

Annual Report 2008

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The German version of the Annual Report is the original and authoritative version.

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# Management Report

## 1. Business activity and general conditions

**1.1. General economic conditions** The year 2008 saw massive macroeconomic problems, which reached a significant peak in particular in October 2008. Although a financial crisis was already being mentioned in 2007, in 2008, it began to have a more or less vehement effect on the real economy.

As a result, global economic growth in 2008 sank by almost half to just 2.1 %. Economic momentum became significantly weaker in all important national economies. In the USA, growth in the real gross domestic product was again recorded at around 1.2 % and in Germany at around 1.4 %. In the Asian countries too, the rate of growth fell to 3.4 %. Even China, which was still experiencing robust growth of 9 %, failed to achieve double-digit growth for the first time since 2003 – despite the Olympic Games. The important aspect here is that in real economic terms, 2008 began significantly better in all respects, but the economic problems around the world became more clearly noticeable throughout the course of the year.

The problems in the financial sector that have become apparent since summer 2007 reached a massive peak in 2008. The collapse of the Lehman Brothers investment bank in September 2008 was “only” the most high-profile of these. Even before that, the two large American real estate financing bodies Fannie Mae and Freddie Mac were subject to de facto nationalisation. On the day after Lehman Brothers went bankrupt, the US government had to take over the majority of the country’s largest insurer, AIG. Even though Europe has been able to avoid insolvency on the part of larger financial institutions, there were still huge problems here. Banks were offered very extensive government assistance both in the USA and Europe in order to avoid a crisis in the system, which, by autumn of 2008, was no longer completely unthinkable.

A significantly expansive monetary policy played an important role in relieving the financial industry, with support from the real economy. During the year, the base rate in the USA was reduced in several stages from an initial rate of 4.25 % to its historically lowest level of 0.25 %. The European Central Bank, on the other hand, kept interest rates for the main refinancing rate at a con-

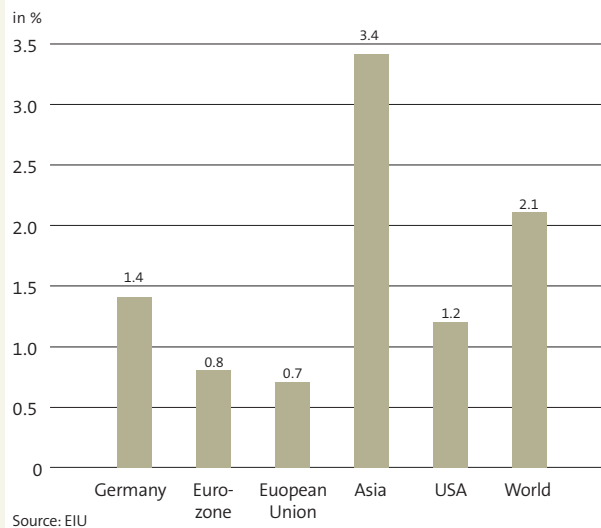
stant 4.0 % in the first half of the year and even temporarily increased it in July 2008 by 25 base points as a result of the risk of inflation driven mainly by oil prices. Only after the aforementioned events on the financial markets in autumn 2008 were interest rates in the eurozone also decreased to 2.5 % in several steps between the middle of October and the end of the year. At the beginning of 2009, this expansive monetary course continued. The same could also be said with regard to fiscal policy, which is clearly on an expansive course in both the USA and the eurozone, and more recently in Asia, with action being taken to support economies.

The stock markets, which had been experiencing growth worldwide up to and including 2007, suffered badly during 2008. During the course of the year, the American benchmark index (Dow Jones Industrials) lost a good third of its value, while both Germany and Japan recorded a loss in excess of 40 %. From these figures alone, it can be seen that there has been a high level of correlation between developments on the various stock exchanges.

After oil prices rose by more than 50 % in 2007, they reached an all-time high in July 2008. The price for a barrel of Brent oil on 11 July 2008 was US\$ 145.61. After that, however, prices began to drop to an extent that had not been anticipated, with the nominal price reaching US\$ 36.24 at the end of the year – less than a quarter (!) of the highest price. This also shows that OPEC’s cartel power, about which so many claims are often made, does not really have such a significant influence. All the same, this resulted in a significant reduction in the inflation pressure from the middle of the year. For the European Central Bank, this was a necessary requirement for the aforementioned interest rate reduction steps.

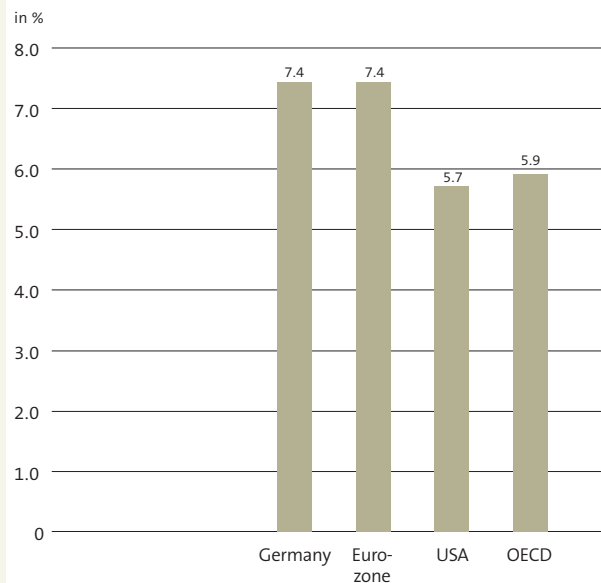
- Real GDP growth for the World, USA, Asia, the European Union, the Eurozone, Germany

**Real GDP growth 2008**



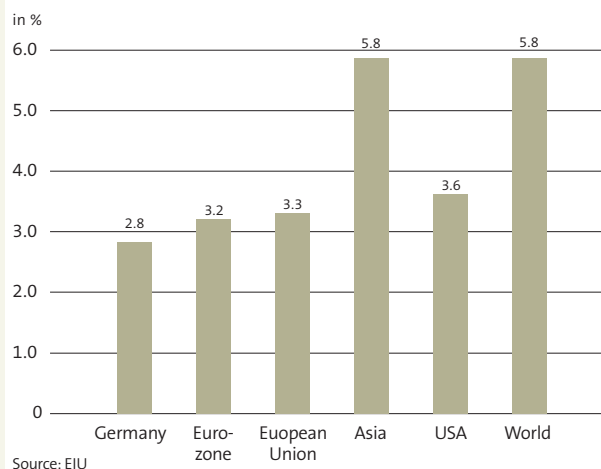
- Unemployment rates for OECD, USA, the Eurozone, Germany

**Unemployment rates 2008**



- Consumer price inflation for the World, USA, Asia, the European Union, the Eurozone, Germany

**Consumer price inflation 2008**



**1.2. Branch-specific conditions** The market for state financing is not uniform within Europe – not all market participants are active in all country. Despite scattered market distortions in the first half of 2008, the public financing market continued, although margins increased. In the second half of 2008, in particular as a result of the credit problems after the Lehmann bankruptcy, there was enormous commotion in this market.

In the time following September 2008, which was critical, several traditional investment banks withdrew from the market in the large public finance markets – Germany, France, Italy and the Iberian Peninsula. At the same time, special institutions active in this sector suffered massive refinancing difficulties, resulting in not much liquidity being available in December 2008. The only participants who were able to act during this time were government-controlled banks and agencies (some of them have been commissioned with the task of making money available to the public sector as a “last resort”). In some EU countries, the public sector was not

obliged to take on larger sums (e.g. in Germany, to a lesser extent in France, the Iberian peninsula and in Scandinavia). In these countries, the effects of the crisis were therefore not felt so strongly at this time. Many market participants are staying away from the capital markets. Some of those who were obliged to obtain financing attempted to negotiate bilateral agreements with the corresponding lenders. In fact, there were also real “victims”, such as Iceland. Towards the end of 2008, capital markets offered clients very limited possibilities for refinancing, investors’ increasing risk aversion reduced the sources of financing enormously, and transactions in the area of guaranteed securities and structured bonds were hardly being performed even in the most well known companies.

### 1.3. Group and company-specific business conditions

**1.3.1. Measures for stabilising the Hypo Real Estate Group**  
Hypo Pfandbrief Bank International S.A. is a member of Hypo Real Estate as a 100 % subsidiary of the DEPFA Bank PLC. The Hypo Real Estate Group has been receiving substantial support measures since the culminating months of 2008 from a consortium from the German Finance Sector and the German Federal Central Bank, along with the federal government and the German Financial Market Stabilization Funds (SoFFin). The liquidity shortage at the DEPFA Bank PLC that threatened the collapse of the bank was initially met with liquidity facilitations and state guarantees. The survival of other companies of the Hypo Real Estate Group, and thus also the Hypo Pfandbrief Bank International S.A. was jeopardised owing to the internal relations of the DEPFA Bank PLC. Reacting to the crisis in December 2008, the management enacted a strategic reorientation and restructuring of the Hypo Real Estate Group.

**Causes of the crisis** In September 2008, the financial market crisis that intensified significantly over 2008 resulted in partial or complete breakdown of individual capital and financial markets. After applying for creditor protection by US-American investment bank Lehman Brothers, from mid-September 2008 onwards, particularly the interbank market, meaning the market where banks lend money to one another, nearly came to a grinding halt. The cause was the continuing loss of trust between the banks, since the risk of a credit granted on the interbank market could not be assessed owing to the potential problems of the debtor bank.

The conduct of the market participants changed significantly. Firstly, the transactions on the money and interbank market or reverse repos were not prolonged. Secondly, the intraday lines, meaning very short-term credit lines, were eliminated. Thirdly, the banks, akin to the Hypo Real Estate Group, had to offer higher cash collaterals, i.e. cash deposits. As a result, the DEPFA Bank PLC, which has been a 100 % subsidiary of the Hypo Real Estate Holding AG since 2 October 2007, experienced a liquidity squeeze that jeopardised its survival. The DEPFA Bank PLC had, in the past, expanded its business volume. To a significant extent, the refinancing was dependent on the interbank market and other short-term, unsecured refinancing possibilities, especially deposits of US-American money market funds. Short-term refinanced funds were issued over long-term in great measure. This business model proved not to be crisis-proof. Generating liquidity through sales of assets was possible only to a limited extent in 2008 owing to the illiquid markets and the strongly expanded spreads. Relations within the Group, such as claims, guarantees and comfort letters also brought about the precarious situation for most companies of the Hypo Real Estate Group, such as the Hypo Pfandbrief Bank International S.A.

**Measures for securing liquidity of the Hypo Real Estate Group** Toward the end of September 2008, in response to the precarious liquidity situation, the Hypo Real Estate Group undertook to hold talks with a consortium from the German financial sector. In two sittings, the federal government, German Federal Central Bank, Federal Financial Supervisory Authority (BaFin) and the top representatives of the German Credit and Insurance Association agreed to additional credit lines for the companies of the Hypo Real Estate Group. In the first round, on 28 September 2008, a capital support measure for the amount of € 35 billion was negotiated. On 5 October 2008, in the second round, this support measure was increased to € 50 billion. The bailout measures are represented as follows:

A special liquidity line was granted by the German Federal Central Bank for the amount of € 35 billion. Furthermore, on 28 October 2008 the Hypo Real Estate Group applied to the German Financial Market Stabilising Funds (SoFFin) for financial guarantee for the provision of liquidity through the German Federal

Central Bank for the amount of € 15 billion. The German Financial Market Stabilising Funds (SoFFin) acceded to the request for financial guarantee on 30 October 2008. The Hypo Real Estate Group could gain access to a further special liquidity assistance from the German Federal Central Bank to the amount of € 15 billion, as interim financing, by submitting this guaranteed debenture bond. The average costs of this liquidity loan exceeded the highest refinancing rate of the German Federal Central Bank by over 250 basis points.

