

# Directors' Report and Financial Statements

In accordance with International Financial Reporting Standards  
31 December 2009

# Content

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## Directors and other information

**Board of Directors**

Dr. J. Bourke (Irish)\*  
Mr. C. Dunne (Irish)\* (Chairman) (appointed 14 January 2009)  
Ms. J. Hoggett (British) (resigned 17 June 2009)  
Mr. S. Rio (French) (appointed 20 May 2009)  
Mr. P. Ryan (Irish)\* (resigned 23 December 2009)  
Mr. K.L. Walsh (Irish) (appointed 13 July 2009)

\* Non-Executive

**Audit Committee**

Dr. J. Bourke  
Mr. P. Ryan (resigned 23 December 2009)

**Secretary & Registered Office**

Ms. E. Tiernan  
1 Commons Street  
Dublin 1  
Ireland

**Solicitors**

Arthur Cox  
Earlsfort Centre  
Earlsfort Terrace  
Dublin 2  
Ireland

**Auditors**

KPMG  
Chartered Accountants and Registered Auditor  
1 Harbourmaster Place  
IFSC  
Dublin 1  
Ireland

**Cover Assets Monitor**

AIB International Financial Services Ltd  
AIB International Centre  
Dublin 1  
Ireland

**Registered Number**

354382

## Directors' Report

The directors of DEPFA ACS BANK ("the Bank") present herewith the audited financial statements for the year ended 31 December 2009.

### Statement of directors' responsibilities

The directors are responsible for preparing the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors are required to prepare the company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and in accordance with the Companies Acts 1963 to 2009.

The financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position and performance of the Bank. The Companies Acts 1963 to 2009 provide in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state that the financial statements comply with IFRSs as adopted by the EU and in accordance with the Companies Acts 1963 to 2009; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Bank will continue in business.

Under applicable law, the directors are also responsible for preparing a Directors' Report. In addition, in accordance with the Transparency (Directive 2004/109/EC) Regulations 2007 (the Transparency Regulations), the directors are required to include in their report a fair review of the business and a description of the principal risks and uncertainties

facing the Bank and a responsibility statement relating to these and other matters, included below.

The directors are responsible for keeping proper books of account that disclose with reasonable accuracy at any time the financial position of the Bank and enable them to ensure that the financial statements comply with the Companies Acts 1963 to 2009. They are also responsible for taking such steps as are reasonably open to them to safeguard the assets of the Bank and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the Republic of Ireland governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

### Responsibility Statement, in accordance with the Transparency Regulations

Each of the directors in office, whose names and functions are listed on page 5 confirm that, to the best of each person's knowledge and belief:

- The Bank financial statements, prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the Companies Acts 1963 to 2009, give a true and fair view of the assets, liabilities and financial position of the Bank at 31 December 2009; and
- The Directors' Report includes a fair review of the development and performance of the business and the position of the Bank, together with a description of the principal risks and uncertainties that it faces.

### Principal activities

The Bank's primary purpose is the issuance of Asset Covered Securities ("ACS") in accordance with the Irish Asset Covered Securities Act, 2001 as amended by the Asset Covered Securities (Amendment) Act 2007 ("the Legislation"). Accordingly the principal activities of the Bank have

been the origination and acquisition of public sector assets and the issuance and ongoing administration of ACS in accordance with the Legislation. The ACS are secured by a cover pool of public sector assets ("the cover pool") which also includes cover asset hedge contracts. The jurisdictions of the public sector entity with the financial obligation under the assets are restricted by the Legislation to member countries of the European Economic Area, USA, Canada, Japan, Switzerland, Australia and New Zealand.

The Bank is regulated by the Irish Financial Regulator, and has a full banking licence. In addition, the Bank is a designated credit institution as defined under the Legislation.

#### Ownership

The Bank is part of the DEPFA Group ("the Group") which comprises DEPFA BANK plc and its subsidiaries. On 2 October 2007 the entire ordinary share capital of DEPFA BANK plc, the parent of the Bank, was acquired by Hypo Real Estate Holding AG ("HRE Holding"), the parent entity of the Hypo Real Estate Group ("the HRE Group").

There has been no change in the ownership of the Bank during 2009.

#### Dividends

The directors paid dividends of € 160 million in respect of the year ended 31 December 2009 (2008: € nil).

