

## **Compensation report of the Hypo Real Estate Group**

Published on the basis of the corresponding regulations of the Institution Compensation Ordinance of 13 October 2010 (replacing the BaFin Circular 22/2009 of 21 December 2009) and the SoFFin Compensation Principles (as constituted in February 2010)

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## **1 Scope and objective of the compensation report**

This report has been prepared by the Compensation Committee of Hypo Real Estate Holding AG and Deutsche Pfandbriefbank AG on the basis of the Institution Compensation Ordinance of 13 October 2010 (replacing the BaFin Circular 22/2009 of 21 December 2009) and the SoFFin Compensation Principles (as constituted in February 2010).

The compensation report covers the compensation of executive directors of the management boards, managers and employees of Hypo Real Estate AG and subordinate companies ("HRE Group") for the financial years 2009 and 2010.

The Compensation Committee has assessed the appropriateness of the structuring of the compensation systems and submits the following report.

The disclosure requirements of sections 7 and 8 of the Institution Compensation Ordinance are met by and through the publication of this report.

## **2 Context of the reported period**

In the HRE Group the years 2009 and 2010 were characterised by stabilisation measures and strategic repositioning of the Group. The transfer of non-strategic assets to FMS Wertmanagement and the introduction of the new compensation system at the end of 2010 were major milestones as part of this restructuring process.

In 2009 and 2010, various regulatory requirements applicable to compensation in the banking system were implemented by the legislature and bodies responsible for issuing ordinances as well as the BaFin and SoFFin, including the following:

- BaFin Circular 22/2009 of 21 December 2009
- Institution Compensation Ordinance of 13 October 2010 (Institutsvergütungsverordnung)

as well as (with special implications for the HRE Group):

- SoFFin Compensation Principles of February 2010
- The Restructuring Act of 26 November 2010

Compensation guidelines were also created at the international level, such as:

- "FSB Principles for Sound Compensation Practices" of 9 April 2009 and "Principles for Sound Compensation Practices - Implementation Standards" of 25 September 2009
- Directive 2010/76/EC for amending the Directives 2006/48/EC and 2006/49/EC with regard to the capital requirements for the trading book and further securitisation and also with regard to the regulatory review of compensation policy of 24 November 2010 (CRD III)
- CEBS Guidelines on Remuneration Policies and Practices of 10 December 2001

In Germany, the FSB Principles and Standards as well as the compensation-related regulations of the CRD III have been implemented by the Institution Compensation Ordinance.

### **3 Development and introduction of the "new compensation system"**

In 2009 and 2010, the HRE Group developed a "new compensation system" consistent with the regulatory and legal requirements with regard to compensation and, in particular, the requirements relating to adequacy, sustainability (in terms of deferrals of payments based on criteria for sustainable success for Risk Takes) and transparency. This was adopted in May 2010 by the Management Board and Supervisory Board. On the basis of an independent appraisal SoFFin confirmed on 6 May 2010 that the new compensation system was consistent with the compensation principles of the SoFFin. Based on the obligations from the framework agreement of 24 August 2010 the new compensation system had to be implemented within three months after the approval by SoFFin within the ramifications of civil and labour relations legislation. The Management Board of Hypo Real Estate Holding AG and Deutsche Pfandbriefbank AG adhered strictly to this requirement and initiated the necessary implementation steps.

In October 2010, the Management Board postponed the implementation of the "new compensation system" at the request of SoFFin with a view to impending new legal provisions and the Restructuring Act already available in draft form at the time until the intention of the legislative authorities had been conclusively resolved.

The Restructuring Act adopted on 26 November 2010 introduced a regulation in section 10 (2a) FMStFG for companies operating in the financial sector which take advantage of stabilisation measures in accordance with Section 7 of this Act and in which the fund holds at least 75% of the shares either directly or indirectly via one or more subsidiaries. As a result, the monetary compensation payable to the members of executive bodies and employees must not exceed € 500,000 per annum in each case. Variable compensation is inadmissible.