Both capital support measures were released on 13 November 2008 through the credit lines made available by the German Federal Central Bank and the financial sector to the amount of € 50 billion. In particular, this refers to the state-guaranteed loan in the form of liquidity assistance for the amount of 20 billion by the German Federal Central Bank, the issuance of state-guaranteed European Central Bank (ECB) qualified bearer bonds to the amount of € 15 billion, and the issuance of secured debentures to the amount of € 15 billion. Based on the contractual agreements and current interest reference rates, the costs of the liquidity facilitation correspond on average to an ongoing interest margin of 93 basis points p.a. above the three-month EURIBOR. In addition, a debtor warrant has been negotiated with costs of an additional 90 basis points on average p.a. that can be operated cumulatively over seven years, as long as the Group attains a positive result, pre-tax, in the respective financial year, and it (debtor warrant) is limited to a maximum of € 100 million p.a. in the years 2009-2011, or maximum € 150 million in the years 2012 – 2015. The contracts on the liquidity lines with the German Finance Consortium, the German Federal Central Bank, and with the Federal Finance Ministry were signed in November 2008. The liquidity lines were made fully available on 13 November 2008. The liquidity credit assistance and the state guaranteed bearer bonds are due on 31 March 2009.

Furthermore, the German Financial Market Stabilising funds (SoFFin) has guaranteed the Hypo Real Estate Group, in many phases until 3 March 2009, an amount equal to € 52 billion. In the first phase, the German Financial Market Stabilising Funds (SoFFin) offered a guarantee, on 21 November 2008, on € 20 billion. This guarantee was supplemented on 9 December 2008 on similar conditions and for the same duration by an

additional sum of € 10 billion to € 30 billion. The Hypo Real Estate Bank AG, belonging to the Hypo Real Estate Group, could use the guarantees provided by the German Financial Market Stabilising Funds (SoFFin) for collaterals on the debentures to be issued that were due for repayment on 15 January 2009. On 15 January 2009, the guarantee was extended to 15 April 2009. In addition, the German Financial Market Stabilising Funds (SoFFin) increased the guarantee on 20 January 2009 by an additional € 12 billion. In a further step, on 11 February 2009, the Hypo Real Estate Group received an additional guarantee of over € 10 billion until 12 June 2009 from the German Financial Market Stabilising Funds (SoFFin). The Hypo Real Estate Bank AG, which is a part of the Hypo Real Estate Group, issued bearer bonds and thereby covered the short-to-medium-term liquidity requirements of the Group. These debentures are due for repayment on 14 May 2009. The liquidity serves the purpose of repaying due interbank credit and loans, as well as customer deposits. Moreover, with this liquidity, the Hypo Real Estate Group offers additional collaterals in favor of other market participants, central banks, and investors. This is partly due to the extreme strain on international finance markets. The Hypo Real Estate Bank AG paid a commitment fee, calculated pro rata, to the German Financial Market Stabilization Funds (SoFFin) of 0.1 % on the portion of the guarantee which had not been claimed. For guarantees issued, a fee for the amount of 1.5 % p.a. was due by 15 January 2009, and past that date, a fee of 0.5 % is to be paid.

The Hypo Real Estate Holding AG, as well as its significant subsidiaries (Hypo Pfandbrief Bank International S.A. et al.) have transferred or pledged, within the framework of the business with the Consortium from the German financial sector and the German Federal Central Bank, with the involvement of the federal government, almost all available assets to the total nominal value of about € 60 billion as security to collateral agents of the creditors. Furthermore, the Hypo Real Estate Holding AG has pledged the shares to the Hypo Real Estate Bank AG, DEPFA Deutsche Pfandbriefbank AG and the DEPFA Bank PLC as security for the federal guarantee.

Apart from entering into short and medium-term liquidity guarantees, the Hypo Real Estate Group is in late-stage talks with the German Financial Market

Stabilising Funds (SoFFin) on a long-term support through equity participation and liquidity assistance. The Hypo Real Estate Group expects the discussions to conclude soon.

**Restructuring and strategic reorientation of the Hypo Real Estate Group** The board of directors and the supervisory board of the Hypo Real Estate Group finalised the strategic reorientation and restructuring of the Group on 20 December 2008. The company has adapted its business model to the irrevocably changed circumstances of the capital markets and the growing challenges in the real estate business. The intended result of the strategic reorientation is the positioning of the Hypo Real Estate Group as a leading real estate and public financier specialist in Germany and Europe with covered Pfandbrief-oriented refinancing. The structural cost basis will be lowered; balance structure and risk profile will be improved. The corporate structure should be further simplified. The corresponding measures will be implemented in the next three years.

In the area of business real estate financing, the Group will position itself as a partner for the real estate investors in Germany and the important European markets. New business in this area will be generated in future from Munich, London, and Paris. In the area of financing the state, the future activities concentrate on the chosen primary market business in European markets for Pfandbriefe, as well as on the management of the existing business. In the course of this focus, the location of the area is centralised. New business in the domain of infrastructure financing is not intended. Capital market and trading transactions that are not line with the business model shall be terminated. A sale of non-strategic activities shall be considered. The customer related derivatives business shall be continued.

The change in the business model goes hand in hand with a decline in the annual running costs until 2011 by about € 200 million, and until 2013 by about € 250 million. The number of the employees that currently stands at about 1,800 will drop to about 1,000 in the next three years. Of those jobs, two-thirds are placed outside of Germany. With the conclusion of the planned IT-investment programs, an additional 200 jobs approximately will be dispensed with by 2013. The aim of the investment program is the harmonisation and standardisation of the IT land-

scape in the Hypo Real Estate Group.

After the merger of the former Hypo Real Estate Bank International AG with the Hypo Real Estate Bank AG, the next step will be to strive for a merger of the DEPFA Deutsche Pfandbriefbank AG with the Hypo Real Estate Bank AG.

In addition, the Hypo Real Estate Group undertakes to inspect its compensation system with regard to its incentivisation and suitability, and to see to it that they do not induce assumption of unreasonable risks, and are transparent as well as focused on long-term and sustained goals. Moreover, the companies of the Hypo Real Estate Group grant the contracting parties the right to information and the right to inspection.

Furthermore, the board of directors has appointed a new group-wide treasury organisation. The decentralised structure up to now, under which the refinancing activities of the Hypo Real Estate group were being operated by the respective business divisions, has been removed.

**1.3.2. Company-specific business conditions** Hypo Pfandbrief Bank International S.A. reacted to these continuing difficult conditions by exercising restraint in new credit business and in issuing activities.

In 2008 the Bank's main focus was on securing liquidity at all times. In the first half of the year Hypo Pfandbrief Bank International S.A.'s good contacts in the interbank money market proved advantageous. As a result of the high quality of its investment holdings the Bank was in a position at all times during this period to guarantee its liquidity needs from pension and tender transactions. Excess liquidity was invested in the Group. The fact that in the past Hypo Pfandbrief Bank International S.A. has placed great value not only on quality, but also on liquidity (held in a manner that would allow repo transactions / ECB eligibility) has once more paid off.

Hypo Pfandbrief Bank International S.A. was also unable to avoid the negative implications of the financial crisis for the liquidity position and therefore the ability of the Hypo Real Estate Group to survive in the 2nd half of the year. Access to repo transactions with external partners almost completely dried up in the 4th quarter. As a result of the high quality of the assets, it was, how-

ever, possible to expand tender business with the central bank with the result that Hypo Pfandbrief Bank International S.A. only had to make use of the assistance packages of a German Finance Consortium and the German Financial Market Stabilisation Fund (SoFFin) to a slight degree in 2008 (as described in Point 1.3.1.). The claims were made indirectly via DEPFA Bank PLC, Dublin and Real Estate Bank, Munich.

As a result of the high quality of the underlying stock Hypo Pfandbrief Bank International S.A.'s public bonds (Lettres de Gage Publiques) have retained an AAA rating from the ratings agency Standard & Poors. This rating was confirmed on 16 December 2008, although at watch negative as a result of the strained situation within the Group. In October 2008, Standard & Poors reduced the counterparty rating for Hypo Pfandbrief Bank International S.A. most recently as part of the financial crisis with all other units of the Hypo Real Estate Group to BBB with the outlook "developing". The short-term rating was set at A-2 on 24 October 2008.

As a result of the transfer of Hypo Public Finance Bank's business activities to DEPFA Bank plc as of 31 March 2008, DEPFA Bank PLC became the sole shareholder. As of 1 April 2008, Hypo Pfandbrief Bank obtained a comprehensive guarantee from DEPFA Bank PLC.

The Board of Directors of Hypo Pfandbrief Bank International S.A. held various meetings in 2008 and performed several circular resolutions, which advised on procedures that must be reported and made decisions on them in accordance with the Bank's Articles of Association and rules of procedure. The main focus of these was not only the adoption of the annual financial statements for 2007, but also the continued existence of the Bank and the provision of guarantees for the Group's rescue package.

At the Annual General Meeting on 26 March 2008, Mr. Bo Heide-Ottosen (as the chairman), Ms. Julia Hoggett and Mr. Jim Ryan were appointed as new members of the Board of Directors. They replaced Dr. Robert Grassinger, Ms. Heather Nesbitt, Ms. Orla Nicholson, Mr. James Campbell and Mr. Michael Schultheiss as members of the Board of Directors. Mr. Hagen Schmidt and Mr. Klaus Söllner were confirmed as members of

the Board of Directors. Mr. Bo Heide-Ottosen left the body on 29 September 2008. On 9 October 2008, the Annual General Meeting appointed Dr. Fell as a new member and chairman of the Board of Directors. Mr. Jim Ryan left the body on 10 November 2008 and Mr. James Campbell was appointed as a new member as of 10 November 2008.

The management kept the local supervisory authorities (CSSF und Banque Centrale de Luxembourg), as well as the external auditors and trustees informed at all times of the developments in the Group and in the Bank in a comprehensive and timely manner.

A particular challenge during the first half of 2008 was the implementation of the new reporting regulations (FinRep/CoReP). The Bank was able to submit all reports and meet all requirements on time and in the prescribed format.

## 2. Economic report

**2.1. Development of the earnings position** Despite the difficult environment, Hypo Pfandbrief Bank International S.A. was able to continue positive development in its results. The previous year's after-tax profit of € 7.3 million was matched. At € 11.3 million, income before risk provisions increased by 65.1 % in comparison with 2007 (€ 6.8 million). Additions to risk provisions were made only in line with taxation regulations. No impairments of performance were observed and are also not expected at this point in time.

As a result of efficient management of interest and liquidity, it was possible to increase net interest income by 39.6 % in comparison with the previous year. Value adjustments on account of foreseeable persistent declines in value did not have to be made. In compliance with the tax provisions in force in Luxembourg, the option of a general charge for bad and doubtful debts has been used to secure against latent credit risks by increasing this provision by € 3.0 million. Administrative expenses increased in comparison with 2007 by 4.4 % in particular as a result of increased IT costs. Provisions of € 1.1 million have been formed for possible restructuring. The cost-income ratio continued to decrease to 26.1 % (previous year: 34.0 %).

