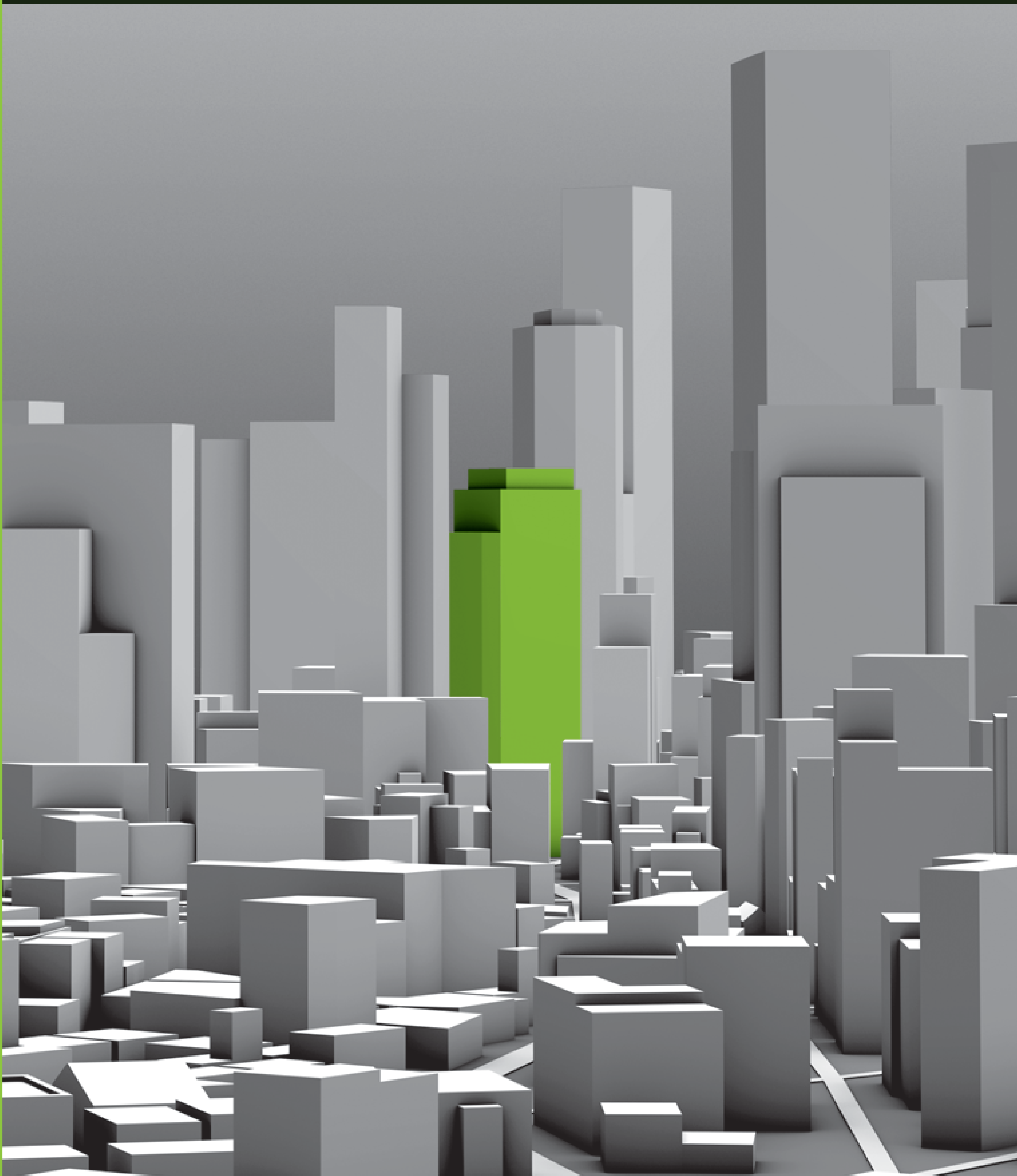
Annual Report 2011

PUBLIC SECTOR FINANCE
REAL ESTATE FINANCE

pbb
DEUTSCHE PFANDBRIEFBANK



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

We operate exclusively in selected European countries and sectors, and are one of the largest lenders in this particular market segment. Our key refinancing instrument is the Pfandbrief. We have an important role to play in financing the real estate sector and public infrastructure in Germany and Europe.

Public Sector Finance

Public Sector Finance focuses on investments in public infrastructure: Public amenities, housing, utilities and waste disposal as well as healthcare and nursing facilities.

Regional focus is placed on European countries with good ratings, in which lending operations can be refinanced by issuing Pfandbriefe.

Real Estate Finance

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

We focus on financing office buildings and residential, retail and logistics real estate.

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

Financial Highlights
Ratings

Financial Highlights		2011	2010
Operating performance according to IFRS			
Pre-tax profit/loss	in € million	188	–135
Net income/loss	in € million	117	–185
Key ratios			
Return on equity before taxes	in %	5.9	–4.4
Return on equity after taxes	in %	3.7	–6.0
Cost-income ratio[1]	in %	67.9	54.0
Balance sheet figures		31.12.2011	31.12.2010
Total assets	in € billion	108.8	186.8
Equity (excluding revaluation reserve)	in € billion	3.2	3.1
Equity	in € billion	3.1	3.4
Personnel			
Employees		1,032	919

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

Ratings of Deutsche Pfandbriefbank AG and its covered bonds[1]		31.12.2011			31.12.2010		
		Fitch Ratings	Moody's	Standard & Poor's	Fitch Ratings	Moody's	Standard & Poor's
Deutsche Pfandbriefbank AG	Long-term	A–	A3	BBB	A–	A3	BBB
	Outlook	Stable	Stable	Stable	Stable	Stable	Stable
	Short-term	F1	P–1	A–2	F1	P–1	A–2
Public sector Pfandbrief		AAA[2][3]	Aaa	AA+	AAA	Aaa	AA+
Mortgage Pfandbrief		AA+	Aa1	AA+	AA+[2]	Aa3	AA+

[1] Ratings of mandated rating agencies.
[2] Credit watch for possible downgrade.
[3] Deutsche Pfandbriefbank AG ended the agreement with Fitch Ratings regarding the rating of its public sector Pfandbriefe in February 2012 (refer to Events after 31 December 2011).

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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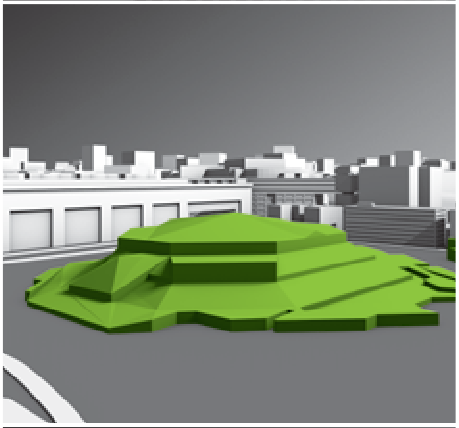
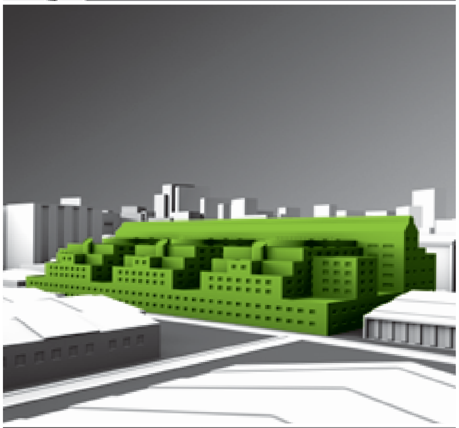
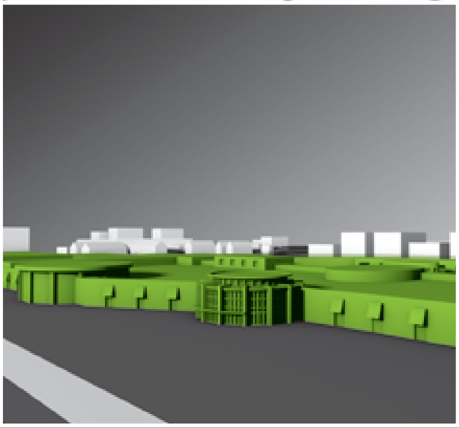




GLL GmbH & Co. MesseTurm KG MesseTurm
€ 155 million

Investment loan (club deal)
Frankfurt, Germany
December 2011

As joint arrangers, pbb and Landesbank Baden-Württemberg (LBBW) have arranged newly structured funding for GLL GmbH & Co. MesseTurm KG. The MesseTurm is one of Frankfurt's landmark buildings. It was designed by the world-renowned Chicago architectural office Murphy Jahn, and was completed in 1990 with a height of 265 meters. The high-rise building has 52 floors of rental office space, a total area of 62,135 m².

Preface of the CEO

Preface of the CEO

As part of the restructuring of HRE Group, we positioned pbb Deutsche Pfandbriefbank as the new strategic core bank of the Group in 2010. Accordingly, we were able to focus on our customers and the market in 2011 which, with the conclusion of the EU state aid proceedings, marked a further major step in the restructuring process. The year was very successful and we have returned pbb Deutsche Pfandbriefbank to the credit and capital markets.

We have reached the goals which we set ourselves: we have provided loans amounting to € 8 billion to our clients, and have thus considerably increased the new business (including extensions of more than one year) compared to the previous year. Due to our comfortable liquidity position on the one hand and the difficult market conditions on the other, we have only accessed the funding markets to a limited extent.

We generated pre-tax profit of €188 million in the financial year 2011, and have now been profitable for six consecutive quarters. The path on which we have embarked as a result of the restructuring and realignment process is proving to be correct and successful.

We intend to continue along this path in 2012. We expect to experience strong demand for financing in our core markets in both business areas, together with a further downturn in supply and adequate margins in most markets. This is where we intend to establish and expand our earnings base with high-margin business, consistent with our risk strategy.

The main challenge will be the appetite of debt investors to invest in Pfandbriefe and unsecured funding instruments. We anticipate that the availability of funding will have a major impact on the volume of new business. We need to find the correct balance between new business and maintaining liquidity – whereby liquidity will be given priority.

In addition to the markets, our main attention continues to be devoted to improving our organisation and internal processes; we have again made considerable progress in these areas in 2011. We are already paving the way for ending the servicing of the portfolio, which was transferred to FMS Wertmanagement in 2010, no later than the scheduled deadline of September 2013. A further aim is to position both Deutsche Pfandbriefbank Group and the affiliated DEPFA Group in such a way that the two entities can be reprivatised separately.

As a result of returning to the credit and capital markets and becoming profitable, we have created further conditions which will enable pbb Deutsche Pfandbriefbank to be reprivatised as a specialist bank for real estate finance and public investment finance.

I should like to thank our customers for the confidence which they have placed in us. Once again, our staff also deserve special thanks: it is their strong level of commitment that has helped to achieve our objectives.

Kind regards

M. Bett

Manuela Better
CEO

«In 2011, we successfully returned pbb Deutsche Pfandbriefbank to the credit and capital markets. As a result, we have created further conditions which enable pbb Deutsche Pfandbriefbank to be reprivatised as a specialist bank for real estate finance and public investment finance. We are on schedule, and intend to continue this strategy.»
Manuela Better

«Our refinancing strategy has meant that we have only had to tap the capital markets to a limited extent in a difficult market climate. The need to maintain liquidity will continue to be a priority in 2012. We anticipate that the funding markets will increasingly return to normal.»
Wolfgang Groth

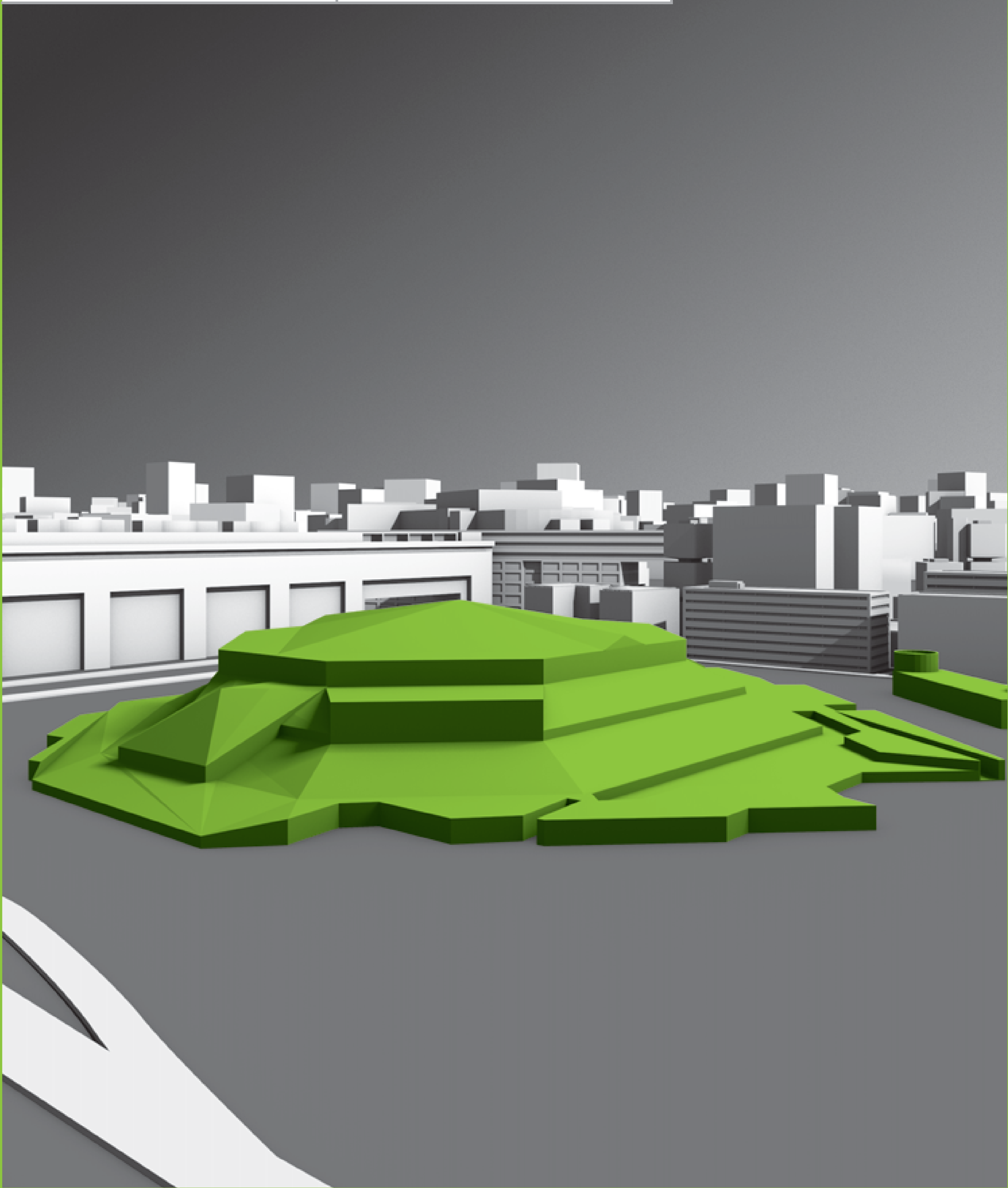
«The volume of new business impressively underlines our strengths in origination. We intend to maintain our position as one of the leading specialist banks and will again provide loans to our real estate customers and the public sector in 2012.»
Dr. Bernhard Scholz

«Having already returned to profitability in the second half of 2010 and following six successive, profitable quarters, we have now reported a profit for 2011. We intend to continue this series in 2012.»
Alexander von Uslar

Paris-Bercy Arena Concession
€ 125 million

Mandated lead arranger
Paris, France
December 2011

pbb closed a senior loan agreement for SAE Palais Omnisports de Paris-Bercy. This company has been the concessionaire of the Bercy Arena in the centre of Paris since 1984. The loan will finance a major refurbishment of the Arena to offer more modularity and a capacity of up to nearly 21,000 seats. The project benefits from strong support by the City of Paris, which is both the grantor of the concession and the majority shareholder of SAE POPB.



Financial Review

Financial Review
Business and Conditions

Macro-economic Situation

In 2011, the development of economic growth seen in 2010 was somewhat mixed worldwide. Only a few countries were able to compensate for the massive downturn seen in the crisis year of 2009. Outside Asia, Germany led the way with growth of 3.0 %. The economies of the countries which are at the focus of the European Bank and government debt crisis were either having to contend with a recession such as Greece (–5.3 %) and Portugal (–1.7%) in 2011, or they were only able to report comparatively low growth such as Italy (0.6 %), Spain (0.7%) and Ireland (1.2 %). Asia continued to report further positive growth. Although the rate of growth in China has declined slightly (9.2 %), it continues to be very high. On the other hand, growth in the USA has weakened appreciably from approximately 3.0 % in 2010 to 1.7 % in 2011.

In terms of monetary policy, the strong expansionary policy of previous years was continued in virtually all major economies during 2011. Accordingly, the European Central Bank (ECB) continued its policy of purchasing limited volumes of government paper which commenced in May 2010. Shortly before the end of the year, the bank sector was also provided with Central Bank money of approximately € 500 billion for a period of three years. The euro-zone has thus entered new territory in terms of the maturities of the loans. Despite this expansionary tendency, growth in inflation remained moderate. At the end of 2011, the main refinancing rate of the European Central Bank was at its all-time low of 1%, after increases seen in the initial months of the year had been reversed in November 2011.

Despite difficult budget conditions, some countries have focused on public sector investments in order to alleviate possible negative economic development. Accordingly, new borrowing in the USA amounted to 10 % of gross domestic product (GDP). On the other hand, Germany occupies a relatively new position in terms of an international comparison, with new borrowing of 1.2 %.

Sector-specific Situation

Overall Situation of the Banking Sector

The mixed performance of the economical conditions in the Western industrialised countries in 2011 has had an impact on the development of business in the banking sector. The fact that the government debt crisis has become more serious has had an even greater impact on the overall banking sector. The rating downgrades of many European countries which are currently the focus of attention (Greece, Portugal, Italy, Spain and Ireland) and the USA were reflected in volatility on the financial markets. Banks with large portfolios of bonds of countries which are currently at the focus of attention have been viewed particularly critically. The European Banking Authority carried out two stress tests in 2011 in order to assess the capital backing of banks. Banks with a low equity ratio are now trying to improve their capital situation with various measures in the near future.

The lack of confidence on markets has again resulted in interbank markets which are only functioning to a very limited extent, as was the case in the autumn of 2008 following the collapse of Lehman Brothers. Despite low levels of interest rates, above-average volumes of funds were deposited in short-term instruments with the central banks in order to assure liquidity. At the same time, it has become more difficult to place uncovered bank issues as a result of weaker demand. The above-mentioned ECB programme of buying up bonds has somewhat improved the liquidity situation of many banks. Because the cautious attitude of markets has in certain cases resulted in a considerable downturn in income at the banks, this has resulted in a reduction of new business and the consolidation of the number of players in the banking sector.

Public Sector Finance

The public sector finance situation in the EU expanded into a debt crisis in 2011: constant or expanding demand for funding was opposed by fewer and fewer investors. The generally higher level of uncertainty resulted in a significant widening of risk premiums, which was reflected in higher interest costs and greater strain imposed on public sector budgets. Since mid-2011, even large economies have for the first time been affected by significant widening of interest costs for new issues. Particular attention focused on Italy and Spain, as a result of the size of these economies. In Germany, government bonds were in demand as a safe investment. The strong demand has meant that yields have fallen to an all-time low.

In order to assure the solvency of individual member countries inside and outside the eurozone, corresponding political measures were taken in the individual countries themselves and also at the EU level (in certain cases in conjunction with IMF funds). Attention focused on interventions of the European Central Bank on the secondary market for government bonds and in particular measures and instruments for permanently overcoming the crisis and reducing debt levels (e.g. the declaration of intent of almost all EU countries for a fiscal pact in December 2011, which specifies mandatory debt limits and fines if certain deficit and debt limits are exceeded). The financing problems affected not only certain EU countries but also the central, regional and local authorities.

In Germany, the public sector finance market continued to offer adequate opportunities for customer-specific finance solutions. As has been the case in the past, the low margins offered by Landesbanken (regional banks) and Förderbanken (development banks) as well as the above-average maturities of the financing arrangements on offer were viewed as challenges. In France, the public sector finance market offered much improved market conditions mainly as a result of the reluctance of French banks and the break-up of a major competitor.

Many investors who demonstrated interest in low-risk lending operations in 2010 changed direction in 2011 as a result of the euro crisis and lack of access of USD refinancing, and withdrew consistently from the market of public projects or projects with public guarantees. Some banks have also sold government bond portfolios. The more stringent requirements imposed by Basel III on capital backing meant that it was necessary for risk and liquidity profiles to be adjusted. On the other hand, local financial institutions with strong deposit business stepped up their operations in public sector finance. However, they were not able to compensate for the general shortage of funds. This provided the banks with an opportunity to conclude financing arrangements with a balanced risk/return profile.

Real Estate Finance

There were very mixed developments on the European real estate markets in 2011. Whereas the real estate markets in Western and Northern Europe in particular and certain individual real estate markets in Eastern Europe were able to continue their positive development, the real estate markets in Southern Europe reported a further decline in demand and the number of transactions in 2011. The growth on the real estate markets slowed down in the final months of 2011. Despite the difficult situation in the financial sector and despite the economic slowdown, the situation on the real estate markets which are relevant for the bank was characterised by comparatively good demand. As a result of the European government debt crisis, a paradigm change has probably taken place among investors, with real estate being the beneficiary.

However, the risk propensity of investors was limited with regard to the quality and location of the properties. The market climate in 2011 was dominated by the high-end property segment in good to very good locations and with properties let on a long-term basis («core properties»). Because of the limited supply and constant demand, this resulted in higher prices of these properties, and thus resulted in a decline in initial yields. Within the various types of commercial properties, retail properties attracted the greatest amount of interest. In addition, the overall development in 2011 benefited from major individual transactions.

The German real estate market in 2011 was very attractive for property investors from Germany and abroad. There was strong demand particularly in the top segments such as retail, followed by residential and office properties, primarily in the metropolitan regions. The nationwide volume of transactions has increased considerably compared with the previous year. Risk propensity in the short term has risen somewhat, and has increasingly been focusing on the category of core properties as a result of the depressing climate in the financial sector. Residential property prices in Germany have on average strengthened in 2011. Demand has been focusing on the main metropolitan areas. However, prospects in attractive secondary locations have also improved. The positive trend reported for property rental activities in the previous year was again confirmed in 2011. For all commercial property types in good to very good locations, rent levels for new rentals at least remained constant or increased. There were signs of stabilisation for the development of rents for properties in secondary locations; however, the development was somewhat weaker compared with new and modern properties. The office property market overall continued to stabilise, but the level of vacant properties at some locations is still relatively high.

The development was also positive in other European core countries. In Great Britain, demand for property returned to the level seen in the previous year, although the British economy and the labour market were not showing any signs of strong growth. Vacancy levels have declined in certain cases. In the office market in London, there has been evidence of a return to strong growth in rents. In France, the volume of transactions in 2011 increased considerably compared with the previous year, although the overall development benefited from major individual property transactions. Office vacancies were still at a high level, but no major completions are expected at many locations in the near future. Because of the selective buying of investors, investments also focused on the segment of high-end properties. The positive development in Scandinavia also continued in the year under review, led by the Swedish market. Events were dominated by domestic investors. Office rents continued to rise in 2011, and vacancy levels declined somewhat. In Poland, the good economic growth resulted in higher transaction volumes in 2011. The office property segment as well as the commercial property segment reported strong growth compared with the previous year. The real estate market in Spain was again characterised by the difficult economic situation in the country in 2011. In Madrid and Barcelona, vacancies reached record levels in certain areas, and thus failed to match the fundamentally positive trend in Europe.

Although some banks reduced or completely discontinued their new business in 2011, financing in the Pfandbrief-eligible field was in many cases easy to obtain for the segment of high-end properties. It is true that competition in 2011 was quite strong for small and mid-size financing arrangements. On the other hand, there was evidence in the case of large volume and complex financing arrangements that the financing banks frequently operated in syndicates. In the individual markets, domestic banks in 2011 confirmed their dominance in the field of commercial property financing compared with the international competition. Overall, the year 2011 saw a reduction in the absolute number of banks which operate new business in commercial real estate financing.

Refinancing Markets

The capital markets were dominated by the government debt crisis in the eurozone last year. Strong issue volumes of covered bonds were reported in the first half of 2011. After the summer of 2011, the unresolved issues regarding country ratings also had a significant impact on the refinancing markets for covered bonds. In consequence, only a small number of benchmark issues were placed in the second half of the year, with reduced volumes. In parallel with this development, the risk premiums for existing issues on the secondary market widened appreciably. In general, it was very difficult for uncovered issues of banks to be traded. Only a small number of banks succeeded in placing such issues.

In order to supply adequate liquidity to the banking sector, the ECB offered a 36-months' facility towards the end of the year; of this facility, approximately € 500 billion was utilised. The government debt crisis also had a significant impact on the development in interest rates in 2011. Accordingly, the spread between the yields of 10-year Italian and German bonds at one point widened by more than 400 basis points. In this context, the market was searching for low-risk investment opportunities, which meant that the risk-free level of interest rates declined sharply. Accordingly, the yield of 10-year government bonds, which amounted to 3.50% in April 2011, had fallen to an all-time low of 1.67% in September.

Major Legal Conditions

The year 2011 was characterised by intense discussions regarding the change in regulatory conditions. The European Banking Authority (EBA) was established on 1 January 2011. The aim of the EBA is to develop uniform bank regulation standards throughout Europe, which are then to be implemented by the national bank regulatory authorities. The second E-Money Act was promulgated on 8 March 2011. The regulations in money laundering law in particular were significant for the Group. The law for optimising the prevention of money laundering, which came into force on 29 December 2011, mainly had an indirect impact for the credit industry. The law for strengthening investor protection and improving the functionality of the capital market (Investor Protection and Functionality Improvement Act) came into force on 8 April 2011. The law introduced significant changes regarding the sale of securities and financial instruments. For implementation, the WpHG Mitarbeiteranzeigeverordnung was promulgated in the Federal Gazette on 30 December 2011. It will come into force on 1 November 2012 (as will Section 34d WpHG). The ordinance regarding the collection of contributions for the restructuring fund for credit institutions was promulgated on 25 July 2011, and provided clarity regarding the extent of the contributions of the credit institutions to the restructuring fund. The law for adjusting the regulations regarding reimbursement in the event of revocation of remote sales agreements and related agreements, which came into force on 4 August 2011, mainly provided modified texts for cancellation policy.

Company-specific Conditions

Organisational and Legal Structure of Deutsche Pfandbriefbank AG

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

Corporate Strategy

With the positive decision of the EU Commission on 18 July 2011 regarding the approval of the state aid of the Federal Republic of Germany for HRE, it simultaneously recognised the viability of the business model of Deutsche Pfandbriefbank AG as a specialist bank for real estate finance and public sector investment finance.

Deutsche Pfandbriefbank AG operates Pfandbrief-eligible new business in the fields of commercial real estate finance and public investment finance in Europe. The numerous and good customer relations are key factors of success in the new business strategy of both areas. The individual loan transactions are selected within the context of a conservative refinancing strategy. The focus is on a consistent risk analysis and concentration on business with an adequate risk/return ratio.

Growth for the next few years has been limited in line with the approval of the European Commission, and new business must generate a defined minimum return. Deutsche Pfandbriefbank AG no longer operates new business in state financing as pure budget financing. The covenants are applicable until Deutsche Pfandbriefbank AG is reprivatised, and are applicable at least until December 2013.

HRE Holding must sell Deutsche Pfandbriefbank Group by no later than the year 2015. Deutsche Pfandbriefbank AG has provided a contractual commitment to continue to provide services for FMS Wertmanagement in defined areas (in particular servicing, refinancing and back-to-back derivatives) as part of the approved outsourcing of assets to the deconsolidated environment FMS Wertmanagement. These contractual commitments are to be terminated due to restrictions of the EU Commission by no later than 30 September 2013.

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

Public Sector Finance New Business Strategy The new business of the public sector finance segment focuses exclusively on public investment financing. The regional focus is on European countries with good ratings in which lending operations can be refinanced by way of issuing Pfandbriefe – at present, the Bank is focusing particularly on Germany and France. In addition, the Bank also operates in other selected European countries. In the field of public investment finance, Deutsche Pfandbriefbank AG offers its customers medium- to long-term financing which is always Pfandbrief-eligible and earmarked for specific purposes in the fields of public amenities, housing, utilities and waste disposal, essential infrastructure, healthcare, nursing facilities and education. The financing arrangements are provided to public sector borrowers, companies with a public sector or private legal form as well as special-purpose vehicles with a public guarantee.

Real Estate Finance New Business Strategy The planning of new business development is based on an in-depth understanding of the market cycles in the respective target countries. In this connection, the market cycle concept is a significant parameter for real estate finance business in these markets in order to take account of the individual challenges in the various markets. The new business strategy in the business segment real estate finance focuses on professional national and international real estate investors (such as real estate companies, institutional investors, real estate funds and also SME customers and customers with a regional focus in Germany). Investment financing will be conducted in the Pfandbrief-eligible European markets, in particular Germany, Great Britain and France, as well as other selected European regions in which Deutsche Pfandbriefbank has had operations in the past. Financing for development projects is provided on a selective basis, and for projects without a speculative nature in the same regions.

Strategy of the Value Portfolio Segment After most of the non-strategic assets have been transferred to FMS Wertmanagement, a relatively small non-strategic portfolio has been retained by Deutsche Pfandbriefbank AG. This portfolio differs from the expiring portfolio in the budget finance segment, and consists of non-strategic or written-down real estate finance as well as certain other asset classes which do not involve a substantial risk for the Bank.

Management Concept

The management concept of Deutsche Pfandbriefbank Group focuses on achieving sustainable growth in the value of the Group. A balanced ratio between risk and return is an essential criterion in this respect: the risks which are taken on must be compatible with external and internal risk-bearing capacity guidelines and must generate an adequate return on the capital which is deployed. Management and measurement is based on a consistent and integrated system of parameters which comprises income, expense as well as risk parameters. Return on equity is the key parameter for Deutsche Pfandbriefbank Group in this respect; this shows the return generated by the capital which is employed. The value of Deutsche Pfandbriefbank Group is increased when return on equity exceeds the costs of equity. In order to determine its return on equity, Deutsche Pfandbriefbank Group expresses its net income in accordance with IFRS as a percentage of average capital excl. AfS reserve and cash flow hedge reserve. The costs of equity correspond to the minimum expectation for the return on the available IFRS capital.

The main value drivers are the extent and margin of new business, the costs and the risks which are taken on. New business is managed on the basis of a newly developed pricing tool which uses the income, costs and the risk of the transactions as the basis of determining prices in a present-value appraisal. This tool also takes account of the covenant of the European Commission arising from the approval of state aid, according to which all new loans extended in strategic new business must generate a defined minimum return. Strict cost discipline is a further driver for boosting return on equity. This is monitored on the basis of absolute costs as well as by means of the cost-income ratio, i.e. the ratio between general administrative expenses and operating revenues.

The main risk parameters of risk management are as follows: economic capital, regulatory capital and the cumulative liquidity position and is described in the risk report. The steering process takes place at the level of the Group. Deutsche Pfandbriefbank Group is also responsible for steering at the level of the three segments Public Sector Finance, Real Estate Finance and Value Portfolio.

Major Events

Restructuring measures The decision of the EU Commission in mid-July 2011 has confirmed the business model of Deutsche Pfandbriefbank AG as a specialist bank for real estate and public investment finance under the following conditions: Real estate finance will be continued as the essential division. Another division is the project-related public investment finance division, whereas traditional public budget financing will not conduct any new business. The existing portfolio of budget financing has been almost completely refinanced with public Pfandbriefe (to a large extent on a matching maturity basis), and is expected to be run down as planned. All servicing activities for FMS Wertmanagement are to be terminated by no later than 30 September 2013. Deutsche Pfandbriefbank has to be reprivatised by the year 2015.

Projects Following the completion of the restructuring process, HRE is concentrating on creating the process-related, operational, financial and balance-sheet-related requirements for reprivatising Deutsche Pfandbriefbank AG and DEPFA Bank plc. HRE also provides support to FMS Wertmanagement for the project of developing a target model for servicing its portfolio which is the responsibility of FMS Wertmanagement. Information technology at Deutsche Pfandbriefbank AG was further standardised in 2011 within the framework of a project. In addition to significant extensions in market and credit risk management, for treasury and operations, a key milestone was successfully completed in the third quarter, when three previous front-end systems were combined to form a single system. The project for optimising the customer-oriented primary processes of the Bank, which was initiated in early 2011, is making scheduled and successful progress. Key objectives of this project are a stronger customer focus as a result of shorter throughput times, higher process reliability and also the achievement of a process landscape which is based on cost efficiency. The project also makes a valuable contribution to the quality assurance of the concept of our future IT platform.

Refinancing Measures On 28 September 2011, Deutsche Pfandbriefbank AG issued a mortgage Pfandbrief with a term of five years and an annual coupon of 2.625 %, and paid a premium of 68 basis points over the current reference price in the swap market. This means that Deutsche Pfandbriefbank AG is now also active on the market with public issues, after private placings had been otherwise carried out in the year under review.

Personnel

Wolfgang Groth was appointed to the Management Board of Deutsche Pfandbriefbank AG by the Supervisory Board with effect from 1 January 2011. The regular election of shareholders' representatives in the Supervisory Board was held at the Annual General Meeting on 18 May 2011. The Annual General Meeting elected Dr. Bernd Thiemann, Dagmar Kollmann, Dr. Günther Bräunig and Dr. Hedda von Wedel. The Supervisory Board elected Dr. Bernd Thiemann as the Chairman of the Supervisory Board and Dagmar Kollmann as the Deputy Chairman of the Supervisory Board. The employees elected Georg Kordick as the employees' representative. Because a second employees' representative was not elected by the employees, Heike Theißing was appointed as a member of the Supervisory Board by the Registergericht (Register Court) on 7 July 2011 upon application of the Management Board and the Chairman of the Supervisory Board.

Ratings

The senior unsecured ratings assigned to Deutsche Pfandbriefbank AG by the 3 mandated rating agencies, Fitch Ratings, Moody's and Standard & Poor's, remained unchanged during 2011. These ratings consider, to varying degrees, the likelihood of external support in a crisis scenario by the German government, which is the ultimate owner of Deutsche Pfandbriefbank AG via the Holding.