In December 2010, in accordance with the Restructuring Act and after consultation with SoFFin, the HRE Group resumed the process (which had previously been postponed) of introducing the "new compensation system" and made the necessary adjustments resulting from the Restructuring Act. In its concept, the "new compensation system" of the HRE Group comprised fixed as well as variable compensation components and was maintained as the target system. The regulations regarding variable compensation are not applicable during the period in which the new legal regulation is in place. Care was taken to ensure that no new entitlements for variable compensation arise due to the introduction of the "new compensation system" in the period and for the period for which the Restructuring Act is applicable. Due to the partly conflicting provisos in the German Restructuring Law and the Institution Compensation Ordinance respectively the CEBS Guideline the provisos of the Institution Compensation Ordinance respectively the CEBS Guideline are not fulfilled completely now. From a legal perspective the German Restructuring Law is higher level legislation and therefore overriding the Compensation Ordinance respectively the CEBS Guideline at least in Germany.

The "new compensation system" was implemented with retroactive effect as of 1 January 2010 with due consideration being given to the Restructuring Act, and in particular Section 10 (2a) FMStFG:

- For Germany, the HRE Group concluded new collective agreements with the Group Works Council in December 2010; these replaced the collective agreements for the "new compensation system" previously concluded in July 2010 and take account of the new legal regulations.
- The employees of the HRE Group were provided either with new employment contracts (Germany) or "letters of variation" at the international locations; for employees in Germany, these refer to the collective agreements of December 2010. For senior executives and

employees at the international locations, which are not covered by the scope of the collective agreements, these refer to the "variable compensation plan" to be adopted by the HRE Group for each calendar year.

- With the background of the Restructuring Act no new entitlements for variable compensation have been founded for 2010 already.

This procedure was approved by the Supervisory Board of Hypo Real Estate Holding AG and Deutsche Pfandbriefbank AG with the resolution of 6 December 2010 and by the SoFFin with the letter of 13 December 2010.

#### **4 Principles and breakdown of compensation**

The fundamental principle of the "new compensation system" is to provide adequate and competitive overall compensation. The overall compensation of managers and employees currently consists exclusively of the annual fixed salary as well as social and incidental benefits. Given that the regulations concerning variable compensation do not apply during the period in which variable compensation for employees of HRE is prohibited by law, there is currently no possibility of offering incentive measures to motivate conduct or recognise performance as part of the compensation system.

The "new compensation system" is based on a world-wide systematic evaluation carried out for all functions within the HRE Group on the basis of a function classification system introduced for this purpose in the year 2010.

##### **4.1 Fixed salary components**

All employees of the HRE Group receive an annual fixed salary which is generally reviewed in an annual review process and adjusted where necessary. The HRE Group determines the fixed salary based on a direct function-specific market comparison. In order to ensure adequacy and competitiveness of the fixed salaries as well as compliance with the regulatory requirements, the HRE Group uses the services of external independent compensation and legal advisors.

With regard to the company pension arrangements, the HRE Group operates various company pension schemes. The HRE Group provides further social and incidental benefits giving due consideration to the regulations of tax and social insurance law.

The regulations of the HRE Group regarding the company pension scheme as well as social and incidental benefits were also reviewed by an external compensation consultant to determine their adequacy and competitiveness. As a result of that review it was established that the HRE Group has to improve its offering for individual benefits in every country.

##### **4.2 Variable compensation components**

Variable compensation is not permitted for the HRE Group at present as a result of Section 10 (2a) FMStFG.

##### **4.3 Individual extra payments**

As part of the restructuring process, special payments were agreed on an individual basis both in Germany and at the international locations for employees occupying positions of particular significance as well as for new employees, who were required for the successful restructuring process.

Following an extensive analysis of the legal situation, in particular Section 10 (2a and c) FMStFG, the Management Board decided on 10 December 2010 that these special payments governed by individual contracts would be paid out for 2010 in accordance with the individual commitments made to the extent that the awards had been earned by 31 December 2010 as a result of the contractually agreed loyalty of the employee and given that the prohibition does not apply to entitlements earned before 1 January 2011. No payments were made for subsequent periods in Germany.

