 3,016 | 4,890 |
| from 3 months to 1 year | 222 | 150 |
| from 1 year to 5 years | 891 | 1,032 |
| from 5 years and over | 1,130 | 1,267 |
| **Total** | **7,995** | **7,632** |

## 45 Loans and Advances to Customers

| Loans and advances to customers, broken down by type of business<br>in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| Loans and advances | 49,090 | 54,736 |
| Public sector loans | 19,139 | 21,725 |
| Real estate loans | 29,919 | 32,984 |
| Other loans and advances | 32 | 27 |
| Investments | 500 | 500 |
| **Total** | **49,590** | **55,236** |

| Loans and advances to customers, broken down by maturities<br>in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| With agreed maturities | 49,590 | 55,236 |
| up to 3 months | 4,008 | 3,608 |
| from 3 months to 1 year | 4,973 | 5,286 |
| from 1 year to 5 years | 21,595 | 20,326 |
| from 5 years and over | 19,014 | 26,016 |
| **Total** | **49,590** | **55,236** |

## 46 Allowances for Losses on Loans and Advances

| **Breakdown**<br>in € million | **31.12.2012** | **31.12.2011** |
|---|---|---|
| Individual allowances for losses on loans and advances to other banks | – | 17 |
| Individual allowances for losses on loans and advances to customers | 283 | 396 |
| Portfolio-based allowances | 42 | 64 |
| **Total** | **325** | **477** |

| **Development**<br>in € million | Individual allowances | Portfolio-based allowances | **Total** |
|---|---|---|---|
| **Balance at 1.1.2011** | **460** | **101** | **561** |
| Changes affecting income | 12 | –23 | –11 |
| Gross additions | 54 | 14 | 68 |
| Releases | –33 | –37 | –70 |
| Increase of the present value due to passage of time (unwinding) | –9 | – | –9 |
| Changes not affecting income | –59 | –14 | –73 |
| Use of existing loan-loss allowances | –87 | –14 | –101 |
| Effects of currency translations and other changes not affecting income | 28 | – | 28 |
| **Balance at 31.12.2011** | **413** | **64** | **477** |
| **Balance at 1.1.2012** | **413** | **64** | **477** |
| Changes affecting income | 15 | –22 | –7 |
| Gross additions | 48 | 18 | 66 |
| Releases | –25 | –40 | –65 |
| Increase of the present value due to passage of time (unwinding) | –8 | – | –8 |
| Changes not affecting income | –145 | – | –145 |
| Use of existing loan-loss allowances | –145 | – | –145 |
| Effects of currency translations and other changes not affecting income | – | – | – |
| **Balance at 31.12.2012** | **283** | **42** | **325** |

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

## 47 Financial Investments

| Breakdown<br>in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| AfS financial investments | 3,920 | 3,916 |
| Shares in non-consolidated subsidiaries | 1 | 1 |
| Debt securities and other fixed-income securities | 3,917 | 3,913 |
| Equity securities and other variable-yield securities | 2 | 2 |
| dFVTPL financial investments | 83 | 148 |
| Debt securities and other fixed-income securities | 83 | 148 |
| LaR financial investments | 21,569 | 24,613 |
| Debt securities and other fixed-income securities | 21,569 | 24,613 |
| **Total** | **25,572** | **28,677** |

The carrying amounts of the LaR financial investments were reduced by portfolio-based allowances amounting to € –12 million (2011: € –7 million).

pbb 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 or due to a missing control respectively a missing significant influence. These companies in the legal form of limited or private are not traded in an active market. Therefore, the investments are measured at cost. The carrying amount of these financial investments amounted to € 1 million as of 31 December 2012 (2011: € 2 million). In financial year 2012, financial investments, for which it is not possible for the fair value to be reliably established, were derecognised for € 1 million (2011: € 1 million). This resulted in a profit of less than € 1 million.

| Financial investments, broken down by maturities<br>in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| Unspecified terms | 3 | 3 |
| With agreed maturities | 25,569 | 28,674 |
| Up to 3 months | 3,131 | 1,654 |
| From 3 months to 1 year | 1,507 | 1,500 |
| From 1 year to 5 years | 8,121 | 10,987 |
| From 5 years and over | 12,810 | 14,533 |
| **Total** | **25,572** | **28,677** |

pbb Group has made use of the IASB amendments to IAS 39 and IFRS 7, published on 13 October 2008, and reclassified financial assets. pbb 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.

pbb Group 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 €9.5 billion (2011: €8.7 billion) became due.

In the financial year 2012 securities with a reclassified carrying amount of €0.1 billion (2011: €0.1 billion) were sold. Thereby a net profit of €6 million (2011: €6 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 and similar income.

The following tables summarise the carrying amounts and fair values as of 31 December 2012 and 31 December 2011 as well as fair value gains and losses that would have been recognised in 2012 and 2011 if the financial assets had not been reclassified.

| **Reclassifications 2012** | into: Financial investment loans and receivables (LaR) | | | Effect in reporting period if no assets would have been reclassified (1.1.–31.12.2012) | |
|---|---|---|---|---|---|
| | | | **31.12.2012** | | |
| | 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 | 10.9 | 10.5 | 5 | 187 |

| **Reclassifications 2011** | into: Financial investment loans and receivables (LaR) | | | Effect in reporting period if no assets would have been reclassified (1.1.–31.12.2011) | |
|---|---|---|---|---|---|
| | | | **31.12.2011** | | |
| | 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 | 12.1 | 11.3 | 8 | –309 |

## 48 Property, Plant and Equipment

| Breakdown<br>in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| Plant and operating equipment | 2 | 3 |
| **Total** | **2** | **3** |

| Development of property, plant and equipment<br>in € million | 2012 | 2011 |
|---|---|---|
| **Plant and operating equipment** | | |
| **Acquisition/production costs** | | |
| **Balance at 1.1.** | **19** | **21** |
| Changes in the group of consolidated companies | – | – |
| Changes from foreign currency translation | – | – |
| Additions | – | – |
| Reclassifications | – | – |
| Disposals | –1 | –2 |
| **Balance at 31.12.** | **18** | **19** |
| **Depreciation and write-ups** | | |
| **Balance at 1.1.** | **16** | **16** |
| Changes in the group of consolidated companies | – | – |
| Changes from foreign currency translation | – | – |
| Depreciation | 1 | 2 |
| Impairment losses | – | – |
| Write-ups | – | – |
| Reclassifications | – | – |
| Disposals | –1 | –2 |
| **Balance at 31.12.** | **16** | **16** |
| **Carrying amounts** | | |
| **Balance at 31.12.** | **2** | **3** |

## 49 Intangible Assets

| Breakdown<br>in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| Software acquired | 4 | 6 |
| Internally generated software | 34 | 21 |
| Other intangible assets | 1 | 8 |
| **Total** | **39** | **35** |

| Development of intangible assets | | | | 2012 | 2011 |
|---|---|---|---|---|---|
| in € million | Software acquired | Internally generated software | Other intangible assets | Total | Total |
| **Acquisition/production costs** | | | | | |
| **Balance at 1.1.** | **74** | **36** | **8** | **118** | **108** |
| Changes in the group of consolidated companies | – | – | – | – | – |
| Changes from foreign currency translation | – | – | – | – | – |
| Additions | 2 | 16 | – | 18 | 15 |
| Reclassifications | – | 7 | –7 | – | – |
| Disposals | – | –8 | – | –8 | –5 |
| **Balance at 31.12.** | **76** | **51** | **1** | **128** | **118** |
| **Amortisation and write-ups** | | | | | |
| **Balance at 1.1.** | **68** | **15** | – | **83** | **76** |
| Changes in the group of consolidated companies | – | – | – | – | – |
| Changes from foreign currency translation | – | – | – | – | – |
| Amortisation | 4 | 8 | – | 12 | 11 |
| Impairment losses | – | – | – | – | – |
| Write-ups | – | – | – | – | – |
| Reclassifications | – | – | – | – | – |
| Disposals | – | –6 | – | –6 | –4 |
| **Balance at 31.12.** | **72** | **17** | – | **89** | **83** |
| **Carrying amounts** | | | | | |
| **Balance at 31.12.** | **4** | **34** | **1** | **39** | **35** |

## 50 Other Assets

| Other assets<br>in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| Positive fair values from derivative financial instruments | 6,821 | 5,714 |
| Hedging derivatives | 6,821 | 5,714 |
| Fair value hedge | 5,819 | 4,800 |
| Cash flow hedge | 1,002 | 914 |
| Salvage acquisitions | 176 | 90 |
| Other assets | 238 | 254 |
| **Total** | **7,235** | **6,058** |

pbb Group acquired a salvage acquisition for € 102 million in Japan on 31 August 2012. The carrying amount of the salvage acquisition was € 89 million as at balance sheet date.

## 51 Income Tax Assets

| Income tax assets<br>in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| Current tax assets | 53 | 55 |
| Deferred tax assets | 1,633 | 1,419 |
| **Total** | **1,686** | **1,474** |

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.

## 52 Subordinated Assets

The balance sheet items does not contain subordinated assets.

## 53 Repurchase Agreements

As a pledgor of genuine repurchase agreements, pbb Group has pledged assets with a book value of € 0.5 billion (2011: € 2.3 billion). The securities are still recognised as assets. The considerations which have been received amount to € 0.4 billion (2011: € 2.2 billion) and are recognised as liabilities and thereof mainly as liabilities to other banks. Assets in repurchase agreements are the only transferable assets the acquirer can sell or repledge in the absence of default according to IAS 39.37 (a).

## 54 Securitisation

As of 31 December 2012 pbb Group has the synthetic securitisation Estate UK-3 with a transaction period of 15 years (maturity 2022) and a total volume of lending of € 449 million (2011: € 460 million) in the portfolio. The issuer of the transaction with commercial mortgage loans is pbb. The securitisation programme contains a first-loss piece totalling € 17 million (2011: € 18 million). Thereof risks are neither held by interest sub-participations nor by purchase of own junior tranches. Overall a reduction of expected loss according to Basel II of € 120 million (2011: € 118 million) was achieved.