#### Directors

The names of the directors in office at the date of the signing of the audited financial statements for the year ended 31 December 2009 are set out on page 5.

#### Directors' and Secretary's interest in the share capital

As part of the recapitalisation of the HRE Group, the German Financial Markets Stabilisation Fund/German Finanzmarktstabilisierungsfonds ("SoFFin") became the only shareholder of Hypo Real Estate Holding AG on 13 October 2009.

The interests of the directors and company secretary, in office at 31 December 2009 and of their spouses and minor children in the shares of the Bank or HRE Group undertakings are set out below:

| Interest in shares in Hypo Real Estate Holding AG | 31 December 2009 | 31 December 2008 |
|---|------------------|------------------|
| Cyril Dunne                                       | -                | 94,079           |
| <b>Company Secretary</b>                          |                  |                  |
| Elaine Tiernan                                    | -                | -                |

No directors held any options on HRE Holding shares at 31 December 2009 (31 December 2008: € nil).

#### Major events

The very formidable challenges which DEPFA ACS BANK continued to face throughout 2009 will become clear from the content of this Directors' Report. It will be equally clear that the comprehensive and continuous support provided by the Bank's parent, DEPFA BANK plc, and its parent, HRE Holding, was essential in enabling DEPFA ACS BANK to meet those challenges successfully. That support is evident from the major events which impacted on the HRE Group during the course of the year and which are discussed below:

**Measures designed to assure liquidity** In the financial year 2009, the HRE Group continued to utilise liquidity aid provided by a syndicate from the German financial sector and SoFFin. The liquidity support amounted to a total of € 95 billion as of 31 December 2009. The development of this support is set out in the table below.

On 4 November 2009, SoFFin initially extended the entire guaranteed line of € 52 billion for the HRE Group until 30 June 2010. This extension was necessary because the guarantees expired on 18 November 2009. Deutsche Pfandbriefbank AG, which belongs to the HRE Group, can continue to utilise SoFFin guaranteed line in order to back bonds which are to be issued. The conditions are unchanged: Accordingly, Deutsche Pfandbriefbank AG paid to the SoFFin a pro-rata commitment commission of 0.1%

calculated in relation to that part of the guaranteed line which was not drawn down. A commission of 0.5% p.a. is charged for utilisation of the guaranteed line.

On 21 December 2009, SoFFin, the HRE Group and a syndicate from the German financial sector agreed a new structure for the liquidity facility which has been in place since November 2008 for the HRE Group with an original volume of € 50 billion. Principal repayments of € 7 billion meant that the new liquidity facility declined to € 43 billion in the course of 2009. Of this figure, the syndicate from the German finance sector provided around € 23 billion. The new facility was paid out over two dates, on 23 December 2009 and on 30 December 2009. Deutsche

Pfandbriefbank AG issued € 20 billion of securities which, as had previously been the case, were partially refinanced via Central Banks and also partially via the market. The facility was fully backed by means of SoFFin guarantees dated until 22 December 2010. The federal guarantees for € 35 billion and the portfolio of securities for an original amount of around € 60 billion, which acted as collateral for the original facility of € 50 billion, were accordingly cancelled or released. This restructuring has resulted in lower costs for the HRE Group for the provision of liquidity. Interest is charged on the securities taken up by the syndicate at a rate of EURIBOR +0.10% p.a. The SoFFin guarantees cost a commitment commission of 0.10 basis points p.a. if undrawn or 0.50% p.a. if utilised.