<b>Profit and loss account in tabular form</b>			
in thousand €			
		<b>31.12.2008</b>	<b>Previous year</b>
Net interest income		16,357	11,717
Net commission income		-713	-471
Net income from financial operations		105	-744
Staff costs	-1,485		-1,753
Other administrative expenses	-2,511		-2,041
Depreciation in respect of property, plant and equipment	-289		-313
Administrative expenses		-4,286	-4,107
Other operating income/expenses		-170	447
Operating result before risk provisions		11,293	6,842
Capital gains/losses in respect of investment holdings		-57	3,452
Risk provisions		-3,000	-1,500
Operating result after risk provisions		8,236	8,794
Taxes		-936	-1,494
<b>Net income for the year</b>		<b>7,300</b>	<b>7,300</b>

**2.2. Development of the assets situation** The balance-sheet total of Hypo Pfandbrief Bank International S.A. totalled € 9,211 million as of 31 December 2008 after € 10,739 million as of 31 December 2007.

Receivables including securities total € 8,125 million. That corresponds to a decline of 15.9 % in comparison with 31 December 2007 (€ 9,666 million).

In the period under review, the bank did not acquire any securities or bonds. Securities totalling a nominal € 30 million were sold. The decline is therefore almost exclusively due to final maturities and the reduction in borrowing/investments within the Group. Derivatives were only used to hedge risks resulting from market changes.

All securities are assigned to the investment portfolio, where they are valued in accordance with the mitigated lowest-value principle. Value adjustments on account of foreseeable persistent declines in value did not have to be made. As of 31 December 2008, for securities in the investment portfolio with a book value of € 4,587 million, lower market values amounting to € 4,028 million existed. Of these value differences, € 604 million was attributable to changes in credit spreads. The remaining differences in value were covered by opposite interest rate derivatives positions. If business activities were to cease, however, as of the reporting date it is highly probable that write-offs would have to be performed in this amount.

Market prices or prices/curves set by brokers were used for the market values stated here. For securities for which a value of this kind was not available (€ 1,424 million), the prices were derived from comparable, actively traded securities.

**2.3. Development of the financial situation** As shown under 1.3, the capital structure of Hypo Pfandbrief Bank International S.A. has been affected by the developments on the financial markets and in the Hypo Real Estate Group as of 31 December 2008. Nevertheless, in the reporting year, all current commitments were met.

Refinancing capital totals € 8,807 million. These have decreased by 14.5 % in comparison with the end of the previous year (€ 10,303 million).

Public sector Pfandbriefe (Lettres de Gage Publiques) were issued in 2008 to a total of € 323 million. Registered Pfandbriefe and subordinated funds were not issued in the year under review. In 2008, 13 issued Pfandbriefe for a nominal amount of € 1,004.4 million (previous year: € 1,028.9) fell due. A bearer Pfandbriefe for € 15.0 million was repurchased before term and destroyed.

The commercial paper programme was no longer required at the end of the year (end of previous year: € 45 million). Two new issues were performed in 2008 in EUR. The programme ended as of 31 December 2008.

Balance-sheet own capital as at 31 December 2008 came to € 121.3 million, compared with € 114.0 million at the end of the previous year.

**Banking supervisory data** Also from the point of view of banking supervisory law, Hypo Pfandbrief Bank International S.A. showed a regulatory solid own capital endowment as at 31 December 2008. Liable own capital (in accordance with the new reporting regulations – CoREP) came to € 134.9 million as at 31 December 2007. The own-capital ratio (minimum 8 %) stood at 16.2 % at the mid-year point in 2008; the core capital ratio is 12.7 %. A comparison with 2007 is not possible because the new regulations came into force only at 1 January 2009.

**Liquidity** Hypo Pfandbrief Bank International S.A. has at all times complied with the liquidity principles laid down by supervisory law. The key ratio is that of the assets declared to be liquid to outstanding liabilities. Liquidity is deemed to be sufficient if the outstanding liabilities are covered by assets to the extent of at least 30 %. At the reporting date, this ratio for the Bank stood at 57.9 % (previous year: 40.7 %).

Despite the fulfilment of the supervisory law regulations and due to the close integration of Hypo Pfandbrief Bank International S.A. into Hypo Real Estate Group, there is a very close connection with the liquidity position of the parent group. In addition, during the crisis, the correspondent banks removed intraday limits, so that timely payments are only possible taking into consideration possible delays. This makes the dispatching of funds considerably more difficult and increases the demands on liquidity management.

### 3. Risk report

**3.1. Organisation, responsibilities and tasks** As a member of the Hypo Real Estate Group, Hypo Pfandbrief Bank International S.A. is integrated into the methods/processes of the Group's risk identification, measurement, limitation, control and management. In the context of these requirements and the local regulations, the Bank's risk control function monitors the risks in conjunction with the risk control function of DEPFA Bank PLC, Dublin. This unit, which reports directly to a member of the management who is independent of portfolio and risk management, has the following main functions:

- day-to-day risk measurement and monitoring of market, credit, counterparty, foreign exchange and liquidity risks (largely on the basis of the value-at-risk approach)
- daily determination of economic performance
- independent monitoring of the parameters used to measure risk and performance
- implementation of the risk control concepts (in particular ICAAP) prescribed by the central risk control function

The Bank has set up the appropriate reporting channels and control measures for the monitoring and control of individual risks, which keep not only management and the Bank's Board of Directors informed, but also other sections of the Hypo Real Estate Group.

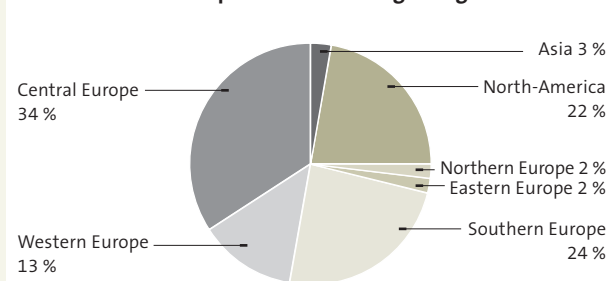
**3.2. Risk measurement, control and management with respect to major types of risk in Hypo Pfandbrief Bank International S.A.**

**3.2.1. Address risks** Address risks may be broken down into credit, counterparty, issuer and country risks and refer in each case to the potential loss of value which may arise in the event of the default or a decrease in credit-worthiness of borrowers, issuers of promissory note loans and securities or counterparties to money-market, securities and derivatives transactions.

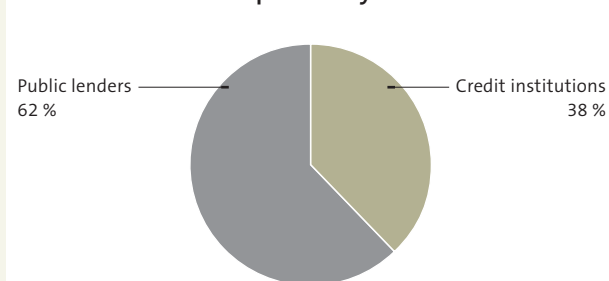
The Bank's exposure to credit risks is restricted to public-sector borrowers and banks in OECD countries. The utilisation of all credit lines is available for each individual counterparty, and also in aggregated form, online on a market-value basis.

The credit portfolio as at 31 December 2008 can be broken down as follows:

**Breakdown of credit portfolio according to region**



**Breakdown of the credit portfolio by borrower**



In the case of organisational measures and the functional separation of credit processes, not only is compliance with the legal conditions in Luxembourg ensured, but also the Bank, as a member of the Hypo Real Estate Group, acts in accordance with the German minimum requirements for risk management (MaRisk).

Counterparty risks designate possible losses in value of interest-rate and foreign-currency based derivatives and futures. Such transactions are concluded predominantly in order to hedge positions in the context of assets/liabilities management. The yardstick for counterparty risks used throughout the Group is a value-at-risk approach based on a market-valuation method using

potential future replacement costs. Counterparty risks outside the group in derivatives, securities and money-market transactions exist with credit institutions, central banks and supranational institutions whose credit-worthiness is to be regarded as above average according to the assessment of external rating agencies and in-house rating procedures. In order to reduce derivatives-based counterparty risks, the Bank uses framework contracts with its business partners which enable the contracts covered by the framework contract to be set against a net claim in the event that the counterparty does not fulfil its obligations (so-called close-out netting). In order to reduce the risk further, where appropriate, security agreements are concluded which may lead to the termination of transactions in the event that the counterparty does not comply with a request to provide security.

The Hypo Real Estate Group designates as country risk the risk of potential transfer and conversion problems with contracting parties based abroad. The risk consists of the possibility that a debtor, who is in principle solvent and willing to pay will not be able to fulfil its payment obligations because it is not in a position to procure foreign currencies or to transfer assets to non-residents on account of measures taken by the state. Country risks are constantly monitored by risk control. Management of country risks by credit-risk management is carried out on the basis of country limits. Depending on the results of the in-house rating process of the Hypo Real Estate Group

- each individual country and
- groups of countries in specific rating corridors

are assigned ceilings restricting business activities. All country ratings and country limits are checked at least once a year by the Hypo Real Estate Group's Risk Management Committee. In addition, in-house risk assessments are regularly checked against the assessments of the major rating agencies.

**3.2.2. Market risk** Market risk refers to the potential loss which may arise as a result of changing prices on financial markets – on account of altered market risk factors (in particular interest rates, currency exchange rates, volatilities). In this connection, as in the case of all banks belonging to the Hypo Real Estate Group, total

lending business, all own issues, the securities making up the investment and liquidity provision holdings and all transactions in derivatives are taken into account.

In doing so, a differentiation is made between general and specialised risks (spread risks). The former measure the possible changes in the present value of positions in the event of shifts in the risk-free interest curve (swap curve). The measurement of spread risks takes account of possible changes in present value in the event that the credit spreads factored in the prices of securities and derivatives alter.

At Hypo Pfandbrief Bank International S.A., as in all banks belonging to the Hypo Real Estate Group, currency risks are hedged as extensively as possible and therefore are present only to a slight extent.

For the purposes of the day-to-day quantification of market risk, Hypo Pfandbrief Bank International S.A. uses value-at-risk approaches. These determine a potential loss assuming a 10-day holding period of the position and a 99 % level of confidence. The period of consideration of historical data is 250 trading days. The value-at-risk is determined daily by risk control at DEPPA Bank PLC, Dublin and reported to local management, the Board of Directors and competent authorities of the Hypo Real Estate Group. The exposure to general interest rate risks as at 31 December 2008 stood at € 3.8 million (previous year: € 1.5 million); general currency risks were at € 0.5 million (previous year: € 0.2 million). The increase in the risk figures here is due to increased volatility in interest rates and exchange rate fluctuations.

Risk measurement systems for credit spreads exist for all relevant positions in the Hypo Real Estate Group and are being continually improved and unified. The increased volatility of the spreads has caused the corresponding value at risk figure to strongly expand in 2008, although the structures and assets do not show any significant changes. However, as HPBI's business model generally holds positions until maturity (particularly for the cover pool), this risk indicator only has limited significance.

The day-to-day determination, limitation and reporting of the value at risk and the present actual value changes are supplemented by regular stress testing. While the

value at risk measures the market risk for “normal” market fluctuations, the simulation of stress scenarios can also measure the potential changes in present value for extreme and extraordinary market movements, so that, in such an event, the continued existence of the company can always be guaranteed. Even under such circumstances, the measured market risk moved within the “normal limits”.

The CSSF circular 08/338 of 19 February 2008 provides for a stress test for credit institutions and investment firms under Luxembourg law, to be carried out on a biannual basis. The interest scenario which is to be applied corresponds to an increase / decrease of all interest rates by 200 base points. For Hypo Pfandbrief Bank International S.A., the potential change in present value for general interest rate risks at the aforementioned interest rate increase as at 31 December 2008 was € -11.8 million and in the case of an interest rate decrease, € 13.5 million.

HPBI is not subject to any further market risks such as equity or inflation risks.