# Notes to the Consolidated Statement of Financial Position (Equity and Liabilities)

## 55 Liabilities to Other Banks

**Liabilities to other banks, broken down by maturities**

| in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| Repayable on demand | 2,058 | 2,007 |
| With agreed maturities | 5,739 | 6,216 |
| Up to 3 months | 378 | 2,435 |
| From 3 months to 1 year | 311 | 786 |
| From 1 year to 5 years | 4,572 | 2,750 |
| From 5 years and over | 478 | 245 |
| **Total** | **7,797** | **8,223** |

## 56 Liabilities to Customers

**Liabilities to customers, broken down by maturities**

| in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| Repayable on demand | 962 | 841 |
| With agreed maturities | 10,933 | 11,522 |
| Up to 3 months | 736 | 675 |
| From 3 months to 1 year | 1,340 | 1,003 |
| From 1 year to 5 years | 5,910 | 5,526 |
| From 5 years and over | 2,947 | 4,318 |
| **Total** | **11,895** | **12,363** |

## 57 Liabilities Evidenced by Certificates

**Liabilities evidenced by certificates, broken down by type of business**

| in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| Debt securities issued | 28,761 | 31,634 |
| Mortgage bonds | 7,681 | 6,984 |
| Public sector bonds | 17,160 | 21,290 |
| Other debt securities | 3,414 | 3,246 |
| Money market securities | 506 | 114 |
| Registered notes issued | 23,789 | 23,404 |
| Mortgage bonds | 6,783 | 6,768 |
| Public sector bonds | 15,711 | 15,527 |
| Other debt securities | 1,295 | 1,109 |
| **Total** | **52,550** | **55,038** |

| Liabilities evidenced by certificates, broken down by maturities<br>in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| With agreed maturities | | |
| Up to 3 months | 6,202 | 4,266 |
| From 3 months to 1 year | 4,125 | 4,767 |
| From 1 year to 5 years | 17,874 | 20,980 |
| From 5 years and over | 24,349 | 25,025 |
| **Total** | **52,550** | **55,038** |

## 58 Trading Liabilities

| Trading liabilities<br>in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| Negative fair values from derivative financial instruments | 3,192 | 9,903 |
| **Total** | **3,192** | **9,903** |

## 59 Provisions

| Breakdown<br>in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| Provisions for pension and similar obligations | – | 2 |
| Restructuring provisions | 71 | 68 |
| Provisions for contingent liabilities and other commitments | 17 | 20 |
| Other provisions | 76 | 73 |
| thereof:<br>Long-term liabilities to employees | 3 | 3 |
| **Total** | **164** | **163** |

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

For the multitude of employees in Germany 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. In the case of active employees there are predominantly modern modular pension plans. Pension provisions are created for obligations arising from direct commitments. The defined benefit 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 (2011: € 3 million). The expectations for 2013 are in the same range. The employer's contribution for the statutory pension insurance amounted to € 8 million in the year 2012 (2011: € 7 million).

| **Discount rates and valuation parameters**<br>in % | **31.12.2012/ 1.1.2013** | **31.12.2011/ 1.1.2012** |
|---|---|---|
| Discount rate | 3.25 | 4.75 |
| Expected return from plan assets | 4.00[1] | 4.25 |
| 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 |

[1] For periods beginning on or after 1 January 2013 IAS 19 (revised 2011) will have to be applied. As per this standard the net interest method is relevant.

The rate of increase over career amounts for members of the Management Board 0.0 % (2011: 0.0 %), for directors and non-pay-scale staff 1.5 % (2011: 1.5 %) and for pay-scale staff 0.5 % (2011: 0.5 %). The guidance tables 2005 G from Klaus Heubeck were used as the biometric basis.

As of 1 January 2005, pbb 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 the expected return including profit participation of the insurer.

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**<br>in € million | **31.12.2012** | **31.12.2011** | **31.12.2010** | **31.12.2009** | **31.12.2008** |
|---|---|---|---|---|---|
| Present value of partly funded pension obligations | 261 | 215 | 217 | 204 | 143 |
| Fair value of plan assets | –197 | –199 | –198 | –198 | –195 |
| **Funding status** | **64** | **16** | **19** | **6** | **–52** |
| Outstanding actuarial profit (+)/loss (–) | –64 | –14 | –14 | –1 | – |
| Outstanding past service cost | – | – | – | – | – |
| **Net of balance sheet value** | **–** | **2** | **5** | **5** | **–52** |
| thereof:<br>Capitalised excess cover of plan assets | – | – | – | – | 52 |
| Pensions provisions recognised | – | 2 | 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 exceeded as of 31 December 2012. For periods beginning on or after 1 January 2013 IAS 19 (revised 2011) will hereto be applied. As per this standard the corridor method is not allowed anymore. Instead, actuarial gains and losses have to be shown in equity. Movements in pension obligations are shown below:

| Development of pension obligations<br>in € million | 2012 | 2011 |
|---|---|---|
| **Balance at 1.1.** | **215** | **217** |
| Changes in the group of consolidated companies | – | – |
| Transfer of staff | – | – |
| Pensions claims vested | 1 | 1 |
| Interest expense | 10 | 9 |
| Actuarial profit (–)/loss (+) | 49 | – |
| Payments to beneficiaries | –14 | –12 |
| **Balance at 31.12.** | **261** | **215** |

The new arisen actuarial loss in 2013 is mainly due to the reduction in the discount rate which, in accordance with IAS 19, has to be linked to the long-term rate for prime fixed-income corporate bonds.

The experience-based adjustment of pension claims (profit [–]/loss [+]) amounts on 31 December 2012 to 1% (2011: 0%; 2010: 0%; 2009: –2%, 2008: 0%) of the corresponding present value of pension claims vested.

Pension expenses are broken down as follows:

| Breakdown of pension expenses<br>in € million | 2012 | 2011 |
|---|---|---|
| Present value of pension claims vested | 1 | 1 |
| Interest expense | 10 | 9 |
| Expected return from plan assets | –8 | –8 |
| Past service cost | – | – |
| Actuarial losses recognised as expense | – | – |
| **Total** | **3** | **2** |

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. For 2013 there are no contributions to plan assets expected. Developments in plan assets are as follows:

| **Development of plan assets**<br>in € million | **2012** | **2011** |
|---|---|---|
| **Balance at 1.1.** | **199** | **198** |
| Changes in the group of consolidated companies | – | – |
| Transfer of staff | – | – |
| Expected return from plan assets | 8 | 8 |
| Outstanding actuarial profit (+)/loss (–) | –1 | – |
| Payments to beneficiaries | –9 | –7 |
| **Balance at 31.12.** | **197** | **199** |

The actual return from the plan assets amounts to € 7 million (2011: € 8 million) in the reporting period.

| **Development of provisions (without provisions for pension and similar obligations)**<br>in € million | Restructuring provisions | Provisions for contingent liabilities and other commitments | Other provisions |
|---|---|---|---|
| **Balance at 1.1.2011** | **83** | **34** | **54** |
| Additions | 2 | 3 | 62 |
| Reversals | –9 | –11 | –11 |
| Increase of the present value due to passage of time (unwinding) | 2 | – | – |
| Amounts used | –11 | –6 | –25 |
| Reclassifications | 1 | – | –7 |
| **Balance at 31.12.2011** | **68** | **20** | **73** |
| | | | |
| **Balance at 1.1.2012** | **68** | **20** | **73** |
| Additions | 11 | 11 | 47 |
| Reversals | –5 | –8 | –15 |
| Increase of the present value due to passage of time (unwinding) | 4 | – | 1 |
| Amounts used | –7 | –5 | –31 |
| Reclassifications | – | –1 | 1 |
| **Balance at 31.12.2012** | **71** | **17** | **76** |

On 19 December 2008 the Management Board and Supervisory Board of pbb Group decided upon the strategic realignment and restructuring of the Group. A restructuring provision amounting to € 120 million was created for obligations relating to the strategic realignment and restructuring in the fourth quarter 2008. In the financial year 2012 € 7 million (2011: € 11 million) were used of this provision. The restructuring provision will probably be completely utilised by the year 2024.

The target structure of the pbb Group was further specified in the fourth quarter of 2012 as part of the strategic refocusing process. Necessary measures, such as termination of servicing for FMS Wertmanagement, the organisational segregation from the affiliated DEPFA Group and European focusing will result in a lower personnel requirement. The employees' representatives and employees themselves have been notified of the planned measures in Company meetings. A new social plan package has been agreed with the employees' representatives. The adjustment to the personnel requirement planned in future has resulted in the need for a figure of € 11 million to be added to the restructuring provision.

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

The other provisions comprise provisions for litigation costs amounting to € 11 million (2011: € 12 million), provisions in connection with town planning agreements of € 9 million (2011: € 9 million) and provisions for long-term liabilities with regard to employees of € 3 million (2011: € 3 million). Additionally, in connection with the transfer of positions to FMS Wertmanagement provisions amounting to € 2 million (2011: € 8 million) are included in other provisions.

**Legal and Arbitration Proceedings** In all jurisdictions in which it carries out its operations, pbb Group is obliged to comply with numerous legal and regulatory requirements and regulations, including certain codes of conduct for avoiding conflicts of interest, combating money laundering, preventing the financing of terrorism, preventing criminal actions and for safeguarding banking, business and data secrecy. In view of the nature and international scope of its business operations and the wide range of relevant requirements and regulations, pbb Group is involved in court, arbitration and regulatory proceedings in several countries. These cases also include proceedings in which the amount of claims of persons who are enforcing corresponding claims is not quantified. pbb Group creates provisions for the uncertain liabilities arising from these proceedings if the potential outflow of resources is sufficiently probable and if the extent of the obligation can be estimated. The probability of the outflow of resources, which, however, generally cannot be estimated with certainty, very much depends on the outcome of the proceedings. The assessment of the probability and quantification of the uncertain liability mainly depends on assessments. The actual liability may differ considerably from this original assessment. With regard to the accounting treatment of the individual cases, pbb Group analyses the developments of the individual proceedings as well as of comparable proceedings and, depending on the significance and difficulty of the specific case, relies on its own expertise or appraisals of external advisors, and in particular legal advisors.

As contractually agreed, pbb has received compensation of € 6 million for a completely repaid French financing arrangement. The customer has instituted legal proceedings before the commercial court of Paris for repayment of the fee, which is alleged to be unreasonable.

The cumulative losses shown in the balance sheet since 2008 and also the annual net losses which have occurred at pbb have meant that the profit-sharing certificates issued by the predecessor institutions of pbb have suffered considerable shares in losses. No interest has accordingly been paid out. Legal proceedings are pending with regard to the various different clauses relating to the participation in losses and the reinstatement of previous distributions which had not been made. In consequence, this may result in an increase and also a further reduction of the repayment claims of the former holders of the profit-participating certificates.

None of the other pending proceedings has a quantified value in dispute of more than € 5 million, or is otherwise of material significance for pbb Group.

## 60 Other Liabilities

| Other liabilities<br>in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| Negative fair values from derivative financial instruments | 6,230 | 5,829 |
| Hedging derivatives | 6,227 | 5,812 |
| Fair value hedge | 5,515 | 5,046 |
| Cash flow hedge | 712 | 766 |
| Derivatives hedging dFVTPL financial instruments | 3 | 17 |
| Other liabilities | 8,208 | 10,294 |
| **Total** | **14,438** | **16,123** |

The largest single item of other liabilities is a liability to FMS Wertmanagement as compensation for assets which were not transferred for legal reasons. 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.

## 61 Income Tax Liabilities

| Income tax liabilities<br>in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| Current tax liabilities | 64 | 82 |
| Deferred tax liabilities | 1,634 | 1,291 |
| **Total** | **1,698** | **1,373** |

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 reserve or cash flow hedge reserve.