| Liquidity support measures for the HRE Group   |              |   |                            |                                       |
|--|--------------|---|----------------------------|---------------------------------------|
| Type of Support  | Date Granted | Date of maturity, taking account of prolongations | Original nominal amount in | Nominal amount as of 31 December 2009 |
|  |              |   | € billion                  | € billion                             |
| Issue of state guaranteed, ECB eligible bearer bonds (repayment of the liquidity credit line of Deutsche Bundesbank of 13 Nov 2008 to 26 Mar 2009) | 26 Mar 2009  | 30 Dec 2009                                       | 20.0                       | 0.0                                   |
| Issue of state guaranteed ECB eligible bearer bonds  | 13 Nov 2009  | 23 Dec 2009                                       | 15.0                       | 0.0                                   |
| Issue of covered bonds   | 13 Nov 2009  | 23 Dec 2009                                       | 15.0                       | 0.0                                   |
| Repayment of a guaranteed line provided by the SoFFin  | 19 Apr 2009  | 30 Jun 2010                                       | 52.0                       | 52.0                                  |
| Issue of SoFFin guaranteed bearer bonds (repayment of the state guaranteed and covered bonds from 26 Mar 2009 to 23 Dec 2009)                      | 23 Dec 2009  | 22 Dec 2010*                                      | 23.0                       | 23.0                                  |
| Issue of SoFFin guaranteed ECB eligible bearer bonds (repayment of the state guaranteed ECB eligible bearer bonds of 26 Mar 2009 to 30 Dec 2009)   | 30 Dec 2009  | 22 Dec 2010                                       | 20.0                       | 20.0                                  |
| <b>Total liquidity support</b>   |              |   |                            | <b>95.0</b>                           |

\* Pursuant to Section 5 (1) of the terms of the bond, partial repayments of € 1.5 billion in each case are to be made as of 23 March/23 June/23 September 2010.

**Recapitalisation** In the financial year 2009, SoFFin recapitalised the HRE Group initially with a total of around € 6 billion; HRE Holding received proceeds of € 3 billion by way of two capital increases in March and in June 2009. In November 2009, the HRE Group received a further € 3 billion. With the decision of 13 November 2009, the EU Commission declared that the further recapitalisation tranche for the HRE Group was provisionally (i.e. until the final decision is taken with regard to the restructuring plan) consistent with the aid regulations of the EC treaty.

The recent capital increase by SoFFin was carried out at the level of HRE Holding and Deutsche Pfandbriefbank AG (formerly Hypo Real Estate Bank AG): SoFFin has paid € 700 million into the reserve of HRE Holding. At Deutsche Pfandbriefbank AG, a figure of € 1.3 billion was paid into the reserves and; € 1 billion was provided in the form of a silent contribution. In addition, in a written statement of intent provided to the HRE Group, SoFFin again confirmed on 6 November 2009 that it intends in future (in line with the regulations of EU Aid Law) to ensure adequate capita-

liquidation of the HRE Group in order to permit the refocusing of the HRE Group and to stabilise the German financial sector. The extent of a further capital increase depends on the planned transfer of assets to a deconsolidated environment. Upon conclusion of the EU aid proceedings, and depending on the result of a subsequent audit, the German Financial Market Stabilisation Authority ("FMMA") possibly intends to set up a deconsolidated environment for assets and to take a decision regarding the subsequent recapitalisation of the HRE Group.

On 16 November 2009 the Group received a non-refundable capital contribution from HRE Holding of € 300 million. This non-refundable contribution qualifies as Regulatory Tier I Capital.

**Proceedings at the European Commission** With the decision of 2 October 2008, the European Commission approved measures designed to cover the liquidity requirement of the HRE Group. In this decision, the Federal Republic of Germany was obliged to submit a restructuring plan for the HRE Group by no later than 1 April 2009. The HRE Group has prepared such a restructuring plan and submitted it on time to the European Commission via the Federal Ministry for Economics. This restructuring plan is currently being reviewed by the European Commission. With the decision of 7 May 2009, the European Commission initiated the so-called "formal review proceedings". With the decision of 13 November 2009, the European Commission extended the formal audit proceedings to include further measures which had in the meantime been granted in favour of the HRE Group. In complex proceedings regarding aid law, the initiation and extension of the formal audit proceedings are the normal procedure; they are conducted by the European Commission without prejudice, and do not anticipate any decision with regard to content. The HRE Group Management Board currently does not expect to receive a definitive decision before the second quarter of 2010.

The Federal Republic of Germany is currently contemplating to make certain commitments vis a vis the European Commission, in connection with the former's application for approval by the European Commission of the state aid package for the group of companies headed by the parent of DEPFA BANK plc, HRE Holding. These draft commitments include procuring the active reduction of some of the business activities of the HRE Group. Such reduction

would comprise for the time being a prohibition on any new asset origination in the Group and the potential divestment of business activities (including subsidiaries) of the Group and the HRE Group in the medium term subject to certain conditions. Moreover, the conditions for a reprivatization of Deutsche Pfandbriefbank AG are being discussed between the Federal Republic of Germany and the European Commission. As the Group and its subsidiaries heavily rely on certain HRE Group and Group intragroup support and services, including, but not limited to, the financing provided by Deutsche Pfandbriefbank AG to the Group, a disposal of DEPFA BANK plc, any subsidiary of DEPFA BANK plc and/or Deutsche Pfandbriefbank AG in the medium term would impact the Group entities' financial and business positions.