**3.2.3. Liquidity risk** The principal aim of controlling liquidity risks is to guarantee the Bank’s unrestricted solvency at any time. In accordance with the in-house limit system, foreseeable incoming and outgoing payment flows and any liquidity-procuring measures, the so-called liquidity position, must be at least in balance at all times over the following five days. This position is determined daily on the basis of conservative precautionary deductions (“haircuts”), monitored by risk control and reported to Management and the Group bodies responsible for risk supervision. Since the deepening of the financial market crisis, however, it has no longer been possible to comply with these requirements at all times. Since that time, the local supervisory authorities have been informed of the Bank’s liquidity situation at least once each week (occasionally also on a daily basis).

Furthermore, in order to be able to recognise short-term refinancing needs at an early stage, a liquidity preview extended to 90 days is produced independent of trading, which serves as the basis for active and foresighted liquidity policy. In addition, every day a liquidity status is determined on the basis of a rolling thirty-day hori-

zon and reported. This covers all future payment flows, together with the liquidity potential arising out of securities not used for cover, and enables precise liquidity control to be carried out.

In order to obtain short-term liquidity, Hypo Pfandbrief Bank International S.A. is dependent on both tender/repo transactions and indirectly on the German financial aid package and the SoFFin through DEPFA Bank plc, Dublin and Hypo Real Estate Bank, Munich.

**3.2.4. Operational risk / business risk** In the Hypo Real Estate Group, operational risk is defined as the danger of losses caused by erroneous in-house practices, human error, technological failure or external events. This definition includes legal risks. The business risk includes that risk of loss as a result of changes in the external business environment, which have a negative impact on the Bank’s business model.

Since all areas of the Group may be affected by operational risks, the Group has implemented a framework complying with Basle II for the purpose of the uniform identification and control of such risks. The overarching Group-wide framework includes the Group policy for understanding and proactively engaging with this type of risk, together with roles and responsibilities and/or processes and instruments.

Identification, analysis and management come under the responsibility of the individual sectors of the Bank. Operational risk events are therefore compiled in a decentralized manner in the loss database in accordance with uniform group criteria. Hypo Pfandbrief International S.A. did not have such a case to report in 2008. In particular the decentralised assessment of key risk indicators is used to identify early indicators for potential sources of risk in the Group. In order to assess sector-specific operational risks and possible management measures, technically supported risk self-assessment is used.

**3.2.5 ICAAP** In 2008, the overall risk position continued to be determined by means of the aggregation of significant types of risk within the ICAAP. In doing so, the new central “economic capital” approach of the Hypo Real Estate Group was adopted by means of a resolution of the Board of Directors of Hypo Pfandbrief Bank

International S.A. DEPFA Bank PLC, Dublin's risk control function is mainly responsible for performance/analysis/further development.

In this process, the "economic capital" is used as the main unit of measurement for the aggregated risk positions and the capital basis. It is defined as the capital necessary to maintain a certain target rating over a 1-year horizon (as at 31 December 2008 "A" and therefore a confidence interval of 99.95 %).

The aim of the Group is to arrange the level of own capital and instruments equivalent to own capital in such a way that the economic capital exceeds this level at Group level with an appropriate safety factor.

For Hypo Pfandbrief Bank International S.A., economic capital includes the types of risk mentioned above. The risks are performed, if possible and reasonable, in accordance with a statistical method, generally a value-at-risk process. The procedures applied are standard in the industry and are constantly evaluated and adapted by means of participation in surveys, reviews and exchange of information with other market participants.

By far the greatest risk to Hypo Pfandbrief Bank International S.A. results from the effects of the expansion of the spread risks, as can already be seen in the valuation of the securities (see item 2.2).

Stress tests are used to supplement this approach, in order to enable stable control both from the point of view of supervisory law and of economics. The stress tests relevant for Hypo Pfandbrief Bank International S.A. include:

- Downgrade scenarios for the largest counterparties
- Quality scenarios with regard to counterparty risks
- Operational risk/business risk scenarios
- Funding scenarios

The results of the Group-wide ICAAPs and the stress tests are submitted to the Group Management Board and the Risk Management Committee of the Hypo Real Estate Group for approval on a monthly basis. A specific ICAAP for Hypo Pfandbrief Bank International S.A. is submitted to local management every quarter and is presented and discussed in meetings of the Board of Directors.

## 4. Forecast report

**4.1. General economic situation** To an even greater extent than usual, the current presentation and discussion of macroeconomic forecasts must include a warning that they are conditional and therefore necessarily uncertain in nature. With a view to the causal effect of forecasts on the reality being forecast, which is not often taken into consideration, the president of DIW Berlin, Klaus Zimmermann, recently recommended that the profession should even restrain itself from publishing forecasts. In fact, according to macroeconomic theory there are also many empirically proven channels, through which expectations can fulfil themselves.

It must still be generally noted that as a result of the high mutual dependency on both a real economic and also a financial level, an individual country is now less able to escape the influence of the situation in other countries than it was in the past. This means that a good internationally coordinated policy is now more desirable than previously. In fact, a downside to globalisation that is not often considered is that as a result of the high level of integration between both financial and goods markets, there is a trend towards the possibilities of international diversification not being as effective.

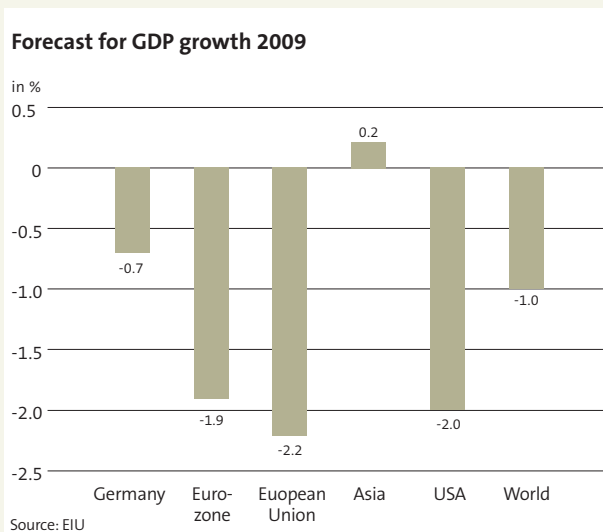
Even though the range of estimates is wide, it can be assumed that the economic downturn will continue in a very pronounced manner and that many regions will experience a significant shrinking of their economies for the first time in many years. As can be seen in the diagram below it is expected that both the European economies and the US economy will shrink by around two percentage points, although there are also significantly more pessimistic forecasts on the market. In summary, the at times very pronounced inflationary pressure in 2007 and 2008 will again disappear. Slight deflation is even expected for the USA in 2009.

The largest and most significant unknown factor in the economic forecast for 2009 is how the financial sector will develop. Last year, the forecast report for 2008 already stated that the need of individual banks to make write-offs could not yet be conclusively assessed, and the same will apply this year. Despite all attempts to assist the financial sector with government support measures, which in Germany were mainly coordinated

via SoFFin, the adjustment in this sector continues. It is still unclear how severe the possible restrictions on credit will end up being for the real economy. This, however, is the ultimate decisive channel through which the financial crisis will be translated into a crisis in the real economy, too.

The development of the employment market in Germany, which remained positive until the end of 2008, will become significantly bleaker in 2009, i.e. unemployment will increase again for the first time since 2003. According to current forecasts, the deterioration of the situation in Germany will still remain relatively moderate in comparison with other industrial nations.

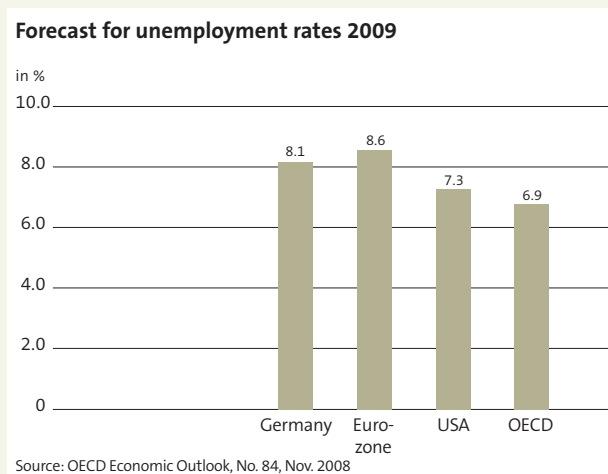
- Real GDP growth for the World, USA, Asia, the European Union, the Eurozone, Germany



- Consumer price inflation for the World, USA, Asia, the European Union, the Eurozone, Germany



- Unemployment rates for OECD, USA, the Eurozone, Germany



## 4.2. Sector-specific situation

**4.2.1. Financial markets** As the financial markets in 2009 are being impacted by severe insecurity, much depends on how quickly and how extensively many banks are able to rectify or stabilise their balance-sheets, reduce their credit portfolios and improve their equity situation. Since all participants will operate on the markets with greater caution, the liquidity will not be available in the usual measure; high-risk premiums will determine how the prices will be ascertained. The possibilities for asset securitisation and sales of receivables will not have any significance in the foreseeable future. The simultaneous, rather insecure, trends of the stock market further exacerbate the situation. The credit offer capped as a result will secure lucrative interest margins to market participants who can refinance themselves by taking recourse to large deposit volumes, or those who have specialised in a business niche, such as a credit business backed by Pfandbriefe.

**4.2.2. Public finance** Public finance will face significant challenges throughout Europe in 2009. On the one hand, many transactions that expire this year must be refinanced, and, on the other hand, the public budgets generally follow long-term investment plans that stretch over several years, and therefore they cannot fully retract their investments. Furthermore, the need for anti-cyclical deficit financing is expected. The somewhat difficult financial situation of some nations, such as Austria, Italy, Greece, Hungary and Ireland, as well as of US-American municipalities can cause a rating downgrading and also lead to payment deficits at municipal level. The interest margins have already increased significantly and that trend will continue, while the terms are reduced. Risk aversion may increase. Overall, liquidity, not prices, is the driving force. Many former participants of the public financing markets must organise their existing portfolios both with regard to credit risks and refinancing; some might withdraw from the market. These factors offer creditors availing of strong refinancing opportunities very margin-attractive business potential with debtors of good creditworthiness.

With the recovery of the financial markets, declining risk-premiums are anticipated, owing to lower refinancing costs. But that cannot be expected prior to 2010.

**4.3. Group- and company-specific situation** The prognoses that apply to the future growth of the Hypo Real Estate Group represent estimations generated on the basis of information available at this time. If the assumptions on which the prognoses are based are not valid, or risks – as those addressed in the risk report – do not appear in the planned amount, then the actual results may deviate from those currently expected.

Most companies in the Hypo Real Estate Group, and thereby also the Hypo Pfandbrief Bank International S.A., were precariously poised from September 2008 onwards. The exact reasons, the development and the measures introduced for stabilising the Hypo Real Estate Group have been described in detail in Section 1.3.1. The Hypo Real Estate Group, and thereby also the Hypo Pfandbrief Bank International S.A., expects to continue operations under the following conditions:

### Exogenous factors

- No legal reservations (especially EU assistance proceedings) or shareholder suits will be enforced against the bailout measures in favour of the Hypo Real Estate Group.
- No further serious intensification of the financial market crisis will occur accompanied by unpredictable consequences, for instance, caused by external shocks, like the breakdown of big states and important banks. The capital market environment will start to stabilise between 2010 and 2012.
- The interbank market and other short-term unsecured refinancing markets, as well as long-term secured and unsecured refinancing markets recover.
- The crisis of the real estate markets does not lead to shortage of credits and securities to an extent that the survival of the company is jeopardised.