## **5 Governance structure for compensation**

In line with the regulations of the German Stock Corporation Act (Aktiengesetz), the HRE Group has a two-tier executive body and management structure. This consists of the Supervisory Board, which is an independent supervisory body, and the Management Board, which is responsible for the management of the organization. The Supervisory Board monitors, determines, and holds the responsibility for the compensation of the members of the Management Board, and the Management Board monitors, determines, and holds the responsibility for the compensation schemes of the HRE Group and ratifies the extent and distribution of compensation. In line with the bylaws for the Supervisory Board of Hypo Real Estate Holding AG and Deutsche Pfandbriefbank AG, the compensation system is subject to approval by the Supervisory Board.

In line with the BaFin Circular 22/2009 published in December 2009, the Management Board of Hypo Real Estate Holding AG and Deutsche Pfandbriefbank AG set up a Compensation Committee on 22 January 2010. The Compensation Committee consists of representatives of Human Resources, Origination, Portfolio & Product Management, Risk Management & Control, Compliance / Corporate Governance, Finance and – as non-voting member – a representative of Internal Audit. The Compensation Committee is chaired by the Head of Human Resources.

The Compensation Committee monitors the adequacy of compensation of the employees of the HRE Group, and also monitors the adequate further development of compensation.

The Compensation Committee reports its resolutions and recommendations to the Supervisory Board and the Management Board and prepares an annual report regarding the adequacy of compensation equally submitted to the Supervisory Board and the Management Board. If and where necessary, the Compensation Committee also reports in specific, event-related situations. The chairman of the Supervisory Board can also directly obtain information from the Compensation Committee.

The Compensation Committee held three ordinary and two extraordinary meetings in 2010.

## **6 Disclosure of compensation data**

### **6.1 No variable compensation for 2009**

In view of the ongoing difficult situation on the financial markets, the continued negative results of the Group and owing to the fact that support is still necessary, the HRE Group did not provide a budget for any discretionary variable compensation for the year 2009 and did not make any such payments. This was applicable, as was the case in 2008, for all subsidiaries and locations.

However, following liaison with the main stakeholders, a voluntary one-off payment was provided as an alternative to the non-payment of variable compensation. With regard to the form and the implementation of the planned alternative solution, the Management Board focused mainly on

ensuring operational stability and avoiding operational and labour law risks backing the motivation and management of key staff in the critical phase of restructuring.

The intention, legal background, extent and content of this payment differed from the discretionary variable compensation which was paid in the past. Under such an alternative solution, the payment in Germany and some other countries was granted only to employees who, in return, waived their entitlement in a legally effective manner to any payment of discretionary variable compensation for the year 2009 and, in certain cases, additionally for 2008.

The extent of the voluntary one-off payments amounted to a total of € 25 million throughout the Group.

## 6.2 No variable compensation for 2010

In anticipation of the legally required prohibition of variable compensation according to Section 10 (2a) FMStFG for periods as from 1 January 2011 this prohibition was applied to all subsidiaries and locations of the HRE Group already regarding new entitlements of variable compensation for 2010.

## 6.3 Disclosure of compensation data in accordance with Section 7 of the Institution Compensation Ordinance

The total compensation awarded (excluding any granted deferred payments of previous years) amounted to € 149.0 million for 2009 and € 120.8 million for 2010. Of these figures base salary accounted for € 119.3 million in 2009 and € 116.2 million in 2010. The difference in 2009 consisted in the voluntary one-off payment of € 25 million and individual extra payments of € 4.7 million. In 2010, the difference equals the individual extra payments of € 4.6 million.

### Disclosure according to Section 7 of the Institution Compensation Ordinance

								2009
Compensation components, € million	CEO	COO	CFO	CRO	REF	T/PF	HRE Group	Number of beneficiaries
Base salary	5.0	38.3	14.2	35.7	7.1	19.0	119.3	1 647
Voluntary one-off payment	0.7	7.3	2.9	6.3	2.1	5.7	25.0	1 368
Individual extra payments	0.9	0.9	0.4	0.7	0.5	1.3	4.7	145
<b>Total compensation</b>	<b>6.6</b>	<b>46.5</b>	<b>17.5</b>	<b>42.7</b>	<b>9.7</b>	<b>26.0</b>	<b>149.0</b>	<b>1 647</b>