Fitch Ratings upgraded Deutsche Pfandbriefbank AG's «Viability Rating», which was introduced during the reporting period in order to replace the «Individual Rating», by one notch to bb. Following the introduction of new bank-rating criteria, Standard & Poor's assigned a «Stand-alone Credit Profile» (SACP) of bbb- to Deutsche Pfandbriefbank AG; prior to this, Deutsche Pfandbriefbank AG had an SACP of bb, based on the HRE Group assessment. During the reporting period, Moody's «Bank Financial Strength Rating» (BFSR) for Deutsche Pfandbriefbank AG remained unchanged at E+ with a positive outlook. Following the conclusion of the European Commission's review of state-aid received by HRE Group in July 2011, the successful implementation of the business model will be one of the decisive factors for the evaluation of Deutsche Pfandbriefbank AG.

During the course of 2011 the following changes took place with regard to covered bond ratings which are, to varying degrees, also driven by the senior unsecured ratings: mortgage Pfandbriefe issued by Deutsche Pfandbriefbank AG were upgraded by Moody's from Aa3 to Aa1 and confirmed at AA+ by Fitch Ratings. The bank's Public Sector Pfandbriefe were placed on «Rating Watch Negative» by Fitch Ratings in October 2011 in the context of the deterioration of some sovereign ratings.

With regard to subordinated debt ratings, the following rating changes occurred, inter alia driven by changes to the assessment of the likelihood of future systemic support against the backdrop of legislative changes: the ratings assigned by Moody's to Deutsche Pfandbriefbank AG's subordinated debt were lowered to B2 with positive outlook. Standard & Poor's downgraded existing Lower Tier 2 ratings from BBB– to BB– in February 2011, but upgraded these ratings to BB+ following the implementation of their new bank-rating criteria in December 2011. Fitch Ratings announced in December 2011 that it was also analysing subordinated debt with a view to eventually downgrading this rating category.

The following table summarises the senior unsecured ratings and covered bond ratings as at the balance sheet date.

Senior unsecured ratings of Deutsche Pfandbriefbank AG and its covered bonds[1]		31.12.2011			31.12.2010		
		Fitch Ratings	Moody's	Standard & Poor's	Fitch Ratings	Moody's	Standard & Poor's
Deutsche Pfandbriefbank AG	Long-term	A–	A3	BBB	A–	A3	BBB
	Outlook	Stable	Stable	Stable	Stable	Stable	Stable
	Short-term	F1	P–1	A–2	F1	P–1	A–2
Public Sector Pfandbrief		AAA[2)3)]	Aaa	AA+	AAA	Aaa	AA+
Mortgage Pfandbrief		AA+	Aa1	AA+	AA+[2)]	Aa3	AA+

1) Ratings from mandated rating agencies
2) Credit/rating watch negative
3) Deutsche Pfandbriefbank AG ended the agreement with Fitch Ratings regarding the rating of its Public Sector Pfandbriefe in February 2012 (refer to «Events after 31 December 2011»).

The rating agencies may alter or withdraw their ratings at any time as deemed appropriate. For the evaluation and usage of ratings, please refer to the rating agencies' pertinent criteria and explanations, 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 Deutsche Pfandbriefbank AG.

Operation of the Supervisory Board

The Supervisory Board of Deutsche Pfandbriefbank AG consisted of the following persons from 1 January 2011 to 31 December 2011: Dr. Bernd Thiemann (Chairman), Dagmar Kollmann (Deputy Chairman), Dr. Günther Bräunig, Dr. Hedda von Wedel, Ursula Bestler (employees' representative, until 18 May 2011), Georg Kordick (employees' representative) and Heike Theißing (employees' representative, after 7 July 2011). In 2011, the Supervisory Board of Deutsche Pfandbriefbank AG held five meetings and adopted a circulation resolution outside meetings. During the period of their office, all members of the Supervisory Board attended more than half of the meetings.

In the period between 1 January 2011 and 31 December 2011, the Supervisory Board of Deutsche Pfandbriefbank AG had a Risk Management and Liquidity Strategy Committee (RLA), consisting of Dr. Günther Bräunig (Chairman), Dagmar Kollmann and Dr. Bernd Thiemann. The Risk Management and Liquidity Strategy Committee held eight meetings, and generally discussed exposures in weekly telephone conferences.

On 13 April 2011, the Supervisory Board adopted resolutions concerning the consolidated financial statements 2010 and the annual financial statements 2010 of Deutsche Pfandbriefbank AG. With the resolution of 18 May 2011, the regulations regarding the management of annual general meetings in the articles of incorporation of Deutsche Pfandbriefbank AG were modified in such a way that these regulations are now consistent with the articles of incorporation of HRE Holding AG. The Supervisory Board and Management Board discussed the EU aid proceedings regarding the approval of the liquidity and capital support which had been provided. The Supervisory Board noted the EU catalogue of approval and, following the positive decision of the EU Commission, concerned itself with the implementation of the covenants by the Management Board. On 10 August 2011, the Supervisory Board extended the mandate of Manuela Better as a member of the Management Board and Chairman of the Management Board by a further five years until 31 January 2017.

The Supervisory Board discussed the strategy of Deutsche Pfandbriefbank Group, and also discussed the development of new business as well as the subjects of liquidity and refinancing. Regulatory requirements were a further key aspect of deliberations. In the course of the intense discussions regarding the assurance of adequate compensation of employees in order to maintain the operational viability of the Bank, the Supervisory Board concluded that the measures proposed by the Management Board are urgently necessary.

The Management Board informed the Supervisory Board regularly and promptly with regard to the economic and financial development of Deutsche Pfandbriefbank 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 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 monitored the functionality of the Internal Control System (ICS) and the Control Attestation Process (CAP). The objective of the CAP is to assure a systematic review of the key controls set up in the Group, and is thus intended to ensure a further improvement of the Internal Control System. The Supervisory Board also analysed the probable effects of «Basel III» which will have a negative impact on the Bank. The Supervisory Board assessed the necessary independence of the auditor, awarded the audit engagement to the auditor and agreed the fee with the auditor.

The Risk Management and Liquidity Strategy Committee (RLA) prepared 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 regularly discussed the liquidity and funding situation. In 2011, it also concerned itself extensively with regulatory requirements (e.g. ICAAP).

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: 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 has accepted the result of the audit carried out by the auditor and has not raised any objections. In the accounts meeting, the Supervisory Board approved the annual financial statements prepared by the Management Board. The Supervisory Board also refers to the compensation report included in the financial review and the statement of compliance with the Public Corporate Governance Code of the Federal Government published on the website of HRE Group.

The Supervisory Board would like to thank the Management Board and all members of staff for their work in the year under review.

Deutsche Pfandbriefbank AG as an Employer

Following extensive restructuring in the year 2010, the focus for 2011 was on stabilising the personnel situation. Whereas Deutsche Pfandbriefbank AG employed a total of 919 persons at the end of 2010, this figure had risen to 1,032 at the end of 2011. The increase in personnel is mainly connected with the process of continuing servicing of the portfolio of FMS Wertmanagement. The necessary organisational changes have been initiated in order to boost the efficiency of providing this service. The adjusted fluctuation[1)] in the Group declined in 2011. Greater focus on personnel development measures has also contributed towards stabilising the personnel situation.

Compensation Report

The individual details of compensation for the financial year 2011 for each individual 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 2011.

Deutsche Pfandbriefbank does not make any payments for the activities of its Management Board. The compensation of the Management Board has been paid exclusively by HRE Holding, and the pension commitments have been issued exclusively by HRE Holding. Accordingly, for information and transparency considerations, the Group payments and pension commitments of the Management Board provided by HRE Holding are detailed in the following.

Supervisory Board

In accordance with Section 10 (1) of the articles of incorporation, the members of the Supervisory Board of Deutsche Pfandbriefbank AG 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.

[1)] 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

Group compensation to members of the Management Board of HRE Holding	2011			2010		
in € thousand	Monetary compensation	Benefits in kind[1]	Total	Monetary compensation	Benefits in kind[1]	Total
Manuela Better	500	14	514	500	13	513
Wolfgang Groth (after 1 January 2011)	500	39	539	–	–	–
Dr. Bernhard Scholz	500	32	532	500	18	518
Alexander von Uslar	500	22	522	500	19	519
Total[2]	2,000	107	2,107	2,667[3]	94[4]	2,761

[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.
[3] Including monetary compensation for the following members of the Management Board who stepped down from the Management Board in the course of 2010: Dr. Kai-Wilhelm Franzmeyer (€ 500 thousand), Frank Krings (€ 500 thousand) and Dr. Axel Wieandt (€167 thousand), thus a total of €1,167 thousand.
[4] Including benefits in kind for the following members of the Management Board who stepped down from the Management Board in the course of 2010: Dr. Kai-Wilhelm Franzmeyer (€ 2 thousand), Frank Krings (€ 28 thousand) and Dr. Axel Wieandt (€14 thousand), and thus a total of € 44 thousand

Pension commitments of the members of the Management Board of HRE Holding	2011				2010
in € thousand	Present value of pension claims vested	Interest expense	Outstanding past service cost	DBO as of 31.12.2011	DBO as of 31.12.2010
Manuela Better, Chairman	83	117	275	2,938	2,463
Dr. Bernhard Scholz	1,388	64	–	2,741	1,342
Alexander von Uslar	74	105	–	2,326	2,208
Total	1,545	286	275	8,005	6,013

Provisions Supervisory Board compensation 2011 Annual compensation per member		Value added tax	2011	2010
in € thousand	Compensation	19%	Total	Total
Ursula Bestler, until 18.5.2011[1]	4.17	0.79	4.96	11.90
Dr. Günther Bräunig	10.00	1.90	11.90	11.90
Dagmar Kollmann	10.00	1.90	11.90	11.90
Georg Kordick[1]	10.00	1.90	11.90	11.90
Heike Theißing after 7.7.2011[1]	5.00	0.95	5.95	0.00
Dr. Bernd Thiemann	10.00	1.90	11.90	11.90
Dr. Hedda von Wedel	10.00	1.90	11.90	11.90
Total	59.17	11.24	70.41	71.40

[1] employee representative

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. Despite the regulations of the Restructuring Act and the related prohibition of paying variable compensation the compensation system which was implemented in the financial year 2010 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 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 with the involvement of the employees' representatives; this premium is considerably lower than the originally envisaged variable compensation and has been agreed with the Supervisory Board and also with the owners.

Compensation Committee In the year 2011, 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 HRE Group held a total of two ordinary and one extraordinary meetings in the year 2011, and mainly considered 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 2009 and 2010
> Preparation of a proposal for defining the risk takers in accordance with Section 5 of the Institutsvergütungsverordnung (Institute Compensation Ordinance) for 2011
> Deliberation of the principles within the framework of the salary review 2011 and an assessment of adequacy, with due consideration being given to the legal and regulatory requirements

The following criteria were defined for identification as part of the regular review of the risk takers in 2011:

> All managing directors of the companies of HRE Holding, Deutsche Pfandbriefbank AG, DEPFA Bank plc, Hypo Pfandbrief Bank International S.A., pbb Services GmbH, DEPFA ACS Bank and Hypo Public Finance Bank
> All second tier executives who report directly to the Management Board of HRE 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) of HRE Group

Accordingly, 4.2% of the workforce in total are risk takers. The Management Board of HRE Holding as well as Deutsche Pfandbriefbank AG have approved the proposal of the Compensation Committee and have adopted corresponding resolutions.

Sustainability

Companies have responsibility particularly with regard to their owners, their customers, their employees, society and the environment.

Ecological Sustainability The Group is committed towards encouraging and maintaining an environment which is worth living. Accordingly, the Group ensures that manufacturers and suppliers meet the defined environmental protection requirements and are correspondingly certified. Internally, this objective is met for instance by way of paper-saving work procedures or the use of modern energy-saving devices. Energy consumption has been further reduced by using video conference systems in order to avoid business travel. A new company car regulation specifies that only vehicles with low carbon emissions are permitted to be purchased.

Social Commitment In 2011, Deutsche Pfandbriefbank AG demonstrated its social responsibility mainly via its two foundations, namely pbb Stiftung Deutsche Pfandbriefbank and pbb Stiftung für Kunst und Wissenschaft. Since they were originally established in 1987 and 1968 respectively by predecessors of Deutsche Pfandbriefbank AG, the foundations have had their own capital which is segregated from that of the Bank and which can be used exclusively for meeting the objectives of the foundation.

pbb Stiftung Deutsche Pfandbriefbank supports projects for promoting art and culture. It places particular emphasis on encouraging young artists of the future. With its architecture prize which enjoys nationwide recognition, it also takes the initiative itself to improve architectural culture in commercial properties in Germany. The architecture prize is awarded to commercial buildings which are exemplary in terms of aesthetics and ecology. Since 1992, this renowned prize has been awarded every two years. The competition is one of the small numbers of prizes which deals exclusively with commercial building architecture. In 2006, it was extended to include a prize for up-and-coming architects, which provides young architects with a platform and encourages a dialogue between young architects and experienced architects, clients and investors. Both competitions enjoy the patronage of the Federal Minister for Transport, Construction and Municipal Development and the Bund Deutscher Architekten (BDA).

pbb Stiftung für Kunst und Wissenschaft 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.

Development in Earnings

Deutsche Pfandbriefbank Group

In the year 2011, Deutsche Pfandbriefbank Group reported pre-tax result of €188 million. As predicted at the beginning of the year, the Group was thus profitable in its first complete financial year after the conclusion of the restructuring and realignment process of the Group, illustrating the success of these measures. The sustainability of the positive development is also underlined by the fact that a pre-tax profit could be reported for each quarter of the year 2011. The factors behind the good result of the year 2011 were the profitability of the portfolio, released provisions for losses on loans and advances and one-off effects.

In the previous year, the Group reported a negative pre-tax result of €–135 million. However, the income statement of this period still included the effects of the positions transferred to FMS Wertmanagement in October 2010. High allowances for losses in loans and advances arose in the previous year mainly from those transferred positions. In addition, considerable expenses of liquidity support were incurred in the previous year.

The development in earnings in 2011 compared with the the previous year is detailed in the following:

Key financials Deutsche Pfandbriefbank Group		2011	2010	Change
Operating performance				
Operating revenues	in € million	526	652	–126
Net interest income and similar income	in € million	371	600	–229
Net commission income	in € million	32	–10	42
Net trading income	in € million	–8	77	–85
Net income from financial investments	in € million	3	–17	20
Net income from hedge relationships	in € million	–56	–45	–11
Balance of other operating income/expenses	in € million	184	47	137
Provisions for losses on loans and advances	in € million	–12	443	–455
General administrative expenses	in € million	357	352	5
Balance of other income/expenses	in € million	7	8	–1
Pre-tax profit/loss	in € million	188	–135	323
Income taxes	in € million	71	50	21
Net profit/loss	in € million	117	–185	302
Key ratios				
Cost-income ratio	in %	67.9	54.0	
Return on equity before taxes	in %	5.9	–4.4	
Return on equity after taxes	in %	3.7	–6.0	

Operating Revenues The operating revenues amounted to € 526 million, and were thus lower than the previous year figure (2010: € 652 million). The decline of the operating revenues resulted mainly from a decreased net interest income due to the reduction of interest-bearing assets and a regressive net trading income. These developments were partially compensated by a net commission income, which was now positive, and an increased balance of other operating income/expenses.

In 2011, net interest income of € 371 million was lower than the corresponding previous year figure of € 600 million, mainly because the transfer of positions to FMS Wertmanagement resulted in positive rate margins being given up. Moreover, the portfolio declined in the business areas in which Deutsche Pfandbriefbank Group does not generate any new business in line with the conditions of the European Commission. However, this effect was partially balanced out by new business margins which were higher compared with existing business margins. Premature repayment penalties and the fact that financial liabilities were redeemed before maturity for market-smoothing purposes or at the request of customers resulted in income of € 43 million (2010: € 32 million).

Net commission income was positive at € 32 million (2010: €–10 million) and was boosted by a one-off income item of € 7 million. The main items in commission expenses were charges for securities account management (€ 3 million; 2010: € 8 million), and expenses of €4 million for positions transferred synthetically to FMS Wertmanagement (2010: € 0 million). Expenses for liquidity support in 2011 only amounted to less than € 1 million (2010: €74 million), and are attributable to an effect due to the payment of a profit-linked premium to the Federal Republic of Germany, which had to be paid sooner than originally planned. The premium became necessary because HRE (as the Group which is relevant for determining the payment) generated profits sooner than originally planned. In the previous year, the expenses were incurred for the liquidity support in connection with the guarantees of SoFFin.

Net trading income was negative at €–8 million (2010: €77 million). Deutsche Pfandbriefbank Group did not hold any portfolios with the aim of generating short-term profits (trading book). Accordingly, net trading income for the year 2011 was attributable mainly to one-off income of € 6 million resulting from the sale of a synthetical CDO which had been completely impaired in previous years, and also expenses of €–11 million relating to interest rate derivatives (2010: €–29 million). In the previous year, net trading income included income of €106 million from an HRE-internal guarantee. The guarantee was transferred to FMS Wertmanagement in 2010.

In the year 2011, the net income from financial investments of €3 million was slightly positive (2010: €–17 million), and resulted mainly from sales of financial assets in the measurement category AfS. Deutsche Pfandbriefbank Group has neither any direct exposure nor any indirect exposure to Greek sovereign counterparties. As of 31 December 2011, there was no need to impair the security holdings with regard to other countries which are currently the focus, for instance Spain, Italy, or Portugal, because there were no objective indications of any impairment in accordance with IAS 39.59. In the net income from financial investments of the previous year, impairments of €–36 million in relation to securities more than compensated for profits of €19 million resulting from the sale of financial assets which had been impaired in previous years.

The net income from hedge relationships amounted to €–56 million (2010: €–45 million) and was thus more negative than was the case in the previous year. A valuation result of €–37 million (2010: €–37 million) resulted from designated at Fair Value through Profit or Loss (dFVTPL) assets and related derivatives. On balance sheet date 2011, four positions with a total nominal value of €185 million were classified as dFVTPL. An expense of €–32 million (2010: €–15 million) mainly resulted from three bonds issued by the Republic of Portugal with a nominal value of €105 million. The market values of these bonds which in particular declined as a result of the widening of the issuer's credit spreads had to be considered in profit or loss, because the instruments are hedged only against interest rate risks. Hedge inefficiencies within the range of 80 % to 125 % permitted in accordance with IAS 39 resulted in costs of €–19 million (2010: €–8 million).

The balance of other operating income/expenses amounted to €184 million (2010: €47 million), and was thus considerably higher than the previous year figure. The main individual items in the balance of other operating income/expenses was a net income for the servicing for the ongoing operation of FMS Wertmanagement as well as services of pbb Services provided to DEPFA and HRE Holding totalling €144 million (2010: €101 million). The servicing income compensated the corresponding general administrative expenses. Foreign currency translation resulted in income of €7 million in 2011 (2010: expense of €–13 million). Furthermore, the previous year figure was affected by additions to provisions of €–21 million, which were incurred in connection with the process of transferring the positions to FMS Wertmanagement.

Provisions for Losses on Loans and Advances The positive development on the real estate markets resulted in net releases of €–12 million in provisions for losses on loans and advances in the reporting period (2010: additions of €443 million).

In the financial year 2011, individual allowances to loans and advances were necessary only for a small number of real estate financings; that is why the net additions to the individual allowances to loans and advances decreased to € 21 million (2010: € 534 million). As was the case in the previous year, no specific provisions had to be created in relation to public sector financing. There was no need for any individual allowances as of 31 December 2011 in relation to financial investments, because there were no objective indications of an impairment in accordance with IAS 39.59.

Portfolio-based allowances are created only for receivables for which there have so far not been any indications of an individual impairment. Portfolio-based allowances of €–23 million were released in the financial year 2011 (2010: €–109 million). These releases were mainly attributable to rating improvements for financing; on the other hand, the high release in the previous year was mainly attributable to the creation of higher individual allowances.

General Administrative Expenses General administrative expenses of € 357 million were slightly higher than the previous year figure (2010: € 352 million). Decreased other administrative expenses of € 215 million were overcompensated by personnel expenses which were higher in 2011 (€129 million, 2010: € 94 million). Personnel expenses in 2011 were higher than in the previous year mainly as a result of a disproportional high one-off effect due to the reversal of personnel provisions in the year 2010. Furthermore, the average number of employees in 2010 (923) was lower than the figure of the year 2011 (993). The additional employees were recruited for the servicing for the ongoing operation of FMS Wertmanagement. The decline in other general administrative expenses was mainly attributable to lower consultancy expenses. In the previous year, other general administrative expenses were affected by consultancy and IT expenses incurred in connection with the project for transferring the positions to FMS Wertmanagement. Because general administrative expenses increased slightly and because operating revenues declined, the cost-income ratio increased to 67.9 % (2010: 54.0 %). This ratio contains income and expenses from the servicing to third parties.

Balance of Other Income / Expenses As was the case in the previous year, the positive balance of other operating income/expenses of €7 million (2010: € 8 million) was mainly due to the reversal of restructuring provisions.

Pre-tax Profit / Loss The pre-tax profit/loss amounted to € 188 million in 2011 (2010: €–135 million). Deutsche Pfandbriefbank Group has thus reported a positive pre-tax result for the complete reporting period and also for all quarters in 2011. Return on equity before taxes amounted to 5.9 % (2010: –4.4 %).

Taxes on Income The expenses of €18 million for current taxes and the expenses of € 53 million for deferred taxes resulted in a total tax expense of €71 million (2010: € 50 million). The tax rate was to 15.83 % (2010: 15.83 %), and the current tax rate amounted to 37.7 % (2010: 36.9 %).

Net Income / Loss Net income/loss in the financial year 2011 was positive at € 117 million, whereas a loss of €–185 million was reported in the previous year. Return on equity after taxes amounted to 3.7 % (2010: –6.0 %).

Operating Segment Public Sector Finance (PSF)

Key financials Public Sector Finance		2011	2010	Change
Operating performance				
Operating revenues	in € million	63	73	–10
Net interest income and similar income	in € million	109	88	21
Net commission income	in € million	–3	–5	2
Net trading income	in € million	–3	1	–4
Net income from financial investments	in € million	5	–9	14
Net income from hedge relationships	in € million	–48	–	–48
Balance of other operating income/expenses	in € million	3	–2	5
Provisions for losses on loans and advances	in € million	–	–	–
General administrative expenses	in € million	54	46	8
Balance of other income/expenses	in € million	2	–	2
Pre-tax profit/loss	in € million	11	27	–16
Key ratio				
Cost-income ratio	in %	85.7	63.0	

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. The segment comprises public-sector financing, in which Deutsche Pfandbriefbank Group generates new business, and budget financing.

The pre-tax profit/loss of the segment amounted to €11 million (2010: €27 million). This decline is mainly attributable to deteriorations in the market values for securities of the measurement category dFVTPL.

Operating Revenues Net interest income increased from €88 million to €109 million in 2011. The increase was mainly attributable to one-off income from the redemption of liabilities. Moreover, the interest margin of new business was higher than the margin of existing business. The resultant positive effect was able to partially compensate for the effects of the reduction in the portfolio due to repayments. Net commission income amounted to €–3 million, and was roughly equivalent to the previous year figure (2010: €–5 million), resulting from various factors, including charges for securities account management. A net trading income of €–3 million was generated in the current reporting period (2010: €1 million). The net income from financial investments of € 5 million (2010: €–9 million) mainly reflected the result of disposing securities of measurement category LaR; the negative result of the previous year was attributable to impairments of securities. The negative net income from hedge relationships of €–48 million (2010: €0 million) was mainly attributable to deteriorations in the market values of securities of the measurement category dFVTPL issued by the Republic of Portugal. The balance of other operating income/expenses of €3 million (2010: €–2 million) included income from foreign currency translation.

Provisions for Losses on Loans and Advances As was the case in the previous year, no additions to provisions for losses on loans and advances were necessary in the current reporting period.

General Administrative Expenses General administrative expenses in 2011 of €54 million were higher than in the previous year (2010: €46 million) and resulted mainly from a one-off effect due to the reversal of personnel provisions in the year 2010. The cost-income ratio rose to 85.7% (2010: 63.0%).

Operating Segment Real Estate Finance (REF)

Key financials Real Estate Finance		2011	2010	Change
Operating performance				
Operating revenues	in € million	274	571	–297
Net interest income and similar income	in € million	245	551	–306
Net commission income	in € million	37	71	–34
Net trading income	in € million	–11	–3	–8
Net income from financial investments	in € million	1	–2	3
Net income from hedge relationships	in € million	–7	–	–7
Balance of other operating income/expenses	in € million	9	–46	55
Provisions for losses on loans and advances	in € million	–1	422	–423
General administrative expenses	in € million	138	151	–13
Balance of other income/expenses	in € million	3	–	3
Pre-tax profit/loss	in € million	140	–2	142
Key ratio				
Cost-income ratio	in %	50.4	26.4	

The operating segment Real Estate Finance comprises all commercial real estate financing arrangements of the Group.

In 2011, pre-tax profit/loss in the segment amounted to €140 million (2010: €–2 million). The main reason for this improvement was significantly declined additions to provisions for losses on loans and advances. This positive development more than compensated for the decline in the income base due to the reduced portfolio.

Operating Revenues Operating revenues declined from € 571 million in the previous year to € 274 million. Net interest income decreased to € 245 million (2010: € 551 million) due to the reduction in interest-bearing assets as part of the restructuring. On the other hand, the portfolio volume from ongoing business remained virtually constant because, after the completion of the restructuring process, the volume of new business returned to a point at which it approximately matched the amount of repayments. Because the new business margins were higher than the margins of existing business, there was a positive impact on net interest income. Net commission income of € 37 million was significantly lower than the corresponding previous year figure (2010: €71 million). The main reason for the decline was lower commission income from lending operations. The net trading income of €–11 million in the current reporting period was slightly below the previous year figure (2010: €–3 million). The net income from financial investments also amounted to €1 million (2010: €–2 million) because only immaterial sales were generated and also because it was not necessary for any write-ups or write-downs to be recognised. Hedge relationships which were not completely effective within the range permitted by IAS 39 resulted in net income from hedge relationships of €–7 million (2010: € 0 million). As was the case in the previous year, the balance of other operating income/expenses of € 9 million (2010: €–46 million) comprised foreign currency translation effects.

Provisions for Losses on Loans and Advances A net amount of €–1 million could be released from the provisions for losses on loans and advances (2010: additions of €422 million). The additions to individual allowances of net €15 million (2010: € 511 million) resulted from a small number of individual cases. Portfolio-based allowances of €–29 million (2010: €–107 million) were released mainly due to rating upgrades of financings. The releases in provisions for losses on loans and advances reflect the positive development of the real estate finance markets and the change in the restructured portfolio.

General Administrative Expenses The general administrative expenses in 2011 amounted to €138 million, and were lower than the corresponding previous year figure (2010: €151 million) due to lower consultancy expenses. Because operating revenues declined to a greater extent than general administrative expenses, the cost-income ratio increased to 50.4 % (2010: 26.4 %).

Operating Segment Value Portfolio (VP)

Key financials Value Portfolio		2011	2010	Change
Operating performance				
Operating revenues	in € million	168	5	163
Net interest income and similar income	in € million	–	–27	27
Net commission income	in € million	–2	–76	74
Net trading income	in € million	6	79	–73
Net income from financial investments	in € million	–3	–6	3
Net income from hedge relationships	in € million	–1	–	–1
Balance of other operating income/expenses	in € million	168	35	133
Provisions for losses on loans and advances	in € million	–11	21	–32
General administrative expenses	in € million	159	52	107
Balance of other income/expenses	in € million	2	–	2
Pre-tax profit/loss	in € million	22	–68	90
Key ratio				
Cost-income ratio	in %	94.6	>100.0	

The operating segment Value Portfolio mainly comprises selected structured products and securities which cannot be allocated to the portfolio of Public Sector Finance or Real Estate Finance. In addition, this segment also includes the income and expenses attributable to the services of FMS Wertmanagement.

In 2011, pre-tax profit/loss of the segment was positive at € 22 million (2010: €–68 million).

Operating Revenues Operating revenues increased from € 5 million in the previous year to €168 million in 2011. Net interest income was at € 0 million (2010: €–27 million) because the interest-bearing assets which remained after the transfer to FMS Wertmanagement had an equal interest margin. Net commission income was less negative at €–2 million (2010: €–76 million). In 2011, net commission income included charges for the positions transferred synthetically to FMS Wertmanagement and a present-value effect resulting from the premium which had to be paid to the Federal Republic of Germany sooner than originally planned. In the previous year, net commission income was affected mainly by expenses of €–74 million incurred in connection with the liquidity support measures. Net trading income of € 6 million in 2011 resulted from a one-off income of € 6 million generated by the sale of a CDO which had been completely impaired in previous years. In the previous year, net trading income included income of €106 million from an HRE-internal guarantee. This guarantee has no longer existed since the fourth quarter of 2010. In 2011, net income from financial investments of €–3 million (2010: €–6 million) was mainly attributable to disposal of financial assets whereas, in the previous year, it resulted from impairments and additions to portfolio-based allowances in relation to financial assets of the measurement category LaR. The balance of other operating income/expenses of €168 million (2010: € 35 million) mainly included income from the servicing for the ongoing operation of FMS Wertmanagement, which in turn compensated for the corresponding general administrative expenses. The considerable increase in the balance of other operating income/expenses was mainly due to the fact that, in the previous year, the service income for the ongoing operation of FMS Wertmanagement was only generated in the fourth quarter of 2010.

Provisions for Losses on Loans and Advances The model reserve for CDOs had to be released to a large extent at €–6 million. Due to additional payment receipts of €–5 million, an amount of €–11 million could be released in provisions on losses on loans and advances (2010: additions of €21 million).

General Administrative Expenses General administrative expenses of €159 million were higher than the figure for the previous year (2010: €52 million). The increase was attributable to the additional general administrative expenses which were incurred in connection with the services for the ongoing operation of FMS Wertmanagement. In 2011, these expenses related to the complete financial year, whereas in 2010 they related only to the fourth quarter. Because operating revenues increased to a considerably greater extent than general administrative expenses, the cost-income ratio improved to 94.6 % (2010: >100 %).

Consolidation & Adjustments

Key financials Consolidation & Adjustments		2011	2010	Change
Operating performance				
Operating revenues	in € million	21	3	18
Net interest income and similar income	in € million	17	–12	29
Net commission income	in € million	–	–	–
Net trading income	in € million	–	–	–
Net income from financial investments	in € million	–	–	–
Net income from hedge relationships	in € million	–	–45	45
Balance of other operating income/expenses	in € million	4	60	–56
Provisions for losses on loans and advances	in € million	–	–	–
General administrative expenses	in € million	6	103	–97
Balance of other income/expenses	in € million	–	8	–8
Pre-tax profit/loss	in € million	15	–92	107

The Consolidation & Adjustments column is used to reconcile the total segment results with the consolidated results.

Pre-tax profit in the Consolidation & Adjustments column was positive at €15 million (2010: €–92 million). The net interest income was generated primarily as a result of the investment of shareholders' equity which was not allocated to the segments.

Development in Assets

Assets in € million	31.12.2011	31.12.2010	Change
Cash reserve	323	224	99
Trading assets	9,818	16,168	–6,350
Loans and advances to other banks	7,632	12,128	–4,496
Loans and advances to customers	55,236	118,642	–63,406
Allowances for losses on loans and advances	–477	–561	84
Financial investments	28,677	33,605	–4,928
Property, plant and equipment	3	5	–2
Intangible assets	35	32	3
Other assets	6,058	5,035	1,023
Income tax assets	1,474	1,545	–71
Current tax assets	55	64	–9
Deferred tax assets	1,419	1,481	–62
Total assets	**108,779**	**186,823**	**–78,044**

Total assets of Deutsche Pfandbriefbank Group amounted to €108.8 billion as of 31 December 2011, and were thus €78.0 billion lower than the corresponding figure as of 31 December 2010 (€186.8 billion).

The decline was mainly attributable to a further reduction of the opposite effects which had increased the total assets when positions were transferred to FMS Wertmanagement in October 2010. These opposite effects, which for instance resulted from the handling of refinancing arrangements or the transfer of risks by way of back-to-back derivatives, were reduced further in 2011:

> At the end of 2011, FMS Wertmanagement was no longer reliant on refinancing funds which Deutsche Pfandbriefbank Group passes through from central banks to the deconsolidated environment or FMS Wertmanagement received the refinancing funds from the affiliated entity DEPFA Group. In consequence, the volume of reverse repos (loans and advances to customers) for FMS Wertmanagement declined from €59.9 billion as of 31 December 2010 to €0 billion as of 31 December 2011. This effect alone caused around 76 % of the decline in total assets.
> The back-to-back derivatives were partly replaced by direct business relations between FMS Wertmanagement and the external customers (novation of derivatives). Overall, the market value of back-to-back derivatives amounted to €7.4 billion as of 31 December 2011, compared with €13.5 billion as of 31 December 2010. The decline affected trading assets.
> The volume of securities issued by FMS Wertmanagement in the portfolio declined from €8.8 billion as of 31 December 2010 to €3.0 billion as of 31 December 2011, resulting in a decline in financial investments.
> The portfolio of synthetically transferred cover funds declined due to maturities from €11.0 billion on 31 December 2010 to €9.0 billion on 31 December 2011; this is the reason for the decline in loans and advances to customers.

Even without the decline in opposite effects, the total assets of Deutsche Pfandbriefbank Group also declined as a result of the scheduled streamlining of some portfolios. This process mainly affected portfolios such as pure budget financing, in which Deutsche Pfandbriefbank Group does not generate any new business in line with the conditions of the European Commission. On the other hand, in real estate finance and public sector investment finance, new business to a large extent compensated for the payments.

The decline in total assets due to the reduction of the opposite effects and due to the portfolio streamlining which is in progress as scheduled was partly compensated by total assets increasing market-related effects. In particular, the lower long-term interest rate level was reflected in an increase in derivative market values and the underlyings in the fair value hedge accounting.

The slight weakening of the euro against the US dollar, the Japanese yen and sterling resulted in increasing total assets and total liabilities disclosed in euros, because the carrying amount of foreign currency assets and liabilities in euros is boosted as a result of currency translation. In addition, as a result of the rating downgrades of some states and also as a result of the weaker euro, Deutsche Pfandbriefbank Group had to provide additional collateral for covered refinancing, resulting in a further increase in the assets total.