## 62 Subordinated Capital

| Breakdown<br>in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| Subordinated liabilities | 1,689 | 2,208 |
| Participating certificates outstanding | – | 6 |
| Hybrid capital instruments | 304 | 287 |
| **Total** | **1,993** | **2,501** |

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<br>in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| With agreed maturities | | |
| Up to 3 months | 89 | 99 |
| From 3 months to 1 year | 502 | 416 |
| From 1 year to 5 years | 430 | 947 |
| From 5 years and over | 972 | 1,039 |
| **Total** | **1,993** | **2,501** |

The appreciation of some instruments of subordinated capital led to an expense of € –17 million in the year 2012 (2011: € –17 million).

**Participating Certificates Outstanding** Issued participatory capital comprises the following issues:

| Participating certificates outstanding<br>in € million | Year of issue | Type | Nominal amount in € million | Interest rate in % | Maturity |
|---|---|---|---|---|---|
| pbb | 1989 | Registered participation certificate | 10 | 8.000 | 2014 |

The participating certificates which matured on 31 December 2012 were disclosed in other liabilities.

The interest claim 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 net loss or balance sheet loss for the year through a reduction in their repayment entitlements.

**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. More over, hybrid capital can be issued both with unlimited maturity and repayable in the long term.

## 63 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 Finanzmarktstabilisierungsfonds-FMS 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 2012 and during the entire financial year 2012 amounts to € 380,376,059.67 which is divided into 134,475,308 ordinary bearer shares in the form of no-par-value shares representing a theoretical interest in the share capital of € 2.83 per no-par-value share. HRE Holding holds 100 % of the share capital of pbb. Finanzmarktstabilisierungsfonds-FMS is the only shareholder of HRE Holding. At 31 December 2012 and 31 December 2011 there was neither authorised capital nor conditional capital.

In the year 2009 Finanzmarktstabilisierungsfonds-FMS provided pbb 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 2012, the silent contribution was reduced by € 53 million to € 129 million (2011: by € 103 million to € 182 million) in the commercial law financial statements of pbb. pbb has a replenishment obligation.

## 64 Foreign-currency Assets and Liabilities

| **Foreign-currency assets and liabilities**<br>in € million | **31.12.2012** | **31.12.2011** |
|---|---|---|
| Foreign-currency assets | 9,225 | 19,058 |
| thereof:<br>USD | 1,530 | 4,790 |
| JPY | 1,072 | 2,026 |
| CHF | 1,638 | 3,148 |
| SEK | 1,583 | 2,811 |
| GBP | 3,042 | 5,927 |
| Others | 360 | 356 |
| Foreign-currency liabilities (excluding own funds) | 9,318 | 18,838 |
| thereof:<br>USD | 1,604 | 4,795 |
| JPY | 1,088 | 1,750 |
| CHF | 1,643 | 3,147 |
| SEK | 1,583 | 2,810 |
| GBP | 3,080 | 6,000 |
| Others | 320 | 336 |

## 65 Trust Business

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

| Trust assets<br>in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| Loans and advances to customers | 3 | 15 |
| **Total** | **3** | **15** |

| Trust liabilities<br>in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| Liabilities to other banks | – | 8 |
| Liabilities to customers | 3 | 7 |
| **Total** | **3** | **15** |

## Notes to the Consolidated Statement of Cash Flows

### 66 Notes to the Items in the Consolidated Statement of Cash Flows

The consolidated statement of cash flows shows the cash flows of the financial year broken down 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 2012 and 2011, no company was purchased or sold.

### Notes to the Financial Instruments

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

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

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

| **Volume of derivatives at 31 December 2012** | 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 | 20,452 | 51,772 | 48,664 | 120,888 | 10,026 | 9,325 |
| Interest rate swaps | 18,691 | 48,893 | 48,648 | 116,232 | 10,012 | 9,308 |
| Interest rate options | 1,761 | 2,879 | 23 | 4,663 | 14 | 17 |
| Call options | 872 | 1,392 | 6 | 2,270 | 14 | – |
| Put options | 889 | 1,487 | 17 | 2,393 | – | 17 |
| **Total** | **20,452** | **51,772** | **48,671** | **120,895** | **10,026** | **9,325** |
| **Foreign-currency-based transactions** | | | | | | |
| OTC products | 4,968 | 479 | 607 | 6,054 | 120 | 97 |
| Spot and forward currency transactions | 4,838 | 38 | – | 4,876 | 23 | 24 |
| Interest rate/currency swaps | 130 | 441 | 607 | 1,178 | 97 | 73 |
| Exchange-traded products | – | – | – | – | – | – |
| Currency options | – | – | – | – | – | – |
| **Total** | **4,968** | **479** | **607** | **6,054** | **120** | **97** |
| **Total** | **25,420** | **52,251** | **49,278** | **126,949** | **10,146** | **9,422** |

| **Use made of derivative transactions at 31 December 2012**<br>in € million | Nominal amount | Fair value positive | Fair value negative |
|---|---|---|---|
| **Interest-based transactions** | | | |
| Fair value hedge accounting | 61,019 | 5,819 | 5,515 |
| Cash flow hedge accounting | 11,017 | 919 | 654 |
| Derivatives hedging dFVTPL financial instruments | 80 | – | 3 |
| Stand-alone derivatives | 48,779 | 3,288 | 3,153 |
| **Total** | **120,895** | **10,026** | **9,325** |
| **Foreign-currency-based transactions** | | | |
| Fair value hedge accounting | – | – | – |
| Cash flow hedge accounting | 667 | 83 | 58 |
| Stand-alone derivatives | 5,387 | 37 | 39 |
| **Total** | **6,054** | **120** | **97** |
| **Total** | **126,949** | **10,146** | **9,422** |

| **Volume of derivatives at 31 December 2011** | 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 | 43,352 | 117,814 | 85,364 | 246,530 | 15,135 | 15,180 |
| Interest rate swaps | 41,167 | 114,471 | 85,339 | 240,977 | 15,115 | 15,138 |
| Interest rate options | 2,185 | 3,343 | 25 | 5,553 | 20 | 42 |
| Call options | 1,009 | 1,621 | 7 | 2,637 | 20 | – |
| Put options | 1,176 | 1,722 | 18 | 2,916 | – | 42 |
| **Total** | **43,352** | **117,814** | **85,364** | **246,530** | **15,135** | **15,180** |
| **Foreign-currency-based transactions** | | | | | | |
| OTC products | 7,861 | 5,619 | 1,377 | 14,857 | 395 | 548 |
| Spot and forward currency transactions | 6,110 | 198 | – | 6,308 | 34 | 190 |
| Interest rate/currency swaps | 1,751 | 5,421 | 1,377 | 8,549 | 361 | 358 |
| Exchange-traded products | – | 26 | – | 26 | 2 | 2 |
| Currency options | – | 26 | – | 26 | 2 | 2 |
| **Total** | **7,861** | **5,645** | **1,377** | **14,883** | **397** | **550** |
| **Total** | **51,213** | **123,459** | **86,741** | **261,413** | **15,532** | **15,730** |

| **Use made of derivative transactions at 31 December 2011** in € million | Nominal amount | Fair value positive | Fair value negative |
|---|---|---|---|
| **Interest-based transactions** | | | |
| Fair value hedge accounting | 67,366 | 4,798 | 5,033 |
| Cash flow hedge accounting | 13,322 | 808 | 674 |
| Derivatives hedging dFVTPL financial instruments | 185 | – | 17 |
| Stand-alone derivatives | 165,657 | 9,529 | 9,456 |
| **Total** | **246,530** | **15,135** | **15,180** |
| **Foreign-currency-based transactions** | | | |
| Fair value hedge accounting | 72 | 2 | 13 |
| Cash flow hedge accounting | 867 | 106 | 92 |
| Stand-alone derivatives | 13,944 | 289 | 445 |
| **Total** | **14,883** | **397** | **550** |
| **Total** | **261,413** | **15,532** | **15,730** |

| **Counterparties** | **31.12.2012** Fair value | | **31.12.2011** Fair value | |
|---|---|---|---|---|
| in € million | positive | negative | positive | negative |
| OECD banks | 8,121 | 8,800 | 9,707 | 12,000 |
| OECD financial institutions | 1,090 | 572 | 5,256 | 3,679 |
| Other companies and private individuals | 935 | 50 | 569 | 51 |
| **Total** | **10,146** | **9,422** | **15,532** | **15,730** |

## 68 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 | **31.12.2012** | **31.12.2011** |
|---|---|---|
| Up to 1 month | – | 5 |
| From 1 month to 3 months | – | 6 |
| From 3 months to 1 year | 2 | 12 |
| From 1 year to 2 years | −3 | 21 |
| From 2 years to 5 years | 13 | 66 |
| From 5 years and over | 312 | 173 |
| **Total** | **324** | **283** |

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

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

## 69 Undiscounted Cash Flows of Financial Liabilities

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

| Contractual undiscounted cash flows of the financial liabilities according to IFRS 7.39<br>in € billion | 31.12.2012 | 31.12.2011 |
|---|---|---|
| Up to 3 months | 8 | 9 |
| From derivative financial instruments | 1 | 1 |
| From non-derivative financial instruments | 7 | 8 |
| From 3 months to 1 year | 9 | 12 |
| From derivative financial instruments | 1 | 2 |
| From non-derivative financial instruments | 8 | 10 |
| From 1 year to 5 years | 38 | 45 |
| From derivative financial instruments | 4 | 8 |
| From non-derivative financial instruments | 34 | 37 |
| From 5 years and over | 46 | 54 |
| From derivative financial instruments | 4 | 5 |
| From non-derivative financial instruments | 42 | 49 |

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 pbb Group is described in the risk and opportunities report.

## 70 Assets Assigned or Pledged as Collateral for Own Liabilities

The following assets and received collaterals were assigned or pledged as collateral:

| **Liabilities**<br>in € million | **31.12.2012** | **31.12.2011** |
|---|---|---|
| Liabilities to other banks | 4,474 | 4,283 |
| **Total** | **4,474** | **4,283** |

The following assets were pledged as collateral for the above liabilities:

| **Assets pledged**<br>in € million | **31.12.2012** | **31.12.2011** |
|---|---|---|
| Loans and advances to customers | 232 | 517 |
| Financial investments | 5,775 | 6,433 |
| **Total** | **6,007** | **6,950** |

The assets pledged mainly resulted from repurchase agreements. The transactions were carried out at the normal standard terms for repurchase transactions and concluded on an arm's-length basis.

## 71 Collaterals Permitted to Resell or Repledge

As of 31 December 2012 and as of 31 December 2011 there were no collaterals that may be resold or repledged in the absence of default.

## 72 Transfer of Financial Assets

Transferred financial assets shall be derecognised if the derecognition criteria of IAS 39 were met. The derecognition concept of IAS 39 requires to derecognise financial assets, if risks and rewards were almost completely transferred.