The amounts are broken down over the individual divisions as of 31 December 2009

### Disclosure according to Section 7 of the Institution Compensation Ordinance

								2010
Compensation components, € million	CEO	COO	CFO	CRO	REF /PSF	T/AM	HRE Group	Number of beneficiaries
Base salary	5.6	34.8	16.5	32.6	12.3	14.4	116.2	1 634
Individual extra payments	0.1	0.8	0.9	1.3	0.3	1.2	4.6	188
<b>Total compensation</b>	<b>5.7</b>	<b>35.6</b>	<b>17.4</b>	<b>33.9</b>	<b>12.6</b>	<b>15.6</b>	<b>120.8</b>	<b>1 634</b>

The amounts are broken down over the divisions as of 31 December 2010

## 6.4 Disclosure of compensation data in accordance with Section 8 of the Institution Compensation Ordinance

The BaFin Circular 22/2009 of 21 December 2009 specifies that financial institutions have to carry out a risk analysis under their own responsibility and identify employees who are able to enter into significant risk positions, so called risk takers.

For the year 2009 only the executive directors of the management boards of Hypo Real Estate Holding AG and Deutsche Pfandbriefbank AG were proposed as risk takers by the Compensation Committee. Beyond the requirement resulting directly from the BaFin circular it was further recommended that the executive directors of DEPFA Bank plc should also be regarded as risk takers for the year 2009. The Management Board of HRE Holding AG, Deutsche Pfandbriefbank AG, and the Executive Board of DEPFA Bank plc approved the proposal of the Compensation Committee and adopted the relevant resolutions. This decision takes account of the fact that, for the year 2009, the overriding objective of the HRE Group was to reduce risks, and also to restructure and reposition the Group. In addition, in 2009, all major decisions in connection with major risk positions were the responsibility of the Management Board.

The total compensation awarded (excluding any granted deferred payments of previous years) of the ten identified risk takers, all of whom are also managing directors, amounted to € 5.6 million for 2009. Of this figure, base salary accounted for € 3.5 million. The difference consists of the voluntary one-off payment of € 0.1 million and individual extra payments of € 2.0 million.

**Disclosure according to Section 8 of  
the Institution Compensation  
Ordinance**

							<b>2009</b>	
<b>Compensation components, € million</b>	<b>CEO</b>	<b>COO</b>	<b>CFO</b>	<b>CRO</b>	<b>REF</b>	<b>T/PF</b>	<b>HRE Group</b>	<b>Number of beneficiaries</b>
Base salary	1.0	0.6	0.1	0.6	0.0	1.2	3.5	10
Voluntary one-off payment	0.0	0.0	0.0	0.0	0.0	0.1	0.1	1
Individual extra payments	0.9	0.3	0.0	0.0	0.0	0.8	2.0	4
<b>Total compensation</b>	<b>1.9</b>	<b>0.9</b>	<b>0.1</b>	<b>0.6</b>	<b>0.0</b>	<b>2.1</b>	<b>5.6</b>	<b>10</b>

The amounts are broken down over the divisions as of 31 December 2009

In addition, a total of € 0.6 million was paid out to one beneficiary as severance payment upon the termination of the employment agreement.

For the year 2010, in line with the BaFin Circular 22/2009 and in consent with the proposal of the Compensation Committee, the Management Board of the HRE Group defined the so-called risk takers in accordance with the following criteria:

- All executive directors of the management boards of Hypo Real Estate Holding AG, Deutsche Pfandbriefbank AG as well as Depfa Bank plc
- All second level managers
- Employees in Origination exercising independent support responsibility for a country, a region or a group of customers or holding an A-vote in the Risk Committee (RC)
- All function holders who are voting members in the Risk Committee (RC), in the Asset and Liability Committee (ALCO), in the ad hoc Committee, in the Finance Committee and also in the Compensation Committee
- All employees who carry out management or specialist functions in which the following substantial risks can be established: Balance sheet risks, P&L risks, credit, liquidity, market, legal, reporting and reputation risks or trustee risks
- In relation to a legal entity or branch, executives or employees holding responsibility either as branch managers or to the respective regulatory authority.