As of 31 December 2011, Deutsche Pfandbriefbank Group had satisfied all conditions regarding its total assets which were made by the European Commission in connection with the state aid measures. In particular, the total assets which were adjusted for several effects from the transfer of positions to FMS Wertmanagement amounted to €100.6 billion, and were thus lower than the mandatory ceiling of €107.0 billion. Furthermore, the strategic total assets adjusted for the pure budget financings was at €58.7 billion and were also lower than the ceiling of €67.0 billion.

Development in the Financial Position

Equity and liabilities in € million	31.12.2011	31.12.2010	Change
Liabilities to other banks	8,223	62,587	−54,364
Liabilities to customers	12,363	17,384	−5,021
Liabilities evidenced by certificates	55,038	63,846	−8,808
Trading liabilities	9,903	16,294	−6,391
Provisions	163	176	−13
Other liabilities	16,123	18,883	−2,760
Income tax liabilities	1,373	1,526	−153
Current tax liabilities	82	83	−1
Deferred tax liabilities	1,291	1,443	−152
Subordinated capital	2,501	2,766	−265
Liabilities	**105,687**	**183,462**	−77,775
Equity attributable to equity holders	**3,092**	**3,361**	−269
Subscribed capital	380	380	–
Silent participation	999	999	–
Additional paid-in capital	5,036	5,036	–
Retained earnings	−3,277	−3,089	−188
Foreign currency reserve	−34	−35	1
Revaluation reserve	−129	255	−384
AfS reserve	−549	−259	−290
Cash flow hedge reserve	420	514	−94
Consolidated profit/loss 1.1.–31.12.	117	−185	302
Minority interest in equity	—	—	–
Equity	**3,092**	**3,361**	−269
Total equity and liabilities	**108,779**	**186,823**	−78,044

As of 31 December 2011, equity attributable to equity holders declined by € 0.3 billion to € 3.1 billion (31 December 2010: € 3.4 billion), mainly due to a decline in the revaluation reserve. The AfS reserve changed from €–0.3 billion as of 31 December 2010 to €–0.5 billion as of 31 December 2011 mainly as a result of the widening of the credit spreads of some public sector financing instruments. The cash flow hedge reserve declined from € 0.5 billion on 31 December 2010 to € 0.4 billion on 31 December 2011 due to various factors, including derivative maturities. No capital increases or capital reductions were carried out in the financial year 2011.

The total liabilities of the Group amounted to €105.7 billion as of 31 December 2011, compared with €183.5 billion as of 31 December 2010. As was the case on the assets' side of the balance sheet, the changes on the liabilities' side of the balance sheet were also mainly attributable to the decline in the opposite effects in connection with the transfer of positions to FMS Wertmanagement. Trading liabilities declined as a result of novations of back-to-back derivatives. Liabilities to other banks declined because it was no longer necessary to raise funds from central banks for FMS Wertmanagement.

In addition, the refinancing requirement declined as a result of the streamlining of some portfolios on the assets side of the balance sheet in line with overall strategy. The liabilities evidenced by certificates declined because expiring issues were only replaced to a minor extent by new issues. The subordinated capital declined due to maturities.

Because new business has not yet been completely paid out, the other obligations increased from € 0.8 billion as of 31 December 2010 to €1.1 billion as of 31 December 2011.

Market-related effects, however, increased the balance sheet total on the assets side and also on the liabilities side. Accordingly, the derivative market values and underlyings measured at fair value increased as a result of the lower level of long-term interest rates. The weak rate of the euro meant that there was an increase mainly in liabilities to other banks and liabilities to customers.

Regulatory Indicators According to German Solvency Regulation

In accordance with the waiver rule set out in Section 2 a KWG, Deutsche Pfandbriefbank AG is exempted from the obligation to determine equity and core capital ratios at the level of the institution.

Summary

The pre-tax result of Deutsche Pfandbriefbank Group amounted to €188 million in 2011. The result benefited from one-off effects; nevertheless, this clearly demonstrates the profitability of Deutsche Pfandbriefbank Group. The fourth quarter of 2011 was the sixth consecutive quarter for which Deutsche Pfandbriefbank Group has reported a positive pre-tax result. This illustrates the success of Deutsche Pfandbriefbank Group in realignment and the profitability of the portfolio following the transfer of the positions to FMS Wertmanagement.

Events after 31 December 2011

In January 2012 Deutsche Pfandbriefbank AG issued a mortgage Pfandbrief amounting to €500 million. The four-year Pfandbrief has a 2.25% coupon, representing a spread of 75 basis points above the reference price on the swap market.

In January 2012 the Management Board decided to open a branch in Stockholm in accordance with the compensation measures set by the European Commission in the approval of the governmental aid. Deutsche Pfandbriefbank Group underlines the proximity to the customer and its presence in the markets as well as the target to use attractive new business opportunities.

On 25 January 2012, in coordination with its governing bodies and with the agreement of the FMSA, FMS Wertmanagement reached a fundamental decision with regard to the target model for the servicing after September 2013. FMS Wertmanagement plans to set up an independent servicing company for its portfolio management. Services in the areas of Operations and IT are to be carried out by a third party. In both cases, FMS Wertmanagement wants to take on staff from Deutsche Pfandbriefbank Group.

Deutsche Pfandbriefbank AG ended the agreement with Fitch Ratings regarding the rating of its Public Sector Pfandbriefe in February 2012 due to, in the bank's opinion, the agency's excessive cover pool overcollateralization requirements. When withdrawing the rating, Fitch assigned a final rating of A+ to the Public Sector Pfandbriefe.

In March 2012 Fitch Ratings completed its industry-wide review of subordinated debt which was announced in December 2011. For Deutsche Pfandbriefbank AG, the application of the adjusted rating criteria resulted in the downgrade of these ratings to BB– from BBB+.

Moreover, the Supervisory Board of Deutsche Pfandbriefbank AG decided to establish an Audit Committee, which will start its activities in 2012.

Apart from the above, no other notable events took place after 31 December 2011.

Risk Report

Organisation and Principles of Risk and Capital Management

HRE has set up a Group-wide risk management and risk controlling system. This represents as well an important precondition for the application of the so-called waiver according to Section 2a KWG. All tasks in accordance with Section 25a 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.

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 Deutsche Pfandbriefbank 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 Deutsche Pfandbriefbank 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 Deutsche Pfandbriefbank 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 Deutsche Pfandbriefbank Group
- Defining and improving organisation structures within Deutsche Pfandbriefbank Group and in particular for risk management, which ensures that all major risks are managed and monitored
- Adopting credit competences as a decision-making framework along the credit processes within Deutsche Pfandbriefbank 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 Deutsche Pfandbriefbank Group. The Risk Management and Liquidity Strategy Committee (RLA) of the Supervisory Board of Deutsche Pfandbriefbank AG is mainly responsible for controlling the overall risk situation and for monitoring, establishing and improving an efficient risk management system, and is also responsible for the liquidity management and assurance of Deutsche Pfandbriefbank Group. 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 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 adopts guidelines/policies, methods for risk measurement, the related parameters as well as methods of monitoring all risk types. The Risk Committee monitors the development of risk-bearing capacity, economic capital, the risk cover funds as well as the credit portfolio and the compliance with limits. It takes decisions regarding suitable measures of credit risk management and discusses the portfolios of HRE Group and hence of Deutsche Pfandbriefbank Group regularly.

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 Deutsche Pfandbriefbank Group, funds transfer pricing as well as market risk management and management of the regulatory capital ratios. This committee is also responsible for preparing decision-making documents for liquidity and refinancing strategies which, following discussions in the Risk Committee, are decided in the same way as acquisitions and disinvestments in the Management Board in HRE respectively Deutsche Pfandbriefbank AG.

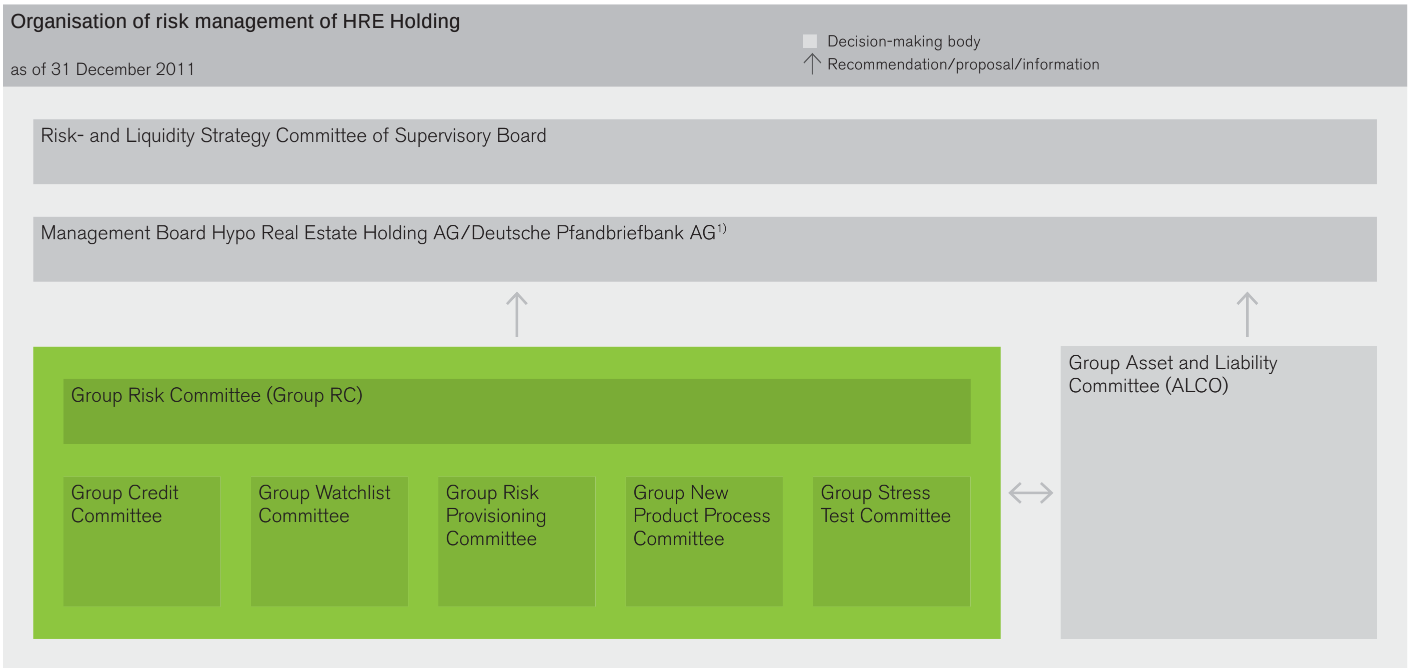
The **Group Credit Committee** of HRE, acting simultaneously for Deutsche Pfandbriefbank AG, comprises the CRO (Chairman), the Chief Credit Officers (CCOs) of the operating segments, the Senior Credit Executives and the head of Risk Management & Control as well as representatives of the front office.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

The **Group Watchlist Committee** of HRE, acting simultaneously for Deutsche Pfandbriefbank AG, meets every month. All exposures of Deutsche Pfandbriefbank Group identified by the early warning system are discussed and, if appropriate, individual measures are decided by these bodies; 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 in the exposure, the extent of the impairment is first determined and the result is presented in the Group Risk Provisioning Committee. It takes decisions within the framework of a predefined set of allocated powers, and provides recommendations regarding the creation and reversal of provisions for losses on loans and advances as well as any necessary rescue acquisitions. The recommendations made by the committee have to be decided by the Management Board of Deutsche Pfandbriefbank AG in line with the relevant set of rules governing powers.

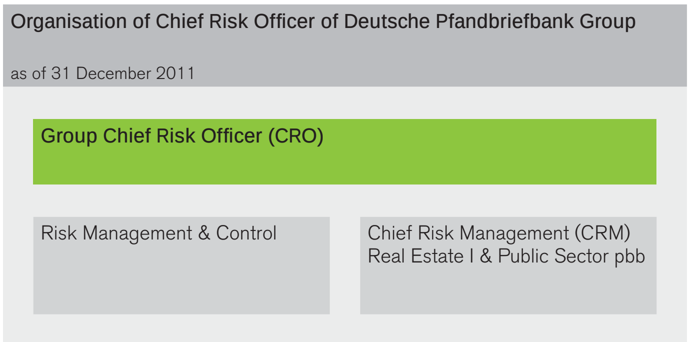
The Group New Product Process Committee ensures that, before business commences with new products or in new markets, the resultant risks as well as the related impact on processes, controls and the infrastructure are systematically analysed and addressed. Operations with new products or in new markets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

The newly established 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 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 Deutsche Pfandbriefbank Group is included:



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

> The entity Risk Management & Control, which is also responsible for monitoring and managing market, counterparty, operational and liquidity risks of Deutsche Pfandbriefbank Group and which is also responsible for Group-wide uniform risk measuring methods, risk reports and credit processes
> The entities Credit Officer Real Estate I & Public Sector pbb of Deutsche Pfandbriefbank Group, who are each responsible for portfolio management and the analysis of new business
> 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. Both were allocated to the CRM Real Estate I & Public Sector pbb unit in the first half of 2011. For the Public Sector Finance and Value Portfolio segments global workout processing is performed in the respective Credit Risk Management (CRM) areas. ImmoTrading GmbH which – inter alia – is responsible for the management of properties which have been included in the portfolio, was allocated to Deutsche Pfandbriefbank AG and the Global Workout Real Estate I unit in the reporting period.

In the period under review Property Analysis & Valuation, which is responsible for the analysis and uniform valuation of the collateral properties using market and LTV methods, was put under the control of the CEO.

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

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

Risk Strategy and Policies

The risk strategy of Deutsche Pfandbriefbank 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 Deutsche Pfandbriefbank Group. The risk strategy was adopted by the Management Board of Deutsche Pfandbriefbank AG in December 2011 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.

The risk strategy reflects the strategic refocusing of Deutsche Pfandbriefbank Group as a specialist for real estate finance and public sector investment finance in Germany and selected countries in Europe with Pfandbrief-oriented refinancing. It is monitored at least annually and updated where necessary.

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 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 and operational risk in particular are quantified and backed with risk cover funds as a 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 intangible risks which are considered to be minor risks, 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 Deutsche Pfandbriefbank Group is managed by:
1. Monitoring the risk-bearing capacity on the basis of comparing economic capital and the available financial resources of Deutsche Pfandbriefbank Group.
2. Monitoring of the risk-weighted assets (RWA) of Deutsche Pfandbriefbank Group at the portfolio level by means of stress tests which are intended to ensure that the 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 Deutsche Pfandbriefbank Group. The Basel-II-compliant management approach shows the average expected loss at the borrower level, and is therefore a major component in risk early recognition and ongoing profitability monitoring. The parameters are reviewed and recalibrated annually.
   - 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 Group.
   - Intensive monitoring and management of individual exposures.
   - Monitoring the risk of losses by way of appropriate impairment triggers in accordance with IAS 39.

Economic Capital and Monitoring the Risk-bearing Capacity

Deutsche Pfandbriefbank Group has established a risk-bearing capacity analysis which is based on the Internal Capital Adequacy Assessment Process (ICAAP). The assessment of internal capital adequacy is based on the concept of economic capital.

Economic capital is defined as «the quantity of capital required by a bank in order to cover the largest potential unexpected total loss with a probability of 99.95% (the confidence level) over a time horizon of one year». The use of a confidence level of 99.95% implies that the bank aims at least to achieve a rating which is equivalent to a good rating of external agencies (A– at Standard & Poor's, A/A2 at Fitch and Moody's).

The individual specific methods of calculating the economic capital for the risk types and the current figures are described in greater detail in section «Result of Risk-bearing Capacity Analysis». As is normal for the sector, economic capital is not calculated for liquidity risk.

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

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

Major Risk Types

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

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

Credit Risk

Definition

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

Credit Risk Strategy and Principles

As part of the restructuring process, HRE and hence Deutsche Pfandbriefbank Group have broken down the overall credit portfolio into a strategic portfolio (Real Estate Finance and Public Sector Finance) and a Value Portfolio. The risk strategy of Deutsche Pfandbriefbank Group also reflects this structure.

In the Public Sector Finance segment, new business of Deutsche Pfandbriefbank Group is confined to Pfandbrief-eligible financing of public investment financings in selected European countries.

New business in Real Estate Finance 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 selective developers.

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

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

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. The report shows the credit risk at the level of the Group and also at the level of the bank in the context of the overall bank risk and the risk-bearing capacity, it reports limit utilisations and violations of existing limits, and also identifies risk concentrations. Key indicators which are relevant for management purposes, such as the development of the EaD, the EL and the Credit VaR are integrated in this report and are discussed by the Management Board of Deutsche Pfandbriefbank AG; the Supervisory Board of Deutsche Pfandbriefbank AG is notified accordingly.
> The Credit Risk Report contains details concerning the portfolio and risk parameters at the Group level and also at the level of the subsidiary institutes.

- For decisions relating to new business and adjustments of conditions, major parameters, contents and analyses are presented to the Credit Committee and discussed.
- In the 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 value at risk) Deutsche Pfandbriefbank 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 section «Result of Risk-bearing Capacity Analysis».

In addition to the stress tests for economic capital, there are also RWA reverse stress tests. They investigate the extent to which a certain risk parameter (e.g. rating, LGD, currency) can change before the minimum capital ratio 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 Deutsche Pfandbriefbank Group is to be successfully completed.

Credit Risk Quantification according to Basel II Deutsche Pfandbriefbank Group – apart from the former DEPFA Deutsche Pfandbriefbank AG – has already received regulatory approval to apply the so-called Advanced Internal Rating-Based Approach (Advanced IRBA) for determining the regulatory capital backing. The final result of the regulatory audit for the introduction of the Advanced IRBA at former DEPFA Deutsche Pfandbriefbank AG is expected in 2012.

EU-wide Stress Test/Recapitalisation Survey HRE Group was involved in the EU-wide stress test which was carried out in the first half of 2011 by the European Banking Authority (EBA) at the highest level of consolidation and was also involved in the recapitalisation survey carried out among European banks by the EBA in the second half of 2011. In both surveys, HRE Group performed better than the minimum ratios specified by the European Banking Authority for tier I capital, and thus did not report any recapitalisation requirement.

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

The credit competences also define the decision-making powers of the individual credit risk managers for prolongations in existing business, depending on the counterparty group and expected loss class. A new set of powers for new business, governing the delegation of powers, has been applicable since the beginning of February 2011.

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

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

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

The 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 Risk Provisioning Committee.

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

Hedging and Minimising Risk by Collateral

At Deutsche Pfandbriefbank Group, property liens relating to the financed properties are particularly important in the Real Estate Finance segment. Other financial securities and guarantees in particular are also accepted as collateral (e.g. credit insurances, contractual guarantees from public authorities, fixed-income securities, purchase of receivables, etc.) in the Public Sector field and especially in public investment financing. Additionally, in Public Investment Finance there exist legal framework requirements as the maintenance obligation, which allows recourse on a public sector entity.

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

Credit Portfolio

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

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 € 87.7 billion as of 31 December 2011 (EaD 31 December 2010: €117.2 billion). The considerable decrease in comparison to the end of 2010 was the result of the reduction of € 28.3 billion in the EaD to the counterparty FMS Wertmanagement as of 31 December 2010, namely to € 7.9 billion as of 31 December 2011.

The EaD to the counterparty FMS Wertmanagement was broken down as follows: for most of the derivatives earmarked to be transferred to FMS Wertmanagement, it was not possible initially to arrange for beneficial ownership to be transferred, which meant that the market price risks of the derivatives were transferred to FMS Wertmanagement by way of concluding derivatives with identical conditions between Deutsche Pfandbriefbank Group and FMS Wertmanagement. These so-called back-to-back transactions accounted for an EaD of € 4.9 billion (31 December 2010: € 9.6 billion). And finally, Deutsche Pfandbriefbank Group held bonds with an EaD of € 3.0 billion (31 December 2010: € 7.9 billion) issued by FMS Wertmanagement, which were provided by FMS Wertmanagement in connection with the claim for compensation of Deutsche Pfandbriefbank Group for the transferred assets and liabilities.

In addition, the credit portfolio EaD of € 87.7 billion also included assets with an EaD of € 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. With effect from 1 December 2010, the credit risks of these assets was transferred by means of guarantees provided by FMS Wertmanagement, so that Deutsche Pfandbriefbank Group ultimately retains a counterparty risk with regard to FMS Wertmanagement in connection with these positions.

In order to constantly avoid EaD fluctuations and distortions in the strategic operating segments of Deutsche Pfandbriefbank Group resulting from the refinancing function which has been taken on, and also to properly reflect the actual economic risk in Deutsche Pfandbriefbank Group, the above EaDs attributable to transactions with FMS Wertmanagement have been detailed merely for information purposes in the following overviews of the portfolio development and structure. The EaD for the total exposure of Deutsche Pfandbriefbank Group determined without the above position amounted to € 79.0 billion.

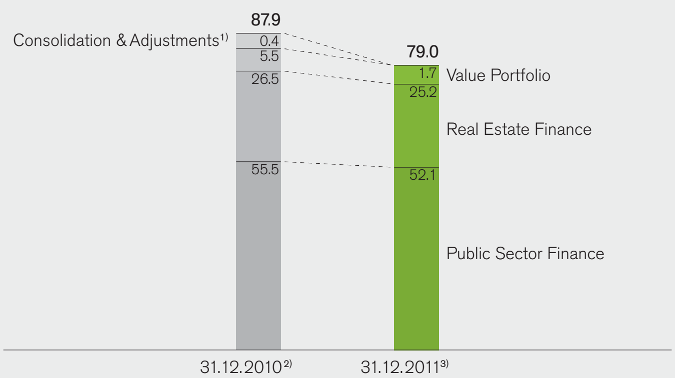
The new business comprised commitments totalling € 8.0 billion (31 December 2010: € 4.1 billion); of this figure, € 6.3 billion was attributable to the Real Estate Finance segment, and €1.7 billion was attributable to the Public Sector Finance segment. Of the figure of € 6.3 billion for the Real Estate Finance segment, € 2.8 billion was attributable to the selected prolongations of existing business. Of the figure shown for public investment finance, € 0.1 billion was attributable to prolongations.

Overview of the Total Exposure of Deutsche Pfandbriefbank Group: € 79.0 billion EaD The credit portfolio is broken down into the following strategic segments:
> Public Sector Finance (PSF)
> Real Estate Finance (REF)
as well as the non-strategic Value Portfolio (VP) which is earmarked for being wound down.

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

Total exposure: EaD according to business segments

in € billion



[1] The amount of €0.03 billion as of 31 December 2011 was attributable to the category «Consolidation & Adjustments»
[2] In addition € 29.3 billion EaD with regard to the counterparty FMS Wertmanagement including guaranteed positions of € 1.0 billion (PSF: € 27.7 billion; VP: € 1.6 billion)
[3] In addition € 8.7 billion EaD with regard to the counterparty FMS Wertmanagement including guaranteed positions of € 0.8 billion (PSF: € 8.2 billion; VP: € 0.5 billion)

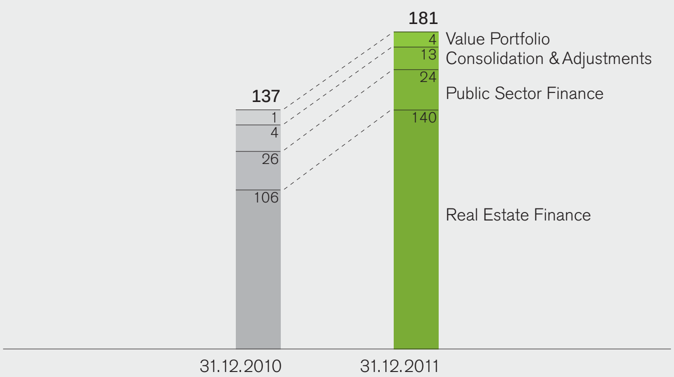
The exposure at default (EaD) of Deutsche Pfandbriefbank Group declined in 2011 from € 87.9 billion as of 31 December 2010 to € 79.0 billion as of 31 December 2011. Overall, there were slight percentage increases in the Public Sector Finance segment (66 %; previous year: 63 %) and the Real Estate Finance segment (32 %; previous year: 30 %). On the other hand, the percentage attributable to the Value Portfolio declined further from 6 % (€ 5.5 billion) in the previous year to 2 % (€ 1.7 billion).

Risk Parameters Expected Loss The expected loss (EL), which is calculated from the annual probability of default (PD), the loss-given default (LGD) and the EaD, amounted to € 181 million as of 31 December 2011 using the parameters specified by Basel II for Deutsche Pfandbriefbank Group.

The expected loss for a period of one year is a key management parameter for the portfolio and is calculated for the entire exposure, with the exception of business with other institutes within HRE and non-performing loans for which an individual allowance has already been recognised.

Total exposure: expected loss according to business segments[1]

in € million



[1] The expected loss is calculated for the entire exposure in the banking book, with the exception of non-performing loans for which an individual allowance has already been recognised

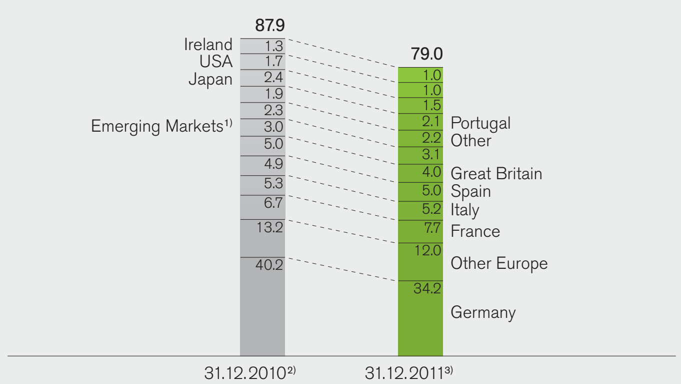
Economic Credit Risk Capital The economic capital for credit risk – calculated by the credit portfolio model – amounted to € 1.7 billion (31 December 2010: € 1.3 billion) for a confidence level of 99.95 % and a period of one year disregarding diversification effects to other risk types. Details regarding the calculation are set out in the section «Result of Risk-bearing Capacity Analysis».

Regional Breakdown of the Portfolio In the year under review, the exposure of Deutsche Pfandbriefbank Group focused on Western Europe. Germany continued to account for most of the overall exposure, with 43 % (€ 34.2 billion). Compared with the end of 2010, the exposure in the USA declined by € 0.7 billion to € 1.0 billion, and relates entirely to financial institutions in the USA. The fact that the exposure to Japan has declined by € 0.9 billion to € 1.5 billion is due mainly to the planned repayment of a mortgage loan and also a reduction of exposures to financial institutions in the Value Portfolio.

The percentage of the category «Other Europe» remained stable at 15 % as of 31 December 2011 in comparison with the year before and contains as largest items Austria with € 7.0 billion (31 December 2010: € 6.9 billion) and Sweden with € 1.3 billion (31 December 2010: € 1.5 billion). Compared with the previous year the percentage of the category «Emerging Markets» in accordance with the IMF definition had slightly increased and mainly comprised Poland with € 2.1 billion (31 December 2010: € 1.8 billion) and Hungary with € 0.7 billion (31 December 2010: € 0.8 billion). Deutsche Pfandbriefbank Group no longer has exposures in the emerging-market countries of India and Russia.

Total portfolio: EaD according to regions

in € billion



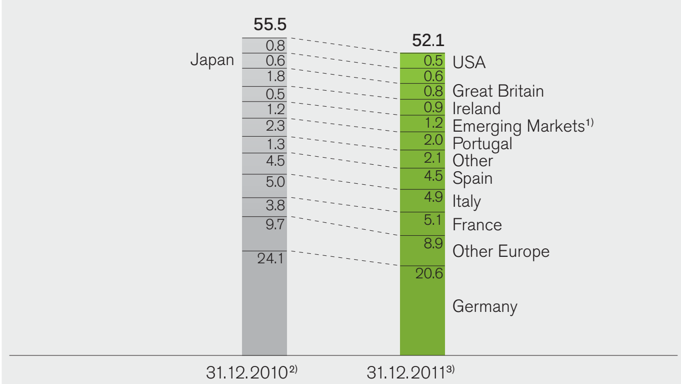
[1] Emerging markets in accordance with the IMF definition
[2] In addition € 29.3 billion EaD with regard to the counterparty FMS Wertmanagement including guaranteed positions of € 1.0 billion. The figures without guaranteed positions were fully attributable to Germany (€ 28.3 billion). The guaranteed positions were fully attributable to Italy (€ 1.0 billion)
[3] 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)

Public Sector Finance: € 52.1 billion EaD Portfolio Development and Structure The portfolio of the strategic operating segment Public Sector Finance (PSF) amounted to € 52.1 billion as of 31 December 2011 (31 December 2010: € 55.5 billion).

Most of the exposure was to be found in Western Europe. The percentage of the segment portfolio remained stable with the exception of France and Germany. The major part of «Other Europe» contained Austria with € 6.9 billion (31 December 2010: € 6.8 billion). The exposure in the USA related almost entirely to financial institutions located in the USA.

Public Sector Finance: EaD according to regions

in € billion

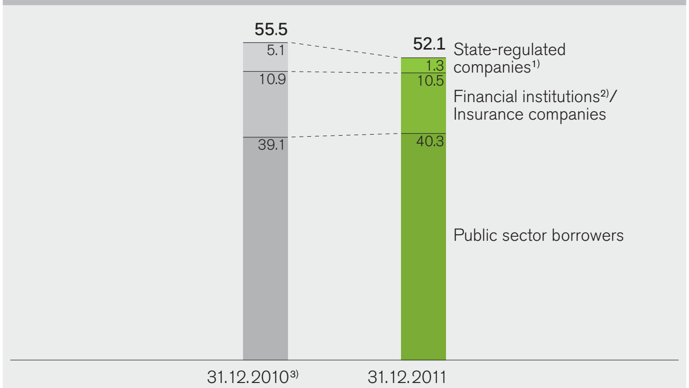


[1] Emerging markets in accordance with the IMF definition
[2] In addition € 27.7 billion EaD with regard to the counterparty FMS Wertmanagement, which was fully attributable to Germany; the Public Sector Finance segment did not include any positions guaranteed by FMS Wertmanagement
[3] In addition € 8.2 billion EaD with regard to the counterparty FMS Wertmanagement which was fully attributable to Germany; including guaranteed positions of € 0.5 billion

The position «Public Sector Borrowers» included receivables due from sovereigns (33 %), public sector enterprises (29 %) and municipalities (38 %).

Public Sector Finance: EaD according to counterparty structure

in € billion

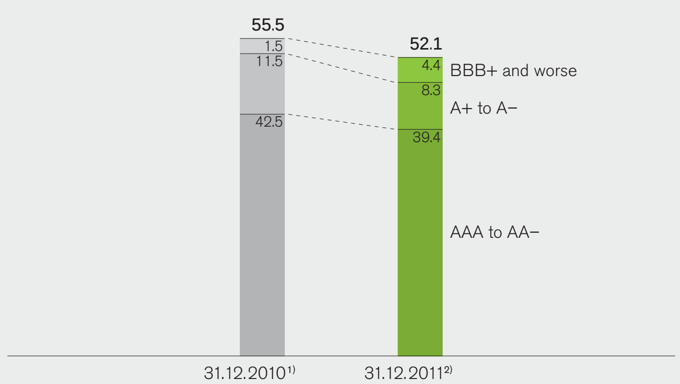


[1] E.g. water utilities, power supply utilities, etc.
[2] Financial institutions with a state background or state guarantee
[3] Figures include an additional amount of € 0.4 billion (0.6 %) attributable to the counterparty category «Other»

The still high percentage of public sector borrowers in this segment, which are mostly still classified as «investment grade», was reflected in the rating. The content of positions with a rating of BBB+ and worse increased from € 1.5 billion in December 2010 to € 4.4 billion due to internal reclassifications. The exposure in the non-investment-grade field was € 0.5 billion or 1.0 % (31 December 2010: € 0.1 billion) and comprised transactions with sovereigns and sub-sovereigns in Europe as well as other financial institutions in the USA.

Public Sector Finance: EaD according to internal ratings

in € billion



[1] In addition € 27.7 billion EaD to the counterparty FMS Wertmanagement, which was fully attributable to the rating class AAA. The Public Sector Finance segment did not include any positions guaranteed by FMS Wertmanagement

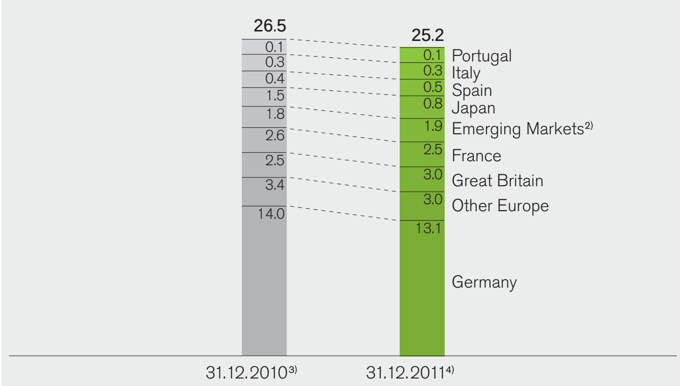
[2] In addition € 8.2 billion EaD (including guaranteed positions of €0.5 billion) to the counterparty FMS Wertmanagement, which was fully attributable to the rating class AAA to AA-

Risk Parameters The expected loss (EL) of the portfolio of the Public Sector Finance segment was stable for the whole last period (31 December 2011: € 24 million; 31 December 2010: € 26 million). The minor decrease in expected loss was mainly attributable to the reduction of the exposure and to improvements in the PD and LGD parameters at a few customers.

Real Estate Finance: € 25.2 billion EaD Portfolio Development and Structure The EaD of the Real Estate Finance portfolio of Deutsche Pfandbriefbank Group declined by a total of € 1.3 billion compared with 31 December 2010. The customer derivatives included in the portfolio accounted for EaD of € 0.8 billion as of 31 December 2011, compared with a figure of € 0.6 billion EaD at the end of 2010. Whereas the percentage of Great Britain in relation to the overall portfolio increased, the percentage attributable to Japan declined to approximately half of the exposure.