However, the transferring party could retain a continuing involvement in derecognised assets. Normal representations and warranties in connection with the transfer, e.g. relating to fraud, good faith and fair dealings, do not represent a continuing involvement. pbb Group has no continuing involvement in transferred and derecognised financial assets, but renders the servicing for FMS Wertmanagement against compensation on an arm's-length basis. The transfer of the position is disclosed in the note Transfer of Positions to FMS Wertmanagement; the impacts of the transfer is disclosed in the note Relationship With Related Parties.

## 73 Fair Values of Financial Instruments

The recognised fair values of financial instruments according to IFRS 7 correspond to the amounts at which, in the opinion of pbb 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 the note Financial Instruments.

All financial assets and liabilities that are measured at fair value are grouped into the three fair value hierarchies by pbb Group. 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 December 2012**<br>in € million | **Total** | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| **Assets** | | | | |
| Financial assets at fair value through profit or loss | 9,227 | 83 | 9,065 | 79 |
| Trading assets | 3,325 | – | 3,324 | 1 |
| dFVTPL financial investments | 83 | 83 | – | – |
| Hedging derivatives | 5,819 | – | 5,741 | 78 |
| Financial assets at fair value not affecting profit or loss | 4,921 | 3,919 | 998 | 4 |
| AfS financial investments[1] | 3,919 | 3,919 | – | – |
| Cash flow hedge derivatives | 1,002 | – | 998 | 4 |
| **Total** | **14,148** | **4,002** | **10,063** | **83** |
| **Liabilities** | | | | |
| Financial liabilities at fair value through profit or loss | 8,710 | – | 8,706 | 4 |
| Trading liabilities | 3,192 | – | 3,190 | 2 |
| Hedging derivatives | 5,515 | – | 5,513 | 2 |
| Derivatives hedging dFVTPL financial instruments | 3 | – | 3 | – |
| Financial liabilities at fair value not affecting profit or loss | 712 | – | 712 | – |
| Cash flow hedge derivatives | 712 | – | 712 | – |
| **Total** | **9,422** | **–** | **9,418** | **4** |

[1] Excluding shares in non-consolidated subsidiaries

| Fair value hierarchy at 31 December 2011<br>in € million | Total | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| **Assets** | | | | |
| Financial assets at fair value through profit or loss | 14,766 | 148 | 14,569 | 49 |
| Trading assets | 9,818 | – | 9,818 | – |
| dFVTPL financial investments | 148 | 148 | – | – |
| Hedging derivatives | 4,800 | – | 4,751 | 49 |
| Financial assets at fair value not affecting profit or loss | 4,829 | 3,915 | 912 | 2 |
| AfS financial investments[1] | 3,915 | 3,915 | – | – |
| Cash flow hedge derivatives | 914 | – | 912 | 2 |
| **Total** | **19,595** | **4,063** | **15,481** | **51** |
| **Liabilities** | | | | |
| Financial liabilities at fair value through profit or loss | 14,966 | – | 14,947 | 19 |
| Trading liabilities | 9,903 | – | 9,902 | 1 |
| Hedging derivatives | 5,046 | – | 5,028 | 18 |
| Derivatives hedging dFVTPL financial instruments | 17 | – | 17 | – |
| Financial liabilities at fair value not affecting profit or loss | 766 | – | 766 | – |
| Cash flow hedge derivatives | 766 | – | 766 | – |
| **Total** | **15,732** | **–** | **15,713** | **19** |

[1] Excluding shares in non-consolidated subsidiaries

In the current reporting period, for several financial instruments quoted prices on active markets were no longer available due to changes in the market conditions. Nevertheless, the fair values of these financial instruments could be determined based on input data observable on the market. Hence, financial assets with a fair value of €1 million were reclassified from level 2 into level 3 of the fair value hierarchy. In the financial year 2012, there have been neither reclassifications from level 1 into level 2, nor reclassifications from level 2 in level 1.

The following tables present the changes in level 3 instruments for the financial years 2011 and 2012:

| **Changes in level 3 financial assets** | Financial assets at fair value through profit or loss | | Financial assets at fair value not affecting profit or loss | |
|---|---|---|---|---|
| in € million | Trading assets | Hedging derivatives | Cash flow hedge derivatives | **Total** |
| **Balance at 1.1.2011** | **8** | **18** | **33** | **59** |
| Comprehensive income | | | | |
| Income statement | – | –3 | – | –3 |
| Revaluation reserve | – | – | – | – |
| Purchases | – | 32 | – | 32 |
| Sales | – | – | –33 | –33 |
| Changes due to transfer to FMS Wertmanagement | – | – | – | – |
| Issues | – | – | – | – |
| Settlements | – | – | – | – |
| Transfers into Level 3 | – | 2 | 2 | 4 |
| Transfers out of Level 3 | –8 | – | – | –8 |
| **Balance at 31.12.2011** | **–** | **49** | **2** | **51** |
| **Balance at 1.1.2012** | **–** | **49** | **2** | **51** |
| Comprehensive income | | | | |
| Income statement | – | 30 | – | 30 |
| Revaluation reserve | – | – | 2 | 2 |
| Purchases | 1 | – | – | 1 |
| Sales | – | –2 | – | –2 |
| Changes due to transfer to FMS Wertmanagement | – | – | – | – |
| Issues | – | – | – | – |
| Settlements | – | – | – | – |
| Reclassification into Level 3 | – | 1 | – | 1 |
| Reclassification out of Level 3 | – | – | – | – |
| **Balance at 31.12.2012** | **1** | **78** | **4** | **83** |

| Changes in level 3 financial liabilities | Financial liabilities at fair value through profit or loss | | Financial liabilities at fair value not affecting profit or loss | |
|---|---|---|---|---|
| in € million | Trading liabilities | Hedging derivatives | Cash flow hedge derivatives | Total |
| **Balance at 1.1.2011** | **–253** | **–7** | **–** | **–260** |
| Comprehensive income | | | | |
| Income statement | 28 | –11 | – | 17 |
| Revaluation reserve | – | – | – | – |
| Purchases | – | – | – | – |
| Sales | 216 | – | – | 216 |
| Issues | – | – | – | – |
| Settlements | 8 | – | – | 8 |
| Transfers into Level 3 | – | – | – | – |
| Transfers out of Level 3 | – | – | – | – |
| **Balance at 31.12.2011** | **–1** | **–18** | **–** | **–19** |
| **Balance at 1.1.2012** | **–1** | **–18** | **–** | **–19** |
| Comprehensive income | | | | |
| Income statement | – | 9 | – | 9 |
| Revaluation reserve | – | – | – | – |
| Purchases | – | 7 | – | 7 |
| Sales | –1 | – | – | –1 |
| Issues | – | – | – | – |
| Settlements | – | – | – | – |
| Reclassification into Level 3 | – | – | – | – |
| Reclassification out of Level 3 | – | – | – | – |
| **Balance at 31.12.2012** | **–2** | **–2** | **–** | **–4** |

Of the total gains or losses for the year 2012 recognised in profit or loss amounting to € 42 million relates to assets and liabilities, which were classified in level 3 on balance sheet date and which were measured at fair value. Gains from assets at fair value through profit or loss of € 32 million are included in net income from hedge relationships (€ 30 million). The changes recognised in equity (cash flow hedge reserve) mainly relate (€ 2 million) to cash flow hedge derivatives held in the balance sheet date. Gains from liabilities at fair value through profit or loss of € 9 million are included in net income from hedge relationships.

In the years 2012 and 2011, pbb Group did not reclassify any financial liabilities from level 2 into level 3.

Although pbb 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 2012 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 December 2012**<br>in € million | Favourable changes | Unfavourable changes |
|---|---|---|
| **Assets** | | |
| Financial assets at fair value through profit or loss | | |
| Hedging derivatives | 5.2 | −4.5 |
| **Total** | **5.2** | **−4.5** |
| **Liabilities** | | |
| Financial liabilities at fair value through profit or loss | | |
| Trading liabilities | 0.1 | −0.1 |
| Hedging derivatives | 0.1 | −0.1 |
| **Total** | **0.2** | **−0.2** |

| **Sensitivities of level 3 instruments at 31 December 2011**<br>in € million | Favourable changes | Unfavourable changes |
|---|---|---|
| **Assets** | | |
| Financial assets at fair value through profit or loss | | |
| Hedging derivatives | 2.3 | −2.2 |
| **Total** | **2.3** | **−2.2** |
| **Liabilities** | | |
| Financial liabilities at fair value through profit or loss | | |
| Trading liabilities | 0.1 | −0.1 |
| Hedging derivatives | 6.5 | −5.0 |
| **Total** | **6.6** | **−5.1** |

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.

In the following the measurement 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 original debt instruments for which no active market price is available is determined as the present value for future expected cash flows on the basis of related benchmark interest curves and credit spreads. In specific terms, this means that the credit spread is calculated for a comparable instrument with a price from an active market, and is then used together with the standard rate curve of the respective currency for discounting the cash flows of the illiquid instrument. The rate curve and the prices for liquid instruments are derived from standard providers.

The fair value of interest and currency interest swap agreements and also interest rate futures are determined on the basis of discounted future expected cash flows. The market interest rates applicable for the remaining maturity of the financial instruments are used for the purpose of the calculation. The fair value of forward exchange transactions is determined on the basis of current forward rates. Options are valued using exchange rate quotations or recognised models for determining option prices. For simple European options, the current Black-Scholes models (currency and index instruments) or lognormal models (interest instruments) are used as the valuation models. In the case of more exotic instruments, the interest rates are simulated via one- and multidimensional term structure models with use of the current interest rate structure as well as caps or swaption volatilities as parameters relevant for valuation purposes. One- and multifactor models are used for interest-currency products.

A hazard rate model which corresponds to the market standard is used for credit derivatives such as credit default swaps. The model uses the standard rate curve for the respective currency as well as the CDS spreads and recovery rates of the respective issuer. The input data are used for deriving probabilities of default and probabilities of survival, which in turn are used for measuring the cash flows.

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.

Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably determined are measured at cost according to IAS 39.46.