### Endogenous factors

- The Hypo Real Estate Group finds access to the secured and unsecured refinancing markets and can replace the financial support of the consortium from the German Financial Sector and the German Federal Central Bank with the participation of the federal government, as well as the German Financial Market Stabilising Funds (SoFFin) through independent refinancing. The preconditions for that are, apart from market access, among others, better ratings for the companies of the Hypo Real Estate Group.

- The Hypo Real Estate Group is successful in regaining the trust of its customers and in contracting new business on attractive conditions.
- The restructuring of the Hypo Real Estate Group leads to an increase in the efficiency and productivity, business operations may be streamlined.
- The Hypo Real Estate Group can successfully rehabilitate malfunctioning financing, or phase it out.
- The new orientation and structure of the Hypo Real Estate Group allows the anticipation of potential crises in the future, or is able to respond to them without endangering the survival of the Group.

If the preconditions are not fulfilled, the continuation of the operations of some or all of the companies of the Hypo Real Estate Group and, consequently, of the Hypo Pfandbrief Bank International S.A. too, will be starkly endangered.

The prognosis of the future growth of the Group is based on the strategic reorientation and restructuring enacted by the board of directors in December 2008 (see section 1.3.1).

Even in case of continued business operations, it is, however, impossible, on account of the currently unpredictable course of the crisis in the capital and financial markets, to reliably assess the future terms and conditions of the market. The international financial markets are fragile and functioning partially, or only under restrictions. Thus, notwithstanding federal rescue packages, the interbank market above all is starkly troubled. On that basis, further strain on the credit economy – and resultantly also on the Hypo Real Estate Group – cannot be ruled out, even in the upcoming quarter. The most significant effects or risks on the asset, finance and success of the Hypo Real Estate Group are represented as follows, and similarly have a direct or indirect influence on the Hypo Pfandbrief Bank International S.A.:

#### Earning position

On account of the points described below, in the upcoming years, the Hypo Real Estate Group will likely not attain a level of distributable profit. Losses are expected at least for the financial years 2009 and 2010.

- The disbursements for the credits and liquidity lines made available by other banks and the German Fed-

eral Central Banks, as well as credits and liquidity lines provided within the scope of the German Financial Market Stabilising Funds (SoFFin), including additional costs for an interim solution to the liquidity shortage by the German Federal Central Bank significantly exceed the refinancing rates up to now (see section 1.3.1.). For that reason, the interest surplus is heavily strained, leading to a decline in the profitability of the Hypo Real Estate Group.

- The rating downgrading by the agency Standard & Poor's (long-term BBB), Moody's (long-term A2) and Fitch (long-term A-) will render the refinancing more expensive and so further encumber the interest surplus, insofar as the ratings do not improve significantly with the aid packages.
- Further expansion of the credit spreads and a deterioration of the pool of securities may lead to additional costs that will affect net income from the collateralized debt obligations in the financial and trading results. Furthermore the risks of shortage and other impairments of the market conditions will lead to a cutback in the current market value of the trading results, yet to be settled, that would be directly ascertainable in the profit and loss statement. Further value-adjustments may become necessary pursuant to IAS 39 of Held-for-Trading in the reclassified stocks under the rating category "Loans and Receivables."
- Amortisation of securities and credits may be necessary if due to the crisis in the capital and financial markets, companies or states experience payment defaults, or must declare bankruptcy.
- In response to the difficult refinancing possibilities, the Hypo Real Estate Group will focus on new business which can be refinanced with Pfandbriefe. On the whole, new business in commercial real estate financing and public financing will significantly reduce in comparison to previous years. On the one hand, the commission surplus will decline as a result. On the other, the amount of portfolios will likely reduce due to elimination and sales, so that the interest surplus is encumbered. Furthermore, it is possible to experience capital loss owing to negative market value that will further impinge upon the interest surplus or the financial situation.
- Following the trend of the US-American real estate market, the prices of some European real estate markets will also radically decline, as in Great Britain or Spain. Even the situation experienced by some pub-

lic and infrastructure customers has worsened. As a result of that, and on account of the generally deteriorating macroeconomic situation, the standard for protection against credit risk in 2009 and 2010 will likely be higher.

- As part of the adjustment process of the business model to the new market situation and the planned repositioning of the Hypo Real Estate Group, high costs emerged in the third and the fourth quarters of 2008. Even in 2009 and 2010, more expenses will accrue that will not have the scope of the expenses of the previous year and that should be overcompensated by means of the long-term savings effects arising from the restructuring.
- Litigations could impact the profits of the Hypo Real Estate Group.
- On account of the rating downgrading, several ISDA [International Swaps and Derivatives Association] master agreements, as well as Guaranteed Investment Contracts were terminated, which may possibly lead to expenses arising from premature termination of the contracts, possibly also to expenses of procurement of hedging activities. In the process, the bank could incur additional costs on account of the limited choice of contracting parties in the light of its current long-term ratings. Further rating downgrading would lead to more terminations on account of ISDA master agreements.

#### Assets situation

- If the credit spreads of the states and other banks expand even further, the market value of the securities issued by them will decrease. The Hypo Real Estate Group reclassified a lion's share of available-for-sale securities pursuant to IAS 39 "Restructuring of Financial Assets," as adapted in October 2008, into the rating category "Loans and Receivables." For the remaining assets, the available-for-sale-securities, the expansion in the credit spread would, however, lead to a further strain on the market value, and consequently, on the AFS-deposits.
- The portfolio asset is likely to decline through reduction or sales, depending on the focus on the Group's functioning business fields.
- The tense situation, and the subsequently introduced measures for stabilising the Hypo Real Estate Group, have resulted in debates in politics, the media, and in the public sphere. Overall, the image of Hypo Real Estate

Group has suffered. Negative consequences for future business and customer relations cannot be ruled out.

#### Financial situation

- Currently, the refinancing of the Hypo Real Estate Group is greatly dependent on the capital support measures that have already been negotiated and those additionally required through the German Financial Market Stabilising Funds (SoFFin), as well as the German Finance Consortium and the German Federal Central Bank. If the interbank markets continue to malfunction, the refinancing for the Hypo Real Estate Group will continue to remain handicapped. Furthermore, as a result the access to particular refinancing markets through the rating downgrading can be impeded or in extreme cases rendered impossible. Moreover, the exact requirement for liquidity, among other things, depends on customer practices and the growth of the markets. Even changes in the levels of currency and interest rates can have a significant impact. As a result of the insecurities, liquidity bottlenecks in the future cannot be ruled out.
- The liquidity measures granted by the German Financial Market Stabilising Funds (SoFFin) as well as the German Finance Consortium and the German Federal Central Bank are for a limited period. Depending on the situation of the Hypo Real Estate Group and the markets, it may be necessary that the Hypo Real Estate Group would require longer (longer-term) federal capital support. If this is not granted or is in conflict with EU regulations, the continuation of the business operations may be jeopardised.
- The Hypo Real Estate Group has issued irrevocable credit undertakings and liquidity facilitation. Withdrawals could lead to liquidity outflows. Moreover, continued rating downgradings could lead to further terminations on account of ISDA master agreements, which can cause liquidity outflows.
- In case the Hypo Real Estate Group cannot use the credits provided by the German Finance Consortium and the German Federal Central Bank in due time, the creditors could realise the assets and holdings of the Hypo Real Estate offered as collateral. In that case, the Hypo Real Estate Holding AG may lose control of significant parts of the Group. As per IFRS, they would have to be closed off or spun off. In extreme cases, the Hypo Real Estate Holding AG may lose all its assets, which could lead to bankruptcy.

- The amortisation of the goodwill of the business or the firm undertaken in 2008 on collateralised debt obligations and other assets, as well as on account of the disbursements in connection with the strategic reorientation and restructuring of the Hypo Real Estate Group, led to a significant reduction in the IFRS equity capital and the core capital resources of the Hypo Real Estate Group. The Hypo Real Estate Group expects the regulatory core capital share to improve significantly through the capital support measures of the German Financial Market Stabilization Funds (SoFFin). In the years 2009 and 2010, the IFRS equity capital and the regulatory core capital could further diminish owing to the negative effects on earnings as explained above.

The adjusted business model represents a chance for the Hypo Real Estate Group. In the commercial real estate financing sector, presumably many competitors will withdraw from the market, or be seriously weakened. Additionally, on account of the liquidity squeeze on the market, loans will be more restrictively extended. As a result, the margins in real estate financing market will most probably increase if the refinancing markets settle down. The globalisation of cash flows and investors of large-volume projects will rate a specialised commercial real estate financier such as the Hypo Real Estate Group on account of its specialised market and product knowledge; its expertise will be recognised despite liquidity problems in the market. Even in the public financing sector, many competitors are impeded owing to the financial market crisis. For that reason, the experience gained by the Hypo Real Estate Group in the Pfandbriefe sector can be advantageous. Based on that, the Hypo Real Estate Group will seek to generate, in 2009 and 2010, market opportunities and new business at attractive margins. Conforming to the strategy, the focus will therefore remain on Pfandbriefe-based follow-up financing and on newly acquired businesses in the domains of commercial real estate and public sector.

On account of the conditions of the support measures of the German Financial Market Stabilization Funds (SoFFin) and the poor earnings of the Hypo Real Estate Group, no dividends will be paid for the financial year 2008. For the same reason, the payment of a dividend in subsequent years is not expected to be made. The earnings for the years 2009 and 2010 will be significantly

encumbered by disbursements for the liquidity capital, disbursements related to the strategic reorientation and restructuring of the Group, as well as those occurring due to the expected continuation of the amortisations on claims and securities on account of the economic downturn. Overall negative pre-tax results are expected at group level for 2009 and 2010.

**4.3.2. Company-specific situation** A reliable prognosis relating to the future development of the earnings, assets and financial situation cannot be rendered in light of the risk or other influencing factors given above. Despite the continuing capital market crisis, the Board of Directors and the management sees no need to undertake specific provisions on the existing claims.

The future of the Hypo Pfandbrief Bank International S.A. is completely dependant on the performance of the Hypo Real Estate Group and its role in the strategic new orientation of the Group. No decision has yet been made on the Luxembourg site.

#### 5. Miscellaneous

Dr. Fell resigned from his position on the Board of Directors on 20 January 2009. Mr. Matthew Cyril Dunne was appointed to the Board of Directors on 2 February 2009 and was elected as the Chairman of the Board. On 23 February, Mr. Stephane Rio and Mr. Michael Schultheiss were called upon to join the Board of Directors. At that point in time, Ms. Julia Hoggett left the Board of Directors.

No further proceedings of particular importance to the assets, financial and earnings situation for the previous fiscal year occurred after the end of the year.

