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Annual Press Briefing

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Manuscript – the spoken word prevails.

1. Introduction (Manuela Better)

Good morning, ladies and gentlemen!

Welcome to the annual press briefing of pbb Deutsche Pfandbriefbank. We are especially pleased that you have been able to attend today.

Like 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** *(diagram 1)*.

- At € 124 million, **pre-tax profit** in accordance with IFRS is fully within our expectations. pbb has thus been profitable for ten consecutive quarters – and for the second full year in a row.

- We achieved an aggregate **new business** volume of € 5.6 billion, thereby proving of our origination power – particularly during the fourth quarter, with € 2.7 billion originated during that quarter alone.

- We clearly exceeded our expectations concerning **funding**, in every respect: raising a total of € 6.5 billion, we achieved a high funding volume – with maturities that clearly go beyond the planned timeframe for re-privatisation at the end of 2015. To us, this is a clear expression of trust by the capital markets, affirming that we are on the right track.

We have set ourselves the goal to boost our new business volumes **during 2013**. Focusing on our core business as a European specialist bank for real estate finance and public investment finance, we will strengthen our market presence in these businesses. To add further support to our business, today we are launching retail deposit-taking, through our online platform pbbdirekt.com.

My colleague Alexander von Uslar will now present and discuss the preliminary results for the 2012 financial year in detail.

2. Results 2012 (Alexander von Uslar)

Good morning, ladies and gentlemen.

Allow me to make a few introductory observations before commenting on the financial statements:

- pbb generated pre-tax profits of € 124 million, in accordance with IFRS, during 2012. As Manuela Better already pointed out, we are thus within the target framework that we set ourselves at the start of the year.

- When making our forecast at the time, we took into account several factors which had either benefited results for 2011 – or which would burden performance during 2012.

    - We deliberately maintained liquidity during 2012. As we all know, this does not come for free: the costs of this conservative liquidity strategy burdened net interest income for 2012.

      In addition, net interest income for 2011 had included effects of € 43 million, at the overall bank level, predominantly resulting from the buy-back of debt instruments. Comparable effects amounted to € 17 million in 2012.

    - The **bank levy** amounted to € -24 million in 2012, compared to just € -2 million the year before.

    - Furthermore, the lower level of interest rates available on investments resulted in lower income from the liquidity position and equity investments.

The figures which we will present to you today are preliminary; accordingly, they are as yet unaudited. We will publish the audited financial statements and the annual report on 10 April 2013.

2.1 Consolidated results of Deutsche Pfandbriefbank

I will now present the details of pbb's consolidated financial statements in accordance with IFRS. However, in presenting these results I will depart from the traditional income statement structure; instead I will discuss the various items in line with the logical structure of our business.

2.1.1 Results from the lending business

Income from the lending business is recognised in two items: net interest income and net commission income *(diagram 2)*.

- At € 296 million (2011: € 371 million), **net interest income** remained the key source of income.
    - Average interest-bearing assets declined over the previous year. However, the factors contributing to the decline included risk-reducing measures: for instance, we reduced exposures in Italy and Portugal in a targeted manner – some of these exposures had high interest rates.
    - higher margins generated on new business – compared to existing exposures – had a positive effect,
    - net interest income was burdened, as explained at the beginning, by an increased liquidity position in order to prevent future funding risks. Moreover, lower market interest rates resulted in lower interest income from own funds and the liquidity position invested.
- **Net commission income** totalled € 23 million (2011: € 32 million). We generate commissions, for example, in the form of syndication and other fees.

This income from the lending business is offset by expenses, in the form of **provisions for losses on loans and advances**. Thanks to the improved financial circumstances of individual loans, and the successful restructuring of exposures, the bank released a net € 4 million in provisions for losses on loans and advances (in 2011, provisions were released in an amount of € 12 million). Only a few individual exposures saw material changes in provisions for losses on loans and advances. The positive development is also reflected in the decline of problem loans, from € 1.3 billion to € 1.1 billion.

2.1.2 Other results related to our business activities

We reduced **general administrative expenses** by € 16 million, to € 341 million (2011: € 357 million) *(diagram 3)*.

- **Non-personnel expenses** fell to € 210 million (2011: € 228 million), due in particular to lower IT expenses resulting from the successful conclusion of a multi-year consolidation project.