Under these criteria, 134 functions were classified as risk takers for 2010. This is equivalent to approximately 10% of the overall workforce.

For the following disclosure of compensation data a distinction is made between risk takers and executive directors of the management boards. Please note that the above-mentioned 134 risk taker functions also comprise executive directors of the management boards.

The total compensation awarded (excluding any granted deferred payments of previous years) of the 114 identified risk takers (excluding executive directors of the management boards) amounted to € 20.9 million for 2010. Of this figure, fixed salary accounted for € 18.8 million. The difference comprises the individual extra payments of € 2.1 million.

Disclosure according to Section 8 of the Institution Compensation Ordinance								2010
Compensation components, € million	CEO	COO	CFO	CRO	REF /PSF	T/AM	HRE Group	Number of beneficiaries
Fixed salary	1.0	2.8	2.6	4.5	4.2	3.7	18.8	114
Individual extra payments	0.0	0.2	0.4	0.6	0.2	0.7	2.1	44
<b>Total compensation</b>	<b>1.0</b>	<b>3.0</b>	<b>3.0</b>	<b>5.1</b>	<b>4.4</b>	<b>4.4</b>	<b>20.9</b>	<b>114</b>

The amounts are broken down over the divisions as of 31 December 2010

In addition, a figure of € 320 thousand was paid out to two beneficiaries as severance payments upon the termination of their employment agreements. The maximum individual amount was € 230 thousand.

In addition, a payment of € 20 thousand was agreed for one beneficiary for commencing the employment agreement.

The total compensation awarded (excluding any granted deferred payments of previous years) for the 21 executive directors of the management boards amounted to € 6.3 million for 2010. Of this figure, fixed salary accounted for € 5.9 million. The difference comprises the individual extra payments of € 0.4 million.

Disclosure according to Section 8 of the Institution Compensation Ordinance								2010
Compensation components, € million	CEO	COO	CFO	CRO	REF /PSF	T/AM	HRE Group	Number of beneficiaries
Fixed salary	1.0	0.7	1.1	1.3	0.5	1.3	5.9	21
Individual extra payments	0.0	0.0	0.1	0.1	0.0	0.2	0.4	3
<b>Total compensation</b>	<b>1.0</b>	<b>0.7</b>	<b>1.2</b>	<b>1.4</b>	<b>0.5</b>	<b>1.5</b>	<b>6.3</b>	<b>21</b>

The amounts are broken down over the divisions as of 31 December 2010

As a result of the prohibition of variable compensation, no deferred payments were granted in 2010 nor any compensation depending on a sustainable development in value.

## 7 Effects of the Restructuring Act and adequacy of compensation

The cancellation of the variable compensation components has resulted in a reduction in overall monetary compensation. The overall compensation had previously reflected market conditions and was thus adequate. This was confirmed in 2010 by an independent expert engaged by SoFFin.

After the suspension of the variable compensation component, this is currently no longer the case; this has also been confirmed by an independent expert and established by the Compensation Committee in its extraordinary meeting held on 25 March 2011.

As a consequence, in addition to the movement of labour and/or enticing away of employees on a general level and in particular of specialists and key staff, who are required for a successful turnaround of the group it is becoming increasingly difficult to recruit specialists and high-performers on the labour market.



Concludingly, the Compensation Committee has ascertained that compensation in the HRE Group at the end of 2010 no longer adequate due to the complete cancellation of the variable compensation. This applies to both monetary compensation and to incidental benefits.

In the meeting on 6 December 2010, the Supervisory Board acknowledges that in order to sustain the operational stability of the Group the Management Board of the HRE Group shall develop a compensation scheme taking effect in 2011, which is compliant with the applicable statutory provisions of the Restructuring Act. The proposal shall be submitted to SoFFin for approval and, if necessary, subsequently be presented to the Supervisory Board in due course for resolution. The proposed compensation scheme must be function-specific and remain clearly below the originally foreseen variable compensation in total.

Unterschleissheim, October 2011

Compensation Committee of  
Hypo Real Estate Holding AG and  
Deutsche Pfandbriefbank AG