Luxembourg, 30 March 2009

The Board of Directors



- 24 **Balance-sheet as at 31 December 2008**
  - 26 **Profit and loss account for the period from 1 January to 31 December 2008**
  - 28 **Report of the Réviseur d'Entreprises**
  - 29 **Assurance from the legal representatives**
-

# Annual Accounts

## Balance-Sheet as at 31 December 2008

<b>Assets</b>			
in €			
		<b>31.12.2008</b>	<b>Previous year</b>
Cash in hand, balances at central banks and postal check offices	10,900,496	1,788	
Treasury bills and other bills eligible for refinancing with central banks		405,564,594	532,258,376
Treasury bills and similar securities	405,564,594		532,258,376
Loans and advances to credit institutions		713,354,120	1,664,053,748
Municipal loans and loans guaranteed by public institutions	607,683,343		653,420,805
Other loans and advances	105,670,777		1,010,632,943
of which: payable on demand	63,149,442		70,308,864
Loans and advances to customers		273,027,026	289,444,180
Municipal loans and loans guaranteed by public institutions	273,027,026		289,431,680
Other loans and advances	-		12,500
Bonds and other fixed-interest securities		6,722,284,232	7,180,111,547
Public sector issuers	1,925,210,586		2,017,217,689
Other issuers	4,659,282,294		5,025,338,139
Own bonds	137,791,352		137,555,719
Property, plant and equipment		348,613	502,268
Other assets		73,109	59,550
Prepayments and accrued income		1,085,211,514	1,072,871,618
<b>Total assets</b>		<b>9,210,763,704</b>	<b>10,739,303,075</b>

<b>Liabilities</b>				
in €			<b>31.12.2008</b>	<b>Previous year</b>
Amounts owed to credit institutions			2,054,062,996	3,003,748,966
Issued public-sector registered Pfandbriefe		5,000,000		5,000,000
of which: with agreed maturity dates or periods of notice		5,000,000		5,000,000
Other liabilities		2,049,062,996		2,998,748,966
of which: payable on demand		286,689,977		148,509,190
of which: with agreed maturity or periods of notice		1,762,373,019		2,850,239,776
Amounts owed to customers			1,367,796,661	1,367,796,661
Other liabilities		1,367,796,661		1,367,796,661
Issued public-sector registered Pfandbriefe	1,367,796,661			1,367,796,661
of which: with agreed maturity dates or periods of notice	1,367,796,661			1,367,796,661
Debts evidenced by certificates			5,384,750,633	5,931,632,502
Issued bonds		5,384,750,633		5,886,632,502
Public sector Pfandbriefe	5,384,750,633			5,886,632,502
Other		-		45,000,000
Other liabilities			298,359	333,184
Accruals and deferred income			242,692,136	282,468,517
Provisions			5,841,077	5,301,403
Provisions for taxation		3,966,059		4,614,610
Other provisions		1,875,018		686,793
Subordinated liabilities			34,000,000	34,000,000
Subscribed capital			66,000,000	66,000,000
Offering premiums			15,000,000	15,000,000
Reserves			33,021,842	25,721,842
Profit for the financial year			7,300,000	7,300,000
<b>Total liabilities</b>			<b>9,210,763,704</b>	<b>10,739,303,075</b>

## Profit and Loss Account for the Period from 1 January to 31 December 2008

<b>Expenses</b>				
in €			<b>31.12.2008</b>	<b>Previous year</b>
Interest paid and similar expenses			790,843,000	854,955,679
Commissions payable			757,993	934,330
Result from financial operations			-	744,033
General administrative expenses			3,996,321	3,793,930
Staff costs		1,485,038		1,753,230
of which: wages and salaries	1,272,544			1,537,964
of which: social security	210,771			207,350
of which: relating to pensions	158,963			161,748
Other staff expenses	1,723			7,916
Other administrative expenses		2,511,283		2,040,700
Depreciation and value adjustment in respect of intangible assets and property, plant and equipment			289,420	312,787
Other operating expenses			1,137,343	87,765
Depreciation and value adjustment in respect of loans and advances and provisions for contingent liabilities and credit risks			3,000,000	1,500,000
Depreciation and value adjustment in respect of securities held as financial assets			320,000	1,120,758
Taxes on income from ordinary activity			935,774	1,494,221
Profit for the financial year			7,300,000	7,300,000
<b>Total expenses</b>			<b>808,579,851</b>	<b>872,243,503</b>

<b>Income</b>				
in €			<b>31.12.2008</b>	<b>Previous year</b>
Interest receivable and similar income			807,199,874	866,672,423
arising from fixed-interest securities		333,099,445		349,436,672
Profit from financial business			104,824	-
Commissions receivable			45,400	463,573
Other operating income			966,957	534,347
Income in respect of write-backs of value adjustments in respect of securities held as financial assets, in respect of participating interest and shares held in affiliated companies			262,796	4,573,160
of which: Profits from the sale of fixed-interest securities held as financial assets		262,796		4,573,160
<b>Total income</b>			<b>808,579,851</b>	<b>872,243,503</b>

## Report of the Réviseur d'Entreprises

**Report on the annual accounts** Following our appointment by the Board of Directors dated February 28, 2008, we have audited the accompanying annual accounts of Hypo Pfandbrief Bank International S.A., which comprise the balance-sheet as at December 31, 2008 and the profit and loss account for the year then ended and a summary of significant accounting policies and other explanatory notes.

### **Board of Directors' responsibility for the annual accounts**

The Board of Directors is responsible for the preparation and fair presentation of these annual accounts in accordance with Luxembourg legal and regulatory requirements relating to the preparation of the annual accounts. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of annual accounts that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

**Responsibility of the Réviseur d'Entreprises** Our responsibility is to express an opinion on these annual accounts based on our audit. We conducted our audit in accordance with International Standards on Auditing as adopted by the Institut des Réviseurs d'Entreprises. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the annual accounts are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the annual accounts. The procedures selected depend on the judgement of the Réviseur d'Entreprises, including the assessment of the risks of material misstatement of the annual accounts, whether due to fraud or error. In making those risk assessments, the Réviseur d'Entreprises considers internal control relevant to the entity's preparation and fair presentation of the annual accounts in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Board of Directors, as well as evaluating the overall presentation of the annual accounts. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion** In our opinion, the annual accounts give a true and fair view of the financial position of Hypo Pfandbrief Bank International S.A. as of December 31, 2008 and of the results of its operations for the year then ended in accordance with Luxembourg legal and regulatory requirements relating to the preparation of the annual accounts.

Without qualifying our opinion, we refer to the note "Valuation Methods" of the annual accounts which indicates the existence of a material uncertainty about the Company's ability to continue as a going concern.

In this note is mentioned that the continuance of the Company as a going concern is dependent on the sufficient refinancing of Hypo Real Estate Group and its subsidiaries and this depends on the previously agreed and future necessary measures for the liquidity and capital support by the German Finanzmarkt-Stabilisierungsfonds (SoFFin), the German financial consortium and the German Bundesbank. It is further stated that, in the event of malfunction of the interbanking market, the refinancing for the companies of the Hypo Real Estate Group remains difficult and the access to certain refinancing markets is made difficult and/or in extreme cases is impossible as a result of the downgrading of the rating, future cash flow problems cannot be excluded.

Further it is stated that the asset portfolio includes securities with a book value of TEUR 4,587,061 for which value adjustments to the lower market value amounting to TEUR 4,028,052 are not recognized due to the fact that defaults have not previously occurred and are not expected. In order to avoid future losses resulting from this situation it is particularly necessary that:

- the company has sufficient future liquidity to hold the securities and
- the continuance of the Company as a going concern is possible.

**Report on other legal and regulatory requirements** The management report, which is the responsibility of the Board of Directors, is consistent with the annual accounts.

Luxemburg, March 30, 2009

KPMG Audit S.à r.l. – Réviseurs d'Entreprises  
T. Feld C. Brüne

(This English version of the annual accounts and report is a translation purely for information purposes of the German original, which is legally binding version.)

To the best of our knowledge, we confirm that the annual accounts give an accurate representation of the true asset, financial and earnings situation of the company, according to the accounting principles for annual reports. The management report presents the business development, including the result and the situation of the company, in a way which conveys an accurate picture of the actual circumstances and describes the significant opportunities and risks of the anticipated development of the company.

Luxembourg, 30 March 2009

Klaus Söllner

Hagen Schmidt

Managing Director  
Member of the  
Board of Directors

Managing Director  
Member of the  
Board of Directors

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# Notes

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## 1. General notes

Hypo Pfandbrief Bank International S.A. (HPBI) was founded on 27 July 1999 in Luxembourg under its original name of Pfandbrief Bank International S.A. (PBI). On 14 September 1999 a licence to operate the bank as a mortgage credit bank (Banque d'émission de lettres de gage) was issued by the Minister of Finance of the Grand Duchy of Luxembourg.

The entry into the commercial register was made on 16 August 1999 under number 71104 (Section B). The legal basis for the operation of a mortgage credit bank is laid down in Articles 12-1 to 12-9 of the Law of 5 April 1993 on the financial sector (in its version in force at the time being).

The Bank was originally founded by Bayerische Hypo- und Vereinsbank AG (HVB) and its German mortgage bank subsidiaries, each with equal shares in the capital via a holding scheme.

Within the framework of the reorganisation of the HVB Group in 2003, the commercial real estate business was spun off and bundled with other mortgage bank activities into Hypo Real Estate Group. Since the 31 March 2008 all shares in the bank have been fully taken over by DEPPFA Bank PLC, Dublin (DEPPFA). The bank's subscribed capital is fully paid up.

Hypo Pfandbrief Bank International S.A. is integrated into the group accounts of Hypo Real Estate Holding AG, Munich, as well as into the subgroup accounts of DEPPFA Bank PLC, Dublin. The accounts are available at the registered offices of the respective companies.

## 2. Balance-sheet and valuation methods

The Bank's balance-sheet and valuation methods are in compliance with the rules in force in the Grand Duchy of Luxembourg, in particular the Law of 17 June 1992 regarding the financial statements and the consolidated financial statements of credit institutions ("the Law"). The breakdown of the balance-sheet differs from that provided for in the Law since it is based on the recommendation of the Commission de Surveillance du Secteur Financier (CSSF) on the annual accounts of mortgage credit banks. The annual financial statement was prepared under the premise of continuation of the business.

The continuation of the company is under threat caused by risks, which are shown in Section "4.3. Group and company-related situation" in the Management Report. It is stated there that the continuation of the company is dependent on the refinancing of the Hypo Real Estate Group and their subsidiaries being secured and this depends on the previously agreed and future necessary measures for the liquidity and capital support by the Financial Market Stabilization Fund (SoFFin), the German financial consortium and the Central Bank. Further it is stated that, with a continuation of the failure of the interbanking market, the refinancing for the companies of the Hypo Real Estate Group continues to be made difficult and the access to certain refinancing markets is made difficult and/or in extreme cases is impossible as a result of the downgrading of the rating, which cannot exclude future cash flow problems.

The financial situation of the company is evaluated by the moderate lower of cost or market principle. The unrealised losses contained in the portfolio are detailed in Section 3.5 of the Appendix "Bonds and other fixed interest securities". It is stated that the asset portfolio of in total € 6,722,284 k includes securities with a book value of € 4,587,061 k where the value adjustment was not made for the lower market value of € 4,028,052 k as failures have not previously occurred and are not expected.

In order to avoid a loss resulting from this situation it is particularly necessary that:

- the company has sufficient cash flow in future in order to be able to uphold the securities (holding power) and
- the overall continuation of the company is guaranteed.

With the background of the support measures of the financial market stabilization fund and the German financial consortium, the statutory initiatives provided by the German Federal Government and the future opportunities illustrated in the Management Report, the Management presumes a continuation of the Hypo Real Estate Group and the Bank at the time of reporting.

The capital currency is the Euro (€).

**Value adjustments** The bank pursues a policy of making specific changes in order to cover risks of loss and default in relation to existing claims.

In compliance with the tax provisions in force in Luxembourg, the option of a general charge for bad and doubtful debts has been used to secure against latent credit risks. The upper limit of 1.25 % of the risk-weighted address risks which must be observed in this regard is respected.

## 2.1 Fixed assets

**Property plant and equipment** Property plant and equipment are stated in the balance-sheet at acquisition cost or production cost, less accumulated value adjustment. Property, plant and equipment depreciate over time, which is taken into account by means of scheduled adjustments. The value adjustments are tailored according to normal operating life. Pursuant to the new Luxembourg reporting requirements in 2008, the residual book values of the reporting software used to date of € 188 k was written off unscheduled in the reporting year.

Assets acquired with acquisition/production costs of up to a maximum amount of €70 or with a useful life of less than one year are written off in full in the year of acquisition.

The adjustment rates applied as at the balance-sheet date are set out in the table below.