  Having consolidated our IT application environment over recent years, shifting to standard applications, we now benefit from higher quality at lower cost.

- At € 131 million, **personnel-expenses** remained virtually unchanged (2011: € 129 million).

- The **cost/income ratio** increased to 73 per cent, due to the fact that operating income declined more strongly than general administrative expenses. However, this indicator continues to be distorted by the services we provide to FMS Wertmanagement, which drive up the cost/income ratio. The termination of the servicing will already lead to some improvements in 2013; the full effect will become visible in 2014. At this point, we shall endeavour to achieve a cost/income ratio below 40%.

The **balance of operating income/expenses** amounted to € 131 million during the 2012 financial year (2011: € 184 million).

- This balance comprises income from the **servicing for FMS Wertmanagement**: of € 106 million (2011: € 109 million).

  As you know, this income item is offset by general administrative expenses of virtually the same amount. This is due to the fact that we invoice these services using a 'cost-plus' method, with only a small mark-up. We will terminate the servicing for FMS Wertmanagement during the course of this year.

- The bank generated € 40 million (2011: € 35 million) in net income from IT services provided to our affiliate, DEPFA Group.

- In addition, expenses for the bank levy and related back payments rose to € -24 million (2011: € -2 million).

The **balance of other income/expenses** of € -6 million (2011: € 7 million) mainly reflected changes to restructuring provisions required for pbb's realignment.

2.1.3 Effects from the valuation of financial instruments

Let me now turn to the effects resulting from the valuation of financial instruments *(diagram 4)*. These effects – which developed favourably during the year under review – are driven by changes in market values, and thus we can influence these only to a very limited extend.

- **Net trading income** swung from an € -8 million loss in 2011 to a € 10 million profit in 2012. This was due to effects from the valuation of derivatives. We continue to not have a trading book.

- **Net income from financial investments** increased to € 13 million (2011: € 3 million), comprising € 20 million (2011: € 5 million) capital gains from the sale of securities, as part of the adjustment to the liquidity position. This was offset by net expenses of € -6 million (2011: € -1 million) for portfolio-based provisions on securities carried under the IFRS measurement category 'Loans and Receivables'.

- **Net income from hedge relationships** improved significantly, to € -6 million (2011: € -56 million) during the year under review. Specifically, this was due to the following developments:

    - A positive result of € 2 million (2011: € -37 million) was due to the measurement of assets designated at fair value through profit or loss ("dFVTPL"), in connection with related hedges.

      We sold three securities issued by the Republic of Portugal, classified as dFVTPL, during the first quarter of 2012. The volatility of this item decreased significantly as a result of these sales. As at the reporting date, pbb held only one financial instrument in this measurement category; this security will mature during the second quarter of 2013.

    - In addition, hedge inefficiencies within the range as permitted by IAS 39 (80%-125%) resulted in expenses of € -8 million (2011: € -19 million), mainly caused by mismatched interest rate fixing dates.

2.2 Consolidated total assets

Consolidated total assets as at 31 December 2012 amounted to € 97 billion, down 11% from the previous year's level (31 December 2011: € 109 billion) *(diagram 5)*.

- The decline was mainly attributable to the reduction in counter effects which occurred in relation to the transfer of positions to FMS Wertmanagement.

- Independent from these effects, total assets declined due to the reduction of certain portfolios, in line with strategy, for example in public budget finance.

3. Regulatory capital ratios

As a sub-group of the HRE Group, Deutsche Pfandbriefbank is exempted under the German Banking Act from the obligation to determine capital ratios at the level of the institution. Therefore, I would like to state the pro-forma ratios which we have determined.

Deutsche Pfandbriefbank is well-capitalised. The bank's capital ratios improved during the year under review, particularly as a consequence of the reduction in risk-weighted assets, from € 17.0 billion to € 15.3 billion:

- the tier 1 ratio was 18.1% (31 December 2011: 16.3%), and
- the core tier 1 ratio was 15.8% (31 December 2011: 14.2%).

The bank's capitalisation – excluding the results for 2012 – remained stable, at € 2.8 billion.

Capital ratios would remain at these sound levels, even when applying all effects known under Basel III today: the tier 1 ratio would be 20.1% and the core tier 1 ratio 18.7%.

Thank you very much for your attention.