Real Estate Finance: EaD according to regions[1]

in € billion



[1] In the Real Estate Finance segment, there was no exposure to the counterparty FMS Wertmanagement

[2] Emerging markets in accordance with the IMF definition

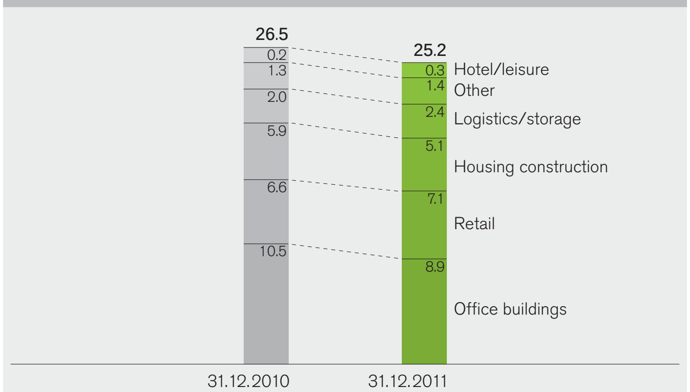
[3] Breakdown including customer derivatives for approx € 0.6 billion

[4] Breakdown including customer derivatives for approx € 0.8 billion

The breakdown of the portfolio according to types of property at the end of 2011 had slightly changed compared with 2010. Noteworthy is the reduction in the property type «Office Buildings» of € 1.5 billion to € 8.9 billion or 36 % of the Real Estate Finance Portfolio (31 December 2010: 40 %). The percentage of Residential properties remained stable at 20 % (31 December 2010: 22 %). Approximately 9 % of the Portfolio amounted on the property type «Logistics/Storage» (31 December 2010: 10 %). In addition, retail property financing accounted for a considerable amount of the Real Estate Finance segment (28 %; 31 December 2010: 25 %).

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

in € billion

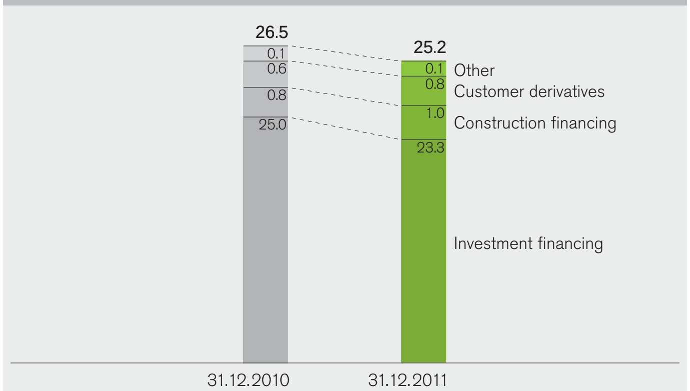


[1] In the Real Estate Finance segment, there is no exposure to the counterparty FMS Wertmanagement

At the end of 2011, the portfolio furthermore was dominated by investment financing (93 %; 31 December 2010: 95 %). Higher risk construction projects in the building phase (building finance) accounted for 4 % of the EaD (31 December 2010: 3.0 %). 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



[1] In the Real Estate Finance segment, there is no exposure to the counterparty FMS Wertmanagement

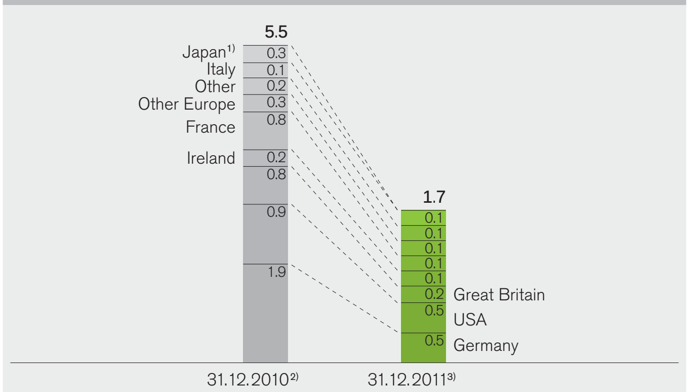
Risk Parameters Using the parameters defined under Basel II, the expected loss for the Real Estate Finance portfolio was €140 million as of 31 December 2011. It has accordingly increased appreciably compared with December 2010 (€106 million), which is primarily caused by the recalibration of the prime rating tool in December 2011.

Value Portfolio: €1.7 billion EaD Portfolio Development and Structure The Value Portfolio comprises non-strategic portfolios of Deutsche Pfandbriefbank Group as well as a part of the transactions which exist with the counterparty FMS Wertmanagement. 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 € 3.8 billion in the exposure as of 31 December 2011 compared with 31 December 2010 was mainly attributable to the decrease of the exposure of almost all countries especially in Germany, USA and Great Britain. In the remaining portfolio as of 31 December 2011, a regional emphasis was formed particularly by Germany and the USA.

Value Portfolio: EaD according to regions

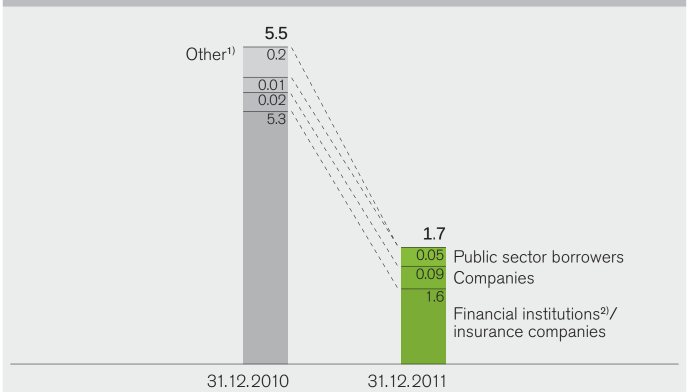
in € billion



[1] The amount attributable to Japan was at €0.0 billion as of 31 December 2011
[2] In addition €1.6 billion EaD to the counterparty FMS Wertmanagement, including guaranteed positions of €1.0 billion. The content without guarantees was fully attributable to Germany. The guaranteed positions were fully attributable to Italy
[3] In addition € 0.5 billion EaD to the counterparty FMS Wertmanagement, including guaranteed positions of € 0.3 billion. The content without guarantees was fully attributable to Germany. The guaranteed positions were fully attributable to Italy

Value Portfolio: EaD according to counterparty structure

in € billion



[1] The amount attributable to the category «Other» was at € 0.0 billion as of 31 December 2011
[2] Including exposure to the affiliated institution DEPFA Bank plc of € 0.1 billion (31 December 2010: € 0.6 billion)

Risk Parameters Using the parameters defined under Basel II, the expected loss for the Value Portfolio was € 4 million as of 31 December 2011. It had increased compared with December 2010 (€1 million) due to a conservative estimation of PD and LGD parameters for some counterparts.

Structured Products

As of 31 December 2011, Deutsche Pfandbriefbank Group had fully state-guaranteed collateralised debt obligations with a nominal value of € 0.8 billion (31 December 2010: € 0.9 billion) and a current internal fair value of € 0.7 billion (31 December 2010: € 0.7 billion).

Compared with the end of 2010 (€ 0.5 billion), nominal holdings of structured securities without a government guarantee which Deutsche Pfandbriefbank Group breaks down into property-related real-estate-linked investments such as Commercial mortgage- backed securities (CMBS), residential mortgage-backed securities (RMBS) and credit-linked investments such as collateralised debt obligations (CDOs, in the narrower sense of the term) and collateralised loan obligations (CLOs) had declined mainly as a result of sales to the current figure of € 0.1 billion as of the end of December 2011.

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

The current internally calculated fair value of these securities which securitise credit risks amounted to €10 million as of 31 December 2011 (31 December 2010: €11 million).

Special-purpose Vehicles in Deutsche Pfandbriefbank Group

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

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

The remaining special-purpose vehicle is an ABS structure which has been completely written down so that no further risks can result for Deutsche Pfandbriefbank Group from this special-purpose vehicle (31 December 2011: nominal € 0.48 billion, 31 December 2010: nominal € 0.64 billion). The consolidation of the special-purpose vehicles had resulted in particular in a balance sheet extension of € 0.4 billion (31 December 2010: € 0.5 billion). However, from 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 2010: € 0.5 billion).

Watchlist and Non-performing Loans: € 2.0 billion[1)]

Early Warning System The early warning system of Deutsche Pfandbriefbank Group has defined triggers (= criteria) for including loans in the watchlist and for being classified as workout loans (e.g. past due payments, failure to meet covenants – e.g. 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, 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.

1) Reporting has been changed over to EaD

Development of Watchlist and Non-performing Loans of Deutsche Pfandbriefbank Group Breakdown of watchlist and non-performing loans as of 31 December 2010 and 31 December 2011:

Breakdown of watchlist and non-performing loans of Deutsche Pfandbriefbank Group				31.12.2011				31.12.2010	
EaD in € million	PSF	REF	VP	Total	PSF	REF	VP	Total	Δ in € million
Workout loans	–	10	15	25	–	16	42	58	–33
Restructuring loans[1]	35	1,273	–	1,308	38	1,141	–	1,179	129
Non-performing loans	**35**	**1,283**	**15**	**1,333**	**38**	**1,157**	**42**	**1,237**	**96**
Watchlist loans	–	648	–	648	–	319	–	319	329
Total	**35**	**1,931**	**15**	**1,981**	**38**	**1,476**	**42**	**1,556**	**425**

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

The watchlist and non-performing loans increased by a total of €425 million.

The watchlist loans increased by €577 million (gross) or €329 million (net). The difference can be explained mainly by restructuring and repayments and also by transfers to the non-performing loan portfolio. In the latter case this essentially comprised one loan of €100 million.

The non-performing loans increased by €280 million (gross) respectively €96 million (net). A figure of €184 million had been restructured or transferred to workout loans.

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 in which the CROs of all subsidiary institutions hence as well of Deutsche Pfandbriefbank AG are represented.

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

Coverage for Non-performing Loans

As of 31 December 2011, there was 38 % cover for the non-performing loans of Deutsche Pfandbriefbank Group (31 December 2010: 52 %). The decline resulted from the sale in 2011 of exposure completely or almost completely written off.

There were no non-performing loans in Public Sector Finance segment as of 31 December 2011. The non-performing loans in Real Estate Finance segment were covered by 33 % (31 December 2010: 34 %), in the Value Portfolio by 90 % (31 December 2010: 97 %).

Market Risk

Definition

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

Market Risk Strategy

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

Organisation of Market Risk Management

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

Market Risk Reports

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

Measurement and Limiting of Market Risk

Market Risk Value at Risk Risk Management & Control uses a variance-covariance approach to calculate the market risk VaR at the overall and sub-portfolio level on a daily basis. All positions are included, whereby the credit spread VaR from positions which are included in the IFRS category Loans & Receivables is not taken into consideration.
> The correlations and volatilities which are used are based on historical time series of the previous 250 trading days, which are included in the calculation on an equally weighted basis.
> For the daily operational risk management, the VaR relates to a holding period of ten days and a one-sided 99% confidence interval.
> When the individual market risk components, such as the interest, FX and credit spread VaR, are aggregated to form a total VaR, which constitutes the basis for the limit monitoring, the historically observed correlations instead of a zero correlation assumption have been used since July 2011.

The market risk VaR amounted to €103 million as of 31 December 2011 (comparative value as of 31 December 2010: €70 million). In the reported period no limit breaches occurred.

The development in the market risk VaR and the market risk limit during 2011 mainly reflects the following events:

In July, the process for calculating the overall VaR from the VaRs of the individual market risk components such as interest rate, FX and credit spread VaR changed over to historically observed correlations from the previous process which involved a zero-correlation assumption. This resulted in a considerable increase in the overall VaR, with virtually unchanged interest rate, FX and credit spread VaRs.

Due to the resultant high limit utilisation, the market risk limit increased by €10 million from €95 million to €105 million. The market risk limit at DEPFA plc was reduced to the same extent, which means that the market risk limit at the HRE Group level remained constant.

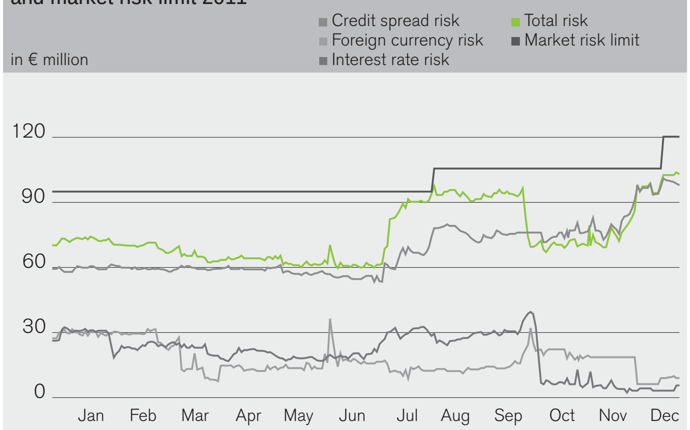
The front office systems were consolidated in October. The related harmonisation resulted in a decline in interest rate VaR and consequently also the overall VaR.

The increase in credit spread VaR and overall VaR between November and the end of the year was mainly attributable to the sharp rise in credit spread volatilities on the markets and the creation of a liquidity buffer according to MaRisk BTR 3.2.

Because credit spread volatilities continue to be high, the market risk limit was increased by €15 million, namely from €105 million to €120 million. Previously unallocated limit (limit reserve) was used for this purpose. The way in which the maximum market risk limit is calculated from the risk-bearing capacity calculation (ICAAP) remained unchanged.

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

Market risk VaR (10 days, 99%) individual risk types and market risk limit 2011



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

Stress Testing Whereas the VaR measurement simulates the market risk under «normal» market conditions, and is not to be understood as a standard for a potential maximal loss, stress scenarios show the market risk under extreme conditions. At Deutsche Pfandbriefbank Group, uniform hypothetical stress scenarios are calculated on a monthly basis for all key risk drivers (credit spreads, interest rates, foreign currency rates). Historical stress scenarios are also simulated. For example, a parallel shift of 200 bp upwards in the interest rate curve would have resulted in a loss of approx. €125 million in the market value for all positions of Deutsche Pfandbriefbank Group (including equity books). The corresponding loss in the market value for the end of 2010 was €53 million. The Management Board and the corresponding committees are regularly informed of the results of the scenario analyses.

Economic Market Risk Capital

For calculating the economic market risk capital, which is taken into consideration for the risk-bearing capacity analysis, the market risk VaR is scaled to a period of one year and also to a higher confidence level (from 99% to 99.95%). Deutsche Pfandbriefbank Group's economic capital for market risk, disregarding diversification effects for other risk types, amounted to €619 million as of 31 December 2011 (31 December 2010: €488 million).

Market Risk Management, Monitoring and Reduction

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

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

Development of the Relevant Market Risk Types

General Interest Rate Risk The total general interest rate risk of Deutsche Pfandbriefbank Group amounted to €5 million as of 31 December 2011. It was thus significantly lower than the corresponding figure of 31 December 2010 (€26 million). On average, the interest rate risk of €20 million for 2011 (max. €39 million; min. €2 million) remained at a low level (average VaR for 2010 €17 million; max. €28 million; min. €11 million).

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 €98 million as of the end of December 2011 (year end 2010: €58 million). Compared with the previous year the increase was mainly attributable to the sharp rise in credit spread volatilities on the markets and the composition of the regulatory required liquidity buffer.

Foreign Currency Risk and Other Market Risks The foreign currency risk which is calculated as a present value amounted to €8 million as of 31 December 2011; the corresponding figure at the end of 2010 was €29 million. The general strategy aims to hedge foreign currency risks as far as possible.

The Group is not exposed to equity price and commodity risks. Inflation risks are essentially hedged.

Financial derivatives are used mainly for hedging purposes.

Liquidity Risk

Definition

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

Liquidity Risk Strategy

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

Organisation of Liquidity Risk Management

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

Liquidity Risk Report

The liquidity management reports are prepared daily on a Group-wide basis and reported to the entire Management Board as well as to Deutsche Bundesbank and 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 and limit the liquidity risks. Contractual cash flows as well as optional cash flows are recognised. These data are regularly subjected to backtesting.

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

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

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

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

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

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

The scenarios are reported to the Management Board of HRE respectively to the Management Board of Deutsche Pfandbriefbank

AG as well as to external bodies, e.g. Deutsche Bundesbank and FMSA.

The requirements relating to the maintenance of liquidity reserves were implemented as part of the process of further developing liquidity risk measurement and in line with the new minimum requirements for risk management (MaRisk). 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 of HRE and a defined escalation process. A liquidity emergency plan has also been adopted in this context; this plan forms the specialist and organisational framework for the treatment of liquidity shortages.

Liquidity risk management is based on various interconnected components which in turn are based on a «liquidity risk tolerance» defined by the Management Board. This ensures that the individual companies of HRE and hence Deutsche Pfandbriefbank Group have adequate liquidity reserves transactions.

Hedging and Reduction of Liquidity Risk

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

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

Development of the Risk Position of Deutsche Pfandbriefbank Group

The development of the liquidity position in 2011 was affected by the continuing stress situation on the capital markets, which limited the refinancing options in parts significantly.

The liquidity risk measurement as of 31 December 2011, determined in line with the cumulative liquidity position (liquid assets as well as forecast net cash flow) in the base scenario, amounted to € 5.7 billion for a 12-month horizon. The decline of € 3.0 billion compared with the previous year was in line with expectations.

The liquidity ratio in accordance with the Liquidity Ordinance amounted to 2.34 at Deutsche Pfandbriefbank AG as of 31 December 2011; it is thus higher than the statutory minimum of 1.0.

Refinancing

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

The refinancing markets in 2011 continued to be characterised by high volatilities. In view of the outstanding EU decision and the associated uncertainty among investors, Deutsche Pfandbriefbank only issued private placements in the first half of 2011. In the second half, only two Pfandbrief benchmark issues were placed on the entire German market. One of these issues was the € 500 million mortgage Pfandbrief issue of Deutsche Pfandbriefbank at the beginning of October 2011. The markets will have to stabilise further particularly in the field of uncovered refinancing in order to guarantee long-term access to uncovered funding.

The stabilisation measures of the ECB involving programmes for buying government bonds and covered bonds, the reduction of leading interest rates as well as the unlimited provision of central bank money have only been able to calm down the markets to a certain extent. In December 2011, Deutsche Pfandbriefbank participated in the three-year tender of the ECB due to the economic benefits involved.

Forecast Liquidity Requirement

There are no significant liquidity imbalances due to the balanced asset-liability profile.

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

Operational Risk

Definition

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

Strategy for Operational Risks

The overriding aims of Deutsche Pfandbriefbank Group are the early recognition, recording, assessment as well as monitoring, prevention and limiting of operational risks as well as an early and meaningful management reporting. Deutsche Pfandbriefbank 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 Deutsche Pfandbriefbank Group.

Risk Reports, Monitoring and Management of Operational Risks

Operational risks are monitored by means of a network of controls, procedures, reports and responsibilities. Within Deutsche Pfandbriefbank Group, each individual 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 Deutsche Pfandbriefbank Group and any required measures in relation to mitigation of identified risks.

Regular reports are prepared for the Chief Risk Officer and the Group Risk Committee. The monthly Group Risk Report includes details concerning operational risk events and losses and key risk issues affecting Deutsche Pfandbriefbank Group. In addition, a quarterly risk report regarding major risk indicators notifies the Management Board of potential risk sources. The results of the annual risk self-assessments for each department are reported to the Risk Committee after the assessment process has been completed. After the completion of a detailed risk assessment the relevant member of the Management Board receives a final report.

Risk Measurement

The economic capital for operational risk amounted to € 103 million as of 31 December 2011 (31 December 2010: €135 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 € 86 million as of 31 December 2011 (31 December 2010: € 80 million).

Major Operational Risks of Deutsche Pfandbriefbank Group

Major operational risks result from the continuing enhancements at HRE Group and therefore also at Deutsche Pfandbriefbank Group. This also comprises the process of rendering services for FMS Wertmanagement as well as ongoing changes in the IT environment. Operational risks are attributable in particular to the high number of manual processes as well as the high number of different processing and monitoring systems. Until the consolidation process has been completed, there will be an increased level of susceptibility to errors with regard to the manual processes and controls which are carried out for ensuring data consistency.

There is also a significant reliance on know-how of key personnel for dealing with the continuing enhancements on the one hand and for operating daily business on the other. This is particularly important given the environment of processing systems and manual processes and controls.

Deutsche Pfandbriefbank Group suffered losses of € 0.2 million in total from operational risks in the course of the financial year 2011 (31 December 2010: €1.5 million). These are primarily related to manual errors in performing control processes. Process and control improvements have been implemented in order to remedy the underlying causes of the losses which have occurred.

Result of Risk-bearing Capacity Analysis

Economic capital according to risk types Excluding diversification effects in € million	31.12.2011	31.12.2010	Δ in € million
Credit risk	1,685	1,329	+356
Market risk	619	488	+131
Operational risk	103	135	−32
Business risk	41	62	−21
Total before diversification effects	**2,448**	**2,014**	+434
Total after diversification effects	**2,247**	**1,811**	+436
Available financial resources	4,173	5,156	−983
Surplus cover/shortfall	+1,926	+3,345	−1,419

Excluding the diversification effects between the individual risk types, the economic capital of Deutsche Pfandbriefbank AG was approx. € 2.4 billion (31 December 2010: € 2.0 billion). If these effects are taken into consideration, the economic capital amounted to around € 2.2 billion (31 December 2010: € 1.8 billion).

The available financial resources declined by € 1.0 billion to € 4.2 billion (31 December 2010: € 5.2 billion). Almost half of the reduction (€ −436 million) was attributable to a decline in subordinate capital or hybrid capital with terms of more than one year, a reduction in IFRS capital (€ −251 million) as well as an increase of € 113 million in deferred taxes. Additionally, since the second quarter, available financial resources had no longer shown the previously included planned result for the next 12 months (€ −130 million). Since the middle of the year, the expected losses from the credit portfolio model had been deducted from the available financial resources (31 December 2011: € −172 million).

There was an economic capital buffer of around € 1.9 billion for a one-year observation period as of 31 December 2011 (31 December 2010: € 3.3 billion). The main risk type based on the ICAAP (measured in terms of economic capital and without explicitly taking account of the liquidity risk) was the credit risk which accounts for 69% of the undiversified economic capital.

In accordance with Section 25 a (1) KWG, credit institutions are obliged to set up appropriate and effective procedures in order to ensure that their risk-bearing capacity can be established and assured in the long term. These procedures complement the regulatory procedures defined in the Solvency Ordinance.

The bank's own risk-bearing capacity calculation is the subject of regulatory reviews («Supervisory Review and Evaluation Process», SREP). On 7 December 2011, BaFin detailed key aspects of the regulatory appraisal in its letter «Regulatory appraisal of bank-internal risk-bearing capacity concepts». For instance, according to this appraisal, hidden charges attributable to securities as part of the long-term assets have to be deducted from the risk cover potential in a liquidation scenario. The corresponding market price risks should be completely recognised in the risk-bearing capacity calculation. However, the concept currently used by Deutsche Pfandbriefbank Group uses a different assumption, namely that there is the ability and intention to hold these securities to maturity. Consequently, the hidden charges attributable to securities as part of the long-term assets are not fully recognised in the risk cover potential. Deutsche Pfandbriefbank Group at present also does not recognise all credit spread risks for securities as part of the long-term assets in the calculation of economic capital.

The risk-bearing capacity concept is currently being developed further in order to ensure that the specific regulatory requirements will be met in future. An assessment is being carried out to determine whether a risk-bearing capacity calculation based on a going-concern assumption would provide a more realistic reflection of the business model of the bank. This further development might have a considerable impact on the risk-bearing capacity analysis.

Method Used for the Individual Risk Types

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

The method of calculating the economic capital for the individual material risk types for the year 2011 is explained in the following.

Credit Risk For calculating credit risk at the portfolio level, Deutsche Pfandbriefbank Group uses a credit portfolio model which follows the approach of a so-called asset value model. The main underlying idea of this approach is that by repeated simulations of correlated rating migrations of borrower defaults as well as a calculation of resulting value changes arising from a corresponding revaluation of the portfolio, probability statements can be made with regard to potential losses from lending business. The loss distribution calculated in this way can then be used to calculate the economic credit risk capital as an unexpected loss. This defines the maximum unexpected loss calculated for a confidence level of 99.95 % which will result within one year due to rating migrations and defaults in lending business. In addition to the loss distribution of the credit portfolio, a significant result is the risk-adjusted allocation of the credit risk capital measured in this way to the individual borrower units using the so-called expected shortfall principle. This ensures proper allocation to the borrowers, and thus constitutes a major module in the risk-oriented management of the credit portfolio.

Due to the expiry of licenses, an in-house development of the credit portfolio model replaced the previously used solution in December 2011. The system change over has not resulted in any changes in the quantification of economic capital for the credit risk.

For a confidence level of 99.95 % and a time horizon of one year the economic capital for credit risk calculated using the credit portfolio model, disregarding diversification effects to other risk types, was €1.7 billion (31 December 2010: €1.3 billion). The increase of € 356 million has been driven mainly by the implementation of new rating modules and also higher credit spreads in the second half of the year.

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

The economic capital for market risk over a one-year horizon was € 619 million as of 31 December 2011, excluding diversification effects to other risk types (31 December 2010: €488 million). The increase of €131 million was mainly due to the fact that the historical correlation between the market risk factors has been recognised since July 2011, and is also due to considerably higher volatilities in credit spreads and the creation of a liquidity reserve in the fourth quarter.

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

The economic capital for operational risk amounted to €103 million as of 31 December 2011 (31 December 2010: €135 million).

Business Risk The calculation of the economic capital for the business risk includes an assumed increase in financing costs as a result of an increased financing requirement with a simultaneous increase in the unsecured refinancing rate. As part of the liquidity risk measurement process, the stress scenario «Further decline» simulates every month the increased financing requirement if certain market events were to occur. For the unsecured funding rate an increase to the historic maximum of credit spreads of the bank's own rating observed on the market is simulated. It is assumed conservatively that both events will occur simultaneously.

The economic capital for business risks amounted to €41 million as of 31 December 2011. The previous year figure of € 62 million still included the risk of no net interest income and net commission income from new business for the next four quarters. Because the risk cover funds do not include any forecast profits for regulatory purposes, the inclusion of this component in the business risk has become redundant.

Liquidity Risk Capitalising for liquidity risk in the narrower sense is not possible. Liquidity risk in the broader sense of an increase in funding costs for potential financing shortages is recognised in the economic capital for the business risk.

Stress Tests

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

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

In addition, there are two integrated stress test scenarios, i.e. scenarios applicable for all risk types (the stress scenario as well as the extreme stress scenario). Both scenarios are based on hypothetical and on historical events. The purpose of the stress scenario is to reflect an unusual but potentially plausible event, whereas the extreme stress scenario is to be associated with extreme events. The stress scenario calculates the effects on the economic capital and also on the risk cover funds. On the other hand, the extreme stress scenario determines only the effects on the available financial resources. A check is performed to determine whether the bank still has positive available financial resources after the occurrence of the extreme scenario.

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

Conception

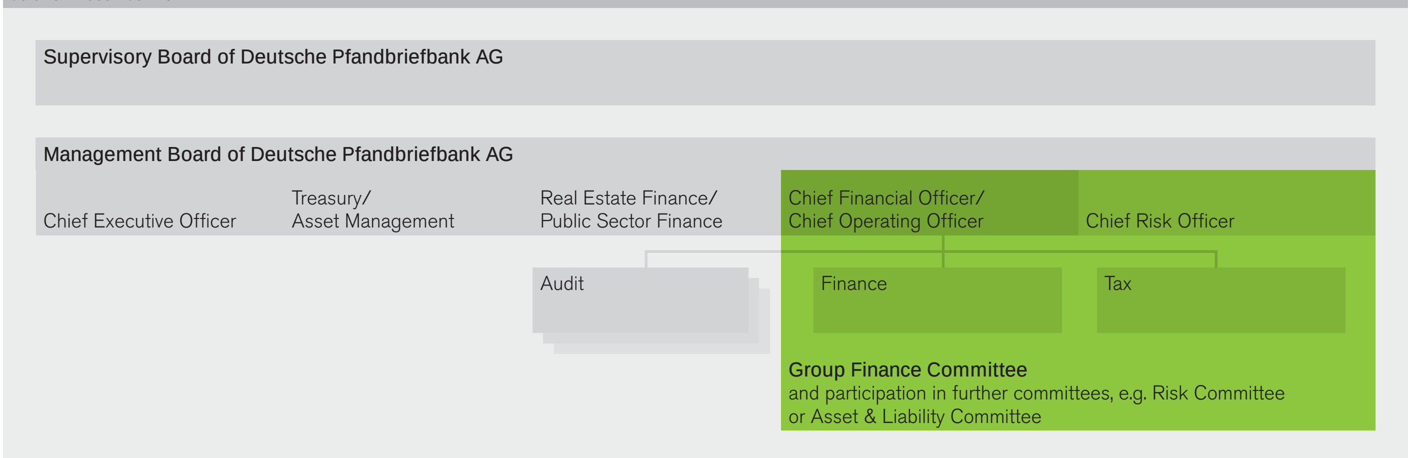
The internal control and risk management system with regard to the accounting process comprises the principles, procedures and measures designed to assure the effectiveness and efficiency of accounting and also to assure compliance with the relevant legal regulations. The aim of the risk management system with regard to the accounting process is to identify and evaluate risks which may oppose the objective of ensuring that the financial statements comply with the relevant rules, to limit risks which have been identified and to check the impact of such risks on the financial statements and also the way in which these risks are presented. The internal control system with regard to the accounting process is an integral component of the risk management system. 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 Deutsche Pfandbriefbank Group the internal control and risk management system with regard to the accounting process is reflected in the structure and procedure organisation. In terms of structure organisation, the internal control and risk management system with regard to the accounting process mainly comprises the Management Board, the Supervisory Board as the control body of the Management Board, the departments which report to the Chief Financial Officer (CFO) and the Group Finance Committee (GFC).

Internal control and risk management system with regard to the Group accounting process

as of 31 December 2011



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

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

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

The CFO is also responsible for managing Finance, Tax and Audit. In the CFO department, the consolidated financial statements are prepared in accordance with IFRS, and the accounting-relevant capital market information is provided. The companies of Deutsche Pfandbriefbank Group prepare their financial statements in accordance with the respective local legal requirements. For Group accounting purposes, the financial statements are harmonised in relation to uniform accounting policies in accordance with IFRS. Each company included in the consolidated financial statements reports its balance sheet, income statement and notes via the consolidation software to a central department in Group Accounting. In Group Accounting, the data of the foreign currency companies are translated into euros by means of the consolidation software. In addition, 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 Deutsche Pfandbriefbank Group. In order to ensure close communication with other departments, the CFO or the Heads of the CFO departments also serve on other committees, for instance the Risk Committee with its sub-committees or the Asset and Liability Committee (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

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

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

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

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

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

Maintenance

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

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

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

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

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 not integrated in the work process, nor is it responsible for the result of the process to be audited. In order to enable it to carry out its duties, the Audit department has a complete and unrestricted right to obtain information regarding the activities, processes and the IT systems.

As a Control and Advisory Committee of the Management Board, the Supervisory Board is able to inspect and audit the accounts and the assets of the company in accordance with Section 111 (2) AktG. In addition, the Management Board regularly reports to the Supervisory Board. The internal control and risk management system with regard to the accounting process is a subject of the deliberations of the Supervisory Board. The Supervisory Board engages the auditor to audit the consolidated financial statements. 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 HRE 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

International growth is expected to be mixed in the year 2012. Whereas strong growth is expected to be reported for GDP in Asia, and slight growth is expected to be reported in the USA, a slight decline is forecast for the eurozone. The countries in the eurozone will probably report mixed performances. The growth forecast for the European Union is estimated to be – 0.2 %. For Ireland, Italy and Spain, growth is expected to be roughly in line with the average for the EU. On the other hand, the Greek (–7.5 %) and Portuguese (– 4.1%) economies are expected to contract much more significantly in 2012. Germany will probably be in line with the EU average (– 0.2 %). As was the case in the previous year, the main uncertainty regarding the forecast for economic growth is due to the further development of European banking and the government debt crisis.

Despite the fact that monetary policy worldwide is expected to be expansionary for the foreseeable future, inflation is not expected to rise appreciably in 2012. On the contrary, the situation in this respect is likely to improve slightly due to the economic slowdown.

Sector-specific Conditions

Overall Situation of the Banking Sector

Prospects for the banking sector in 2012 very much depend on the development of the government debt crisis. As expected most investors will continue to exercise great caution on the market. This will probably pose problems for refinancing and will result in a shortage of supply for loans, although large credit volumes are due to be refinanced in the year 2012. Additional regulatory requirements regarding capital backing pose a further challenge for some players.

Public Sector Finance

The restructuring process on the public finance market and the market for public sector finance which commenced in 2010 will possibly continue in the course of the next two to three years. The number of supra-regional providers and the range of financing products on offer will probably continue to decline in 2012 due to the de facto withdrawal from the market of international competitors and smaller national players. Due to the reduced range of financing products on offer and also the fact that demand has remained constant (because consolidation measures do not have an immediate impact), it will be possible for financing arrangements with good conditions to be concluded. The supply in the German and French market could decline.

In parallel with these developments, countries and central, regional and local authorities will search for other financing opportunities (e.g. public-private partnerships) in order to make further progress with public sector investments. Until the range of financing products offered by public sector financial institutions and other institutions returns to normal in the long term, it can be expected that margins will remain at a relatively high level in the medium term (in the next two to three years), and that banks will increasingly differentiate between public sector borrowers. It can be assumed that the focus of attention will continue to be on public sector investment finance: at the state level in the fields of infrastructure and future technologies and, at the municipal level, in the fields of supply and disposal, health, nursing care and education facilities.

Real Estate Finance

The effects of the government debt crisis will probably have an impact on future economic developments on the markets and that they will thus result in further mixed development of European real estate markets in primary and secondary markets. Overall, the volume of transactions in commercial real estate financing will probably continue to be significantly lower than the level seen in the boom years before the financial crisis. However, the primary real estate markets in Western and Northern Europe are not expected to collapse because, similar to the situation in Germany, the robust labour market and relatively low volume of new building in the past are factors which are stabilising the market. Despite the continuing uncertainty resulting from the European government debt crisis, we therefore expect to see a slightly stable development on the real estate markets in our core markets. Investors will probably continue to have an interest in acquiring high-quality properties in good locations with tenants with high credit ratings. Accordingly, German building approval statistics for the third quarter of 2011 show that the number of approved owner-occupied properties has increased by 35% over the past year. The markets of Southern Europe will again suffer from the effects of the government debt crisis in 2012, which is limiting investor interest. This means that property prices as well as rents, particularly for office premises, will probably continue to decline slightly. There might be an improvement in the field of prime retail properties.