In the financial year 2012, the market interest rates in the short- and medium-term scope decreased strongly and in the long-term scope it decreased moderately. The cause is attributable to the monetary policy of the ECB, that's target it was to reduce the refinancing of states in the sovereign debt crisis. These included mainly providing high cash position and the repurchase of government bonds. As a consequence, credit spreads narrowed sharply within the euro countries in the course of the year. These factors have had the following impact on the fair market values of the financial instruments of pbb Group:

| **Fair values of financial instruments** | | **31.12.2012** | | **31.12.2011** |
|---|---|---|---|---|
| in € million | Carrying amounts | Fair value | Carrying amounts | Fair value |
| **Assets** | **94,915** | **94,221** | **106,923** | **105,244** |
| Cash reserve | 1,937 | 1,937 | 323 | 323 |
| Trading assets (HfT) | 3,325 | 3,325 | 9,818 | 9,818 |
| Loans and advances to other banks[1] | 7,995 | 7,817 | 7,615 | 7,386 |
| Category LaR | 7,995 | 7,817 | 7,615 | 7,386 |
| Loans and advances to customers[1] | 49,265 | 50,143 | 54,776 | 55,158 |
| Category LaR | 49,265 | 50,143 | 54,776 | 55,158 |
| Financial investments | 25,572 | 24,178 | 28,677 | 26,845 |
| Category AfS | 3,920 | 3,920 | 3,916 | 3,916 |
| Category dFVTPL | 83 | 83 | 148 | 148 |
| Category LaR | 21,569 | 20,175 | 24,613 | 22,781 |
| Other assets | 6,821 | 6,821 | 5,714 | 5,714 |
| thereof: Hedging derivatives | 6,821 | 6,821 | 5,714 | 5,714 |
| **Liabilities** | **91,615** | **91,688** | **103,758** | **103,183** |
| Liabilities to other banks | 7,797 | 7,809 | 8,223 | 8,224 |
| Liabilities to customers | 11,895 | 12,159 | 12,363 | 12,504 |
| Liabilities evidenced by certificates | 52,550 | 52,487 | 55,038 | 54,159 |
| Trading liabilities (HfT) | 3,192 | 3,192 | 9,903 | 9,903 |
| Other liabilities | 14,188 | 14,194 | 15,730 | 15,794 |
| thereof: Hedging derivatives | 6,227 | 6,227 | 5,812 | 5,812 |
| Derivatives hedging dFVTPL financial instruments | 3 | 3 | 17 | 17 |
| Subordinated capital | 1,993 | 1,847 | 2,501 | 2,599 |
| **Other items** | **1,110** | **1,004** | **1,175** | **1,094** |
| Contingent liabilities | 75 | 75 | 38 | 38 |
| Irrevocable loan commitments | 1,035 | 929 | 1,137 | 1,056 |

[1] Reduced by allowances for losses on loans and advances

The fair values of the liabilities in relation to cover pool assets which were synthetically transferred to FMS Wertmanagement were € 6 million (2011: € 64 million) higher than the carrying amounts.

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 accordance with IAS 39**

| in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| **Assets** | **94,915** | **106,923** |
| Loans and receivables (LaR) | 78,829 | 87,004 |
| Available for sale (AfS) | 3,920 | 3,916 |
| Held for trading (HfT) | 3,325 | 9,818 |
| dFVTPL assets (dFVTPL) | 83 | 148 |
| Cash reserve | 1,937 | 323 |
| Positive fair values from hedging derivatives | 6,821 | 5,714 |
| **Liabilities** | **91,615** | **103,758** |
| Held for trading (HfT) | 3,192 | 9,903 |
| Financial liabilities at amortised cost | 82,193 | 88,026 |
| Negative fair values from hedging derivatives | 6,230 | 5,829 |

## 74 Exposure to Selected European Countries

**Exposure to selected European countries as of 31 December 2012**

| in € million | Counterparty | IAS 39 measurement category | Up to 3 months | From 3 months to 1 year | From 1 year to 5 years | From 5 years and over | Total | Nominal amount | Fair value |
|---|---|---|---|---|---|---|---|---|---|
| **Italy** | Sovereign | LaR | – | – | 98 | 150 | **248** | 242 | 197 |
| | | AfS | – | – | – | 1,250 | **1,250** | 1,060 | 1,250 |
| | Sub-sovereign | LaR | – | 22 | 10 | 1,134 | **1,166** | 1,112 | 869 |
| | State-guaranteed | LaR | – | – | 26 | 674 | **700** | 595 | 581 |
| **Portugal** | Sovereign | LaR | – | – | 46 | – | **46** | 37 | 42 |
| | | AfS | – | – | 44 | 101 | **145** | 165 | 145 |
| | | dFVTPL | – | – | – | – | – | – | – |
| | Sub-sovereign | LaR | 100 | – | 86 | 244 | **430** | 430 | 301 |
| | State-guaranteed | LaR | – | – | 202 | 374 | **576** | 547 | 389 |
| **Spain** | Sub-sovereign | LaR | – | 6 | 832 | 1,282 | **2,120** | 1,888 | 1,554 |
| | | HfT | – | – | – | 5 | **5** | 35 | 5 |
| | State-guaranteed | LaR | 42 | 100 | 106 | 174 | **422** | 399 | 375 |
| **Hungary** | Sovereign | LaR | – | – | 258 | 131 | **389** | 335 | 336 |

**Exposure to selected European countries as of 31 December 2011**

| in € million | Counterparty | IAS 39 measurement category | Up to 3 months | From 3 months to 1 year | From 1 year to 5 years | From 5 years and over | **Total** | Nominal amount | Fair value |
|---|---|---|---|---|---|---|---|---|---|
| **Italy** | Sovereign | LaR | 798 | 817 | 101 | 146 | **1,862** | 1,788 | 1,754 |
| | | AfS | – | – | – | 1,021 | **1,021** | 1,060 | 1,021 |
| | Sub-sovereign | LaR | 11 | – | 47 | 1,212 | **1,270** | 1,222 | 1,045 |
| | State-guaranteed | LaR | – | – | – | 768 | **768** | 667 | 677 |
| **Portugal** | Sovereign | LaR | 50 | – | 47 | – | **97** | 86 | 86 |
| | | AfS | – | – | 16 | 79 | **95** | 165 | 95 |
| | | dFVTPL | – | – | 17 | 45 | **62** | 105 | 62 |
| | Sub-sovereign | LaR | – | – | 187 | 245 | **432** | 430 | 218 |
| | State-guaranteed | LaR | – | – | 360 | 470 | **830** | 806 | 488 |
| **Spain** | Sub-sovereign | LaR | – | 345 | 683 | 1,318 | **2,346** | 2,155 | 2,011 |
| | | HfT | – | – | – | 2 | **2** | 35 | 2 |
| | State-guaranteed | LaR | – | – | 260 | 180 | **440** | 422 | 411 |
| **Hungary** | Sovereign | LaR | – | – | 117 | 266 | **383** | 334 | 287 |

As of 31 December 2012 and as of 31 December 2011 pbb Group did not have any exposure to sovereign, sub-sovereign, and state-guaranteed counterparties of Greece, Cyprus and Ireland.

The exposure to selected countries shown in the table contains loans and advances and securities. In addition, it shows interest rate derivatives to sovereign and sub-sovereign counterparties. The interest rate derivatives are netted with collaterals. Time lags in providing the collaterals and haircuts are not taken into account. State-guaranteed exposure contains for example loans and advances to banks and corporations which are guaranteed by sovereigns or sub-sovereigns. As of 31 December 2012 and as of 31 December 2011 pbb Group did not have any credit default swaps whose underlyings are linked to sovereigns, sub-sovereigns and state-guaranteed exposures of the countries shown above.

For the total exposure as of 31 December 2012 and as of 31 December 2011 the exposure at default according to regions is disclosed in the risk and opportunities report.

For financial assets which are measured at fair value affecting income changes in value are directly included in the book value. pbb Group tests financial assets which are not measured at fair value affecting income for impairments. Allowances for loans and advance or impairments for securities are created if there is objective evidence that it will not be possible for the entire amount which is due according with the original contractual conditions to be recovered. As per 31 December 2012 and as of 31 December 2011 there was no such objective evidence.

The fair values of the exposure to selected European countries were determined by applying the measurement methods disclosed in the note Fair Values of Financial Instruments.

## 75 Past Due but Not Impaired Assets

The following table shows the total portfolio of the partly or completely past due but not impaired loans and advances as of 31 December 2012 and as of 31 December 2011. However, no individual allowances were made for these assets respectively the collaterals underlying these assets as pbb Group does not consider that there is any issue regarding their recoverability. Such timing issues in receipts of payments due occur regularly (up to three months) in the normal course of business and do not, by themselves, impair the quality of the asset.

### LaR Assets

| **LaR assets: past due but not impaired (total investments)**<br>in € million | **31.12.2012** | **31.12.2011** |
|---|---|---|
| Up to 3 months | 665 | 331 |
| From 3 months to 6 months | 71 | 25 |
| From 6 months to 1 year | 67 | 61 |
| From 1 year and over | 75 | 18 |
| **Total** | **878** | **435** |

| **Carrying amounts LaR assets**<br>in € billion | **31.12.2012** | **31.12.2011** |
|---|---|---|
| Carrying amount of LaR assets that are neither impaired nor past due | 77.6 | 86.3 |
| Carrying amount of LaR assets that are past due but not impaired (total investment) | 0.9 | 0.4 |
| Carrying amount of individually assessed impaired LaR assets (net) | 0.6 | 0.7 |
| Balance of portfolio-based allowances | 0.1 | 0.1 |
| **Total** | **79.2** | **87.5** |
| thereof:<br>Loans and advances to other banks (including investments) | 8.0 | 7.7 |
| Loans and advances to customers (including investments) | 49.6 | 55.2 |
| Financial investments (gross) | 21.6 | 24.6 |

The carrying amount of assets that would otherwise be past due or impaired and whose terms have been renegotiated amounts to € 90 million (2011: € 77 million).

The fair value of collaterals for the impaired financial assets amounts to approximately € 0.6 billion (2011: € 0.7 billion). The collaterals mainly consist of land charges.

**AfS Assets** As of 31 December 2012 and as of 31 December 2011 pbb 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<br>in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| **Contingent liabilities** | **75** | **38** |
| Guarantees and indemnity agreements | 75 | 38 |
| Loan guarantees | 4 | 6 |
| Performance guarantees and indemnities | 71 | 32 |
| **Other commitments** | **1,035** | **1,137** |
| Irrevocable loan commitments | 1,035 | 1,137 |
| Book credits | 102 | 73 |
| Guarantees | 31 | 51 |
| Mortgage and public sector loans | 902 | 1,013 |
| **Total** | **1,110** | **1,175** |

The former Hypo Real Estate Bank International AG, a predecessor institute of pbb, Munich, has overtaken with the announcement as of 2 January 2006 irrevocable and unconditional guarantees to fulfil all liabilities of Hypo Public Finance Bank puc, Dublin. By the fact that all shares of Hypo Public Finance Bank puc, Dublin, were sold, the commitment was limited according the guarantee contract to all liabilities, which existed until the date of sale. Due to the current development in earnings, assets and financial position as well as the expected future development, pbb does not rule out the default of Hypo Public Finance Bank puc, Dublin, but a default should be rather unlikely.

In accordance with the framework agreement for transferring risk positions and non-strategic operations to a deconsolidated environment constituted under federal law in accordance with Section 8 a of Finanzmarktstabilisierungsfondsgesetz pbb assumes joint and several liability for all payment obligations of its subsidiaries resulting from the transaction agreements which have been transferred as part of the process of transferring assets to FMS Wertmanagement.