4. Review of the year 2012 (Manuela Better)

4.1 New business

Ladies and Gentlemen,

At the outset I said that we are looking back on a successful year, with some good solid business. However, developments during the course of the year once again demonstrated the high degree of **dependency between new business and funding**.

At the end of 2011 and the beginning of 2012, all market players were faced with very high uncertainty concerning the scope available in the funding markets. For this reason, we throttled back our origination activities at first, leading to a relatively slow first half of the year. Clearly, our **priority is on liquidity rather than on achieving target new business volumes** – and we will keep things that way.

We observed already during the first quarter of 2012 that funding markets were sufficiently deep. Accordingly, we accelerated sales efforts again, **demonstrating our origination strength** during the second half of the year.

This led to the following picture *(diagram 6)*:

- **New business** originated during 2012 (including loan extensions of more than 12 months) **totalled € 5.6 billion**, with commercial real estate finance accounting for the largest part: € 4.9 billion. New business in public-sector investment finance, our second business segment, amounted to € 0.7 billion.

- We significantly **boosted our performance during the course of the year**:

    - New business volume during the two first two quarters amounted to € 0.8 billion and € 0.7 billion, respectively.

    - We doubled this, on a quarterly basis, to € 1.4 billion in the third quarter.

    - In the fourth quarter, new business rose to € 2.7 billion – once again twice the amount originated during the third quarter. This means that the fourth quarter of 2012 even exceeded the strong final quarter of the previous year, when we generated € 2.3 billion in new business.

We concluded these new exposures at **higher margins – yet at lower risk**, compared to the previous year.

Allow me now to talk briefly about key aspects in our new business. We continue to overweight specific markets that offer particular opportunities. This **portfolio approach** applies to both real estate finance and public investment finance.

- **Real Estate Finance**

  - As in the previous year, we originated the majority of real estate loans in **Germany**, which accounted for a 32 per cent share. We overweighted Scandinavia, with a share of 20 per cent. Since we consider the Scandinavian market to be sustainably attractive, we opened a new office in Stockholm in 2012, as planned.

    The **United Kingdom** was our third most important market, accounting for some 17 per cent of new business, followed by France (15 per cent) and Central and Eastern Europe (12 per cent).

  - New business was almost equally distributed amongst the four **property types** of offices, logistics, residential and retail/shopping properties – our focal points in real estate finance. The relative proportion of these four segments within our portfolio also changed compared to the previous year: our portfolio approach not only applies to countries but also to types of property.

  - The average **loan-to-value ratio** for new exposures dropped markedly, to 56 per cent (2011: 65 per cent).

    This shows that banks – not just pbb – require real estate investors to make a higher equity contribution to financings – and that investors make such contributions. In fact, many investors consciously use this additional buffer as a cushion against potential real estate fluctuations.

- **Public Investment Finance**

  - In our public investment finance franchise we were almost exclusively active in our core markets of **France** (77 per cent) and **Germany** (20 per cent). Likewise, our portfolio approach led to a shift: in 2011, Germany accounted for the largest share of new business, at 55 per cent.

  - **Counterparties** in the public investment finance business were public-sector entities or corporations; alternatively, loans were granted against a state guarantee, for example, within the scope of export financing schemes.

  - At around 7 years, the average maturity was lower than in the previous year (2011: 10.3 years), which has made it easier for us to refinance these loans.

4.2 Portfolio

During the period under review, pbb Deutsche Pfandbriefbank's **overall portfolio** declined by € 6.7 billion, to € 75.3 billion (shown as Exposure at Default or EaD, in line with Basel II). To adequately represent actual economic risk exposure, this figure does not include EaD figures from back-to-back transactions with, and positions guaranteed by, FMS Wertmanagement; these are not considered part of the core exposure. As in the previous year, the decline was due in particular to maturities in the run-off portfolio. This portfolio consists of assets from the budget finance business segment, which is being run off on the balance sheet, without new business being originated.

We actively reduced our exposure to borrowers in **European countries in focus** *(diagram 7)*. Excluding real estate finance, exposure to Spain, Portugal and Italy, amounted to a total of € 8.8 billion – roughly 25 per cent lower than at the end of 2011. We have no exposure to Greece or Cyprus. Only a clearly smaller part of this overall exposure is against the respective sovereign; the majority is against sub-sovereign borrowers. We manage these portfolios very actively indeed. During 2013 this portfolio will be reduced by another € 0.5 billion through maturities alone.