The difference in economic developments reported in the EU countries will also have an impact on rental activities. Whereas it is possible that there will continue to be robust development on the real estate markets in Western and Northern Europe, it will probably continue to be difficult in Southern Europe to re-let properties and force through rent increases. This disparity will also be reflected in the development of vacancy rates. On the European commercial real estate markets, property prices and rents will probably mostly remain unchanged or fall slightly in 2012. A slight increase in property prices and rents is only possible in the metropolitan areas and prime locations (essentially in Germany, France, Great Britain and Sweden). The prospects with regard to secondary locations and properties are likely to be most affected by the further development of the current climate on the market and the situation on the financial markets. Demand for retail premises in 2012 is again likely to exceed the demand for commercial properties.

Competition in the field of real estate finance will also continue to undergo changes. The number of present real estate financiers who operate new business will probably continue to decline, or the real estate financiers are likely to specialise to a greater extent in terms of regions and market segments. Because of the limited refinancing opportunities available beyond the Pfandbrief, conservative financing structures will continue to dominate the market. It will be very difficult to obtain finance for speculative properties for the foreseeable future. On the other hand, new competitors such as insurers and pension funds will increasingly break into the direct real estate financing market in order to achieve better diversification for their investments.

Refinancing Markets

The government debt crisis means that it is almost impossible to make a sound forecast. We expect that the year 2012 will again be affected by the uncertainty of the markets. This is clearly illustrated by the fact that credit institutions are holding very high levels of liquidity with the central banks. Liquidity in the interbank market is thus low, although the measures which have been initiated (three-year facilities of the ECB and guarantees of SoFFin) should ensure that adequate liquidity is available to the banking sector.

It will only be possible for banks to place uncovered issues in exceptional cases; on the other hand, we are expecting that it will be possible for covered bonds to be issued. Accordingly, the Pfandbrief (which is a premium product among covered bonds) will continue to play a major role in the refinancing of banks.

The development of interest rates in 2012 will depend essentially on the following issues:
- Will it be possible to stabilise the refinancing of the problem countries?
- Will the consolidation and savings measures of the euro countries be sufficient to restore lost confidence in the euro?
- Will the support measures of the ECB result in increased inflation expectations?

It is likely that it will not be possible for these aspects to become clearer before the second quarter, which means that yields will remain until then at a low level as a result of the high degree of uncertainty. However, the yields are likely to rise as soon as the measures which have already been adopted, and which will be adopted in future, demonstrate that they are successful and as soon as confidence returns to the markets.

Company-specific Conditions

The forecasts regarding the future development of Deutsche Pfandbriefbank 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 (such as those addressed in the risk report) occur to an extent which has not been calculated, the actual results may differ considerably from the results which are currently expected.

Positive Going Concern

On 18 July 2011, the European Commission approved the state aid for HRE. With its positive decision, the European Commission has also accepted the viability of the business model of Deutsche Pfandbriefbank AG as a specialist bank for real estate finance and public sector investment finance. The decision of the European Commission relates to all aid elements granted to HRE since the autumn of 2008, i.e. capitalisations, guarantee lines and the transfer of items to the deconsolidated environment FMS Wertmanagement, and requires appropriate compensation measures. In the course of its assessment, the Management Board of Deutsche Pfandbriefbank AG has not identified any major items of uncertainty which relate to events or conditions and which cast considerable doubts on the going-concern assumption of Deutsche Pfandbriefbank AG and its subsidiaries.

Future Development in Assets, Financial Position and Earnings

Deutsche Pfandbriefbank Group has closed the year 2011 with a pre-tax profit of €188 million, and has underlined its profitability with six successive quarters with a positive result. Deutsche Pfandbriefbank Group is also forecasting a positive pre-tax result for the years 2012 and 2013. However, in 2012 this will probably be lower than the corresponding figure of 2011, because the profit will not benefit from one-off effects to the same extent, the bank levy will burden the result, and because normalised additions to provisions for losses on loans and advances will have to be assumed. In specific terms, a pre-tax profit of between €100 million and €140 million (before extraordinary factors) is forecasted for the year 2012. As a result of an increase in net interest income due to new business and also a reduction in general administrative expenses, pre-tax profit for the year 2013 is expected to be above €150 million. This assumes that there will be no serious turmoil on the markets, such as defaults of sovereign states or interest and currency turmoils. Due to a requirement in line with the principle of burden sharing required by the EU Commission, profits will be retained at Deutsche Pfandbriefbank Group until reprivatisation, and will be used for repaying the dormant contribution of the Federal Republic of Germany.

The profit of the Group will probably be generated primarily in the Real Estate Finance segment. Slightly positive results are being forecast for the Public Sector Finance and Value Portfolio segment.

With new business (incl. prolongations with maturities of more than one year) of €8.0 billion, Deutsche Pfandbriefbank Group has attained its objective in 2011, and has demonstrated strong market presence. Deutsche Pfandbriefbank Group will again take advantage of attractive market opportunities in 2012 and 2013, and will conclude new business with good margins. However, the development of the markets and in particular the refinancing market will be taken into consideration in this respect. Assuming that markets continue to be essentially trouble-free, Deutsche Pfandbriefbank Group expects to report new business equivalent to the figure for 2011. This comprises prolongations which will be carried out if this results in economic benefits for Deutsche Pfandbriefbank Group.

Total assets in 2011 declined appreciably to €108.8 billion mainly due to the diminishing opposite effects of the transfer of positions to FMS Wertmanagement. However, the extent of opposite effects will probably continue to decline in future, although to a much lower extent than was the case in 2011. In addition, FMS Wertmanagement will refinance its operations on a stand-alone basis to an even greater extent and will thus no longer require Deutsche Pfandbriefbank Group to pass on funds. Overall, it is expected that total assets will decline slightly in 2012. One of the contributing factors in this respect is that the Group is not operating any new business in certain areas, such as budget financing. In 2013, total assets might increase slightly compared with 2012, if new business can be generated to the planned extent. However, the development in total assets is not fully subject to the control of Deutsche Pfandbriefbank Group. Market-related factors such as changes in exchange rates and market interest rates can also have an impact on total assets.

Opportunities The developments in assets, financial position and earnings which have occurred since the transfer of items to FMS Wertmanagement, and also the expected developments, illustrate the potential of Deutsche Pfandbriefbank Group. The conclusion of the approval procedure of the European Commission was a further milestone for the realignment of Deutsche Pfandbriefbank Group. This results in the following opportunities for Deutsche Pfandbriefbank Group:

> The conclusion of the EU aid proceedings has increased the level of security for customers and lenders. This means that Deutsche Pfandbriefbank Group will probably be able to conclude transactions more easily.
> In addition, following the conclusion of the refocusing process and the successful conclusion of projects such as the EU aid proceedings, Deutsche Pfandbriefbank Group can now focus on its customers and core business areas. The focus will be on public investment finance and commercial real estate finance in selected target markets. Proximity to customers is reflected by various factors, including the Management Board's decision taken at the beginning of 2012 to open a branch in Stockholm.
> Deutsche Pfandbriefbank Group has strong experience in the Pfandbrief market, where it can build on existing customer relations. Because of their high quality and stable maturity profile, Pfandbriefe are relatively unaffected by market turmoil. Deutsche Pfandbriefbank Group thus uses an instrument which continues to be in demand on the capital market.
> There is strong demand for financing on the markets which are relevant for Deutsche Pfandbriefbank Group. At the same time, some competitors will be compelled to withdraw from the markets or to concentrate on individual regions. In this context and also in view of its considerable knowledge of the market and products as well as its existing customer relations, there will be opportunities for Deutsche Pfandbriefbank Group to write low-risk new business in conjunction with attractive margins.
> Deutsche Pfandbriefbank Group has become much more attractive on the labour market; this is supported by new staff development measures which have been introduced. By that high performing and highly qualified staff and senior executives can be retained in the Group to support Deutsche Pfandbriefbank Group in attaining its ambitious objectives.
> A further opportunity is provided by the strict cost focus of Deutsche Pfandbriefbank Group. This is a process in which the prevailing status quo is constantly questioned and analysed in order to identify appropriate improvement measures.
> In addition, Deutsche Pfandbriefbank Group has already achieved major success in harmonising its IT systems. Further projects for harmonising and further developing its IT systems have already been initiated. This will result in further efficiency gains.

Risks However, it is also possible that the development in assets, financial position and earnings might have to contend with problems. The extent of these potential problems is influenced particularly by the occurrence or non-occurrence of the following risks, or the extent to which such risks might materialise:

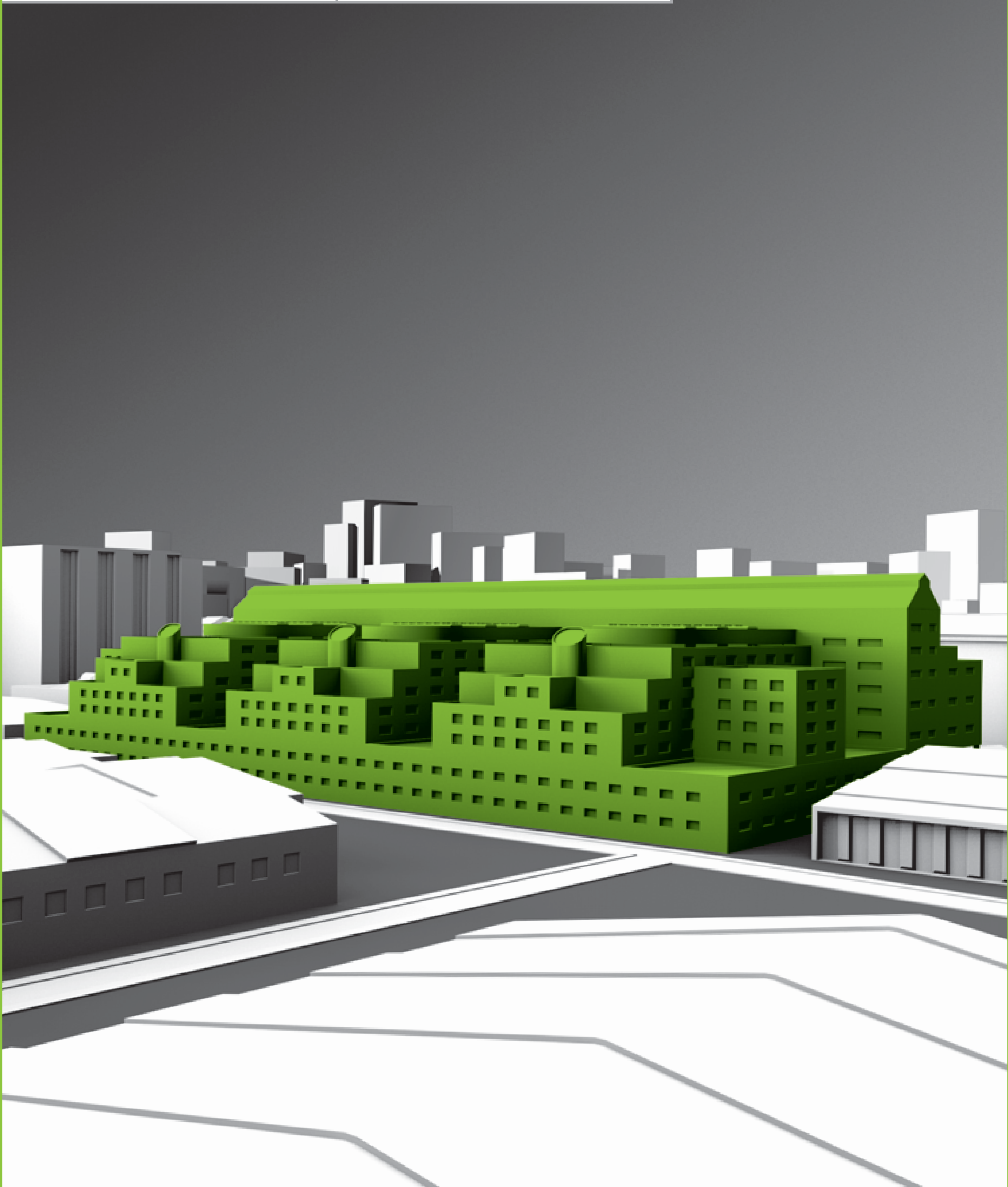
> Some European countries in 2011 were only able to obtain funds with the support of international aid programmes. If the debt crisis of some countries deteriorates any further, a partly or complete claims waiver might become necessary for creditors, or sovereign debtors might become insolvent in an orderly or disorderly manner. In these cases, Deutsche Pfandbriefbank Group might also have to recognise considerable impairments on loans and advances and securities. These impairments might increase if, due to interrelationships or market turmoil, the crisis negatively affecting some countries which are currently considered to be solvent. Deutsche Pfandbriefbank Group has neither a direct nor an indirect exposure to Greek sovereign counterparties.
> It is true that the situation on the real estate markets improved in 2011. Nevertheless, it is possible that significant impairment losses will have to be recognised in relation to loans and advances. These impairment losses depend primarily on the economic situation of the financed object. However, a further factor can also be a general crisis affecting individual real estate markets.
> Due to the financial crisis, the situation on the refinancing markets has undergone considerable change in recent years. Firstly, it has become more difficult to place issues on the market. Secondly, the debt crisis affecting some European countries has been one of the factors which has resulted in a major loss of confidence and significantly lower turnover on the interbank market, i.e. the market on which banks lend money to each other. If the problems affecting the refinancing markets continue or become more serious, there might be negative consequences for the liquidity situation of Deutsche Pfandbriefbank Group, despite the existing cushion.
> The rating agencies continue to adapt their methodologies and models in order to assess, amongst other factors, the changing macro-economic environment and the potential impact of the European sovereign debt crisis. These measures, alongside the specific rating drivers for Deutsche Pfandbriefbank AG and its Covered Bonds, could lead to rating changes. Downgrades to bank and/or Covered Bond ratings could have a negative impact particularly on the bank's refinancing capacity and hence on its financial position and profitability.

- The risk-bearing capacity concept is currently being developed further in order to ensure that the specific regulatory requirements will be met in future. An assessment is being carried out to determine whether a risk-bearing capacity calculation based on a going-concern assumption would provide a more realistic reflection of the business model of the Bank. This further development might have a considerable impact on the risk-bearing capacity analysis.
- Membership of HRE Group has had a negative impact on the image of Deutsche Pfandbriefbank Group in recent years. Even if success has already been achieved as a result of the Bank reentering markets, it is possible that there may be negative consequences for meeting targets of Deutsche Pfandbriefbank Group.
- Litigation which is currently pending and litigation which might become pending in future might have a considerably negative impact on the results of Deutsche Pfandbriefbank Group.
- Deutsche Pfandbriefbank Group has initiated projects for optimising processes and the IT infrastructure; some of these have already been successfully completed, whereas others are still ongoing. Despite the projects, Deutsche Pfandbriefbank Group is exposed to operational risks, such as its reliance on key positions, technology risks due to the large number of accounting systems and a higher level of staff fluctuation. These risks might result in material losses. The risks might also become relevant for the service obligations assumed by Deutsche Pfandbriefbank Group for the ongoing operation FMS Wertmanagement.
- 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 development in earnings. For instance, the modified obligations regarding more stringent liquidity requirements presented by the Basel Committee on Banking Supervision (Basel III) might have a negative impact on profitability, or profitability might be reduced by more stricter 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 introduction of a contribution on financial market transactions is discussed in the majority of countries of the European Union. The purchase and sale of fungible securities or options and other financial instruments shall be taxed. This contribution could burden the result of Deutsche Pfandbriefbank Group and could make the business of Deutsche Pfandbriefbank Group unprofitable.
- In accordance with the EU Rating Ordinance of September 2009, external ratings can in future be used in banks for calculating capital requirements only if the corresponding rating agencies are registered in line with the EU Rating Ordinance and if they are regulated by the relevant regulatory authorities. If agencies issue ratings outside the European Union, regulation in the other country must correspond to the European standards. Whereas the registration processes for instance of the major rating agencies have been concluded, the process of checking the regulatory standards of various other countries is still ongoing. If the regulations of other countries are not recognised, this might have a negative impact on the financial situation of Deutsche Pfandbriefbank Group because this would result in a higher requirement for backing with regulatory capital.

Niam Nordic Investment Fund III Office Portfolios
SEK 1,650 million

Investment Loan (Club Deal)
Sweden
June 2011

pbb and Skandinaviska Enskilda Banken AB (SEB) acted as joint mandated Lead Arrangers in providing investment finance to NIAM III News AB for the «News» and «Palmfelt» office portfolios in Sweden. Both banks have equal shares in the underwriting of this transaction. The office portfolios consist of four office buildings, three of them in Stockholm and one in Lund in southern Sweden.



Consolidated Financial Statements

Consolidated Financial Statements
Income Statement

Income/expenses in € million	Note | Page	2011	2010	Δ in € million	Δ in %
Operating revenues		526	652	−126	−19.3
Net interest income and similar income	32 | 85	371	600	−229	−38.2
Interest income and similar income		3,691	4,949	−1,258	−25.4
Interest expenses and similar expenses		3,320	4,349	−1,029	−23.7
Net commission income	33 | 85	32	−10	42	>100.0
Commission income		38	79	−41	−51.9
Commission expenses		6	89	−83	−93.3
Net trading income	34 | 85	−8	77	−85	<−100.0
Net income from financial investments	35 | 85	3	−17	20	>100.0
Net income from hedge relationships	36 | 86	−56	−45	−11	−24.4
Balance of other operating income/expenses	37 | 86	184	47	137	>100.0
Provision for losses on loans and advances	38 | 86	−12	443	−455	<−100.0
General administrative expenses	39 | 86	357	352	5	1.4
Balance of other income/expenses	40 | 87	7	8	−1	−12.5
Pre-tax profit/loss		**188**	**−135**	323	>100.0
Taxes on income	41 | 87	71	50	21	42.0
Net income/loss		**117**	**−185**	302	>100.0
attributable to: Equity holders (consolidated profit/loss from the parent company)		117	−185	302	>100.0

Statement of Comprehensive Income

Statement of comprehensive income	2011			2010		
in € million	Before tax	Tax	Net of tax	Before tax	Tax	Net of tax
Net income/loss	**188**	**71**	**117**	**–135**	**50**	**–185**
Additional paid-in capital	–	–	–	–1	–	–1
Retained earnings	–3	–	–3	–298	–	–298
Foreign currency reserve	1	–	1	–1	–	–1
AfS reserve	–406	–116	–290	95	26	69
Cash flow hedge reserve	–121	–27	–94	1,427	383	1,044
Total other comprehensive income of the period	–529	–143	–386	1,222	409	813
Total comprehensive income of the period	**–341**	**–72**	**–269**	**1,087**	**459**	**628**
attributable to: Equity holders (consolidated profit/loss from the parent company)	–341	–72	–269	1,087	459	628

Disclosure of components of comprehensive income in € million	2011	2010
Net income/loss	**117**	**–185**
Additional paid-in capital	–	–1
Unrealised gains/losses	–	–
Changes due to transfer to FMS Wertmanagement	–	–1
Retained earnings	–3	–298
Unrealised gains/losses	–3	–113
Changes due to transfer to FMS Wertmanagement	–	–185
Foreign currency reserve	1	–1
Unrealised gains/losses	1	–1
Changes due to transfer to FMS Wertmanagement	–	–
AfS reserve	–290	69
Unrealised gains/losses	–290	–69
Changes due to transfer to FMS Wertmanagement	–	138
Cash flow hedge reserve	–94	1,044
Unrealised gains/losses	–94	108
Changes due to transfer to FMS Wertmanagement	–	936
Total other comprehensive income of the period	–386	813
Total unrealised gains/losses	**–386**	**–75**
Total changes due to the transfer to FMS Wertmanagement	**–**	**888**
Total comprehensive income of the period	**–269**	**628**

Statement of Financial Position

Assets in € million	Note | Page	31.12.2011	31.12.2010[1]	Δ in € million	Δ in %	1.1.2010[1]
Cash reserve	8 | 76, 43 | 89	323	224	99	44.2	618
Trading assets	9 | 76, 44 | 89	9,818	16,168	−6,350	−39.3	1,435
Loans and advances to other banks	10 | 76, 45 | 89	7,632	12,128	−4,496	−37.1	74,318
Loans and advances to customers	10 | 76, 46 | 89	55,236	118,642	−63,406	−53.4	82,639
Allowances for losses on loans and advances	11 | 77, 48 | 90	−477	−561	84	15.0	−3,326
Financial investments	12 | 77, 49 | 91	28,677	33,605	−4,928	−14.7	43,329
Property, plant and equipment	13 | 77, 50 | 93	3	5	−2	−40.0	10
Intangible assets	14 | 77, 51 | 93	35	32	3	9.4	28
Other assets	15 | 78, 52 | 94	6,058	5,035	1,023	20.3	11,801
Income tax assets	24 | 79, 53 | 94	1,474	1,545	−71	−4.6	4,365
Current tax assets		55	64	−9	−14.1	131
Deferred tax assets		1,419	1,481	−62	−4.2	4,234
Total assets		**108,779**	**186,823**	−78,044	−41.8	**215,217**

Equity and liabilities in € million	Note | Page	31.12.2011	31.12.2010[1]	Δ in € million	Δ in %	1.1.2010[1]
Liabilities to other banks	16 | 78, 57 | 95	8,223	62,587	−54,364	−86.9	67,625
Liabilities to customers	16 | 78, 58 | 95	12,363	17,384	−5,021	−28.9	12,378
Liabilities evidenced by certificates	16 | 78, 59 | 96	55,038	63,846	−8,808	−13.8	109,193
Trading liabilities	17 | 78, 60 | 96	9,903	16,294	−6,391	−39.2	1,872
Provisions	18 | 78, 61 | 96	163	176	−13	−7.4	153
Other liabilities	19 | 78, 62 | 99	16,123	18,883	−2,760	−14.6	13,635
Income tax liabilities	24 | 79, 63 | 99	1,373	1,526	−153	−10.0	3,733
Current tax liabilities		82	83	−1	−1.2	85
Deferred tax liabilities		1,291	1,443	−152	−10.5	3,648
Subordinated capital	20 | 79, 64 | 100	2,501	2,766	−265	−9.6	3,895
Liabilities		**105,687**	**183,462**	−77,775	−42.4	**212,484**
Equity attributable to equity holders		3,092	3,361	−269	−8.0	2,733
Subscribed capital	65 | 101	380	380	–	–	380
Silent participation	21 | 79, 65 | 101	999	999	–	–	999
Additional paid-in capital		5,036	5,036	–	–	5,037
Retained earnings	65 | 101	−3,277	−3,089	−188	−6.1	−1,276
Foreign currency reserve		−34	−35	1	2.9	−34
Revaluation reserve		−129	255	−384	<−100.0	−858
AfS reserve		−549	−259	−290	<−100.0	−328
Cash flow hedge reserve		420	514	−94	−18.3	−530
Consolidated profit/loss 1.1.–31.12.		117	−185	302	>100.0	−1,515
Equity		**3,092**	**3,361**	−269	−8.0	**2,733**
Total equity and liabilities		**108,779**	**186,823**	−78,044	−41.8	**215,217**

[1] In accordance with IAS 8.14 (b), there has been a change in the way of recognising the bonds which were allocated to the IAS 39 measurement category loans and receivables. Details are described in the note Consistency.

Statement of Changes in Equity

Statement of changes in equity

	Equity attributable to equity holders								
						Revaluation reserve			
in € million	Subscribed capital	Silent participation	Additional paid-in capital	Retained earnings	Foreign currency reserve	AfS reserve	Cash flow hedge reserve	Consolidated profit/loss	Equity
Equity at 1.1.2010	**380**	**999**	**5,037**	**–1,276**	**–34**	**–328**	**–530**	**–1,515**	**2,733**
Capital increase	–	–	–	–	–	–	–	–	–
Transaction costs of capital measures	–	–	–	–	–	–	–	–	–
Treasury shares	–	–	–	–	–	–	–	–	–
Distribution	–	–	–	–	–	–	–	–	–
Total comprehensive income for the year	–	–	–	–113	–1	–69	108	–185	–260
Transfer to retained earnings	–	–	–	–1,515	–	–	–	1,515	–
Changes in the group of consolidated companies	–	–	–	–	–	–	–	–	–
Changes due to transfer to FMS Wertmanagement (transaction with owners)	–	–	–1	–185	–	138	936	–	888
Equity at 31.12.2010	**380**	**999**	**5,036**	**–3,089**	**–35**	**–259**	**514**	**–185**	**3,361**
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	–	–	–	–	–	–	–	–	–
Changes due to transfer to FMS Wertmanagement (transaction with owners)	–	–	–	–	–	–	–	–	–
Equity at 31.12.2011	**380**	**999**	**5,036**	**–3,277**	**–34**	**–549**	**420**	**117**	**3,092**

Statement of Cash Flows

Statement of Cash Flows[1] in € million	2011	2010
Net income/loss	**117**	**–185**
Write-downs, provisions for losses on, and write-ups of, loans and advances and additions to provisions for losses on guarantees and indemnities	–10	450
Write-downs and depreciation less write-ups on non-current assets	75	–81
Change in other non-cash positions	432	–609
Result from the sale of investments, property, plant and equipment	–4	–15
Other adjustments	–300	–494
Subtotal	**310**	**–934**
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	–31	199
Loans and advances to other banks	7,074	–16,071
Loans and advances to customers	77,871	5,633
Other assets from operating activities	87	–121
Liabilities to other banks	–54,449	27,490
Liabilities to customers	–5,156	1,702
Liabilities evidenced by certificates	–9,902	–23,411
Other liabilities from operating activities	–4,470	–705
Interest income received	3,158	4,894
Dividend income received	–	–
Interest expense paid	–3,042	–4,532
Taxes on income paid	–10	64
Cash flow from operating activities	**11,440**	**–5,792**
Proceeds from the sale of non-current assets	–6,839	5,650
Payments for the acquisition of non-current assets	–4,142	–206
Proceeds from the sale of investments	–	–
Payments for the acquisition of investments	–	–
Cash flow from investing activities	**–10,981**	**5,444**
Proceeds from capital increases	–	–1
Subordinated capital, net	–360	–32
Cash flow from financing activities	**–360**	**–33**
Cash and cash equivalents at the end of the previous period	224	618
+/– Cash flow from operating activities	11,440	–5,792
+/– Cash flow from investing activities	–10,981	5,444
+/– Cash flow from financing activities	–360	–33
+/– Effects of exchange rate changes and non-cash valuation changes	–	–13
Cash and cash equivalents at the end of the period	**323**	**224**

[1] Explanations in Note 68.

Notes

1 General Information

The group is headed by Deutsche Pfandbriefbank AG 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 Sonderfonds für Finanzmarktstabilisierung (SoFFin). Deutsche Pfandbriefbank 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

Deutsche Pfandbriefbank AG has prepared its financial statements for the period ended 31 December 2011 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 315a (1) HGB (German Commercial Code). With the exception of specific regulations relating to fair value hedge accounting for a portfolio hedge of interest risks in IAS 39 all mandatory IFRS rules have been completely endorsed by the EU. Deutsche Pfandbriefbank Group does not apply this type of hedge accounting. Therefore, the financial statements are accordingly consistent with the entire IFRS and also with the IFRS as applicable in the EU.

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

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

The Management Board of Deutsche Pfandbriefbank AG prepared these consolidated financial statements on 14 March 2012 under the going-concern assumption. On 18 July 2011, the European Commission approved the state aid for HRE. With its positive decision, the European Commission has also accepted the viability of the business model of Deutsche Pfandbriefbank AG as a specialist bank for real estate finance and public sector investment finance.

Initially Adopted Standards, Interpretations and Amendments

The following standards, interpretations and amendments were applicable initially in the financial year 2011:

> IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments
> Amendment to IAS 32 Financial Instruments: Presentation on Classification of Rights Issues
> Amendments to IFRS 1 Limited Exemptions from Comparative IFRS 7 Disclosures for First-time Adopters
> Amendment to IFRIC 14 Prepayments of a Minimum Funding Requirement
> Annual Improvements to IFRSs 2010

IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments clarifies the accounting when an entity issues shares or other equity instruments to extinguish all or parts of a financial liability. There have not been any impacts on Deutsche Pfandbriefbank Group.

Amendment to IAS 32 Financial Instruments: Presentation on Classification of Rights Issues addresses the issuer's accounting for rights, options and warrants to acquire a fixed number of own equity instruments that are denominated in a currency other than the functional currency of the issuer. As Deutsche Pfandbriefbank Group has not issued any such products at present, the amendment will not have any impacts on the Group.

Amendments to IFRS 1 Limited Exemptions from Comparative IFRS 7 Disclosures for First-time Adopters clarify comparative disclosures relating financial instruments for IFRS first-time adopters. Because Deutsche Pfandbriefbank Group is not a first-time adopter of the IFRS there have not been any impacts.

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

In the course of the project Business Combination Phase II the following standards and interpretations were amended and were combined in Annual Improvements to IFRSs 2010:

> IFRS 3 (revised) Business Combinations
> IAS 27 (revised) Consolidated and Separate Financial Statements
> IAS 21 The Effects of Changes in Foreign Exchange Rates
> IAS 28 Investment in Associates
> IAS 31 Interests in Joint Ventures

> IAS 32 Financial Instruments Presentation
> IAS 39 Financial Instruments Recognition and Measurement

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

The majority of the amendments of Annual Improvements to IFRSs 2010 are applicable for financial years beginning on or after 1 January 2011. Annual Improvements to IFRSs 2010 does not have material impacts in Deutsche Pfandbriefbank Group. The amendment to IAS 34 Interim Financial Reporting is an exception which will result in extended financial instruments disclosures in the consolidated interim financial statements of Deutsche Pfandbriefbank Group.

Endorsed Standards, Interpretations and Amendments, Which Are Not Yet Mandatorily Applicable In November 2011 the European Union endorsed the Amendments to IFRS 7 Financial Instruments: Disclosures – Transfer of Financial Assets. The amendments require disclosure of information that enables users of financial statements to understand the relationship between transferred financial assets that are not derecognised in their entirety and the associated liabilities; and to evaluate the nature of, and risks associated with, the entity's continuing involvement in derecognised financial assets. The amendments shall be applied for financial years beginning on or after 1 July 2011 and could increase the disclosures of Deutsche Pfandbriefbank Group concerning derecognition of financial assets.. It is not planned to apply the standards earlier than mandatory.

Published Standards, Interpretations and Amendments Which Are Not Yet Endorsed The following standards, interpretations and amendments will probably have material impacts on Deutsche Pfandbriefbank Group:
> IFRS 9 Financial Instruments and Subsequent Amendments to IFRS 9 and IFRS 7
> IFRS 10 Consolidated Financial Statements
> IFRS 12 Disclosure of Interests in Other Entities
> IFRS 13 Fair Value Measurement
> Amendments to IAS 1 Presentation of Items of Other Comprehensive Income (OCI)
> Amendments to IAS 19 Employee Benefits

It is not planned to apply the standards earlier than mandatory.

The IASB is replacing the standard IAS 39 Financial Instruments: Recognition and Measurement by IFRS 9 Financial Instruments in several project phases. The IASB published new policies in 2009 and 2010 for the first project phase Classification and Measurement. On the other hand, finally adopted standard parts are not yet available for the two other project phases Impairment Methodology and Hedge Accounting. With regard to the classification of the financial instruments, the Classification and Measurement part in its current version only provides the two categories measurement at fair value and measurement at amortised cost. Financial debt instruments are classified on the assets' side of the balance sheet depending on the business model of the entity for managing financial assets and the characteristics of the contractual cash flows of the financial asset. On the other hand, equity instruments and dFVTPL assets generally have to be measured at fair value. On the liabilities side of the balance sheet, all non-derivative liabilities which are not used for trading purposes or which are not designated for measuring at fair value have to be measured at amortised cost. In the case of the dFVTPL liabilities, changes in value which are attributable to the change in the entity's own credit risk have to be recognised directly in equity. The initial application of the new standard IFRS 9, which is envisaged for financial years beginning on or after 1 January 2015, will probably have a material impact for Deutsche Pfandbriefbank Group. In future, it will be necessary for some assets and liabilities which have previously been measured at amortised cost presumably to be measured at fair value, and vice versa. Applying IFRS 9 initially will require additional disclosures, which were added to the regulations of IFRS 7. However, it will only be possible to make a definitive assessment of the entire impacts on Deutsche Pfandbriefbank Group when all parts of IFRS 9 have been completely published.

IFRS 10 Consolidated Financial Statements supersedes the guidance regarding control and consolidation including IAS 27 Consolidated and Separate Financial Statements and SIC-12 Consolidation – Special Purpose Entities. IAS 27 is renamed in Separate Financial Statements and includes solely the guidance regarding separate financial statements. In IFRS 10 the determination of control is enhanced by a broad guidance which demonstrates multiple forms of how a reporting entity can control another entity. The new standard has to be applied for financial years beginning on or after 1 January 2013. There may be changes in the group of consolidated companies of Deutsche Pfandbriefbank Group due to IFRS 10.

IFRS 12 Disclosure of Interests in Other Entities expands the disclosure requirements concerning the nature, risks and financial implications of an entity's investment in subsidiaries, associates, joint arrangements and non-consolidated special purpose entities. The new standard has to be applied for financial years beginning on or after 1 January 2013. Due to the requirements of IFRS 12 Deutsche Pfandbriefbank Group will probably extend disclosures regarding its interests in other entities.

Material 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). In consequence, the fair value of a liability would represent the default risk, i.e. the own credit risk. For measuring financial instruments applying bid price respectively asking price, if these prices represent the fair value in the best way. IFRS 13 expands the disclosure requirements regarding the fair value hierarchy. These additional disclosures are similar to the disclosures of IFRS 7 Financial Instruments: Disclosures, but they are required not only for financial instruments but also for all assets and liabilities. IFRS 13 is applicable to financial years beginning on or after 1 January 2013. The standard is applicable prospectively. In particular, the amendments of the currently applicable fair value measurement methods, for example considering the bid price, respectively the asking price, and including the own credit risk, may result in material impacts on Deutsche Pfandbriefbank Group.

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 – including subtotals for both groups. Amendment to IAS 1 is applicable for periods beginning on or after 1 July 2012. Deutsche Pfandbriefbank Group will adjust its disclosures accordingly.