The Restructuring Fund Ordinance specifies an additional charge for the so-called bank levy. The difference between the actually determined bank levy and the calculated standard amount for the years 2011 to 2019 can be subsequently charged in the following two years in each case. However, the obligation to pay the additional amount arises only if corresponding profits are generated in subsequent financial years; the amount of this payment is capped by the feasibility or charge specified in the ordinance. Whether the additional payment becomes due, and also the extent of such an additional payment, accordingly depend on profits being generated in subsequent years. The additional payment which pbb can be charged in 2013 is € 32 million. As far as can be seen at present, it is not assumed that the additional amount will be fixed in full.

Due to a requirement in line with the principle of burden sharing required by the EU Commission, profits will be retained at pbb Group until reprivatisation, and will be used for repaying the silent participation of the Federal Republic of Germany.

pbb Group is a lessor 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 2012. The minimum obligations arising from non-terminable leasing arrangements will result in expenses of € 14 million in 2013, € 32 million in total in the years 2014 to 2017 and € 35 million in total for 2018 and beyond. In the previous year the non-terminable operating lease agreements were as follows: for business year 2012: € 13 million, in business years 2013 to 2016 € 37 million in total and for 2017 and beyond € 41 million in total. Operating lease agreements were made on an arm's-length basis and are mainly related to the rental of land and buildings. The agreements include partial renewal options that the lease can be extended for several periods, and escalation clauses in the form of stepped rents or indexation clauses and release clauses as well.

For pbb Group irrevocable loan commitments form the largest part of other commitments. Irrevocable loan commitments comprise all commitments of a creditor which can grant a loan and advance at a later date and which can cause a credit risk. These are mainly credit commitments which are not fully drawn.

## 77 Key Regulatory Capital Ratios (Based on German Commercial Code)

In accordance with the waiver regulation set out in Section 2 a KWG, pbb is exempted from the requirement to establish the equity and core capital ratios at the level of the institution.

The waiver regulation set out in Section 2 a KWG states that a credit institution or financial services institution which has its registered offices within Germany and which is part of a regulated group of institutions or financial holding group does not have to comply with the following regulations if these regulations are complied with at the level of the ultimate parent company:

> Regulations regarding solvency (equity in relation to risk-weighted assets)
> Regulations regarding large loans (equity in relation to loans extended to individual borrower units)
> Regulations set out in Section 25 a (1) Clause 3 No. 1 KWG for establishing and assuring risk-bearing capacity, defining strategies, setting up processes for identifying, assessing, managing, monitoring and communicating risks.

The pbb Group voluntarily discloses these figures on a pro forma basis.

The regulatory capital of the pbb Group in accordance with the Solvency Regulation (SolvV) on a pro forma basis is as follows:

| **Own funds**[1)]<br>in € million | 31.12.2012 | 31.12.2011 |
|---|---|---|
| Core capital (Tier I) | 2,898 | 2,762 |
| Supplementary capital (Tier II) | 1,179 | 1,383 |
| **Equity capital** | **4,077** | **4,145** |
| Tier III capital | – | – |
| **Total** | **4,077** | **4,145** |

[1)] Consolidated pursuant to section 10 a German Banking Act [KWG]; pro forma as per prepared annual financial statements and after result distribution

The risk-weighted assets, the operational risks and the market risk positions on a pro forma basis are as follows:

| **Risk-weighted assets**[1) ]<br>in € billion | **31.12.2012** | **31.12.2011** |
|---|---|---|
| Risk-weighted assets | 15.3 | 17.0 |

[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 Basel II advanced IRB approach for authorised portfolios, otherwise Basel II standardised approach; pro forma as per prepared annual financial statements and after result distribution

| **Operational risks**<br>in € million | **31.12.2012** | **31.12.2011** |
|---|---|---|
| Total | 86 | 80 |

| **Market risk positions**<br>in € million | **31.12.2012** | **31.12.2011** |
|---|---|---|
| Currency risks | 6 | 6 |
| Interest rate risks | – | – |
| **Total** | **6** | **6** |

The capital ratios have been determined on the basis of the definition of shareholders' equity in accordance with SolvV and also using risk-weighted assets in accordance with Basel II. On a pro forma basis, the capital ratios are as follows:

| **Key capital ratios**[1)]<br>in % | **31.12.2012** | **31.12.2011** |
|---|---|---|
| Core capital ratio[2)] | 18.9 | 16.3 |
| Equity capital ratio[3)] | 26.7 | 24.5 |
| Own funds ratio (overall indicator)[2)] | 26.6 | 24.4 |

[1)] pro forma as per prepared annual financial statements and after result distribution
[2)] Including risk-weighted credit risk positions as well as the capital requirements for market risk positions and operational risks scaled with the factor 12.5
[3)] Including risk-weighted credit risk positions as well as the capital requirements for operational risks scaled with the factor 12.5

## 78 Group Auditors' Fee

| Group auditors' fee<br>in € thousand | 2012 | 2011 |
|---|---|---|
| Audit | 2,948 | 3,549 |
| Other assurance services | 611 | 1,578 |
| Tax advisory services | 2 | 51 |
| Other non-audit services | 4,291 | 1,300 |
| **Total** | **7,852** | **6,478** |

The table shows fees to the group auditor KPMG AG Wirtschaftsprüfungsgesellschaft.

## 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, retirement benefit schemes for post-employment benefits for employees are also included under related parties.

Transactions with related entities or persons were performed on an arm's-length basis under consideration of the characteristics of section 311 et seq. AktG (German Stock Corporation Act). In accordance with Section 7d FMStBG, the regulations of the Aktiengesetz (Stock Corporation Act) regarding controlling entities are not applicable to Finanzmarktstabilisierungsfonds-FMS, central government and the corporations, institutions and special funds established by central government as well as related persons or other companies which are directly or indirectly dependent on them. This is not applicable for the application of regulations regarding the representation of employees in the supervisory board of a company controlled by Finanzmarktstabilisierungsfonds-FMS. According to IAS 24.25, pbb Group is exempted from the requirement of reporting on events, receivables and liabilities including obligations with related parties in accordance with IAS 24.18 if these parties are also controlled by the Federal Republic of Germany or if the Federal Republic of Germany is involved in the joint management of such related parties or if it has a material influence over such parties.

**Related Entities** Finanzmarktstabilisierungsfonds-FMS, a special fund of the Federal Government in accordance with Section 2 (2) FMStFG, represents the ultimate parent entity of HRE Holding and thus also of pbb. Accordingly, pbb is a government-related entity and a related party to other companies which are controlled, jointly controlled or significantly influenced by the Federal Republic of Germany. In addition to the parent entity HRE Holding and the affiliated company DEPFA FMS Wertmanagement is also controlled by the Federal Republic of Germany and is thus a related party of pbb Group. In the year 2012, pbb Group reimbursed Finanzmarktstabilisierungsfonds-FMS expenses (excluding bank levy) of € 0 million (2011: € 4 million).

There were no loans and advances (netted by liabilities) of pbb Group to its parent company HRE Holding as of 31 December 2012 and as of 31 December 2011. As of 31 December 2012, HRE Holding held financial investments of pbb Group amounting to € 0.8 billion (2011: € 0.8 billion). The net interest income of pbb Group to HRE Holding amounted to € 12 million (2011: € – 2 million). A balance of € 2 million in other operating income/expenses (2011: € 0 million) is attributable to IT services for HRE Holding.

pbb Group had loans and advances (netted by liabilities) to its affiliated company DEPFA of € 0.2 billion as of 31 December 2012 (2011: € 0.4 billion) and subordinated liabilities of € 0.3 billion (2011: € 0.3 billion). In the financial year 2012 pbb Group realised a net interest income of € – 43 million (2011: € – 85 million) and a net commission income of € 2 million (2011: € 3 million) to DEPFA. The net income from IT services provided to DEPFA was € 40 million (2011: € 35 million).

There were no business relationships with the sister entity Hypo Real Estate Finance B.V. i.L., Amsterdam in the years 2012 and 2011. Besides, assets and liabilities had not been existed.

As of 31 December 2012, loans and advances to non-consolidated companies amounted to € 1 million (2011: € 3 million); the liabilties amounted to € 0 million (2011: € 0 million). Loans and advances to associated companies which were not measured with the equity method amounted to € 43 million (2011: € 45 million), whereas the liabilities were at € 0 million (2011: € 0 million).

The following major transactions with FMS Wertmanagement affected the development in assets of pbb Group:

- The pbb Group has transferred market risks to FMS Wertmanagement by means of back-to-back derivatives. Overall, the transfer has had the effect of boosting the balance sheet by € 1.0 billion in the position trading assets (2011: € 7.4 billion). Of this figure, € 0.7 billion (2011: € 4.2 billion) was attributable to business with FMS Wertmanagement. The positive market values of original business which was not transferred directly amounted to € 0.3 billion as of 31 December 2012 (2011: € 3.2 billion). These are opposed by negative market values of the corresponding back-to-back derivatives with external third parties; these are reflected in the same amount in the development in the financial position.
- The carrying amount of securities which were issued by FMS Wertmanagement declined from € 3.0 billion as of 31 December 2011 to € 2.2 billion as of 31 December 2012. These securities are disclosed as financial investments.
- The deposition of unneeded liquidity of FMS Wertmanagement in the central bank amounting to € 0.5 billion (2011: € 0.7 billion) in loans and advances to other banks resulted in a slight reduction of total assets in receivables to other banks, respectively liabilities to other banks.

The financial position of the pbb Group was influenced by the transfer of original business to FMS Wertmanagement by means of back-to-back derivatives; this had the effect of increasing the balance sheet total by € 1.0 billion in the position trading liabilities (2011: € 7.4 billion). Of this figure, € 0.3 billion (2011: € 3.2 billion) was attributable to business with FMS Wertmanagement. The negative market values of original business which was not directly transferred amounted to € 0.7 billion as of the balance sheet date (2011: € 4.2 billion). This was opposed by positive market values of original business which was not directly transferred; this was reflected in the same amount in the development in assets.

The development in assets and liabilities resulted in the following effects which were recognised in profit or loss. However, because these effects were almost completely cancelled out by the corresponding market transactions, they had only an immaterial impact on profit or loss. The only material effect in the income statement resulted from servicing for the ongoing operations of FMS Wertmanagement. The balance of other operating income/expenses of € 106 million (2011: € 109 million) compensated for the expenses which were incurred by pbb Group for servicing. According to conditions of the European Commission, the servicing will end in September 2013.

All further transactions carried out in the current financial year and in the previous period with companies, which were controlled, jointly controlled or significantly influenced by the Federal Republic of Germany, related to operational business, and overall were immaterial for pbb Group.

On 31 December 2012 liabilities to defined contribution plans amounted to € 3 million (2011: € 1 million).