- Exposure to **Italy** has been reduced, as planned, by close to 40 per cent during 2012, to € 3.1 billion. Half of this exposure is against sub-sovereign borrowers.

- Our loans to borrowers in **Portugal** declined by 20 per cent during the year under review, to a level of € 1.6 billion, including € 0.2 billion against the Portuguese state.

- The largest exposure in the European countries in focus is now against **Spain**: this exposure declined by around 10 per cent, to € 4.1 billion, exclusively against financial institutions – largely in the form of covered securities – and public-sector authorities, but not against the Spanish state.

4.3 Funding of the lending business

Looking at the year 2012 as a whole, funding markets developed favourably, despite the uncertainty at the outset. Accordingly, pbb's funding activities were very successful indeed *(diagram 8)*. We were **regularly active as an issuer**, raising medium- to long-term unsecured funds in significant volumes, and with continuously narrowing spreads over the course of the year.

Aggregate new long-term **funding volume** amounted to € 6.5 billion, with an average maturity of 6.4 years.

- Of the total volume about two-thirds (€ 4.2 billion) was in **Pfandbriefe**. We issued three public euro-denominated benchmark Mortgage Pfandbriefe, and each issue was subsequently tapped. Moreover, we placed a sterling-denominated Pfandbrief for the first time since the summer of 2007 – a very important placement for our new business in the UK market.

- We raised the remaining € 2.3 billion in unsecured funds, via **promissory notes and senior unsecured bearer bonds**, with an average maturity of 4.5 years.

  We see both the volume and maturity of unsecured financing as a positive sign of confidence investors have placed in pbb Deutsche Pfandbriefbank as a borrower, beyond the planned timing of re-privatisation.

Our **start with new issues into the year 2013** has also been very successful. We already placed a **Mortgage Pfandbrief** issue and a **bearer bond**, both public benchmark issues, with the latter already tapped by € 360 million.

pbb participated in the European Central Bank's long-term refinancing operation in December 2011 and March 2012. We already used the first dates for partial repayments; meanwhile, we have fully repaid the funds raised through these transactions.

Further broadening our funding base has to remain our objective. For this reason, we launched our **retail deposit-taking business** today. I will cover this in more detail in a moment, when I will discuss the outlook for 2013.

5. Outlook

Ladies and Gentlemen,

This brings me to our priorities for 2013.

As the most important single step in the restructuring and realignment of pbb Deutsche Pfandbriefbank, we transferred non-strategic assets to the FMS Wertmanagement in 2010, and have been managing these portfolios as a service provider to FMS WM since then. We will terminate the servicing relationship as at 30 September 2013: at this time, we will hand over the task to FMS Wertmanagement's own servicing company.

Transfer the servicing is an obligation imposed by the EU Commission in its decision regarding state aid proceedings in 2011. But we also want to hand over the servicing because managing portfolios exclusively for third parties is not part of our business model. This means that once we have terminated the servicing function, we will be able to **focus exclusively on our core business**.

We also want to use 2013 to further sharpen pbb's focus on **penetrating relevant markets**, and to **broaden our funding base**.

5.1 Handing over the servicing function

The final technical step for handing over the servicing function will be the **separation of IT systems**. For this purpose, we will duplicate our software systems, and will hand over a fully operational version to FMS Wertmanagement *(diagram 9)*.

We are also working towards creating opportunities for our **members of staff** currently working on our servicing function to move to FMS Wertmanagement's service company.

- Firstly, this will help us ensure that service company staff will be familiar with the portfolio.

- Secondly, this will open up employment opportunities to our staff – opportunities which pbb will no longer be able to offer. Approximately 190 of around 990 full-time jobs at pbb in Germany and abroad will be affected.

5.2 Boosting market penetration

With the termination of the servicing function, pbb will achieve the **target model** for its business activities *(diagram 10)*: we are a specialist bank focusing on commercial real estate finance and public investment finance, refinancing this business predominantly via Pfandbrief issues. In Europe, we have a broader market presence than most of our competitors, which are often restricted to their respective home markets.

We offer a **comprehensive range of products and services**:

- In the lending business, we are active as a **sole lender**, or together with partners, particularly where large-ticket financings are concerned. For this purpose, we have access to a broad network of partner banks and other financing sources – such as mezzanine or private equity houses, with whom we jointly arrange customised financing solutions for our clients.