Due to Amendments to IAS 19 Employee Benefits the corridor approach of recognising actuarial gains or losses is prohibited. 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 benefits 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, the treatment of settlements in connection with postemployment benefits is amended by IAS 19. The Amendment to IAS 19 will generally have impacts on employee benefits accounting and disclosure of Deutsche Pfandbriefbank Group. In particular, the cancellation of the corridor approach will increase equity volatility and will change the measurement of plan asset income. Besides, the disclosures in the notes will have to be extended. The Amendments to IAS 19 are applicable for periods beginning on or after 1 January 2013.

Furthermore, the IASB published the following standards, interpretations and amendments, which will probably not have material impact on Deutsche Pfandbriefbank Group or which were not relevant:

- IFRS 11 Joint Arrangements
- IAS 27 Separate Financial Statements
- IAS 28 Investments in Associates and Joint Ventures
- IFRIC Interpretation 20: Stripping Costs in the Production Phase of a Surface Mining
- Amendments to IAS 12 Income Taxes – Deferred tax: Recovery of Underlying Assets
- Amandments to IFRS 1 – Severe Hyperinflation and Removal of Fixed Dates for First-Time Adopters
- Amendments to IAS 32 Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities
- Amendments to IFRS 7 Financial Instruments: Disclosure – Offsetting Financial Assets and Financial Liabilities

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

Consolidated Financial Review The consolidated financial review meets the requirements of section 315 (1) and (2) HGB (German Civil Code) and DRS 15. It comprises a report on the business and conditions, a report on the net assets, financial position and results of operations, a report of significant events after 31 December 2011, and a forecast report as well as a risk report. The risk report contains information which, under IFRS 7, is required to be disclosed (especially in the chapters Credit Risk, Market Risk and Liquidity Risk). Events after the balance sheet date are described in the report of events after 31 December 2011 and the major events.

3 Consistency

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

In accordance with IAS 8.14 (b), there has been a change in the way of recognising the bonds which were allocated to the IAS 39 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. In future, these instruments will be disclosed completely as financial investments. In accordance with IAS 8.19 (b), the change has been carried out retrospectively, which means that the previous year figures have been adjusted accordingly. Financial investments have increased by €17.3 billion as of

31 December 2010 (31 December 2009: €12.4 billion); loans and advances to other banks have declined by € 3.1 billion (31 December 2009: € 3.8 billion) and loans and advances to customers have declined by €14.2 billion (31 December 2009: € 8.6 billion).

The way in which exchange rate effects are disclosed in the cash flow statement was adjusted in the course of the financial year 2011. The line Effects of exchange rate changes and non-cash valuation changes is now used to disclose only the effects of exchange rate changes in cash and cash equivalents. All other effects resulting from exchange rate changes are allocated to the cash flows from operating activities, investing activities and financing activities.

Apart from above, as of 31 December 2011 Deutsche Pfandbriefbank Group applied the equal accounting and measurement principles as in the consolidated financial statements as of 31 December 2010.

4 Uniform Consolidated Accounting

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

5 Transfer of Positions to FMS Wertmanagement

With economic effect from 1 October 2010, Deutsche Pfandbriefbank Group transferred positions to FMS Wertmanagement, a public law institution with partial legal capacities of Bundesanstalt für Finanzmarktstabilisierung (FMSA), which was established on 8 July 2010. 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 Deutsche Pfandbriefbank 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. The effects which reduced total assets were partially compensated for by opposite effects. These amounted to €113.4 billion as of 30 September 2010, € 94.0 billion as of 31 December 2010 and € 20.2 billion as of 31 December 2011. The opposite effects are attributable to synthetically transferred positions, for instance in the form of back-to-back derivatives, or the performing of refinancing functions for FMS Wertmanagement, for instance in the form of reverse repos.

The decrease of opposite effects from the transfer of positions to FMS Wertmanagement mainly resulted from lower reverse repos. FMS Wertmanagement no longer used Deutsche Pfandbriefbank Group to pass through the funding. In addition, a novation or true sale was reached for positions whose risks were transferred by back-to-back derivatives or subparticiapations in October 2010.

6 Consolidation

Deutsche Pfandbriefbank AG and subsidiaries (including special-purpose entities)	Fully consolidated		Not fully consolidated (due to immateriality/not to be consolidated according to SIC-12)		
	Total	Thereof special-purpose entities	Total	Thereof special-purpose entities	Total
1.1.2011	12	4	10	2	22
Additions	–	–	–	–	–
Disposals	–	–	–	–	–
Mergers	–	–	3	–	3
31.12.2011	12	4	7	2	19

Associated companies and other investments	Associated companies	Other investments	Total
1.1.2011	4	6	10
Additions	–	–	–
Disposals	–	–	–
31.12.2011	4	6	10

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 basically for the period ended 31 December 2011.

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, totalling €1 million. Net losses are almost completely included in the Group financial statement by depreciation on investments, provisions and profits transferred. The pooled total assets of the non-consolidated subsidiaries account for less than 0.1% of the Group total assets. The shares in the non-consolidated companies are shown as AfS financial investments.

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

With the purchase and transfer agreement of 26 July 2011, Deutsche Pfandbriefbank AG acquired the limited partner share of the already fully consolidated IMMO Immobilien Management GmbH & Co. KG, Munich, for €1, and thus directly holds all shares in the company. The acquisition has not had any impact on the consolidated financial statements of Deutsche Pfandbriefbank Group.

Also with the purchase and transfer agreement of 26 July 2011, IMMO Invest Real Estate GmbH, Munich, acquired the limited partner share in the already fully consolidated Ragnarök Vermögensverwaltung AG & Co. KG, Munich, for €1. Deutsche Pfandbriefbank AG thus indirectly holds all shares in Ragnarök Vermögensverwaltung AG & Co. KG. The acquisition has not had any impact on the consolidated financial statements of Deutsche Pfandbriefbank Group.

In September 2011, the subsidiaries Frappant Altona GmbH, Munich, IMMO Trading GmbH, Munich and Meridies Grundbesitz- und Bebauungsgesellschaft mbH, Munich, which were not consolidated due to materiality reasons, were merged with Deutsche Pfandbriefbank AG. The mergers have not had any significant impact on the the consolidated financial statements of Deutsche Pfandbriefbank Group.

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

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 Deutsche Pfandbriefbank Group which result in partial derecognition due to a continuing involvement.

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

Collaterals with the same counterparty and same conditions (e.g. ISTA frame contract) are netted and 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 trading instruments are recognised in net trading income.

If there is a difference between transaction price and market value at trade date and the difference results from unobservable data that have a significant impact on the measurement of a financial instrument, the difference (so-called day one profit) is not recognised immediately in profit or loss but is recognised over the life of the transaction. The remaining difference is recognised directly in profit or loss when the inputs become observable, when the transaction matures or is closed out.

Designated at Fair Value through Profit or Loss (dFVTPL) If certain conditions are satisfied, financial assets or liabilities can be classified at fair value through profit or loss when they are initially recognised. A designation can be made if the use of the measurement category means that a recognition and measurement inconsistency is either avoided or considerably reduced, and management and performance measurement of a portfolio of financial instruments are based on the fair values or if the instrument contains a separable embedded derivative. Deutsche Pfandbriefbank Group classifies financial assets under the dFVTPL category only for the first two cases. As of 31 December 2011, only fixed-income securities and loans and advances are held in the category dFVTPL. Financial liabilities are not classified into this category. The portfolio of fixed-income securities and loans and advances is managed on fair value basis. In addition, open interest risk positions of the portfolio are to a large extent closed by hedging derivatives. Because changes in the fair value of derivatives under IAS 39 in principle have to be recognised in profit or loss, the designation of fixed-income securities and loans and advances into the category dFVTPL will avoid inconsistency in terms of measurement. As a result of the designation of fixed-income securities, 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, Deutsche Pfandbriefbank Group does not have any effect resulting from the instruments being measured at the own current credit risk. The fixed-income securities in the category dFVTPL are disclosed as financial investments. 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 the past, Deutsche Pfandbriefbank Group has used the HtM category. As a result of the changed intention of not necessarily holding the financial investments to maturity the entire portfolio of HtM investments was reclassified as of 1 July 2007 in accordance with IAS 39.51 into the category AfS. In financial years 2011 and 2010, no financial assets were classified as HtM.

Loans and Receivables (LaR) Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables include bonded 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. Deutsche Pfandbriefbank Group only classifies securities as AfS but not loans and advances.

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

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

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

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

Derivatives Derivatives are measured at fair value. Changes in fair value are recognised in profit or loss if the derivatives are not part of cash flow hedge accounting. The measurement gains and losses from stand-alone derivatives are recognised in net trading income and from hedging derivatives in net income from hedge relationships. 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. Deutsche Pfandbriefbank 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 Deutsche Pfandbriefbank Group assesses on a case-by-case basis whether there is objective evidence for impairment. The criteria used to determine if there is such objective evidence included:

- significant financial difficulties of the borrower
- overdue contractual payments of either principal or interest or other breaches of contract
- becoming probable that the borrower will enter bankruptcy or other financial reorganisation
- renegotiations due to economic problems
- when available, the market price of the asset

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

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

To measure the impairment loss, the following factors are especially considered:

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

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

- historical loss experience in portfolios of similar credit risk characteristics
- a judgement whether current economic conditions and credit conditions improved or deteriorated compared to the past
- the estimated period between impairment occurring and the impairment being identified
- state of the current economic cycle

Hedge Accounting Hedging relationships between financial instruments are classified as a fair value hedge, a cash flow hedge or hedge of a net investment in a foreign operation in accordance with IAS 39. Hedging instruments are mainly interest rate derivatives, for example interest rate swaps and options. Mainly interest rate risks are hedged but also other types of risk, for instance currency risks.

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

If the hedge of the fair value in the course of the reporting period meets the criteria of IAS 39.88, the hedge is accounted as follows:

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

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

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

For cash flow hedge accounting purposes derivatives are used to hedge the interest rate risk as part of asset/liability management. For instance, future variable interest payments on variable interest receivables and liabilities are swapped for fixed payments primarily by means of interest rate swaps.

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

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

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

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

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

Hedge of a Net Investment in a Foreign Operation A net investment hedge is a hedge of the foreign currency exposure on a net investment in a foreign operation. Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Deutsche Pfandbriefbank Group did not hedge a net investment in a foreign operation in the financial year 2011 and as of 31 December 2010.

8 Cash Reserve

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

9 Trading Assets

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

10 Loans and Advances

Loans and advances to other banks and loans and advances to customers are measured in accordance with IAS 39 at amortised cost if they are not categorised dFVTPL or AfS or a hedged item of a fair value hedge. As of 31 December 2011, and as of 31 December 2010, Deutsche Pfandbriefbank Group did not have loans and advances which are classified as AfS or dFVTPL.

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

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

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

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

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

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

12 Financial Investments

dFVTPL, LaR and AfS securities are recognised and disclosed as financial investments. dFVTPL and AfS financial assets are measured at fair value. Changes in the fair value are through profit or loss in case of dFVTPL financial assets and are recognised in net income from hedge relationships. Changes in fair value of AfS financial assets are disclosed as a separate item of equity (AfS reserve) not affecting profit or loss until the asset is sold, withdrawn, disposed of, or if an impairment is established for the financial asset in accordance with IAS 39.58 et seq. Therefore, the cumulative profit or loss previously recognised in equity is now affecting profit or loss. Individual allowances on AfS financial assets are directly deducted from the carrying amount of the assets. Portfolio-based allowances on AfS financial assets shall not be created for AfS financial assets. AfS financial assets which are hedged effectively against market price risks are part of the 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 2011 and 2010, Deutsche Pfandbriefbank Group did not have any HtM financial assets.

13 Property, Plant and Equipment

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

Useful lives

in years

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

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

14 Intangible Assets

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

Software is an intangible asset with a finite useful life. Purchased software is measured at amortised cost of purchase. Deutsche

Pfandbriefbank Group capitalises internally generated software if it is probable that future economic benefits will flow to the Group and the expenses can be measured reliably. Expenses eligible for capitalisation include external directly attributable costs of materials and services as well as personnel expenses for employees directly associated with an internally generated software project. Software is amortised on a straight-line basis over expected useful lives of three to five years. In addition, intangible assets with a finite useful life have to be tested for impairment 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. Discounts and premiums are recognised on a prorata basis. Interest-free liabilities are recognised with their present value. Deutsche Pfandbriefbank Group has not designated any liabilities into the category dFVTPL. All income and expenses from liabilities including net gains and net losses resulting from redemption of liabilities are recognised in net interest income and similar income.

17 Trading Liabilities

Refinancing positions of the trading portfolio measured at fair value are recognised in trading liabilities. In addition, trading liabilities also include negative market values of trading derivatives and of standalone derivatives of the bank book. Trading liabilities are measured at fair value. Unrealised and realised profits and losses attributable to trading liabilities are recognised in net trading income through profit or loss.

18 Provisions

Under IAS 37.36 et seq., the best estimate is used for measuring provisions for contingent liabilities and contingent losses attributable to pending transactions. Long-term provisions are generally discounted.

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

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

The interest rate used for discounting defined benefit obligations is based on the long-term interest rates at balance sheet date on high- class fixed-income corporate bonds. The expected return on plan assets is derived from the assumed long-term profitability of reinsurances of pensions.

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

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

19 Other Liabilities

Besides negative fair values from derivative financial instruments (hedging derivatives and derivatives hedging dFVTPL financial instruments), accruals are one of the items recognised in other liabilities. Accruals arose from liabilities for products or services which have been received or supplied and have not yet been paid for, invoiced by the supplier or formally agreed. This also includes short-term liabilities to employees, for instance flexitime credits and vacation entitlements. The accruals are measured at the amount likely to be utilised.

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

20 Subordinated Capital

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

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

21 Silent Participation

SoFFin provided Deutsche Pfandbriefbank AG with a silent participation of €1.0 billion deducted by transaction costs. 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 2011 and as of 31 December 2010 no company of Deutsche Pfandbriefbank Group has provided a commitment for share-based compensation.

23 Currency Translation

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

Income and expenses attributable to currency translation 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 pay-out of the corporate income tax claim which was capitalised on 31 December 2006 has begun since 1 January 2008 over a period of ten years independently of a dividend payment. The interest-free claim had to be shown with the present value. A rate of 3.7% p. a. has been used for discounting purposes. Changes of the capitalised corporate income tax claims due to tax assessment notes for previous periods in the year 2011 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 2011 and of 31 December 2010 Deutsche Pfandbriefbank Group did not own material non-current assets held for sale.

26 Future-related Assumptions and Estimation Uncertainties

When the financial statements are being prepared, Deutsche Pfandbriefbank Group makes future-related assumptions as well as estimations, resulting in a considerable risk of a major change to the disclosed assets and liabilities becoming necessary during the next financial year.

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

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

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

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

Embedded Derivatives According to IAS 39.11, an embedded derivative has to be separated from the host contract and has to be measured separately if, in addition to other criteria, the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract. The economic risks of the host contracts and embedded derivatives are assessed on the basis of measuring methods to evaluate the existence of an obligation to separate.

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

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

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

With regard to the capitalisation of losses carried forward and other tax credits, the extent as well as the availability of such tax benefits are subject to estimation. Major losses carried forward are subject to national German tax law, and their availability also depends on the restrictions set out in section 10d EStG, 8c KStG as well as section 10a GewStG. Deferred tax assets arising from losses carried forward are recognised as far as it is likely that taxable income will be available to offset the non-utilised tax losses carried forward.

Segment Reporting

27 Notes to Segment Reporting by Operating Segment

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

The presentation of the segments of Deutsche Pfandbriefbank 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.

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. Deutsche Pfandbriefbank Group will generate new business in public investment finance. No new business will be realised by Deutsche Pfandbriefbank Group in public sector finance as a 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.

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.

Value Portfolio (VP) The operating segment Value Portfolio mainly presents the opposite effects which occurred in connection with the transfer of positions to FMS Wertmanagement. Furthermore, the segment comprises selected structured products as well as income and expenses attributable to the servicing for the ongoing operations of FMS Wertmanagement.

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

In 2011 the composition of the segments was adjusted. The adjustment mainly resulted from issues which arose or ceased due to the newly implemented steering after the transfer of positions to FMS Wertmanagement. According to IFRS 8.30 the disclosure is made on the basis of the former and the new segment composition.

Income/expenses in € million		PSF	REF	VP	Consolidation & Adjustments	Deutsche Pfandbriefbank
Operating revenues	2011	63	274	168	21	526
	2011[1]	69	284	165	8	526
	2010	73	571	5	3	652
Net interest income and similar income	2011	109	245	–	17	371
	2011[1]	62	259	33	17	371
	2010	88	551	–27	–12	600
Net commission income	2011	–3	37	–2	–	32
	2011[1]	–3	37	–2	–	32
	2010	–5	71	–76	–	–10
Net trading income	2011	–3	–11	6	–	–8
	2011[1]	–8	–9	9	–	–8
	2010	1	–3	79	–	77
Net income from financial investments	2011	5	1	–3	–	3
	2011[1]	4	–	–1	–	3
	2010	–9	–2	–6	–	–17
Net income from hedge relationships	2011	–48	–7	–1	–	–56
	2011[1]	–	–	–	–56	–56
	2010	–	–	–	–45	–45
Balance of other operating income/expenses	2011	3	9	168	4	184
	2011[1]	14	–3	126	47	184
	2010	–2	–46	35	60	47
Provisions for losses on loans and advances	2011	–	–1	–11	–	–12
	2011[1]	–	–1	–11	–	–12
	2010	–	422	21	–	443
General administrative expenses	2011	54	138	159	6	357
	2011[1]	54	138	126	39	357
	2010	46	151	52	103	352
Balance of other income/expenses	2011	2	3	2	–	7
	2011[1]	–	–	–	7	7
	2010	–	–	–	8	8
Pre-tax profit	2011	**11**	**140**	**22**	**15**	**188**
	2011[1]	**15**	**147**	**50**	**–24**	**188**
	2010	**27**	**–2**	**–68**	**–92**	**–135**

[1] According to the former segment structure.

Cost-income ratio[1] in %		PSF	REF	VP	Deutsche Pfandbriefbank
Cost-income ratio (based on operating revenues)	2011	85.7	50.4	94.6	67.9
	2010	63.0	26.4	>100.0	54.0

[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.

As part of the process of further developing segment reporting, certain non-original assets (mainly the investment of own funds) are now no longer disclosed as financing volumes. In accordance with IFRS 8.30, the segmentation of the financing volumes is disclosed on the basis of the old segmentation, and also on the basis of the new segmentation.

Balance-sheet-related measures, broken down by operating segment in € billion		PSF	REF	VP	Consolidation & Adjustments	Deutsche Pfandbriefbank
Equity[1]	31.12.2011	1.0	1.2	0.1	0.9	3.2
	31.12.2010	0.3	1.4	0.1	1.3	3.1
Risk-weighted assets[2]	31.12.2011	4.3	12.1	0.6	–	17.0
	31.12.2010	2.7	12.3	1.1	–	16.1
Financing volumes[2]	31.12.2011	44.0	23.5	1.1	–	68.6
	31.12.2011[3]	45.3	25.3	1.2	–	71.8
	31.12.2010	52.3	26.7	2.6	–	81.6

[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 Basle II advanced IRB approach for authorised portfolios, otherwise Basle II standardised approach; pro forma as per prepared annual financial statements and after result distribution.
[3] According to the former segment structure.

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

Deutsche Pfandbriefbank AG is, according to the Waiver Rule regulated in section 2a KWG, exempted from the obligation to determine the equity capital ratio and the core capital ratio on a subgroup level.

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

> Relating to solvency (equity capital in relation to risk-weighted assets)
> Relating to large exposure (equity capital in relation to credit to single borrower units)
> For setting up internal control measures according to section 25a KWG if these are monitored and fulfilled on the level of the superordinated company

31 Breakdown of Operating Revenues

Operating Revenues by Products Operating revenues from other products mainly resulted from income for the servicing for the ongoing operation of FMS Wertmanagement as well as services of pbb Services provided to DEPFA and HRE Holding totalling to €144 million (2010: €101 million).

Operating revenues by products

in € million		Public sector financings	Commercial real estate financings	Other products	Deutsche Pfandbriefbank
Operating revenues	2011	63	274	189	526
	2010	73	571	8	652

Operating Revenues by Regions Deutsche Pfandbriefbank 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	Deutsche Pfandbriefbank
Operating revenues	2011	488	38	–	526
	2010	599	29	24	652

Operating Revenues by Customers Net income of €109 million (2010: € 35 million) recognised in the Value Portfolio segment resulted from services for the ongoing operation of FMS Wertmanagement. Because the net income accounts for more than 10 % of all operating revenues of Deutsche Pfandbriefbank Group, FMS Wertmanagement is a major client in accordance with IFRS 8.34. The net income compensates for the expenses of the Deutsche Pfandbriefbank Group incurred in connection with servicing.

Notes to the Income Statement

32 Net Interest Income and Similar Income

Net interest income and similar income, broken down by categories of income/expenses in € million	2011	2010
Interest income and similar income	**3,691**	**4,949**
Lending and money-market business	2,141	3,410
Fixed-income securities and government-inscribed debt	971	907
Current result from swap transactions (balance of interest income and interest expenses)	579	632
Interest expenses and similar expenses	**3,320**	**4,349**
Liabilities to other banks and customers	1,014	1,261
Liabilities evidenced by certificates	2,182	2,934
Subordinated capital	124	154
Total	**371**	**600**

Total interest income for financial assets that are not measured at fair value through profit or loss, amount to € 3.7 billion (2010: € 4.9 billion). Total interest expenses for financial liabilities that are not measured at fair value through profit or loss amount to € 3.3 billion (2010: € 4.3 billion).

Net interest income and similar income includes income of € 9 million (2010: €70 million) due to the increase in the present value of the adjusted allowances resulting over a period of time and an expense of €–17 million (2010: €–17 million) due to the increase in the present value of the adjusted liabilities over a period of time.

33 Net Commission Income

Net commission income in € million	2011	2010
Securities and custodial services	–3	–8
Lending operations and other service operations	35	–2
thereof: Costs of the liquidity support	–	–74
Total	**32**	**–10**

Net commission income is attributable exclusively to financial assets and financial liabilities which are not designated at fair value through profit or loss. Commission income from trust activities amount to € 0 million (2010: € 0 million), with commission expenses at € 0 million (2010: € 0 million).

34 Net Trading Income

Net trading income in € million	2011	2010
From interest rate instruments and related derivatives	–12	–29
From credit risk instruments and related derivatives	6	106
From foreign currency instruments and related derivatives	–2	–
Total	**–8**	**77**

35 Net Income From Financial Investments

Net income from financial investments in € million	2011	2010
Income from financial investments	10	54
Expenses from financial investments	7	71
Total	**3**	**–17**

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 2011 and 2010. Based on measurement categories, net income from financial investments is broken down as follows:

Net income from financial investments by IAS 39 categories in € million	2011	2010
AfS financial investments	3	4
LaR financial investments	–	–21
Total	**3**	**–17**

36 Net Income from Hedge Relationships

Net income from hedge relationships in € million	2011	2010
Result from fair value hedge accounting	–19	–6
Result from hedged items	169	–210
Result from hedging instruments	–188	204
Result from dFVTPL investments and related derivatives	–37	–37
Result from dFVTPL investments	–39	–34
Result from derivatives related to dFVTPL investments	2	–3
Ineffectiveness from cash flow hedge accounting affecting income	–	–2
Total	**–56**	**–45**

37 Balance of Other Operating Income/Expenses

Balance of other operating income/expenses in € million	2011	2010
Other operating income	315	173
Other operating expense	131	126
Balance of other operating income/expenses	**184**	**47**

Other operating income mainly consisted of income from services for the ongoing operations of FMS Wertmanagement and services of pbb Services rendered to DEPFA and HRE Holding totalling €246 million (2010: €143 million). The service income for the ongoing operations of FMS Wertmanagement compensated the corresponding general administrative expenses. An income of €7 million (2010: expenses of €13 million) resulted from foreign currency translation.

Other operating expenses included income for the servicing of FMS Wertmanagement which was forwarded to affiliated companies amounting to €102 million (2010: €43 million). In the previous period balance of other operating income/expenses was burdened with additions to provisions in connection with the transfer of positions to FMS Wertmanagement amounting to €21 million. In the financial year 2011, the bank levy initially resulted in expenses of €2 million.

38 Provisions for Losses on Loans and Advances

Provisions for losses on loans and advances in € million	2011	2010
Provisions for losses on loans and advances	–2	425
Additions	68	742
Releases	–70	–317
Provisions for contingent liabilities and other commitments	–9	21
Additions	2	24
Releases	–11	–3
Recoveries from written-off loans and advances	–1	–3
Total	**–12**	**443**

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.

39 General Administrative Expenses

General administrative expenses in € million	2011	2010
Personnel expenses	129	94
Wages and salaries	101	71
Social security costs	19	15
Pension expenses and related employee benefit costs	9	8
Other general administrative expenses	215	242
Consulting expenses	50	64
IT expenses	121	130
Office and operating expenses	14	17
Other administrative expenses	30	31
Depreciation/amortisation	13	16
On software and other intangible assets excluding goodwill	11	12
On property, plant and equipment	2	4
Total	**357**	**352**

Cost-income ratio in %	2011	2010
Cost-income ratio	67.9	54.0

40 Balance of Other Income/Expenses

Balance of other income/expenses in € million	2011	2010
Other income	9	16
thereof: Releases of restructuring provisions	9	16
Other expenses	2	8
thereof: Additions to restructuring provisions	2	8
Balance of other income/expenses	**7**	**8**

41 Taxes on Income

Breakdown in € million	2011	2010
Current taxes	18	18
Deferred taxes	53	32
thereof: Deferred taxes on capitalised losses carried forward	15	11
Total	**71**	**50**

Current taxes amount to €18 million (2010: €18 million). The current taxes contain tax income for prior years of €5 million (2010: €3 million).

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

Development of deferred taxes in € million	2011	2010
Deferred taxes recognised in the statement of financial position	128	38
Difference to prior year	90	–548
thereof: Recognised in income statement	–53	–32
Recognised in AfS reserve	116	–26
Recognised in cash flow hedge reserve	27	–383
Recognised in other equity	–	–107

The recognition of deferred taxes in other equity in the previous financial year was mainly due to the asset transfer to FMS Wertmanagement.

Reconciliation in € million	2011	2010
Net income/loss before taxes	188	–135
Applicable (legal) tax rate in %	15.83	15.83
Expected (computed) tax expense	30	–21
Tax effects		
arising from foreign income	3	4
arising from tax rate differences	23	13
arising from tax-free income	–	–1
arising from deductible and non-deductible items	16	54
arising from valuation adjustments and non-application of deferred taxes	3	3
arising from prior years and other aperiodical effects	–5	–2
arising from other differences	1	–
Reported taxes on income	**71**	**50**
Group tax ratio in %	**37.7**	**–36.9**

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, dividends and capital gains or losses both domestically and internationally. Regulations for the determination of taxable income were applied as valid for the particular jurisdiction.

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

The item effects arising from valuation adjustments and non-application of deferred taxes comprises major effects from not recognised deferred tax assets at 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 in € million	2011	2010
Loans and advances to other banks/customers (including loan loss allowances)	11	–
Financial investments	39	193
Trading assets	192	287
Other assets/liabilities	1,031	811
Liabilities to other banks/to customers	–	108
Others	18	44
Deferred tax liabilities	**1,291**	**1,443**
Loans and advances to other banks/customers (including loan loss allowances)	6	202
Financial investments	225	125
Provisions	81	23
Other assets/liabilities	780	607
Trading liabilities	183	361
Liabilities evidenced by certificates	3	6
Losses carried forward	141	157
Others	–	–
Deferred tax assets	**1,419**	**1,481**

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 Deutsche Pfandbriefbank AG the tax rate for the valuation of deferred taxes is 27.80% (2010: 26.84%).

On the reporting date, there are unused loss carry-forward totalling €3,560 million (2010: €3,519 million) at corporate tax level and €3,712 million (2010: €3,717 million) at trade tax level. Deferred tax assets have been stated as €481 million (2010: €564 million) at corporate tax level and €545 million (2010: €611 million) at trade tax level, because the criteria for recognition in accordance with IAS 12.34 et seq. were satisfied. The loss carry-forward can be utilised for an unlimited period of time. Additionally temporary differences of €5 million (2010: €60 million) were not recognised with deferred tax assets.

From the origination and reversal of temporary differences deferred tax expenses arose of €39 million (2010: €21 million).

A deferred tax income of €5 million (2010: €0 million) resulted from tax rate changes.

The current tax expense was reduced by the use of previously unrecognised tax losses of €0.2 million (2010: 0.5 million).

On differences associated with investments in subsidiaries, deferred tax liabilities in the amount of €634 million (2010: €480 million), has not been stated because it is the ability and the intention to invest profits permanently in these subsidiaries.

42 Net Gains/Net Losses

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

Net gains/net losses in € million	2011	2010
Loans and receivables	15	–382
Available for sale	3	4
Held for trading	–8	77
Designated at fair value through P&L	–37	–37
Financial liabilities at amortised cost	31	–9

Notes to the Statement of Financial Position (Assets)

43 Cash Reserve

Cash reserve in € million	31.12.2011	31.12.2010
Balance with central banks	323	224
Total	323	224

Cash in hand as of 31 December 2011 amounts to less than €1 million as was the case in the previous year.

44 Trading Assets

Trading assets in € million	31.12.2011	31.12.2010
Positive fair values from derivative financial instruments	248	764
Stand-alone derivatives (bank book)	9,570	15,404
Total	9,818	16,168

45 Loans and Advances to Other Banks

Loans and advances to other banks, broken down by type of business in € million	31.12.2011	31.12.2010
Loans and advances	6,886	9,056
Public sector loans	2,602	3,329
Real estate loans	–	28
Other loans and advances	4,284	5,699
Investments	746	3,072
Total	7,632	12,128

Loans and advances to other banks, broken down by maturities in € million	31.12.2011	31.12.2010
Repayable on demand	293	4,365
With agreed maturities	7,339	7,763
up to 3 months	4,890	4,545
from 3 months to 1 year	150	686
from 1 year to 5 years	1,032	1,126
from 5 years and over	1,267	1,406
Total	7,632	12,128

46 Loans and Advances to Customers

Loans and advances to other banks, broken down by type of business in € million	31.12.2011	31.12.2010
Loans and advances	54,736	58,702
Public sector loans	21,725	22,658
Real estate loans	32,984	35,941
Other loans and advances	27	103
Investments	500	59,940
Total	55,236	118,642

Loans and advances to customers, broken down by maturities in € million	31.12.2011	31.12.2010
Unspecified terms	–	–
With agreed maturities	55,236	118,642
up to 3 months	3,608	62,605
from 3 months to 1 year	5,286	5,654
from 1 year to 5 years	20,326	24,132
from 5 years and over	26,016	26,251
Total	55,236	118,642

47 Volume of Lending

Volume of lending in € million	31.12.2011	31.12.2010
Loans and advances to other banks	6,886	9,056
Loans and advances to customers	54,736	58,702
Contingent liabilities	38	102
Total	**61,660**	**67,860**

48 Allowances for Losses on Loans and Advances

Development in € million	Individual allowances	Portfolio-based allowances	Total
Balance at 1.1.2010	**2,776**	**550**	**3,326**
Changes affecting income	464	−110	354
Gross additions	741	1	742
Releases	−207	−110	−317
Increase of the present value due to passage of time (unwinding)	−70	–	−70
Release model reserve	–	−1	−1
Changes not affecting income	−2,780	−339	−3,119
Addition and disposals in the group of consolidated companies	5	–	5
Use of existing loan-loss allowances	−704	−1	−705
Reclassifications	13	–	13
Effects of currency translations and other changes not affecting income	113	−1	112
Changes due to transfer to FMS Wertmanagement	−2,207	−337	−2,544
Balance at 31.12.2010	**460**	**101**	**561**
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
Release model reserve	–	–	–
Changes not affecting income	−59	−14	−73
Addition and disposals in the group of consolidated companies	–	–	–
Use of existing loan-loss allowances	−87	−14	−101
Reclassifications	7	–	7
Effects of currency translations and other changes not affecting income	21	–	21
Changes due to transfer to FMS Wertmanagement	–	–	–
Balance at 31.12.2011	**413**	**64**	**477**

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

Breakdown in € million	31.12.2011	31.12.2010
Individual allowances for losses on loans and advances to other banks	17	36
Individual allowances for losses on loans and advances to customers	396	424
Portfolio-based allowances	64	101
Total	477	561

49 Financial Investments

Breakdown in € million	31.12.2011	31.12.2010
AfS financial investments	3,916	2,293
Shares in non-consolidated subsidiaries	1	2
Debt securities and other fixed-income securities	3,913	2,289
Equity securities and other variable-yield securities	2	2
dFVTPL financial investments	148	317
Debt securities and other fixed-income securities	148	317
LaR financial investments	24,613	30,995
Debt securities and other fixed-income securities	24,613	30,995
Total	28,677	33,605

Financial investments, broken down by maturities in € million	31.12.2011	31.12.2010
Unspecified terms	3	4
With agreed maturities	28,674	33,601
Up to 3 months	1,654	3,754
From 3 months to 1 year	1,500	3,275
From 1 year to 5 years	10,987	11,509
From 5 years and over	14,533	15,063
Total	28,677	33,605

The carrying amounts of the LaR financial investments were reduced by portfolio-based allowances amounting to €–7 million (2010: €–5 million).

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

Deutsche Pfandbriefbank 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 € 8.7 billion became due.

In the financial year 2011 securities with a reclassified carrying amount of € 0.1 billion (2010: € 0.5 billion) were sold due to the decided reduction of portfolios. Thereby a net profit of € 6 million (2010: net loss of €–2 million) was realised.

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

The following tables summarise the carrying amounts and fair values as of 31 December 2011 and 31 December 2010 as well as fair value gains and losses that would have been recognised in 2011 and 2010 if the financial assets had not been reclassified.

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

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

Securities listed on the stock exchange	31.12.2011		31.12.2010	
in € million	listed	unlisted	listed	unlisted
Debt securities and other fixed-income securities	27,387	1,287	31,286	2,315
Equity securities and other variable-yield securities	–	2	–	2
Total	**27,387**	**1,289**	**31,286**	**2,317**

Deutsche Pfandbriefbank Group cannot determine reliably a fair value for some shares in companies for which there is no market value available and which are not fully consolidated or are not accounted for using the equity method due to considerations of materiality. These companies in the legal form of limited or private are not traded in an active market. Therefore, the investments are measured at amortised cost. The carrying amount of these financial investments amounted to € 2 million as of 31 December 2011 (2010: € 2 million). In financial year 2011, financial investments, for which it is not possible for the fair value to be reliably established, were derecognised for € 1 million (2010: € 7 million). As in the previous year, this did not result in a profit.