**Related Persons** pbb Group defines related persons as the Management Board, the Supervisory Board, employees in the second tier of management at pbb as well as members of management of the subsidiaries of pbb as well as their respective close relatives. pbb paid neither fixed remuneration nor severance payments to the Management Board during the financial years 2012 and 2011. For 2012, the total remuneration paid to former members of the Management Board and their surviving dependants amounted to € 5,133 thousand (2011: € 5,140 thousand). The Supervisory Board remuneration for the reporting period amounted to € 84 thousand (2011: € 70 thousand). This figure was composed exclusively of fixed remuneration.

| Vested remuneration paid to persons with key function in the Group (Senior Management)[1] | | | 2012[2] | 2011 |
|---|---|---|---|---|
| in € thousand | Remuneration[3] | Severance payments | Total | Total |
| Total | 8,929 | 192 | **9,121** | **8,561** |

[1] Members of the second management level of pbb and managing directors of subsidiaries of pbb
[2] The considerable increase is mainly due to the reduction in the discount rate which, in accordance with IAS 19, has to be based on the long-term rate for prime fixed-income corporate bonds
[3] Reporting follows the so-called vested principle. The components of compensation which were vested in the relevant period 2011 are reported

| Pension obligations to persons with key function in pbb Group (Senior Management)<br>in € thousand | 31.12.2012 | 31.12.2011 |
|---|---|---|
| Total[1] | 77,552 | 66,653 |

[1] Thereof € 67,434 thousand (2011: € 59,668 thousand) for pensioners and surviving dependants

**Statement according to section 15 a WpHG** During the complete business years 2012 and 2011 HRE Holding held all shares of pbb. Hence, members of the Management Board and the Supervisory Board did not hold shares of the Company as at 31 December 2012 and as at 31 December 2011. In the years 2012 and 2011 no shares or share derivatives of pbb were purchased or sold by members of the Management Board and the Supervisory Board.

## 80 Employees

| Average number of employees | 2012 | 2011 |
|---|---|---|
| Employees (excluding apprentices) | 1,042 | 993 |
| thereof: senior staff in Germany | 20 | 20 |
| **Total** | **1,042** | **993** |

## 81 Members of the Supervisory Board and of the Management Board

**Supervisory Board of pbb**
as of 31 December 2012

| Name and place of residence | Principal activity | Function in the Supervisory Board | Function in the Committees of the Supervisory Board: Audit Committee | Function in the Committees of the Supervisory Board: Risk Management and Liquidity Strategy Committee |
|---|---|---|---|---|
| **Dr. Bernd Thiemann**<br>Kronberg | Former Chairman of the Management Board of DG Bank AG | Chairman | Member | Member |
| **Dagmar Kollmann**<br>Bad Homburg | Chairperson of the Partners Committee of Kollmann GmbH | Deputy Chairperson | Chairperson | Member |
| **Dr. Günther Bräunig**<br>Frankfurt/Main | Member of the Management Board of KfW | Member | Member | Chairman |
| **Dr. Christian Gebauer-Rochholz**<br>Hochheim | Bank employee | Workers' Council Representative[1] | | |
| **Dr. Alexander Groß**<br>Teltow | Head of the Economic Policy department in the Bundesministerium für Wirtschaft und Technologie | Member[2] | | |
| **Georg Kordick**<br>Poing | Bank employee | Workers' Council Representative | | |
| **Dr. Ludger Schuknecht**<br>Frankfurt/Main | Head of the Fundamental Financial and Economic Issues department in the Bundesministerium der Finanzen | Member[2] | | |
| **Heike Theißing**<br>Munich | Bank employee | Workers' Council Representative | | |
| **Dr. Hedda von Wedel**<br>Andernach | President of the Bundesrechnungshof, retired | Member | Member | |

[1] from 20 November 2012
[2] from 1 June 2012

**Management Board of pbb**
as of 31 December 2012

| Name and place of residence | Function in the Management Board | Mandates held in Supervisory Bodies under the Respective Law for Major Corporations |
|---|---|---|
| **Manuela Better**<br>Munich | CEO/CRO | > Member of the Board of Directors of DEPFA Bank plc<br>> Non-executive Director of DEPFA ACS Bank<br>> Non-executive Director of Hypo Public Finance Bank |
| **Wolfgang Groth**<br>Tawern | Treasury/Asset Management | > Non-executive Director of DEPFA Bank plc<br>> Non-executive Director of Hypo Public Finance Bank |
| **Dr. Bernhard Scholz**<br>Regensburg | Real Estate Finance/Public Investment Finance | |
| **Alexander von Uslar**<br>Gruenwald | CFO/COO | > Member of the Board of Directors of DEPFA Bank plc<br>> Non-executive Director of DEPFA ACS Bank |

## 82 Holdings of pbb

**Holdings of pbb as of 31 December 2012**
Additional Statement according to HGB

| Name and place of business | Interest in % Total Sec 16 (4) Aktiengesetz | Interest in % of which held indirectly | Currency | Equity in thousands | Net income/ loss in thousands |
|---|---|---|---|---|---|
| **Subsidiaries** | | | | | |
| **Consolidated subsidiaries** | | | | | |
| Hayabusa Godo Kaisha, Tokyo | 100.00 | 100.00 | JPY | 179,892 | 109,892 |
| House of Europe Funding I Ltd.[1], Grand Cayman | – | – | EUR | 1 | – |
| Hypo Real Estate Capital India Corp. Private Ltd. i.L., Mumbai | 100.00 | – | INR | 19,786 | 7,546 |
| Hypo Real Estate Capital Japan Corp., Tokyo | 100.00 | – | JPY | 30,417,625 | –632,239 |
| Hypo Real Estate International LLC I, Wilmington | 100.00 | – | EUR | 80,550 | –57,313 |
| Hypo Real Estate International Trust I, Wilmington | 100.00 | – | EUR | 80,545 | –57,277 |
| IMMO Immobilien Management GmbH & Co. KG, Munich | 100.00 | – | EUR | 3,127 | 61 |
| Little Britain Holdings (Jersey) Ltd., Jersey | 100.00 | – | GBP | 24,686 | –4,479 |
| Ragnarök Vermögensverwaltung AG & Co. KG[2], Munich | 100.00 | 6.00 | EUR | 3,868 | –12 |
| **Non-consolidated subsidiaries** | | | | | |
| DEPFA Finance N.V., Amsterdam | 100.00 | – | EUR | 4,842 | 470 |
| FUNDUS Gesellschaft für Grundbesitz und Beteiligungen mbH[3], Munich | 100.00 | – | EUR | 904 | 1 |
| GfI-Gesellschaft für Immobilienentwicklung und -verwaltung mbH i.L., Stuttgart | 100.00 | – | EUR | 11 | – |
| Immo Immobilien Management Beteiligungsgesellschaft mbH, Munich | 100.00 | – | EUR | 31 | 2 |
| IMMO Invest Real Estate GmbH[3], Munich | 100.00 | – | EUR | 28 | 1,095 |
| **Associated companies** | | | | | |
| SANO Grundstücks-Vermietungsgesellschaft mbH & Co. Objekt Dresden KG, Duesseldorf | 33.33 | – | EUR | –4,380 | 180 |
| SOMA Grundstücks-Vermietungsgesellschaft mbH & Co. Objekt Darmstadt KG, Duesseldorf | 33.33 | – | EUR | –10,261 | –348 |
| WISUS Beteiligungs GmbH & Co. Zweite Vermietungs-KG, Munich | 33.00 | – | EUR | –2,266 | 271 |

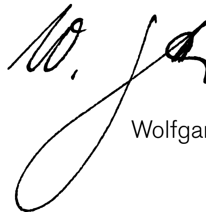
[1] Special-purpose entity without capital investment consolidated according to SIC-12
[2] General partner liability (Komplementärhaftung) of pbb
[3] Profit transfer by shareholders on the basis of profit and loss transfer agreement

| **Exchange rates** | | |
|---|---|---|
| €1 equates to | | **31.12.2012** |
| Great Britain | GBP | 0.8161 |
| India | INR | 72.5600 |
| Japan | JPY | 113.6100 |

Munich, 19 March 2013

Deutsche Pfandbriefbank Aktiengesellschaft
The Management Board

Manuela Better



Wolfgang Groth

Dr. Bernhard Scholz

Alexander von Uslar

# Responsibility Statement

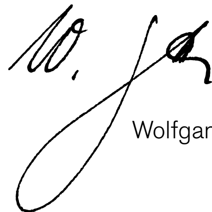


To the best of our knowledge, and in accordance with the applicable reporting principles, the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group, and the Group management report includes a fair review of the development 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, 19 March 2013

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, comprising consolidated statement of financial position, consolidated income statement, consolidated statement of comprehensive income, consolidated statement of cash flows, consolidated statement of changes in equity and notes, together with the group management report for the business year from 1 January to 31 December 2012. 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 § 15 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.

Munich, 20 March 2013

KPMG AG
Wirtschaftsprüfungsgesellschaft
[original German version signed by:]

| Wiechens<br>Wirtschaftsprüfer<br>[German Public Auditor] | Schmidt<br>Wirtschaftsprüferin<br>[German Public Auditor] |
|---|---|

# Summary of Quarterly Financial Data

| pbb Group | 2011 | | | | 2012 |
|---|---|---|---|---|---|
| in € million | 4th quarter | 1st quarter | 2nd quarter | 3rd quarter | 4th quarter |
| **Operating performance** | | | | | |
| Operating revenues | 104 | 103 | 120 | 130 | 114 |
| Net interest income and similar income | 78 | 76 | 74 | 72 | 74 |
| Net commission income | 7 | 3 | 3 | 14 | 3 |
| Net trading income | –12 | – | –2 | 1 | 11 |
| Net income from financial investments | 4 | –4 | 9 | 6 | 2 |
| Net income from hedge relationships | –22 | –2 | –1 | 3 | –6 |
| Balance of other operating income/expenses | 49 | 30 | 37 | 34 | 30 |
| Provisions for losses on loans and advances | –10 | 4 | 5 | –7 | –6 |
| General administrative expenses | 96 | 78 | 86 | 89 | 88 |
| Balance of other income/expenses | 7 | – | 1 | 1 | –8 |
| Pre-tax profit/loss | 25 | 21 | 30 | 49 | 24 |

| Real Estate Finance | 2011 | | | | 2012 |
|---|---|---|---|---|---|
| in € million | 4th quarter | 1st quarter | 2nd quarter | 3rd quarter | 4th quarter |
| **Operating performance** | | | | | |
| Operating revenues | 58 | 55 | 65 | 76 | 68 |
| Net interest income and similar income | 60 | 54 | 55 | 56 | 62 |
| Net commission income | 7 | 4 | 3 | 15 | 3 |
| Net trading income | –12 | – | –1 | – | 3 |
| Net income from financial investments | 1 | – | 8 | 4 | 4 |
| Net income from hedge relationships | –5 | –2 | – | 1 | –2 |
| Balance of other operating income/expenses | 7 | –1 | – | – | –2 |
| Provisions for losses on loans and advances | –10 | 3 | 5 | –7 | –6 |
| General administrative expenses | 37 | 32 | 37 | 34 | 36 |
| Balance of other income/expenses | 3 | – | 1 | – | –4 |
| Pre-tax profit/loss | 34 | 20 | 24 | 49 | 34 |