- In such cases, we may additionally be mandated as **arranger**, compiling a syndicate on the client's behalf from amongst a group of financiers; or as **agent**, managing financings on behalf of a syndicate.

  We also act as **underwriters**, where we initially provide finance as a sole lender, and then sell down parts of these loans to interested partners, within the framework of syndication.

  The roles of arranger, agent or underwriter offer **potential for additional income**.

To **boost market penetration and optimise our market presence**, we plan the following measures during 2013:

- We will expand our **market-facing teams** across all functions, by around 50 staff members over the medium term. The number of staff in other functions will be reduced.

- We have strengthened our **local presences** with additional offices in Stockholm, Berlin, Dusseldorf and Hamburg. This will enable us to enhance coverage of these regional markets.

- We will further develop our **processes**, in order to speed up our business – fulfilling a key client need. I would like to describe two examples to illustrate the changed processes.

  - Besides structured, complex financings, we offer standardised products to our clients. Using what we call **'fast track'**, we aim to be able to submit a standardised loan agreement to our clients within a short period of time. In a first step, we have rolled out this process for financings in Germany since October 2012, with UK and France to follow.

  - Likewise, we will change the new **business process** – with the objectives of enhancing the quality of lending decisions and accelerating them.

5.3 Establishing deposit-taking business within pbb

Ladies and Gentlemen,

I would now like to turn to another initiative for the year 2013. Today we are launching pbb's deposit-taking business. Our **online platform pbbdirekt.com** went live this morning. pbb direkt is not a bank in its own right, but a service offered by pbb Deutsche Pfandbriefbank *(diagram 11)*.

Retail investors are now able to make **term deposits** for 6 months, 1 year, 2 years and 3 years as well as **overnight deposits** with pbb Deutsche Pfandbriefbank. We offer retail investors attractive interest rates and low fees.

Why would pbb enter the deposit-taking business? To us, retail deposit-taking provides an opportunity for **broadening our funding base**. In this context, we will be using these deposits as a supplement.

The interest rates which we are offering to retail investors will be oriented upon the costs for our unsecured funding. Against this background we envisage being able to offer **competitive rates** for deposits.

As you know, the market for deposits is very large indeed; new competitors entered the market in the recent past. We therefore assume that we will be able to attract deposit volumes that will sustainably broaden our funding. Nonetheless, our market share for deposits in Germany is likely to remain clearly below 0.5 per cent – the **competitive environment will therefore not change materially**.

5.4 Outlook for 2013

The Management Board assesses the scenario for pbb Deutsche Pfandbriefbank in 2013 as follows: As in the previous years, the scope available in the **funding markets** will continue to determine new business volumes. There are no indications at present of a situation similar to the one seen at the beginning of 2012, where the entire sector saw significant uncertainty in the funding markets.

For the 2013 financial year, we envisage a marked increase in **new business volumes** (including extensions beyond one year) compared to 2012, in our two business segments of real estate finance and public investment finance. As in the past, the majority of new business will be in real estate finance.

Looking at results of operations for 2013, we anticipate the following developments:

- We want to clearly increase **net interest income**.

  We have assumed provisions for losses on loans and advances to be at normalised levels. Results would be strengthened if no significant provision for losses on loans and advances were necessary – as was the case in 2012.

- The **balance of other operating income and expenses** will decline upon the termination of the servicing. Whilst income will fall away immediately and completely, the full effect of cost reductions reflected in general administrative expenses will not occur straight away, due to fixed costs and the removal of synergies.

  Nonetheless, we anticipate a marked reduction in general administrative expenses.

- Considering all these factors, pbb Deutsche Pfandbriefbank anticipates once again achieving a **positive pre-tax profit** for 2013, **in excess of € 100 million**.

- Effects from the **valuation of financial instruments** are hard to predict: However, during 2013, the entire financial services sector will have to change its approach to the valuation of derivatives, in line with requirements by external auditors and due to changed market conventions. We are unable to estimate the potential impact of these changes as yet. Depending on market developments, they may have a marked impact on results for the 2013 financial year, with any offsetting effects only occurring during subsequent years.

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Ladies and Gentlemen,

This brings me to the conclusion of my comments. I would like to thank you all for your interest and attention. We would now be pleased to answer your questions.