50 Property, Plant and Equipment

Breakdown in € million	31.12.2011	31.12.2010
Plant and operating equipment	3	5
Total	3	5

Development of property, plant and equipment in € million	2011	2010
Plant and operating equipment		
Acquisition/production costs		
Balance at 1.1.	21	32
Changes in the group of consolidated companies	–	–8
Changes from foreign currency translation	–	1
Additions	–	1
Reclassifications	–	–
Disposals	–2	–5
Balance at 31.12.	19	21
Depreciation and write-ups		
Balance at 1.1.	16	22
Changes in the group of consolidated companies	–	–7
Changes from foreign currency translation	–	–
Depreciation	2	5
Impairment losses	–	–
Write-ups	–	–
Reclassifications	–	–
Disposals	–2	–4
Balance at 31.12.	16	16
Carrying amounts		
Balance at 31.12.	3	5

51 Intangible Assets

Breakdown in € million	31.12.2011	31.12.2010
Software acquired	6	8
Internally generated software	21	17
Other intangible assets	8	7
Total	35	32

Development of intangible assets in € million	Software acquired	Internally generated software	Other intangible assets	2011 Total	2010 Total
Acquisition/production costs					
Balance at 1.1.	74	27	7	108	92
Changes in the group of consolidated companies	–	–	–	–	–
Changes from foreign currency translation	–	–	–	–	–
Additions	4	4	7	15	17
Reclassifications	–	6	–6	–	–1
Disposals	–4	–1	–	–5	–
Balance at 31.12.	74	36	8	118	108
Amortisation and write-ups					
Balance at 1.1.	66	10	–	76	64
Changes in the group of consolidated companies	–	–	–	–	–
Changes from foreign currency translation	–	–	–	–	–
Amortisation	5	6	–	11	11
Impairment losses	–	–	–	–	1
Write-ups	–	–	–	–	–
Reclassifications	–	–	–	–	–
Disposals	–3	–1	–	–4	–
Balance at 31.12.	68	15	–	83	76
Carrying amounts					
Balance at 31.12.	6	21	8	35	32

52 Other Assets

Other assets in € million	31.12.2011	31.12.2010
Positive fair values from derivative financial instruments	5,714	4,607
Hedging derivatives	5,714	4,607
Fair value hedge	4,800	3,630
Cash flow hedge	914	977
Salvage acquisitions	90	86
Other assets	240	313
Deferred charges and prepaid expenses	14	29
Total	6,058	5,035

53 Income Tax Assets

Income tax assets in € million	31.12.2011	31.12.2010
Current tax assets	55	64
Deferred tax assets	1,419	1,481
Total	1,474	1,545

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

54 Subordinated Assets

The following balance sheet items contain subordinated assets:

Subordinated assets in € million	31.12.2011	31.12.2010
Loans and advances to customers	–	70
Total	–	70

55 Repurchase Agreements

As a pledgor of genuine repurchase agreements, Deutsche Pfandbriefbank Group has pledged assets with a book value of € 2.3 billion (2010: € 1.8 billion). The securities are still recognised as assets. The considerations which have been received amount to € 2.2 billion (2010: € 0.1 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).

56 Securitisation

As of 31 December 2011 Deutsche Pfandbriefbank Group has the synthetic securitisation Estate UK-3 with a maturity of 15 years and a total volume of lending of € 460 million in the portfolio. The issuer of the transaction with commercial mortgage loans is Deutsche Pfandbriefbank AG.

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

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

Securitisation programmes usually provide for a small part of the risks being retained in the form of a first-loss piece or interest subparticipation on the part of the pledgor. For the programme mentioned above, first-loss pieces amount to € 18 million (2010: € 17 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 € 160 million (2010: € 120 million) was achieved with the above-mentioned synthetic securitisation programme.

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

57 Liabilities to Other Banks

Liabilities to other banks by maturities in € million	31.12.2011	31.12.2010
Repayable on demand	2,007	15
With agreed maturities	6,216	62,572
Up to 3 months	2,435	59,499
From 3 months to 1 year	786	1,199
From 1 year to 5 years	2,750	1,465
From 5 years and over	245	409
Total	8,223	62,587

58 Liabilities to Customers

Liabilities to customers by maturities in € million	31.12.2011	31.12.2010
Repayable on demand	841	3,464
With agreed maturities	11,522	13,920
Up to 3 months	675	1,240
From 3 months to 1 year	1,003	1,529
From 1 year to 5 years	5,526	4,885
From 5 years and over	4,318	6,266
Total	12,363	17,384

59 Liabilities Evidenced by Certificates

Liabilities evidenced by certificates, broken down by type of business in € million	31.12.2011	31.12.2010
Debt securities issued	31,634	40,344
Mortgage bonds	6,984	8,494
Public sector bonds	21,290	26,346
Other debt securities	3,246	5,218
Money market securities	114	286
Registered notes issued	23,404	23,502
Mortgage bonds	6,768	7,144
Public sector bonds	15,527	15,318
Other debt securities	1,109	1,040
Total	55,038	63,846

Liabilities evidenced by certificates, broken down by maturities in € million	31.12.2011	31.12.2010
With agreed maturities		
Up to 3 months	4,266	2,621
From 3 months to 1 year	4,767	8,959
From 1 year to 5 years	20,980	26,071
From 5 years and over	25,025	26,195
Total	55,038	63,846

60 Trading Liabilities

Trading liabilities in € million	31.12.2011	31.12.2010
Negative fair values from derivative financial instruments	367	871
Other trading liabilities	2	2
Stand-alone derivatives (bank book)	9,534	15,421
Total	9,903	16,294

61 Provisions

Breakdown in € million	31.12.2011	31.12.2010
Provisions for pension and similar obligations	2	5
Restructuring provisions	68	83
Provisions for contingent liabilities and other commitments	20	34
Other provisions	73	54
thereof: Long-term liabilities to employees	3	3
Total	163	176

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

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

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

Non-German Group entities only have defined contribution plans. For almost all international entities, a defined percentage of fixed salary is paid into externally managed pension funds for employees as a part of defined contribution pension schemes. Expenses in respect of contribution-based plans amounted to € 3 million (2010: € 5 million). The expectations for 2012 are in the same range.

Discount rates and valuation parameters in %	31.12.2011/ 1.1.2012	31.12.2010/ 1.1.2011
Discount rate	4.75	4.75
Expected return from plan assets	4.25	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

The rate of increase over career amounts for members of the Management Board 0% (2010: 0%), for directors and non-pay-scale staff 1,5% (2010: 1.5%) and for pay-scale staff 0.5% (2010: 0.5%). As of 1 January 2005, Deutsche Pfandbriefbank AG took out reinsurance which is classified as a qualifying insurance policy under IAS 19 to protect itself against parts of the risks arising from the defined-benefit pension commitments. The expected return of the plan assets has been calculated by employing the long-term risk-free interest rate in accordance with the investment strategy of the plan assets.

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

Funding status in € million	31.12.2011	31.12.2010	31.12.2009	31.12.2008	31.12.2007
Present value of partly funded pension obligations	215	217	204	143	116
Fair value of plan assets	−199	−198	−198	−195	−156
Funding status	**16**	**19**	**6**	**−52**	**−40**
Outstanding actuarial profit (+)/loss (–)	−14	−14	−1		
Outstanding past service cost	–	–	–	–	–
Net of balance sheet value	**2**	**5**	**5**	**−52**	**−40**
thereof: Capitalised excess cover of plan assets	–	–	–	52	40
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 not exceeded as of 31 December 2011 and as of 31 December 2010. Movements in pension obligations are shown below:

Development of pension obligations in € million	2011	2010
Balance at 1.1.	**217**	**204**
Changes in the group of consolidated companies	–	–
Transfer of staff	–	–
Pensions claims vested	1	1
Interest expense	9	10
Actuarial profit (–)/loss (+)	–	13
Payments to beneficiaries	−12	−11
Balance at 31.12.	**215**	**217**

The experience-based adjustment of pension claims (profit [–]/ loss [+]) amounts on 31 December 2011 to 0% (2010: 0%; 2009: −2%; 2008: 0%, 2007: 1%) of the corresponding present value of pension claims vested as of 31 December 2011.

Pension expenses are broken down as follows:

Breakdown of pension expenses in € million	2011	2010
Present value of pension claims vested	1	1
Interest expense	9	10
Expected return from plan assets	−8	−9
Past service cost	–	–
Actuarial losses recognised as expense	–	–
Total	**2**	**2**

The pension expenses are part of general administrative expenses.

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

Development of plan assets in € million	2011	2010
Balance at 1.1.	198	198
Changes in the group of consolidated companies	–	–
Transfer of staff	–	–
Expected return from plan assets	8	9
Outstanding actuarial profit (+)/loss (–)	–	–
Payments to beneficiaries	–7	–9
Balance at 31.12.	199	198

The actual return from the plan assets amounts to €8 million (2010: €9 million).

Development of provisions in € million	Restructuring provisions	Provisions for contingent liabilities and other commitments	Other provisions
Balance at 1.1.2010	100	11	37
Changes in the group of consolidated companies	–	–	–
Change due to transfer to FMS Wertmanagement	–	–3	–6
Changes due to foreign currency translation	–	–	–
Additions	8	29	38
Reversals	–16	–3	–2
Increase of the present value due to passage of time (unwinding)	2	–	–
Amounts used	–11	–1	–4
Reclassifications	–	1	–9
Balance at 31.12.2010	83	34	54
Balance at 1.1.2011	83	34	54
Changes in the group of consolidated companies	–	–	–
Change due to transfer to FMS Wertmanagement	–	–	–
Changes due to foreign currency translation	–	–	–
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

On 19 December 2008 the Management Board and Supervisory Board of Deutsche Pfandbriefbank Group decided upon the strategic realignment and restructuring of the Group. A restructuring provision amounting to €120 million was created for obligations relating to the strategic realignment and restructuring in the fourth quarter 2008. In the financial year 2011 €11 million (2010: €11 million) were used of this provision. The provision will probably be completely utilised until the year 2024.

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

The other provisions comprise provisions for litigation costs amounting to €12 million (2010: €2 million), provisions in connection with town planning agreements of €9 million (2010: €9 million) and provisions for long-term liabilities with regard to employees of €3 million (2010: €3 million). Additionally, in connection with the transfer of positions to FMS Wertmanagement provisions amounting to €8 million (2010: €21 million) are included in other provisions.

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

Legal verdicts of the labour courts and also the regional labour courts in Munich and Baden-Württemberg are not consistent, which means that legal actions of employees in relation to bonus payments for 2008 respectively 2009 have in certain cases been completely rejected, although in certain cases such actions have been partially allowed. At present, the Company has in two cases submitted an appeal to the Federal labour court (Deutsche Pfandbriefbank AG and pbb Services). It is assumed that, as a result of various measures taken by Deutsche Pfandbriefbank Group, the risk of legal action taken by employees in relation to bonus payments has been considerably reduced.

62 Other Liabilities

Other liabilities in € million	31.12.2011	31.12.2010
Negative fair values from derivative financial instruments	5,829	4,316
Hedging derivatives	5,812	4,293
Fair value hedge	5,046	3,578
Cash flow hedge	766	715
Derivatives hedging dFVTPL financial instruments	17	23
Other liabilities	10,238	14,518
Deferred income	56	49
Total	**16,123**	**18,883**

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

63 Income Tax Liabilities

Income tax liabilities in € million	31.12.2011	31.12.2010
Current tax liabilities	82	83
Deferred tax liabilities	1,291	1,443
Total	**1,373**	**1,526**

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.

64 Subordinated Capital

Breakdown in € million	31.12.2011	31.12.2010
Subordinated liabilities	2,208	2,480
Participating certificates outstanding	6	15
Hybrid capital instruments	287	271
Total	**2,501**	**2,766**

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

Subordinated capital, broken down by maturities in € million	31.12.2011	31.12.2010
With agreed maturities		
Up to 3 months	99	215
From 3 months to 1 year	416	113
From 1 year to 5 years	947	1,193
From 5 years and over	1,039	1,245
Total	**2,501**	**2,766**

The appreciation of some instruments of subordinated capital led to an expense of €–17 million in the year 2011 (2010: €–13 million).

Participating Certificates Outstanding Issued participatory capital comprises the following issues:

Participating certificates outstanding in € million	Year of issue	Type	Nominal amount in € million	Interest rate in %	Maturity
Deutsche Pfandbriefbank AG	1989	Registered participation certificate	10	8.000	2014
Deutsche Pfandbriefbank AG	2002	Bearer participation certificate	50	7.000	2012

The participating certificates which matured on 31 December 2011 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. Moreover, hybrid capital can be issued both with unlimited maturity and repayable in the long term.

65 Equity

Subscribed capital equals the maximum liability of the shareholder for the liabilities of the corporation to its creditors. Additional paid-in capital includes premiums from the issue of shares and the contribution of SoFFin to reserves. Retained earnings were generally created only from net income of the current financial year or previous periods. This includes legal reserves to be created from net income and other retained earnings.

The subscribed capital as of 31 December 2011 and during the entire financial year 2011 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 Deutsche Pfandbriefbank AG. SoFFin is the only shareholder of HRE Holding.

In the fourth quarter 2009 SoFFin provided Deutsche Pfandbriefbank AG with a silent participation of €1.0 billion. The silent participation participates in the cumulative loss calculated in accordance with the regulations of commercial law to the same extent that the silent participation is related to the total carrying amount of all liable capital shares which participate in the cumulative loss. The total loss of the silent partner in relation to the cumulative loss under commercial law is limited to its silent contribution. The cumulative loss which is attributable to the year 2008 is not used for calculating the loss participation. At the end of the year, the silent contribution was reduced by €103 million to €182 million (2010: by €318 million to €285 million) in the commercial law financial statements of Deutsche Pfandbriefbank AG. Deutsche Pfandbriefbank AG has a replenishment obligation.

66 Foreign-currency Assets and Liabilities

Foreign-currency assets and liabilities in € million	31.12.2011	31.12.2010
Foreign-currency assets	19,058	19,948
thereof: US$	4,790	8,358
JP¥	2,026	2,499
CHF	3,148	3,247
SEK	2,811	1,237
GB£	5,927	3,699
Others	356	908
Foreign-currency liabilities (excluding own funds)	18,838	20,975
thereof: US$	4,795	8,391
JP¥	1,750	2,267
CHF	3,147	3,267
SEK	2,810	1,809
GB£	6,000	4,256
Others	336	985

67 Trust Business

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

Trust assets in € million	31.12.2011	31.12.2010
Loans and advances to customers	15	22
Total	**15**	**22**

Trust liabilities in € million	31.12.2011	31.12.2010
Liabilities to other banks	8	15
Liabilities to customers	7	7
Total	**15**	**22**

Notes to the Statement of Cash Flows

68 Notes to the Items in the Statement of Cash Flows

The 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 2011, no company was purchased or sold.

Notes to the Financial Instruments

69 Derivative Transactions

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

In order to minimise (reduce) both the economic and the regulatory credit risk, 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, Deutsche Pfandbriefbank 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.

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

Volume of derivatives at 31.12.2011	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
Forward rate agreements	–	–	–	–	–	–
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**
Other transactions						
OTC products	–	–	–	–	–	–
Credit derivatives	–	–	–	–	–	–
Total	–	–	–	–	–	–
Total	**51,213**	**123,459**	**86,741**	**261,413**	**15,532**	**15,730**

Use made of derivative transactions at 31.12.2011	Nominal amount	Fair value	
in € million		positive	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**
Other transactions			
Stand-alone derivatives	–	–	–
Total	–	–	–
Total	**261,413**	**15,532**	**15,730**

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

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

Counterparties in € million	31.12.2011 Fair value positive	31.12.2011 Fair value negative	31.12.2010 Fair value positive	31.12.2010 Fair value negative
OECD banks	9,707	12,000	11,848	14,354
OECD financial institutions	5,256	3,679	8,432	5,983
Other companies and private individuals	569	51	495	271
Total	**15,532**	**15,730**	**20,775**	**20,608**

70 Cash Flow Hedge Accounting

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

Cash flow hedge: periods of hedged items when cash flows are expected to occur in € million	31.12.2011	31.12.2010
Up to 1 month	5	8
From 1 month to 3 months	6	–5
From 3 months to 1 year	12	3
From 1 year to 2 years	21	27
From 2 years to 5 years	66	84
From 5 years and over	173	388
Total	**283**	**505**

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

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

71 Undiscounted Cash Flows of Financial Liabilities

The contractual undiscounted cash flows from derivative and non-derivative financial instruments of the financial liabilities according to IFRS 7.39 are split up into the following remaining maturities as of 31 December 2011:

Contractual undiscounted cash flows of the financial liabilities according to IFRS 7.39 in € billion	31.12.2011	31.12.2010
Up to 3 months	9	65
From derivative financial instruments	1	2
From non-derivative financial instruments	8	63
From 3 months to 1 year	12	19
From derivative financial instruments	2	4
From non-derivative financial instruments	10	15
From 1 year to 5 years	45	56
From derivative financial instruments	8	12
From non-derivative financial instruments	37	44
From 5 years and over	54	70
From derivative financial instruments	5	8
From non-derivative financial instruments	49	62

In conformity with the requirements, the contractual undiscounted cash flow maturities are presented in accordance with the worst-case scenario, meaning that if there are options or terminations rights involved the most unfavourable case from a liquidity perspective is assumed. This presentation does not reflect the economic management which is based on expected cash flows. The liquidity risk strategy and management of Deutsche Pfandbriefbank Group is described in the Risk Report.

72 Assets Assigned or Pledged as Collateral for Own Liabilities

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

Liabilities in € million	31.12.2011	31.12.2010
Liabilities to other banks	4,283	59,132
Total	4,283	59,132

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

Assets pledged in € million	31.12.2011	31.12.2010
Loans and advances to customers	517	719
Financial investments	6,433	9,548
Total	6,950	10,267

The assets pledged mainly resulted from repurchase agreements. The transactions were carried out at the normal standard terms for repurchase transactions.

73 Collaterals Permitted to Resell or Repledge

The fair value of collaterals that may be resold or repledged in the absence of default amounted to € 0 billion as of 31 December 2011 (2010: € 62.3 billion). Deutsche Pfandbriefbank Group received the collaterals as part of repurchase agreements and is principally obliged to return the collaterals to the grantor. The majority of collaterals which can be sold or repledged in the absence of default results from collaterals of FMS Wertmanagement which are pledged for funding at central banks or in bilateral repo. The funding is transferred to FMS Wertmanagement which does not have direct access to ECB funding due to its missing banking status. As of 31 December 2011 no refinancings for FMS Wertmanagement was taken.

74 Fair Values of Financial Instruments

The recognised fair values of financial instruments according to IFRS 7 correspond to the amounts at which, in the opinion of Deutsche Pfandbriefbank Group, an asset could be exchanged on the balance sheet date between willing, competent business partners or the amount at which a liability could be settled between such business partners. The fair values were determined as of the balance sheet date based on the market information available and on valuation methods described in note Financial Instruments.

As per the amendment to IFRS 7 Financial Instruments: Disclosures issued in March 2009 all financial assets and liabilities of Deutsche Pfandbriefbank Group that are measured at fair value should be grouped into the fair value hierarchies. The three-level hierarchy is based on the degree to which the input for the fair value measurement is observable:
> Level 1 – quoted priced (unadjusted) in active markets for identical financial assets or financial liabilities.
> Level 2 – inputs that are observable either directly or indirectly, other than quoted prices included within Level 1.
> Level 3 – valuation techniques that include inputs that are not based on observable market data (unobservable inputs).

The following tables show financial assets and financial liabilities measured at fair value grouped into the fair value hierarchy:

Fair value hierarchy at 31.12.2011 in € million	Total	Level 1	Level 2	Level 3
Assets				
Financial assets at fair value through P&L	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 P&L	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 P&L	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 P&L	766	–	766	–
Cash flow hedge derivatives	766	–	766	–
Total	**15,732**	**–**	**15,713**	**19**

[1] Excluding participating interests and shares in non-consolidated subsidiaries

Fair value hierarchy at 31.12.2010 in € million	Total	Level 1	Level 2	Level 3
Assets				
Financial assets at fair value through P&L	20,115	317	19,772	26
Trading assets	16,168	–	16,160	8
dFVTPL financial investments	317	317	–	–
Hedging derivatives	3,630	–	3,612	18
Financial assets at fair value not affecting P&L	3,268	2,291	944	33
AfS financial investments[1]	2,291	2,291	–	–
Cash flow hedge derivatives	977	–	944	33
Total	**23,383**	**2,608**	**20,716**	**59**
Liabilities				
Financial liabilities at fair value through P&L	19,895	–	19,635	260
Trading liabilities	16,294	–	16,041	253
Hedging derivatives	3,578	–	3,571	7
Derivatives hedging dFVTPL financial instruments	23	–	23	–
Financial liabilities at fair value not affecting P&L	715	–	715	–
Cash flow hedge derivatives	715	–	715	–
Total	**20,610**	**–**	**20,350**	**260**

[1] Excluding participating interests and shares in non-consolidated subsidiaries.

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 € 4 million were reclassified from level 2 into level 3 of the fair value hierarchy. Financial instruments with a fair value of €15 million were reclassified from level 3 into level 2 due to improvements in the market.

In the financial year 2011, 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 business years 2010 and 2011:

Changes in Level 3 financial assets

in € million	Financial assets at fair value through P&L		Financial assets at fair value not affecting P&L	
	Trading assets	Hedging derivatives	Cash flow hedge derivatives	Total
Balance at 1.1.2010	9	18	48	75
Comprehensive income				
Income statement	−1	6	–	5
AfS reserve	–	–	–	–
Purchases	–	–	–	–
Sales	–	–	–	–
Changes due to transfer to FMS Wertmanagement	–	–	−15	−15
Issues	–	–	–	–
Settlements	–	–	–	–
Transfers into Level 3	–	–	–	–
Transfers out of Level 3	–	− 6	–	− 6
Balance at 31.12.2010	8	18	33	59
Balance at 1.1.2011	8	18	33	59
Comprehensive income				
Income statement	–	−3	–	−3
AfS reserve	–	–	–	–
Purchases	–	32	–	32
Sales	–	–	−33	−33
Changes due to transfer to FMS Wertmanagement	–	–	–	–
Issues	–	–	–	–
Settlements	–	–	–	–
Reclassification into Level 3	–	2	2	4
Reclassification out of Level 3	−8	–	–	−8
Balance at 31.12.2011	–	49	2	51

Changes in Level 3 financial liabilities in € million	Financial liabilities at fair value through P&L Trading liabilities	 Hedging derivatives	Financial liabilities at fair value not affecting P&L Cash flow hedge derivatives	Total
Balance at 1.1.2010	**–236**	**–7**	**–18**	**–261**
Comprehensive income				
Income statement	78	–	–	78
AfS reserve	–	–	2	2
Purchases	–	–	–	–
Sales	–	–	–	–
Changes due to transfer to FMS Wertmanagement	85	–	16	101
Issues	–	–	–	–
Settlements	–	–	–	–
Transfers into Level 3	–180	–	–	–180
Transfers out of Level 3	–	–	–	–
Balance at 31.12.2010	**–253**	**–7**	**–**	**–260**
Balance at 1.1.2011	**–253**	**–7**	**–**	**–260**
Comprehensive income				
Income statement	28	–11	–	17
AfS reserve	–	–	–	–
Purchases	–	–	–	–
Sales	216	–	–	216
Changes due to transfer to FMS Wertmanagement	–	–	–	–
Issues	–	–	–	–
Settlements	8	–	–	8
Reclassification into Level 3	–	–	–	–
Reclassification out of Level 3	–	–	–	–
Balance at 31.12.2011	**–1**	**–18**	**–**	**–19**

In the year 2010, level 3 instruments were disclosed in the position changes due to the transfer to FMS Wertmanagement, which meet the derecognition criteria of IAS 39.14 et seq. and which were transferred either physically or synthetically.

Of the total gains or losses for the year 2011 recognised in profit or loss amounting to €14 million relates to assets and liabilities, which were classified in level 3 on balance sheet date and which were measured at fair value through profit or loss. Gains or losses from assets at fair value through profit or loss of €–3 million (hedging derivatives) are included in net income from hedge relationships. Gains or losses from liabilities at fair value through profit or loss of €17 million are included in net trading income (€28 million) and in net income from hedge relationships (€–11 million).

In the year 2011, Deutsche Pfandbriefbank Group did not reclassify any financial liabilities from Level 2 into Level 3, or vice versa.

Although Deutsche Pfandbriefbank Group believes that its estimates of fair value are appropriate, using reasonably possible alternative input factors will significantly impact the fair value. The following table shows the fair value sensitivity of Level 3 instruments as of 31 December 2011 which have been quantified on the basis of the specified valuation parameters taking account of scenarios usual in the market:

Sensitivities of Level 3 instruments at 31.12.2011 in € million	Favourable changes	Unfavourable changes
Assets		
Financial assets at fair value through P&L		
Hedging derivatives	2.3	–2.2
Total	**2.3**	**–2.2**
Liabilities		
Financial liabilities at fair value through P&L		
Trading liabilities	0.1	–0.1
Hedging derivatives	6.5	–5.0
Total	**6.6**	**–5.1**

Sensitivities of Level 3 instruments at 31.12.2010 in € million	Favourable changes	Unfavourable changes
Assets		
Financial assets at fair value through P&L		
Hedging derivatives	4.8	–5.5
Total	**4.8**	**–5.5**
Liabilities		
Financial liabilities at fair value through P&L		
Trading liabilities	0.4	–0.5
Hedging derivatives	0.2	–0.3
Total	**0.6**	**–0.8**

The disclosed favourable and unfavourable changes are calculated independently from each other.

Offsetting effects due to compensating derivatives and hedge relationships attenuate both favourable and unfavourable changes.

The methods and measurement techniques used for the purpose of determining fair value are unchanged compared to the previous period. 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 illiquid 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. Counterparty risk adjustments are taken into account for the measurement of customer derivatives.

Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably determined are measured at cost according to IAS 39.46.

In the course of the financial year 2011, the level of short-term market rates increased slightly; however, medium- and long-term rates declined appreciably due to the economic slow-down which occurred in the course of the year. The recovery of the market which was evident at the beginning of 2011 was not able to continue in the remaining quarters of the financial year 2011 in view of the government debt crisis. Credit spreads accordingly widened across all sectors and across all countries. These factors have had the following impact on the fair market values of the financial instruments of Deutsche Pfandbriefbank Group:

Fair values of financial instruments

in € million	31.12.2011		31.12.2010	
	Carrying amounts	Fair value	Carrying amounts	Fair value
Assets	**106,923**	**105,244**	**184,813**	**183,907**
Cash reserve	323	323	224	224
Trading assets (HfT)	9,818	9,818	16,168	16,168
Loans and advances to other banks[1]	7,615	7,386	12,092	12,062
Category LaR	7,615	7,386	12,092	12,062
Loans and advances to customers[1]	54,776	55,158	118,117	118,592
Category LaR	54,776	55,158	118,117	118,592
Financial investments	28,677	26,845	33,605	32,254
Category AfS	3,916	3,916	2,293	2,293
Category dFVTPL	148	148	317	317
Category LaR	24,613	22,781	30,995	29,644
Other assets	5,714	5,714	4,607	4,607
thereof: Hedging derivatives	5,714	5,714	4,607	4,607
Liabilities	**103,758**	**103,183**	**181,388**	**181,315**
Liabilities to other banks	8,223	8,224	62,587	62,628
Liabilities to customers	12,363	12,504	17,384	17,490
Liabilities evidenced by certificates	55,038	54,159	63,846	63,603
Trading liabilities (HfT)	9,903	9,903	16,294	16,294
Other liabilities	15,730	15,794	18,511	18,514
thereof: Hedging derivatives	5,812	5,812	4,293	4,293
Derivatives hedging dFVTPL financial instruments	17	17	23	23
Liabilities in relation to cover pool assets which were synthetically transferred to FMS Wertmanagement	9,901	9,965	10,925	10,928
Subordinated capital	2,501	2,599	2,766	2,786
Other items	**1,175**	**1,094**	**892**	**863**
Contingent liabilities	38	38	102	102
Irrevocable loan commitments	1,137	1,056	790	761

[1] Reduced by allowances for losses on loans and advances

In the case of certain positions which had not been physically transferred to FMS Wertmanagement but which had been synthetically transferred to FMS Wertmanagement by way of a financial guarantee as of the balance sheet date, the hidden reserves and hidden losses are as follows:

The table above has taken account of the financial guarantees for calculating the fair values (economic view). If these financial guarantees were to be disregarded, the loans and advances to customers would have a fair value which was €64 million lower, whereas contingent receivables from the financial guarantee of €64 million would have to be recognised.

The carrying amounts reflect the maximum on balance sheet exposure to credit risk of the assets and the maximum amount the entity could have to pay of the other items according to IFRS 7.

Asset and liabilities according to measurement categories and classes in € million	31.12.2011	31.12.2010
Assets	**106,923**	**184,813**
Loans and receivables (LaR)	87,004	161,204
Held to maturity (HtM)	–	–
Available for sale (AfS)	3,916	2,293
Held for Trading (HfT)	9,818	16,168
dFVTPL assets (dFVTPL)	148	317
Cash reserve	323	224
Positive fair values from hedging derivatives	5,714	4,607
Liabilities	**103,758**	**181,388**
Held for trading (HfT)	9,903	16,294
Financial liabilities at amortised cost	88,026	160,778
Negative fair values from hedging derivatives	5,829	4,316

75 Exposure to Selected European Countries

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
Belgium	Sovereign	LaR	–	104	–	–	104	100	104
		AfS	–	–	72	–	72	75	72
	Sub-sovereign	LaR	–	–	212	262	474	403	448
Hungary	Sovereign	LaR	–	–	117	266	383	334	287
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	1,958	2,016	1,867	1,702
	State-guaranteed	LaR	–	–	–	23	23	22	20
Portugal	Sovereign	LaR	50	–	47	45	142	131	127
		AfS	–	–	16	79	95	165	95
		dFVTPL	–	–	17	45	62	105	62
	Sub-sovereign	LaR	–	–	151	44	195	194	131
	State-guaranteed	LaR	–	–	325	577	902	878	482
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

As of 31 December 2011 Deutsche Pfandbriefbank Group did not have any exposure to sovereign, sub-sovereign, and state-guaranteed counterparties of Greece and Ireland.

The exposure to selected European 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 2011 Deutsche Pfandbriefbank Group did not have any credit default swaps whose underlyings are linked to sovereigns, sub-sovereigns and state-guarnateed exposures of the countries shown above.

For the total portfolio as of 31 December 2011 and as of 31 December 2010 the exposure at default according to regions is disclosed in the Risk Report.

For financial assets which are measured at fair value affecting income changes in value are directly included in the book value. Deutsche Pfandbriefbank 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 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.

76 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 2011 and as of 31 December 2010. However, no individual allowances were made for these assets respectively the collaterals underlying these assets as Deutsche Pfandbriefbank Group does not consider that there is any issue regarding their recoverability. Such timing issues in receipts of payments due occur regularly (up to three months) in the normal course of business and do not, by themselves, impair the quality of the asset. The total investment in relation to the past due amounts have also been disclosed to put the size of the amounts in question into context.

LaR Assets

LaR assets: past due but not impaired (total investments) in € million	31.12.2011	31.12.2010
Up to 3 months	331	134
From 3 months to 6 months	25	18
From 6 months to 1 year	61	4
From 1 year and over	18	8
Total	**435**	**164**

Carrying amounts LaR assets in € billion	31.12.2011	31.12.2010
Carrying amount of LaR assets that are neither impaired nor past due	86.3	161.0
Carrying amount of LaR assets that are past due but not impaired (total investment)	0.4	0.2
Carrying amount of individually assessed impaired LaR assets (net)	0.7	0.4
Balance of portfolio-based allowances	0.1	0.1
Total	**87.5**	**161.7**
thereof: Loans and advances to other banks (including investments)	7.7	15.2
Loans and advances to customers (including investments)	55.2	132.8
Financial investments (gross)	24.6	13.7

The carrying amount of assets that would otherwise be past due or impaired and whose terms have been renegotiated amounts to € 0 million (2010: € 0 million).

The fair value of collaterals for the impaired financial assets amounts to approximately € 0.7 billion (2010: € 0.4 billion). The collaterals mainly consist of land charges.

AfS Assets As of 31 December 2011 and as of 31 December 2010 Deutsche Pfandbriefbank Group has neither past due and not impaired nor impaired AfS financial investments in the portfolio.

Other Notes

77 Contingent Liabilities and Other Commitments

Contingent liabilities and other commitments in € million	31.12.2011	31.12.2010
Contingent liabilities	**38**	**102**
Guarantees and indemnity agreements	38	102
Loan guarantees	6	14
Performance guarantees and indemnities	32	88
Other commitments	**1,137**	**821**
Irrevocable loan commitments	1,137	790
Book credits	73	25
Guarantees	51	52
Mortgage and public sector loans	1,013	713
Other commitments	–	31
Total	**1,175**	**923**

The former Hypo Real Estate Bank International AG, a predecessor institute of Deutsche Pfandbriefbank AG, has overtaken with the announcement as of 2 January 2006 irrevocable and unconditional guarantees to fulfil all liabilities of Hypo Public Finance Bank 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, Deutsche Pfandbriefbank AG does not rule out the default of Hypo Public Finance Bank puc, Dublin, but a default should be rather unlikely.

In accordance with the framework agreement for transferring risk positions and non-strategic operations to a deconsolidated environment constituted under federal law in accordance with Section 8a of the Financial Market Stabilisation Act, Deutsche Pfandbriefbank AG assumes joint and several liability for all payment obligations of its subsidiaries resulting from the transaction agreements which have been transferred as part of the process of transferring assets to FMS Wertmanagement.