	Value adjustment rate	Method
Office and business equipment	20.00 %	linear
IT (hard-/software)	33.33 %	linear

**Financial assets** Holdings of bonds and other fixed-interest securities intended to serve the business in the long term and fulfilling banking supervisory requirements are valued at acquisition cost or, in the case of foreseeable long term depreciation, at the lower of the stock market or market price in connection with the so-called “Beibehaltungsprinzip” (valuation principle retaining previously established value adjustments). All securities of the cover fund are valued at acquisition costs. Securities hedged by interest-rate swaps (asset swaps) are also valued at acquisition cost.

On the balance-sheet date all securities of the financial assets are valued at acquisition cost.

In this connection we refer to Chapter 3.5 Bonds and other fixed interest securities.

Premiums and discounts are apportioned pro rata temporis in the income statement over the residual maturity of the securities.

## 2.2 Current assets

**Bonds and other fixed-interest securities** Bonds and other fixed-interest securities which are not considered as financial assets are entered at acquisition cost and allocated in full to liquid assets.

The securities are valued on the basis of the strict lowest value principle in accordance with the “Beibehaltungsprinzip”. The values are then shown at the lower of the stock-market price as the balance-sheet date or, if this cannot be established, the probable sales value or at the price which best reflects the value of the securities.

**Loans and advances** Loans and advances are shown at their nominal value. The accrued, non due interest is included in the accruals and deferrals. Premiums and discounts are apportioned according to maturity.

## 2.3 Liabilities / provisions

Liabilities are entered at their nominal or repayment amount, provisions at the amount required on the basis of a reasonable commercial judgement..

## 2.4 Acquisition and /or production costs of similar inventory items and all fungible assets, including securities

The bank uses the weighted average price method to determine the acquisition cost.

## 2.5 Currency conversion

Assets and liabilities not denominated in Euro are converted into the capital currency at the mid spot rate on the balance-sheet date.

Income and expenditure in foreign currency are converted into the capital currency at the relevant current rate.

The effects arising from these valuation principles are shown with an effect on profit in the profit and loss statement.

Covered spot and/or forward items are valued without effect on the profit. The imparity principle is applied to the valuation arising out of uncovered items.

## 2.6 Valuation of financial derivatives

Financial derivatives are recorded on the date of the conclusion of the transaction as off-balance-sheet-items. They are valued at market prices on the relevant trading date having regard to the imparity principle unless they are used to hedge the Bank's market risks.

### 3. Notes on the asset items

#### 3.1 Presentation of assets as at 31 December 2008

Maturity schedule	Treasury bills eligible for refinancing with central banks		Loans and advances to credit institutions (including central bank balances)		Loans and advances to customers	
	31.12.2008	Previous year	31.12.2008	Previous year	31.12.2008	Previous year
in thousand €						
Payable on demand	–	–	74,510	70,311	–	13
Up to 3 months	30,000	10,226	85,529	690,324	–	30,217
Over 3 months and up to 1 year	45,000	116,468	66,429	325,434	–	–
Over 1 year and up to 5 years	250,565	325,564	270,447	307,553	212,421	168,563
Over 5 years	80,000	80,000	227,340	270,434	60,606	90,651
<b>Total</b>	<b>405,565</b>	<b>532,258</b>	<b>724,255</b>	<b>1,664,056</b>	<b>273,027</b>	<b>289,444</b>
Of which: subordinate claims	–	–	–	–	–	–

Loans and advances to financial institutions payable on demand include credit with the central bank amounting to € 10,900 k (previous year € 2 k).

#### 3.2 Presentation of loans and advances and /or bonds and other fixed-interest securities vis-à-vis affiliated companies

in thousand €	31.12.2008	Previous year
Loans and advances to credit institutions	42,061	977,182
Bonds and other fixed-interest securities	186,291	200,829
<b>Total</b>	<b>228,352</b>	<b>1,178,011</b>
Of which: own bonds	137,791	137,556

#### 3.3 Overview of the equity capital in accordance with the CSSF Circular 07/273

in thousand €	Capital requirements
<b>Equity capital requirements for loans and advances which are subject to the standard approach</b>	
Loans and advances from central banks and banks	986
Loans and advances from institutions	3,837
Loans and advances from companies	827
Retail loans and advances	–
Shares	–
Other assets	36
<b>Equity capital requirements for loans and advances which are subject to the IRB approach with own estimation of losses in the event of deficit (advanced IRB approach)</b>	
Loans and advances from central banks and banks	9,134
Loans and advances from institutions	17,111
Loans and advances from companies	–
Retail loans and advances	–
Liabilities in the framework of securitisation	31,983
Equity capital requirements to cover the currency risk	741
Equity capital requirements to cover the operational risk	1,881
<b>Total</b>	<b>66,536</b>
<b>Liable Equity capital</b>	<b>134,959</b>
<b>Equity capital quota (in %)</b>	<b>16.2</b>

**3.4 Information regarding the credit risk**

Loans and advances and bonds and other fixed-interest securities (after deduction of value adjustment) are made up as follows as at the balance-sheet date:

Remaining maturity in thousand €	≤ 1 year	> 1 year ≤ 5 years	> 5 years ≤ 10 years	> 10 years	Total
<b>Credit Institutions</b>					
Europe	501,032	860,190	1,510,525	–	2,871,747
Japan	7,632	47,519	–	–	55,151
Canada	21,400	–	9,948	–	31,348
South Korea	–	28,418	26,990	–	55,408
USA	7,660	19,947	3,977	–	31,584
Others	–	–	17,619	–	17,619
<b>Total</b>	<b>537,724</b>	<b>956,074</b>	<b>1,569,059</b>	<b>–</b>	<b>3,062,857</b>
<b>Public sector borrowers (not including credit institutions)</b>					
Europe	190,458	764,461	911,510	1,311,071	3,177,500
Japan	19,590	54,665	–	–	74,255
Canada	21,262	59,231	26,126	198,926	305,545
South Korea	–	–	32,500	–	32,500
USA	7,164	4,112	20,288	1,415,009	1,446,573
Others	–	–	15,000	–	15,000
<b>Total</b>	<b>238,474</b>	<b>882,469</b>	<b>1,005,424</b>	<b>2,925,006</b>	<b>5,051,373</b>
<b>Overall total</b>	<b>776,198</b>	<b>1,838,543</b>	<b>2,574,483</b>	<b>2,925,006</b>	<b>8,114,230</b>

**3.5 Bonds and other fixed-interest securities  
(after deduction of value adjustments)**

in thousand €	31.12.2008	Previous year
Listed securities	6,022,631	6,379,839
Unlisted securities	699,653	800,273
<b>Total</b>	<b>6,722,284</b>	<b>7,180,112</b>

Bonds and other fixed-interest securities falling due in the following year stand at € 485,633 k.

Bonds of a Member State of the European Union participating in the Euro which are eligible for refinancing with a Central Bank of the Eurozone stand at a nominal amount of € 4,511 million as at the balance-sheet date.

The “Bonds” holding breaks down as follows:

in thousand €	31.12.2008	Previous year
Financial assets	6,722,284	7,042,556
Liquid assets	–	137,556
<b>Total</b>	<b>6,722,284</b>	<b>7,180,112</b>

As at the balance-sheet date, the accumulated amount of apportioned premiums stands at € 1,623 k; accumulated apportioned discounts are shown as € 4,761 k. Repurchase commitments under repurchase agreements stand at € 581,023 k on 31 December 2008, whereas € 956,108 k has been earmarked for tender. Securities to the amount of € 32,500 k were pledged in the framework of the granting of liquidity facilities for the Hypo Real Estate Group by a financial consortium, the German Central Bank and the German Government.

No value adjustments to the lower price value has been effected for securities in the financial assets of a book value of € 4,587,061 k (market value € 4,028,052 k) since to date no failure or default has occurred or is expected.

The market values in question have been based on the market prices and/or prices/pricing curves from brokers. For securities for which such values were not available (€ 1,424 million), the prices for comparable, active securities were used. The resulting credit spreads were reviewed by the Risk Controlling department.

## Notes

### 3.6 Other assets

Other assets (€ 73 k) mainly consist of the outstanding claim arising from rating agencies due to negotiated reimbursements of premiums.

### 3.7 Prepayments and accrued income

Prepayments and accrued income mainly consist of interest-rate accruals and premium and discount depreciations arising from issuing and lending business. Discounts from the issue business stand at € 707,949 k.

## 4. Notes on the liability items

### 4.1 Presentation of liabilities as at 31 December 2008

Maturity schedule in thousand €	Amounts owed to credit institutions		Amounts owed to customers	
	31.12.2008	Previous year	31.12.2008	Previous year
Payable on demand	286,690	148,509	–	–
Up to 3 months	1,555,900	2,613,313	–	–
Over 3 months and up to 1 year	206,473	236,927	–	–
Over 1 year and up to 5 years	5,000	5,000	142,700	112,700
Over 5 years	–	–	1,225,097	1,255,097
<b>Total</b>	<b>2,054,063</b>	<b>3,003,749</b>	<b>1,367,797</b>	<b>1,367,797</b>

Of the amounts owed to credit institutions, € 1,537,131 k arise out of pension agreements.

Debts evidenced by certificates as at 31.12.2008 in thousand €	Public-sector Pfandbriefe	Other bonds	Total
Payable on demand	–	–	–
Up to 3 months	500,000	–	500,000
Over 3 months and up to 1 year	1,582,479	–	1,582,479
Over 1 year and up to 5 years	2,206,246	–	2,206,246
Over 5 years	1,096,026	–	1,096,026
<b>Total</b>	<b>5,384,751</b>	<b>–</b>	<b>5,384,751</b>

Debts evidenced by certificates falling due in the next year amount to € 2,082,478 k.

#### 4.2 Presentation of amounts owed to affiliated companies or companies, in which participating interest is held.

Amounts owed to affiliated companies consist of short-term money-market transactions amounting to € 488 million (previous year: € 947 million).

#### 4.3 Other liabilities

Other liabilities (€ 298 k) as at the balance-sheet date predominantly consist of outstanding payments in respect of value added tax, income tax and social security contributions.

#### 4.4 Accruals and deferred income

Accruals and deferred income mainly consist of interest deferrals and premiums and discounts.

#### 4.5 Provisions

The other provisions shown were constituted to cover liabilities to staff existing as at the balance-sheet date together with liabilities to third parties applying to the financial year ended (audit costs, consulting costs etc.). Additionally a total of € 1,078 k was reserved due to scheduled restructuring measures in the Group.

#### 4.6 Subordinate liabilities

As at 28 December 2000, the Bank accepted a “silent participation” of € 9,000 k. The maturity was indefinite with profit-related interest. For supervisory purposes, this had to be classified as first-tier supplementary capital. With effect from 1 January 2003 the silent participation was converted into a subordinate debt issue. The interest rate, maturity and the supervisory classification remained unchanged. In the reporting year, interest of € 780.3 k was charged to the income statement.

On 18 May 2001, the Bank issued subordinate funds of € 15,000 k. The subordinate funds were increased by € 10,000 k to € 25,000 k on 30 January 2002 on the same terms. The subordinate funds are to be repaid in instalments starting on 18 May 2017 and with a final payment on 18 May 2026; the interest rate is 6.8 % per annum. In the reporting year, interest of € 1,700 k was charged to the income statement. For supervisory purposes, these subordinate funds qualify as second tier supplementary capital.

#### 4.7 Equity capital

The subscribed capital amounts to € 66,000 k and is divided into 66,000 registered shares with no par value.