| Public Sector Finance | 2011 | | | | 2012 |
|---|---|---|---|---|---|
| in € million | 4th quarter | 1st quarter | 2nd quarter | 3rd quarter | 4th quarter |
| **Operating performance** | | | | | |
| Operating revenues | –8 | 7 | 12 | 13 | 15 |
| Net interest income and similar income | 20 | 17 | 14 | 12 | 15 |
| Net commission income | –1 | –1 | – | –1 | 1 |
| Net trading income | –6 | – | –1 | 1 | 8 |
| Net income from financial investments | 3 | –4 | 1 | 2 | –1 |
| Net income from hedge relationships | –16 | – | –1 | 2 | –4 |
| Balance of other operating income/expenses | –8 | –5 | –1 | –3 | –4 |
| Provisions for losses on loans and advances | – | 1 | – | 1 | 2 |
| General administrative expenses | 15 | 12 | 14 | 13 | 14 |
| Balance of other income/expenses | 2 | – | – | – | –1 |
| Pre-tax profit/loss | –21 | –6 | –2 | –1 | –2 |

| Value Portfolio | 2011 | | | | 2012 |
|---|---|---|---|---|---|
| in € million | 4th quarter | 1st quarter | 2nd quarter | 3rd quarter | 4th quarter |
| **Operating performance** | | | | | |
| Operating revenues | 44 | 38 | 41 | 40 | 28 |
| Net interest income and similar income | −5 | 2 | 3 | 2 | −6 |
| Net commission income | 1 | – | – | – | −1 |
| Net trading income | 1 | – | – | – | – |
| Net income from financial investments | – | – | – | – | −1 |
| Net income from hedge relationships | −1 | – | – | – | – |
| Balance of other operating income/expenses | 48 | 36 | 38 | 38 | 36 |
| Provisions for losses on loans and advances | – | – | – | −1 | −2 |
| General administrative expenses | 41 | 33 | 36 | 41 | 38 |
| Balance of other income/expenses | 2 | – | – | 1 | −3 |
| Pre-tax profit/loss | 5 | 5 | 5 | 1 | −11 |

| Consolidation & Adjustments | 2011 | | | | 2012 |
|---|---|---|---|---|---|
| in € million | 4th quarter | 1st quarter | 2nd quarter | 3rd quarter | 4th quarter |
| **Operating performance** | | | | | |
| Operating revenues | 10 | 3 | 2 | 1 | 3 |
| Net interest income and similar income | 3 | 3 | 2 | 2 | 3 |
| Net commission income | – | – | – | – | – |
| Net trading income | 5 | – | – | – | – |
| Net income from financial investments | – | – | – | – | – |
| Net income from hedge relationships | – | – | – | – | – |
| Balance of other operating income/expenses | 2 | – | – | −1 | – |
| Provisions for losses on loans and advances | – | – | – | – | – |
| General administrative expenses | 3 | 1 | −1 | 1 | – |
| Balance of other income/expenses | – | – | – | – | – |
| Pre-tax profit/loss | 7 | 2 | 3 | – | 3 |

# AB Sagax Light Industrial and Warehouse Portfolio

## SEK 4.3 billion

Acquisition refinancing
Sweden and Finland
December 2012

pbb Deutsche Pfandbriefbank has provided a SEK 4.3 billion (approx. € 495 million) facility to some 43 subsidiaries of AB Sagax to extend an existing pbb facility for two industrial and warehouse portfolios. The transaction was closed on 20 December 2012. The two portfolios comprise 94 properties in Sweden and Finland. The majority of the objects are located in the greater Stockholm and HMA (Helsinki Metropolitan Area) regions.

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# Service Chapter

# Service Chapter
# Glossary

**ABS (asset-backed security)** A bond or note that is based on pools of assets.

**ACS (Asset-covered security)** Covered bond subject to the laws of Ireland.

**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.

**Advanced IRBA** Advanced Internal Rating-Based Approach >>Advanced approach

**AfS (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 >>HtM 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.

**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.

**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.

**BaFin (Bundesanstalt für Finanzdienstleistungsaufsicht)** The Bundesanstalt für Finanzdienstleistungsaufsicht is an independent public-law institution with registered offices in Frankfurt am Main and Bonn. In its capacity as the financial market regulatory authority, BaFin monitors and controls all areas of the financial industry under its responsibility for regulating the «Allfinanz» (integrated financial services) sector.

**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 defines new general conditions for the measurement of risk-weighted assets and the minimum capital requirements for credit institutions.

**Basel III** Basel III is based on Basel II, and comprises a set of rules published in a finalised version on 16 December 2010, mainly consisting of two elements «Basel III: A global regulatory framework for more resilient banks and banking systems» and «Basel III: International framework for liquidity risk measurement, standards and monitoring». The purpose of Basel III is to strengthen the stability of the banking sector, and this is to be achieved mainly by the following measures:
1. Compared with Basel II, Basel III specifies much for stringent requirements regarding the quality and quantity of risk cover funds.
2. Much more extensive cover is provided for risks – particularly with regard to capital market statements. For instance, a stress value at risk is required for trading positions.
3. Banks must comply with liquidity requirements.
Basel III is not expected to be introduced before 1 January 2014.

**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 1 capital largely subscribed capital, reserves and certain hybrid capital instruments.
Supplementary capital or Tier 2 capital includes in particular participatory capital, long-term subordinated liabilities, unrealised gains from listed securities and other valuation adjustments for inherent risks.
Tier 3 capital mainly comprises short-term subordinated liabilities and surplus supplementary capital.

**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.

**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.

**CDO (Collateralised Debt Obligation)** 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.

**CDS (Credit default swap)** 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.

**CLO (Collateralised Loan Obligation)** CLOs constitute a segment of >>ABS. These are securities which are backed by loans.

**CMBS (Commercial mortgage-backed security)** A type of >>MBS on commercial real estate.

**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 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. >>CDS).

**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.

**CRM (credit risk management)** Systematic recognition and valuation of >>credit risks as well as the management of responses to credit risks which are identified.

**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.

**DRSC (Deutsches Rechnungslegung Standards Committee)** Private accounting committee. Section 342 HGB which was introduced by the law concerning control and transparency in the corporate field (KonTraG; Gesetz zur Kontrolle und Transparenz im Unternehmensbereich) created the condition necessary for establishing an accounting standard sector organised under private law in accordance with the Financial Accounting Standards Board and International Accounting Standards Board.

**DSC (Debt service coverage)** Relationship between the net income that can be earned from a property and the debt service applicable to the property in question.

**EaD (exposure at default )** The Basel-II-compliant term (exposure at default; EaD) recognises the current utilisation as well as the proportionate interest on loans with which a borrower can be in arrears up to the point at which a loan is considered to default (max. 90 days overdue), as well as those loan commitments which a borrower can still utilise in future despite a significant deterioration in rating.

**ECB (European Central Bank)** Currency authority (central bank) established within the framework of the European Economic and Monetary Union for the member states of the European Monetary Union with registered offices in Frankfurt am Main.

**EL (expected loss)** Expected loss measured against a time horizon of one year – is the product of EaD, PD and LGD.

**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 instruments** This term is in particular used to summarise credits and loans extended, interest-bearing securities, shares, participating interests, liabilities and derivatives.

**FMStG (Financial Market Stabilisation Act)** 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.

**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.

**FVtPL (Fair value through Profit or Loss)** Financial assets which upon initial recognition are designated as assets to be measured at fair value through profit or loss have to be measured subsequently at >>fair value, whereby the changes in value are recognised in the income statement.

**FX (foreign exchange)** The foreign exchange market (FX market) is defined as the global market on which currencies are traded.

**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.

**HtM (held to maturity)** 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).

**HypZert** Company designation of the certification company for valuation in the financial industry.
HypZert(F): Certification as expert for financial industry purposes.
HypZert(MLV): Certification as expert for financial industry purposes abroad.

**IAS (International Accounting Standards)** 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.

**IASB (International Accounting Standards Board)** The IASB is an independent board of international accounting experts which is responsible for developing and as necessary revising the >> IFRS.

**ICAAP (Internal Capital Adequacy Assessment Process)** ICAAP is an internal process which is required by the banking regulator and which guarantees that adequate capital is available for covering all major risks of the Bank.

**IFRS (International Financial Reporting Standards)** The IFRS include the present >> IAS and the interpretations of the Standing Interpretations Committee as well as all standards and interpretations issued in future by the >>IASB.

**IMF (International Monetary Fund)** International organization for creating structured monetary relations between the member states with registered offices in Washington, D.C.

**LaR (loans and receivables)** Loans and receivables are non-derivative financial assets with fixed or determinable payments which are not listed on an active market. The loans and receivables include borrower's note loans.

**Lending risk** Risk that a business partner will not fulfil his contractual payment obligations. The lending risk includes >> default, >> country and settlement risks.

**Lettres de Gage** Covered bond subject to the laws of Luxembourg.

**LGD (loss-given default)** LGD is the fraction of exposure at default that will not be recovered following default.

**LTV (loan-to-value) also: calculated mortgage lending value** Relationship between the funds loaned to the borrower and the value of the collateral.

**MaRisk (German Minimum Requirements for Risk Management of Credit Institutions)** On the basis of Section 25a (1) KWG, MaRisk provides the banks with a flexible and realistic framework for the form of risk management. MaRisk can also be considered to be the specification of the criteria of pillar II in accordance with Basel II.

**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 as trading-book risk positions such as risks relating to interest rates and share prices as well as >> credit risks pertaining to the trading book.

**MBS (mortgage-backed securities)** 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.

**MRICS (Member of the Royal Institution of Chartered Surveyors)** A British professional association for real estate specialists and real estate experts, which now has worldwide operations and which certifies its members in real estate expertise at a high level.

**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.

**PD (Probability of Default)** Expected average probability that a business partner will fail to fulfil his obligations, based on statistical analyses of historic default patterns.

**Profit 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.

**RaRoC (Risk adjusted Return on Capital)** Parameter which calculates the risk-return ratio of a transaction.

**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).

**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.

**RMBS (residential mortgage-backed securities)** RMBS are >>MBS which securitise residential mortgages.

**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.

**SoFFin (financial market stabilisation fund)** 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).

**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.

**SPV (special-purpose vehicle)** A company which is established by banks or investment companies for carrying out certain financing projects. This enables the risk of the lenders and the companies to be limited to this project.

**SREP (Supervisory Review and Evaluation Process)** A regulation applicable under Basel II for the national regulatory authorities whereby every bank has to be reviewed and evaluated once every year with regard to the risk position, risk management, internal organization as well as the quality of its executive functions.

**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 1 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).

**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 funding 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
# Future-oriented Statements
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| Financial calendar | |
|---|---|
| **7 March 2013** | Preliminary Annual Results 2012/Annual Press Briefing |
| **10 April 2013** | Publication of the Annual Report 2012 |
| **14 May 2013** | Publication of the results for the first quarter of 2013 |
| **13 August 2013** | Publication of the results for the second quarter of 2013 |
| **12 November 2013** | Publication of the results for the third quarter of 2013 |

## 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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