The Restructuring Fund Act, which envisages the imposition of a bank levy in Germany, came into force in Germany in December 2010. Details concerning the bank levy are set out in an ordinance regarding the imposition of contributions to the restructuring fund for credit institutions (Restructuring Fund Ordinance). On 20 July 2011, the Federal Cabinet adopted the Restructuring Fund Ordinance with the modifications adopted by the Bundesrat (Upper House). The ordinance came into force on 26 July. The relevant liabilities and derivatives disclosed in the separate financial statements of 2010 constitute the basis for calculating the bank levy to be paid in 2011. On this basis, a figure of €41 million has been indicated for 2011. However, because Deutsche Pfandbriefbank AG reported a loss in its separate financial statements for 2010, only a minimum payment of € 2 million will be imposed in 2011. The Restructuring Fund Ordinance specifies a subsequent payment for years in which the most recently adopted annual financial statements report a net loss for the year or in which the limits of reasonableness are exceeded. Because of the link to future annual payments, there is a possibility of avoidance in accordance with IAS 37.19, which means that a provision does not have to be created for the subsequent payment. The amount which has not been paid and which can be subsequently imposed in the years 2012 and 2013 is purely arithmetical € 39 million.

Deutsche Pfandbriefbank 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 2011. The minimum obligations arising from non-terminable leasing arrangements will result in expenses of €13 million in 2012, € 37 million in total in the years 2013 to 2016 and €41 million in total for 2017 and beyond. In the previous year the non-terminable operating lease agreements were as follows: for financial year 2011: €7 million, in financial years 2012 to 2015 € 21 million in total and for 2016 and beyond € 56 million in total.

For Deutsche Pfandbriefbank Group irrevocable loan commitments form the largest part of other commitments. Irrevocable loan commitments comprise all commitments of a creditor which can grant a loan and advance at a later date and which can cause a credit risk. These are mainly credit commitments which are not fully drawn by the customer.

78 Key Regulatory Capital Ratios (Based on German Commercial Code)

Deutsche Pfandbriefbank AG is according to the Waiver Rule regulated in section 2a KWG exempted from the obligation to determine the equity capital ratio and the core capital ratio on a subgroup level.

The Management Board of HRE Holding manages regulatory capital on the basis of the German Solvency Regulation (SolvV) in connection with section 10 German Banking Act (KWG). According to these standards the total equity capital ratio (equity capital/risk-weighted assets) may not go below 8.0%. In addition, the core capital (Tier I) must consist of at least 50% of equity capital (core capital and supplementary capital), so that the core capital ratio may not be lower than 4.0%. At the same time, the own funds ratio, which is calculated by dividing the own funds by the total risk-weighted assets, must not be lower than 8.0%. The total risk-weighted assets are determined by multiplying the capital requirements for market risk positions and operational risks by 12.5 and adding the resulting figures to the sum of risk-weighted assets for credit risk. These regulatory capital requirements have been met throughout the entire year 2011.

79 Group Auditors' Fee

Group auditors' fee in € thousand	2011	2010
Audit	3,549	3,361
Other assurance services	1,578	2,251
Tax advisory services	51	2
Other non-audit services	1,300	5,588
Total	**6,478**	**11,202**

The table shows fees to the group auditor KPMG AG Wirtschaftsprüfungsgesellschaft.

80 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.

Transactions with related entities or persons were performed on an arms-length basis under consideration of the characteristics of section 311 et sec. AktG (German Stock Corporation Act). According to section 7 (d) FMStBG these requirements are not applicable in relationship to the Finanzmarktstabilisierungsfonds and the German Federation, as well as the bodies, agencies, special funds and entities controlled by them.

Related Entities The loans and advances (netted by liabilities) of Deutsche Pfandbriefbank Group to its parent company HRE Holding as of 31 December 2011 amounted to € 0 billion (2010: € 0.9 billion). As of 31 December 2011, HRE Holding held financial investments of Deutsche Pfandbriefbank Group amounting to € 0.8 billion (2010: € 0 billion).

Deutsche Pfandbriefbank Group had loans and advances (netted by liabilities) to its affiliated company DEPFA of € 0.4 billion as of 31 December 2011 (2010: € 0.3 billion) and subordinated liabilities of € 0.3 billion (2010: € 0.3 billion).

As of 31 December 2011, loans and advances to non-consolidated companies amounted to € 3 million (2010: € 5 million); the liabilties amounted to € 0 million (2010: € 1 million). Loans and advances to associated companies which were not measured with the equity method amounted to €45 million (2010: €46 million), whereas the liabilities were at € 0 million (2010: € 0 million).

In the financial year 2011 Deutsche Pfandbriefbank Group realised a net interest income of €–85 million (2010: € 85 million) and a net commission income of € 3 million (2010: € 310 million) to DEPFA. The net interest income to HRE Holding amounted to €–2 million (2010: € 6 million).

On 31 December 2011 liabilities to defined contribution plans amounted to €1 million (2010: € 0 million).

SoFFin, 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 Deutsche Pfandbriefbank AG. Accordingly, Deutsche Pfandbriefbank AG 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. FMS Wertmanagement is also controlled by the Federal Republic of Germany and is thus a related party of Deutsche Pfandbriefbank Group. In the year 2011, Deutsche Pfandbriefbank Group reimbursed SoFFin expenses (excluding bank levy) of €4 million (2010: €4 million without expenses for liquidity supports).

Total assets of Deutsche Pfandbriefbank Group have been affected by the following major transactions with FMS Wertmanagement:
> Because FMS Wertmanagement does not have bank status, it is not able to independently obtain funding for its operations from the European Central Bank (ECB). Refinancing operations are partially carried out by Deutsche Pfandbriefbank Group, which in turn refinances its operations via the ECB. The volume of these funds which have been forwarded (so-called reverse repos) declined from € 59.9 billion as of 31 December 2010 to € 0 billion as of 31 December 2011. Reverse repos were disclosed as loans and advances to customers.
> Deutsche Pfandbriefbank Group has transferred market risks to FMS Wertmanagement by means of back-to-back derivatives. The positive market values of the back-to-back derivatives amounted to €7.4 billion as of 31 December 2011 (2010: €13.5 billion), and these items were disclosed as trading assets.
> The carrying amount of securities which were issued by FMS Wertmanagement declined from € 8.8 billion as of 31 December

2010 to € 3.0 billion as of 31 December 2011. These securities are disclosed as financial investments.

The financial position of Deutsche Pfandbriefbank Group has been affected by the following major transactions with FMS Wertmanagement:

> Negative market values of the back-to-back derivatives amounted to € 6.5 billion as of 31 December 2011, and these items were disclosed as trading liabilities.
> Deutsche Pfandbriefbank Group has to raise funds from the ECB for FMS Wertmanagement. These funds are disclosed as liabilities due to banks, and declined from € 59.9 billion as of 31 December 2010 to € 0 billion as of 31 December 2011.

The development in assets and in the financial position 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 net income of €109 million (2010: € 35 million) compensated for the expenses which were incurred by Deutsche Pfandbriefbank Group for servicing.

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 Deutsche Pfandbriefbank Group.

Related Persons Deutsche Pfandbriefbank AG did pay neither fixed remuneration nor severance payments to the Management Board during the financial years 2011 and 2010. For 2011, the total remuneration paid to former members of the Management Board and their surviving dependants amounted to € 5,140 thousand (2010: € 5,156 thousand). The Supervisory Board remuneration for the reporting period amounted to €70 thousand (2010: €71 thousand). This figure was composed exclusively of fixed remuneration.

Remuneration paid to persons with key function in the Group (Senior Management)[1]			2011	2010
in € thousand	Remuneration[2]	Severance payments	Total	Total
Total	8,561	–	8,561	7,872

[1] Members of the second management level of Deutsche Pfandbriefbank AG and managing directors of subsidiaries of Deutsche Pfandbriefbank AG
[2] Reporting follows the so-called vested principle. The components of compensation which were vested in the relevant period 2011 are reported.

Pension obligations to persons with key function in the Group (Senior Management) in € thousand	31.12.2011	31.12.2010
Total[1]	66,653	67,406

[1] Thereof € 59,668 thousand (31.12.2010: € 61,891 thousand) for pensioners and surviving dependants

81 Employees

Average number of employees	2011	2010
Employees (excluding apprentices)	993	923
Total	**993**	**923**

82 Summary of Quarterly Financial Data

Deutsche Pfandbriefbank Group	2010				2011
in € million	4th quarter	1st quarter	2nd quarter	3rd quarter	4th quarter
Operating performance					
Operating revenues	191	131	162	129	104
Net interest income and similar income	109	97	95	101	78
Net commission income	10	14	5	6	7
Net trading income	15	–8	8	4	–12
Net income from financial investments	1	–1	–	–	4
Net income from hedge relationships	–4	–15	–12	–7	–22
Balance of other operating income/expenses	60	44	66	25	49
Provisions for losses on loans and advances	25	–2	1	–1	–10
General administrative expenses	76	81	93	87	96
Balance of other income/expenses	8	–	–	–	7
Pre-tax profit/loss	98	52	68	43	25

Public Sector Finance	2010				2011
in € million	4th quarter	1st quarter	2nd quarter	3rd quarter	4th quarter
Operating performance					
Operating revenues	25	17	27	27	-8
Net interest income and similar income	22	27	30	32	20
Net commission income	–1	–1	–1	–	–1
Net trading income	–4	–2	5	–	–6
Net income from financial investments	7	3	–	–1	3
Net income from hedge relationships	–	–11	–14	–7	–16
Balance of other operating income/expenses	1	1	7	3	–8
Provisions for losses on loans and advances	–2	–	–	–	–
General administrative expenses	8	12	14	13	15
Balance of other income/expenses	–	–	–	–	2
Pre-tax profit/loss	19	5	13	14	–21

Real Estate Finance	2010				2011
in € million	4th quarter	1st quarter	2nd quarter	3rd quarter	4th quarter
Operating performance					
Operating revenues	108	74	72	70	58
Net interest income and similar income	84	65	58	62	60
Net commission income	12	15	7	8	7
Net trading income	29	–1	2	–	–12
Net income from financial investments	2	–	–	–	1
Net income from hedge relationships	–	–4	2	–	-5
Balance of other operating income/expenses	–19	–1	3	–	7
Provisions for losses on loans and advances	33	9	2	–2	–10
General administrative expenses	26	30	37	34	37
Balance of other income/expenses	–	–	–	–	3
Pre-tax profit/loss	49	35	33	38	34

Value Portfolio	2010				2011
in € million	4th quarter	1st quarter	2nd quarter	3rd quarter	4th quarter
Operating performance					
Operating revenues	59	37	59	28	44
Net interest income and similar income	14	2	2	1	–5
Net commission income	–	–	–1	–2	1
Net trading income	–9	–1	1	5	1
Net income from financial investments	–8	–4	–	1	–
Net income from hedge relationships	–	–	–	–	–1
Balance of other operating income/expenses	62	40	57	23	48
Provisions for losses on loans and advances	–6	–11	–1	1	–
General administrative expenses	57	38	41	39	41
Balance of other income/expenses	–	–	–	–	2
Pre-tax profit/loss	8	10	19	–12	5

Consolidation & Adjustments	2010				2011
in € million	4th quarter	1st quarter	2nd quarter	3rd quarter	4th quarter
Operating performance					
Operating revenues	–1	3	4	4	10
Net interest income and similar income	–11	3	5	6	3
Net commission income	–1	–	–	–	–
Net trading income	–1	–4	–	–1	5
Net income from financial investments	–	–	–	–	–
Net income from hedge relationships	–4	–	–	–	–
Balance of other operating income/expenses	16	4	–1	–1	2
Provisions for losses on loans and advances	–	–	–	–	–
General administrative expenses	–15	1	1	1	3
Balance of other income/expenses	8	–	–	–	–
Pre-tax profit/loss	22	2	3	3	7

83 Members of the Supervisory Board and of the Management Board

Supervisory Board

Dr. Bernd Thiemann
Kronberg, Former Chairman of the Management Board of DG Bank AG
(Chairman of the Supervisory Board)

Dagmar Kollmann
Bad Homburg, Chairperson of the Partners Committee of Kollmann GmbH
(Deputy Chairperson of the Supervisory Board)

Ursula Bestler (until 18 May 2011)
Munich, Bank employee
(Workers' Council Representative)

Dr. Günther Bräunig
Frankfurt, Member of the Management Board of KfW
(Member of the Supervisory Board)

Georg Kordick
Poing, Bank employee
(Workers' Council Representative)

Heike Theißing (since 7 July 2011)
Munich, Bank employee
(Workers' Council Representative)

Dr. Hedda von Wedel
Andernach, Retired President of the Bundesrechnungshof
(Member of the Supervisory Board)

Management Board

Manuela Better
Munich
(Chairperson of the Management Board)

Wolfgang Groth
Tawern
(Member of the Management Board since 1 January 2011)

Dr. Bernhard Scholz
Regensburg

Alexander von Uslar
Gruenwald

84 Holdings of Deutsche Pfandbriefbank AG

Holdings of Deutsche Pfandbriefbank AG
as of 31.12.2011

Name and place of business	Interest in % Total Sec 16 (4) Stock Corp. Act	of which held indirectly	Currency	Total assets in thousands	Equity in thousands	Net income/loss in thousands	Alternative financial year
Subsidiaries							
Consolidated subsidiaries							
House of Europe Funding I Ltd., Grand Cayman[1]	–	–	EUR	459,481	1	–	–
Hypo Real Estate Capital Hong Kong Corporation Ltd. i.L., Hong Kong	100.00	–	HKD	7,196	6,830	–	–
Hypo Real Estate Capital India Corporation Private Ltd. i.L., Mumbai	100.00	–	INR	318,916	316,067	1,199	01.04.10–31.03.11
Hypo Real Estate Capital Singapore Corporation Private Ltd. i.L., Singapore	100.00	–	SGD	–	–	387	–
Hypo Real Estate Capital Japan Corp., Tokyo	100.00	–	JPY	57,015,446	31,279,690	775,319	–
Hypo Real Estate International LLC I, Wilmington	100.00	–	EUR	137,863	50	–	01.01.–31.12.10
Hypo Real Estate International Trust I, Wilmington	100.00	–	EUR	137,895	–40	–1	01.01.–31.12.10
IMMO Immobilien Management GmbH & Co. KG, Munich	100.00	–	EUR	3,548	3,017	49	–
Little Britain Holdings Ltd., Jersey	100.00	–	GBP	77,942	–9,123	–5,078	–
pbb Services GmbH, Munich	100.00	–	EUR	36,825	3,020	2,909[2]	–
Ragnarök Vermögensverwaltung AG & Co. KG, Munich	100.00	6.00	EUR	4,391	3,864	2,067[3]	–
Non-consolidated subsidiaries							
DEPFA Finance N.V., Amsterdam	100.00	–	EUR	1,231,667	4,372	523	–
FUNDUS Gesellschaft für Grundbesitz und Beteiligungen mbH, Munich	100.00	–	EUR	909	904	–11[2]	–
GfI-Gesellschaft für Immobilienentwicklung und -verwaltung mbH i.L., Stuttgart	100.00	–	EUR	11	11	–	–
Immo Immobilien Management Beteiligungsgesellschaft mbH, Munich	100.00	–	EUR	34	30	1	–
IMMO Invest Real Estate GmbH, Munich	100.00	–	EUR	3,493	28	170[2]	–
WestHyp Immobilien Holding GmbH, Munich	100.00	–	EUR	533	501	35	–
Associated companies							
Archplan Projekt Dianastraße GmbH, Munich	33.20	33.20	EUR	219	–104	61	01.01.–31.12.10
SANO Grundstücks-Vermietungsgesellschaft mbH & Co. Objekt Dresden KG, Duesseldorf	33.33	–	EUR	12,229	–4,560	–127	01.01.–31.12.10
SOMA Grundstücks-Vermietungsgesellschaft mbH & Co. Objekt Darmstadt KG, Duesseldorf	33.33	–	EUR	35,425	–9,913	–705	01.01.–31.12.10
Wisus Beteiligungs GmbH & Co. Zweite Vermietungs-KG, Munich	33.00	–	EUR	9,538	–2,538	242	–

[1] Special purpose entity without capital investment consolidated according to SIC-12.
[2] Profit transfer by shareholders on the basis of profit and loss transfer agreement.
[3] General partner liability (Komplementärhaftung) of Deutsche Pfandbriefbank AG.

In addition, there is a relationship to a special purpose entity European Prime Real Estate No. 1 plc., London, which was set up for own securitisation to risk optimisation. The special purpose entity does not have to be consolidated according to SIC-12.

Exchange rates 1 € equates to		31.12.2011
Great Britain	GB£	0.8353
Hong Kong	HK$	10.0510
India	INR	68.7130
Japan	JP¥	100.200
Singapore	SG$	1.6819

Munich, 14 March 2012

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, 14 March 2012

Deutsche Pfandbriefbank Aktiengesellschaft
The Management Board

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Auditor's Report

We have audited the consolidated financial statements prepared by Deutsche Pfandbriefbank AG, Munich – the balance sheet, the income statement, the statement of comprehensive income, statement of changes in equity, cash flow statement and notes to the consolidated financial statements – together with the group management report for the business year from 1 January to 31 December 2011. 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 § 315a 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 § 315a 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, 15 March 2012

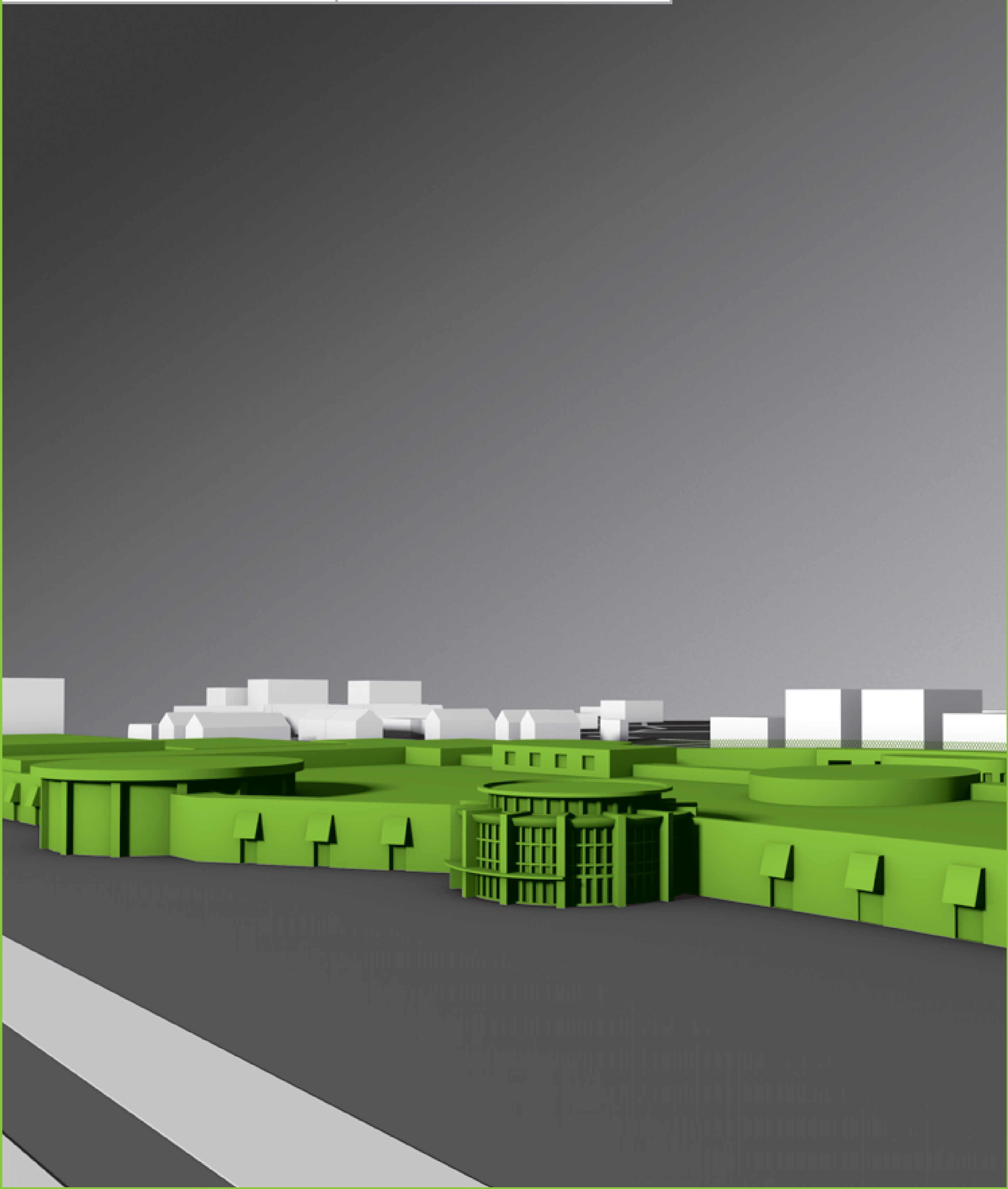
KPMG AG
Wirtschaftsprüfungsgesellschaft
[original German version signed by:]

Wiechens	Muschick
Wirtschaftsprüfer	Wirtschaftsprüfer
[German Public Auditor]	[German Public Auditor]

IMMOFINANZ Group Silesia City Center € 210 million

Refinancing & Development loans (Club Deal)
Katowice, Poland
October 2011

In a club deal, Hessische Landesbank (Helaba) and pbb are providing a refinancing and development facility to IMMOFINANZ Group for the prime shopping centre, the Silesia City Center, in Katowice, Poland. It is the largest and most modern shopping centre in the dynamic region Upper Silesia. Due to high interest by retailers, the centre was extended from 66,000 m² to 86,000 m² rentable space.



Service Chapter

Service Chapter
Glossary

Advanced approach Under the advanced approach method, a bank with a sufficiently developed internal capital allocation procedure (strict criteria in terms of methodology and disclosure) is permitted to use its internal assessments regarding the credit standing of a debtor when assessing the lending risk within its portfolio. There are specialised analysis procedures for different types of loan commitments – e.g. loans to companies and retail customers – that exhibit different loss characteristics.

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 » held-to-maturity financial instruments. Available-for-sale financial instruments include in particular fixed-income securities that cannot or should not be held to maturity and also equity instruments with no final maturity.

Asset-liability management Measures by a bank to control the balance sheet structure and to limit the risks resulting from differences in time periods and insufficient liquidity.

Asset-covered security (ACS) Covered bond subject to the laws of Ireland.

Asset-backed security A bond or note that is based on pools of assets.

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.

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.

BIS Bank for International Settlements headquartered in Basel; as the central bank of the central banks, it is in particular responsible for cross-border banking supervision and for the establishment of internationally valid equity capital requirements for supraregionally operating banks.

BIS equity funds Equity capital that is recognised for regulatory purposes and complies with the Recommendation on Equity issued by the Basel Committee for Banking Supervision in July 1988 (last amended in January 1996) for financial institutes operating on the international stage. It comprises liable equity capital (core capital and supplementary capital) and Tier III capital:

> Core capital or Tier I capital largely subscribed capital, reserves and certain hybrid capital instruments.
> Supplementary capital or Tier II capital includes in particular participatory capital, long-term subordinated liabilities, unrealised gains from listed securities and other valuation adjustments for inherent risks.
> Tier III capital mainly comprises short-term subordinated liabilities and surplus supplementary capital.

Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) 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.

Capacity to meet interest payments Degree to which the rental income from a financed building must, in long-term financing, at least cover the interest service payments. Ratio: DSC (debt service coverage).

Cash flow Equals cash receipts minus cash payments over a given period of time.

Cash-flow hedge Security against the risk of loss of future interest payments under a variable-interest balance sheet transaction obtained by means of a » swap.

Collateralised Debt Obligation (CDO) Collateralised Debt Obligations (CDOs) represent a segment of » asset-backed securities. It represents a debenture bond that is secured by a diversified debt portfolio. A collateralised debt obligation is usually divided into different slices of varying creditworthiness. Usually CDOs are classified according to the object of their investment. If debenture bonds are sold, then one is dealing with so-called cash CDOs – if, however, instead of real bonds their risks alone are sold, these are called synthetic CDOs.

Collateralised Loan Obligation (CLO) Collateralised Loan Obligations (CLOs) constitute a segment of » Asset Backed Securities. These are securities which are backed by loans

Commercial mortgage-backed security (CMBS) A type of » mortgage-backed security (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 default swap (CDS) Financial contract where the risk of a credit event that is specified in advance (e.g. insolvency or deterioration in credit standing) is transferred by an assignee to a guarantor. Irrespective of whether or not the credit event materialises, the guarantor receives a regular premium payment from the assignee for assuming the lending risk.

Credit derivatives Derivative financial instruments that allow one party to the transaction (assignee) to transfer the lending risk relating to a loan or a security to another party (guarantor) against payment of a premium. The risk purchaser therefore bears the lending risk relating to the loan or security without actually having to purchase it (e.g. » credit default swap, » total return swap or » credit-linked note).

Credit-linked notes (CLN) A note issued by an assignee that is only repaid at the nominal value on maturity if a previously specified credit event does not materialise on the side of the debtor. If the credit event does actually occur, the credit-linked note is repaid after deducting the agreed compensatory amount. In contrast to credit default swaps and total return swaps, the guarantor receives his monetary payment in advance from the assignee.

Credit risk Credit risks include the loan default risk, counterparty risk, issuer risk and country risk; they refer to the potential loss that could result from the default or deterioration in credit ratings of loan customers, of issuers of borrowers' note loans, promissory notes and debt securities, or of counterparties in money market, securities and derivatives transactions.

Credit risk management (CRM) Systematic recognition and valuation of » credit risks as well as the management of responses to credit risks which are identified.

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.

Default probability Expected average probability that a business partner will fail to fulfil his obligations, based on statistical analyses of historic default patterns.

Default risk Risk of partial or total loss of a loan.

Deferred compensation An arrangement in which a portion of the wage is paid out at a date after which that income is actually earned.

Deferred taxes Taxes on income that are payable or receivable at a future date and that result from different carrying amounts being shown in the financial and commercial balance sheets. On the reporting date, they do not yet represent actual receivables or liabilities vis-à-vis tax authorities.

Deutsches Rechnungslegung Standards Committee (DRSC) 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.

European Central Bank (ECB) 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.

Expected loss (EL) Expected loss measured against a time horizon of one year – is the product of EaD, PD and LGD.

Exposure at Default (EaD) 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.

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).

Fair value through Profit or Loss (FVtPL) 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.

Financial Market Stabilisation Act (FMStG) This was fast-tracked through Parliament on 17 October 2008. The act enables a package of measures to be implemented for stabilising the financial market. The main component of the act is the establishment of the financial market stabilisation fund.

Financial market stabilisation fund (SoFFin) This was created by the Financial Market Stabilisation Act on 17 October 2008. The aim of the fund is to stabilise the German financial system, to overcome the liquidity shortages and to strengthen the capital base of financial companies. The range of services provided by the fund includes the provision of guarantees (up to € 400 billion) as well as recapitalisation and risk acceptance (up to €70 billion).

Financial instruments This term is in particular used to summarise credits and loans extended, interest-bearing securities, shares, participating interests, liabilities and derivatives.

Foreign exchange (FX) The foreign exchange market (FX market) is defined as the global market on which currencies are traded.

Forward transactions The purchase/sale of financial instruments on a fixed date and at a fixed price; a distinction is made between contingent forward transactions (» options) and unconditional forward transactions (» futures). In contrast to spot transactions, the date when the contract is concluded and the date of performance for the contract are different.

Futures Contracts that are standardised in terms of volume, quality and settlement date under which a trading item belonging to the money market, investment market, precious metals market or currency market is to be delivered or purchased on a specific future date at the specified market price. In many cases, a balancing payment has to be effected in place of delivering or purchasing securities.

German Minimum Requirements for Risk Management of Credit Institutions (MaRisk) 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.

Hedge accounting Depiction of contrary developments in the values of a hedging transaction (e.g. an interest rate swap) and an underlying transaction (e.g. a loan). Hedge accounting aims to minimise the impact on the income statement of the valuation and the recording of valuation results from derivative transactions where such valuation and recording affects net profit or loss.

Hedging Transactions aimed at protecting against the risk of unfavourable price trends (e.g. currency and interest rate risks). A matching position is set up for each position, so that the risk is offset either in whole or in part.

Held to maturity (HtM) Financial assets acquired by third parties that have a fixed maturity and fixed or determinable payments, where the holder intends or is able to hold the asset until final maturity.

Hybrid capital instruments Investment instruments that are characterised by profit-related interest payments. Where interest payments that have not been made when losses have occurred are not paid at a later date (noncumulative hybrid capital instruments) and the instruments do not have a fixed maturity date and/or cannot be terminated by the creditor, then in accordance with regulatory requirements such instruments belong to the core capital. In all other cases, they must be allocated to the supplementary capital (e.g. cumulative hybrid capital instruments).

International Accounting Standards (IAS) Accounting standards issued by the IASC (International Accounting Standards Committee), a specialist international organisation backed by professional associations that deal with accounting issues. The aim is to develop transparent and comparable international accounting systems.

International Accounting Standards Board (IASB) The IASB is an independent board of international accounting experts which is responsible for developing and as necessary revising the » International Financial Reporting Standards (IFRS).

Internal Capital Adequacy Assessment Process (ICAAP) 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.

International Financial Reporting Standards (IFRS) The IFRS include the present International Accounting Standards (>> IAS) and the interpretations of the Standing Interpretations Committee as well as all standards and interpretations issued in future by the IASB (International Accounting Standards Board).

International Monetary Fund (IMF) International organization for creating structured monetary relations between the member states with registered offices in Washington, D.C.

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.

Loans and receivables (LaR) 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.

Loan-to-value (LTV) also: Calculated mortgage lending value Relationship between the funds loaned to the borrower and the value of the collateral.

Loss-given default (LGD) LGD is the fraction of exposure at default that will not be recovered following default.

Market risk Results from uncertainty surrounding changes in market prices and rates (including interest rates, share prices, exchange rates and commodity prices) and also from the correlations between them and their levels of volatility.

Market risk position The market risk position pursuant to Principle I includes foreign currency, commodity and options risks as well 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.

Mortgage-backed securities (MBS) Securitisation of mortgage loans for precise control and reduction of lending risks. MBS are securities whose interest and redemption payments are linked to the payment performance of a pool of loans secured by real estate liens.

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.

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.

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).

Residential Mortgage-Backed Securities RMBS are >> Mortgage-Backed Securities (MBS) which securitise residential mortgages.

Return on equity Ratio showing the relationship between the net income for the year, or a pre-tax performance measure (e.g. pre-tax profit), and average equity capital; indicates the return on the capital put to work by the company or its owners.

Risk assets To be able to map the assets book >> credit risks resulting from the differing credit standings of issuers and/or business partners in accordance with regulatory requirements, balance sheet assets, off-balance-sheet transactions (e.g. warranties and guarantees for balance sheet assets) as well as >> forward transactions, >> swaps and >> option rights are weighted with respect to risk using rate-weighting factors that depend on the rating category of the issuers and/or business partners. Under Principle I, these risk-weighted assets must be backed by 8% liable equity capital.

Risk control Risk Control is responsible for implementing the risk policy prescribed by the Management Board, for the neutral monitoring of lending, market and operational risks, as well as for analysing and reporting on the current and future risk situation. Risk Control is also responsible for specifying measurement and evaluation methods as well as for subsequently carrying out measurements and evaluations of risk and risk results and/or limit controls.

Risk management The taking of business decisions at operational level, portfolio management and/or optimisation of risks in the widest sense of the word on the basis of risk/reward factors (e.g. assignment of lines for credit risks, credit derivatives, etc.) within the strategic framework defined by the Management Board and in accordance with the authorisations issued by the Management Board bestowing direct responsibility for risks and results.

Secondary risk Risk that any losses in rental income on the part of the borrower may jeopardise the capacity to meet interest payments.

Securitisation Securities-based collateralisation and/or conversion of loans (e.g. through bonds) to procure funds. The prime aim is to make the loans tradable on organised investment markets (e.g. stock exchanges). The supplier of capital (= creditor) and therefore the purchaser of the securitised loan assumes the risk of fluctuations in market prices and of loan losses; the borrower (= debtor) must provide regular public proof of his credit standing by means of regular reporting and/or of the highest possible rating by a rating agency.

Segment reporting Breakdown of the total consolidated values by individual segments, e.g. by areas of activity (divisions) or geographical characteristics (regions); this enables conclusions to be drawn regarding performance in individual segments and their contribution to the consolidated result.

Self-assessment Self-assessment is a process whereby the operational risks and the measures taken to minimise risks are regularly identified and evaluated by procedure officers, i.e. by those individuals who are best able to assess the strengths and weaknesses of procedures. In addition to identifying and evaluating risks, self-assessment also provides the basis for drawing up an action plan to open up opportunities for improvement, as well as for the development of risk awareness at all levels within the Bank.

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.

Special-purpose vehicle (SPV) 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.

Supervisory Review and Evaluation Process (SREP) 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 I ratio This ratio is also referred to as the BIS core capital ratio and represents the ratio of a company's risk assets determined in accordance with the provisions of the Bank for International Settlements (BIS) plus its market risk positions to its core capital (see also BIS equity funds).

Trading book Banking regulatory term for positions in financial instruments, interests and tradable loans that are held by a financial institute for the purpose of short-term resale, benefiting from price and interest rate fluctuations. This also includes transactions that are closely related to trading-book positions (e.g. for hedging purposes). Risk-carrying positions that do not belong in the trading book are assigned to the » assets book.

Treasury Division pooling the areas of refinancing and liquidity control, asset/liability management, fixed-income and own-account trading.

Vacancy rate Average percentage of all real estate space that is not used or rented out.

Value at risk Method for quantifying risk; measures the potential future losses that with a certain degree of probability will not be exceeded within a specified period of time.

Financial Calendar

Financial Calendar	
29 March 2012	Publication of the Annual Report for the year 2011
22 May 2012	Publication of the results for the first quarter of 2012
14 August 2012	Publication of the results for the second quarter of 2012
13 November 2012	Publication of the results for the third quarter of 2012

Future-oriented Statements
Internet Service

Future-oriented Statements

This report contains future-oriented statements in the form of intentions, assumptions, expectations or forecasts. These statements are based on the plans, estimates and predictions currently available to the management of Deutsche Pfandbriefbank AG. Future-oriented statements therefore only apply on the day on which they are made. We do not undertake any obligation to update such statements in light of new information or future events. By their nature, future-oriented statements contain risks and factors of uncertainty. A number of important factors can contribute to actual results deviating considerably from future-oriented statements. Such factors include the condition of the financial markets in Germany, Europe and the USA, the possible default of borrowers or counterparties of trading companies, the reliability of our principles, procedures and methods for risk management as well as other risks associated with our business activity.

Internet Service

Visit us at the World Wide Web:
www.pfandbriefbank.com

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