Under the Luxembourg Law of 10 August 1915 on commercial companies, the Bank must allocate every year a sum equivalent to at least 5% of its annual net profit to a legal reserve until such time as the reserve reaches 10 % of the subscribed capital. No distribution may be made from the legal reserve. As at the balance-sheet date, there was a legal reserve of € 1,830 k and free reserves of € 31,192 k.

The bank utilises the tax-credit for the imputation of wealth tax against corporate tax, whereby five times the amount of wealth tax is deposited in a special profits reserve. No distribution of this reserve is possible for five years in so far as wealth tax is no longer to be finally paid. The free reserves contain € 12,640 k for the imputation of the wealth tax. Another corresponding allocation to the reserves will be made for the reporting year.

In accordance with the proposed allocation of profits, a sum of € 365 k is to be allocated to the legal reserve and € 6,935 k to the free reserves.

#### 4.8 Assets deposited as security for own liabilities

Assets of a nominal value of € 1,039,130 k have been deposited with the Central Bank as security. Securities to the amount of € 32,500 k were pledged in the framework of the granting of liquidity facilities for the Hypo Real Estate Group by a financial consortium.

## 5. Notes on the off-balance-sheet Items

Transactions in derivatives on the OTC market are effected exclusively for hedging purposes as part of the Bank's assets/liabilities management. No trading operations involving derivatives were conducted. We have, in principle, entered into netting agreements with our trading partners in the derivatives business with a view to reducing risks.

During the reporting year, we included, as cover, interest-rate and currency swaps amounting to € 143 million. We have entered into contractual agreements with the counterparties concerned to provide for the duties of information and other cooperation obligations. The procedure has been approved by the supervisory authorities and the trustees.

At the end of 2008, the nominal volume of outstanding off-balance-sheet transactions was € 8,767 million, of which € 4,912 million involved affiliated companies.

The address risk arising from derivatives was determined, inter alia, on the basis of the gross replacement costs. These are calculated as the sum of all positive market values, not taking netting agreements into account. At the end of 2008, the address risk thus defined (maximum risk of default) was € 411 million or 4.68 % of the outstanding nominal value. After netting agreements are taken into account, the address risk is reduced to € 321 million.

If, in accordance with banking supervisory criteria, add-ons and also risk weightings are taken into account for potential future risk, there is an address risk on the basis of the market-value method of € 78 million at the end of 2008. The HPBI will also in future pay strict attention to ensuring that the counterparty risk is kept within tight confines through active management. Our counterparties in the derivative business are solely OECD banks.

in million €	Nominal amount Remaining maturity ≤ 1 year	Nominal amount Remaining maturity ≤ 5 years	Nominal amount Remaining maturity > 5 years	Total Nominal amount	Positive market values	Negative market values	Address risks
<b>Interest-rate transactions</b>							
Interest-rate swaps (same currency)	1,549	2,693	3,303	7,545	206	538	–
Interest-rate options – purchases	35	82	–	117	6	–	–
Other interest-rate contracts	–	–	–	–	–	–	–
<b>Foreign exchange transactions</b>							
Currency-swaps	171	–	–	171	7	–	–
Cross-Currency swaps	158	102	674	934	192	16	–
<b>Total</b>	<b>1,913</b>	<b>2,877</b>	<b>3,977</b>	<b>8,767</b>	<b>411</b>	<b>554</b>	<b>78*</b>

\*) on account of netting agreements not being apportionable

Derivatives were concluded only for hedging purposes. As against the negative market values shown above, these are corresponding undisclosed reserves in the hedged underlying transactions.

**6. Notes on the items of profit and loss account****6.1 Geographical origin of income**

The Bank's income arose predominantly out of business with counterparties having their seat in Europe or North America.

**6.2 Result from financial operations**

This item consists of the valuation of foreign currency items and the results of currency transactions concluded for hedging purposes.

**6.3 Other operating income**

This item mainly involves the writing back of provisions for taxes and administration expenses in respect of previous years.

**6.4 Auditor's fees**

The fees for the auditor, KMPG Audit S.à r.l. Luxembourg and member firms of the KPMG network shown for the financial year under review under the item "other administrative expenses" are made up as follows:

Fees for in € including VAT	31.12.2008	Previous year
Audit of financial statements (annual accounts/group accounts)	87,573	98,500
Other audit services	93,745	36,500
Other services	3,450	–
<b>Total</b>	<b>184,768</b>	<b>135,000</b>

**7. Other explanatory notes****7.1 Staff**

The average numbers of staff employed during the year under review were as follows:

Management, including heads of departments: 3.0  
Other staff: 13.1

At the end of the year, the management was comprised of two persons. There were another 11 employees on the staff list.

**7.2 Payments and loans to executive and supervisory bodies**

No loans have been made to members of executive bodies (management and heads of departments) or to other members of the Board of Directors.

The members of the executive bodies were paid emoluments totalling € 556 k for the financial year.

**7.3 Deposit guarantee system**

The Bank is a member of the "Association pour la Garantie des Dépôts, Luxembourg" (AGDL) and thus a member of the deposit-guarantee association of the banking sector in the Grand Duchy of Luxembourg. The creation of a reserve was not necessary.

**7.4 Items not denominated in the balance-sheet currency**

The total amount of assets in foreign currency (excluding Euro currencies) is € 2,496 million. At the end of the year liabilities in foreign currencies carried € 2,502 million. These items are almost fully hedged by currency and interest/currency swaps.

**8. Asset overview**

in thousand €	Acquisition costs	Accruals financial year	Disposals financial year	Depreciation financial year	Accumulated depreciation	Residual cost 31.12.2008	Residual cost previous year
Office and business equipment	918	136	–	–289	–705	349	502
Of which: IT equipment	817	136	–	–277	–625	328	469
Investment securities	7,042,556	257,793	–578,065	–	–	6,722,284	7,042,556
<b>Total</b>	<b>7,043,474</b>	<b>257,929</b>	<b>–578,065</b>	<b>–289</b>	<b>–705</b>	<b>6,722,633</b>	<b>7,043,058</b>

## 9. Special information

**Statement of cover assets held in accordance with Art. 12-1 to 12-9 of the Law of 5 April 1993 on the financial sector** The information is confined to the presentation of public-sector Pfandbriefe. No mortgage-backed Pfandbriefe were issued. Derivative financial instruments with a total value of € 143,100 k were used for cover as at the balance-sheet date.

### 9.1 Statement of cover assets for public-sector Pfandbriefe

in thousand €	31.12.2008
Cover assets	6,279,032
Substitute cover assets	
Securities	45,400
Bank balances	-
<b>Total cover</b>	<b>6,324,432</b>
In circulation	
Bearer securities	5,242,815
Registered securities	678,438
<b>Total circulation (requiring cover)</b>	<b>5,921,253</b>
<b>Excess cover</b>	<b>403,179</b>

### 9.2 Additional breakdown

#### 9.2.1 Cover assets

Standard cover	31.12.2008
in thousand €	
Loans and advances to credit institutions	
Municipal loans or	
Loans guaranteed by public institutions	587,683
Loans and advances to clients	
Municipal loans or	
Loans guaranteed by public institutions	678,592
Bonds of public sector issuers or guaranteed by public institutions	4,660,942
Covered public bearer Pfandbriefe	188,715
Covered public registered Pfandbriefe	20,000
Derivatives	143,100
<b>Subtotal</b>	<b>6,279,032</b>
<b>Substitute cover assets</b>	
Other loans and advances to credit institutions	-
Bonds pursuant to article 42(3) of the UCITS Act	45,400
<b>Total</b>	<b>6,324,432</b>

#### 9.2.2 Cover holding for municipal loans

Breakdown according to orders of magnitude		Number	in thousand €
Up to € 25 million		58	706,903
Up to € 50 million		44	1,519,554
Up to € 100 million		35	2,256,534
Over € 100 million		11	1,841,441
<b>Total</b>		<b>148</b>	<b>6,324,432</b>

Breakdown by country	in thousand €	in %
USA	1,256,927	19.9
Austria	1,222,465	19.3
Germany	1,041,044	16.5
Spain	499,896	7.9
Canada	440,083	7.0
Switzerland	424,242	6.7
Italy	255,658	4.0
Portugal	158,000	2.5
Finland	145,982	2.3
Japan	128,523	2.0
Int. Organisations	118,854	1.9
Belgium	113,347	1.8
France	105,000	1.7
Ireland	90,976	1.4
Slovenia	80,000	1.3
Great Britain	72,073	1.1
Luxembourg	62,215	1.0
South Korea	55,532	0.9
Poland	20,202	0.3
Bulgaria	14,371	0.2
Sweden	11,042	0.2
Slovakia	8,000	0.1
<b>Total</b>	<b>6,324,432</b>	<b>100.0</b>

**9.2.3 Statement of cover assets in terms of present value**

in million €	Cover fund	Public sector Pfandbriefe* requiring cover	Excess cover	in %
Nominal value	6,324	5,921	403	6.8
Present value <sup>2</sup>	6,735	6,140	595	9.7
Present value, in case of shift of the interest-rate curve				
By + 100 bp	6,494	5,967	527	8.8
By - 100 bp	7,003	6,325	678	10.7

1 Lettres de gage publiques; 2 Calculated using original credit spreads

**9.3 Accrued and deferred items**

in thousand €	31.12.2008
<b>Prepayments and accrued income</b>	
Accrued interest	235,159
From issuing and lending business	707,949
Others	142,104
<b>Total</b>	<b>1,085,212</b>
<b>Accruals and deferred income</b>	
Deferred interest	229,337
From issuing and lending business	4,437
Others	8,918
<b>Total</b>	<b>242,692</b>

**9.4 Redemption of own public-sector Pfandbriefe**

During the year under review, we redeemed and wrote back a nominal amount of € 15 million of our own public-sector Pfandbriefe for price regulatory purposes. A holding with a book value of € 137.8 million is shown as at the balance-sheet date. Due to the market situation re-investments are not planned.

**9.5 Interest arrears**

Interest due during the year under review from loans and advances and securities have been received in full.

There are no arrears; no write-offs or value adjustments have been made on interest.

44 **Board of Directors**

44 **Management**

44 **Réviseur Spécial**

# Executive Bodies

## Board of Directors

<b>Dr. Robert Grassinger</b> Chairman until 26 March 2008	Member of the Board of Hypo Real Estate Holding, Munich
<b>Bo Heide-Ottosen</b> Chairman since 27. March until 29 September 2008	Member of the Board of Hypo Real Estate Holding, Munich Member of the Board of DEPFA Bank PLC, Dublin
<b>Dr. Markus Fell</b> Chairman since 9 October 2008	Member of the Board of Hypo Real Estate Holding, Munich
<b>Heather Nesbitt</b> until 26 March 2008	Member of the Board of Hypo Public Finance Bank, Dublin
<b>Orla Nicholson</b> until 26 March 2008	Head of Treasury of Hypo Public Finance Bank, Dublin
<b>Jim Ryan</b> since 27 March until 10 November 2008	Global Head of Balance-Sheet Management of DEPFA Bank PLC, Dublin
<b>Julia Hoggett</b> since 27 March 2008	Member of the Board of DEPFA ACS Bank, Dublin
<b>James Campbell</b> until 26 March 2008 onwards until 10 November 2008	Member of the Board of DEPFA Bank PLC, Dublin
<b>Michael Schultheiss</b> until 26 March 2008	Head of Treasury der Hypo Real Estate Bank, Munich
<b>Hagen Schmidt</b>	Administrateur-Délégué, Trier
<b>Klaus Söllner</b>	Administrateur-Délégué, Trier

## Management

<b>Hagen Schmidt</b>	Administrateur-Délégué, Trier
<b>Klaus Söllner</b>	Administrateur-Délégué, Trier

## Réviseur Spécial

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