## Ratings

In the business year 2009, the mandated rating agencies for DEPFA BANK plc, DEPFA ACS BANK and Hypo Public Finance Bank were Standard & Poor's, Moody's and Fitch Ratings, while Hypo Pfandbrief Bank International (a subsidiary of DEPFA BANK plc) and its Lettres de Gage were rated by Standard & Poor's only. With regard to bank and covered bond ratings, the following major rating changes took place during the business year 2009 and up to the date of signing of the audited financial statements.

At the beginning of February 2009, **Moody's** completed its review of the ratings and downgraded the long-term ratings of the banks by only 1 notch from A2 to A3 in anticipation of German state support. The other ratings were confirmed and the outlook for all ratings is negative. In a further rating action Moody's lowered the rating of the ACS issued by DEPFA ACS BANK from Aa1 to Aa2; this rating for the time being remains under review for downgrade.

At the beginning of April 2009, **Standard & Poor's** placed the bank ratings for all rated entities within the Group, including DEPFA BANK plc, DEPFA ACS BANK, Hypo Public Finance Bank and Hypo Pfandbrief Bank International on "Credit Watch Positive" due to the expected support of the HRE Group by the German State.

Following the Extraordinary General Meeting (“EGM”) of HRE Holding on 2 June 2009, **Fitch Ratings** upgraded the short-term ratings of the Group from F1 to F1+.

**Overview of the ratings of DEPFA ACS BANK  
as of 31 December 2009**

|                          | Standard & Poor's     | Moody's  | Fitch Ratings |
|--------------------------|-----------------------|----------|---------------|
| Long-term rating         | BBB                   | A3       | A-            |
| Outlook                  | Credit Watch positive | Negative | Stable        |
| Short-term rating        | A-2                   | P-1      | F1+           |
| Asset Covered Securities | AAA                   | Aa2      | AAA           |

**Business review**

The performance in 2009 continued to be marked by the extraordinary events in 2008 in which the HRE Group including DEPFA BANK plc and its subsidiary entities including DEPFA ACS BANK were confronted with serious liquidity problems that posed a threat to their very existence. The development of the liquidity support measures during 2009 is described extensively in the section “Major events”.

The business model of the Bank is somewhat different to that of DEPFA BANK plc. While DEPFA ACS BANK is a wholly owned subsidiary of DEPFA BANK plc and receives its short-term funding from DEPFA BANK plc, the business of the Bank is focused on the financing of long-term assets via the issuance of long-term Asset Covered Securities. As a consequence, the limited access the companies in the HRE Group have to the covered bond market continues to have an impact on the operations of the Bank.

The Bank recorded a significant decrease in revenues in 2009, with total operating revenues declining from € 118 million in 2008 to € 24 million in 2009. This however was primarily driven by an increase in commission expenses and a pronounced change in net interest margin.

**Net interest income** decreased by 35% to € 89 million compared with € 136 million in 2008. Given the focus on the long-term financing of public sector assets within its cover pool, the Bank's net interest income is less subject to changes in short-term money market funding rates. As a consequence, whilst down year-on-year, the net interest income of the Bank was only down by 35%. However,

given a significant proportion of the Bank's assets outside the pool are funded in the repo market, predominantly via Central Banks, changes in Central Bank repo funding rates and the haircuts applied to such assets do impact the income of the Bank. Net interest income was derived primarily from the asset base of the Bank. In 2009, net interest income included € -8 million loss on sale of assets (2008: € -11m).

**Net fee and commission expense** totalled € -58 million in 2009, mostly a result of commission costs incurred for the guarantees related to the liquidity support measures (2008: € -11m).

**Net trading income** recorded a gain of € 2 million in 2009 (2008: € -20 million loss). This gain is due to marking to market derivatives that do not qualify for hedge accounting.

**Net income from hedge relationships** amounted to € -10 million (2008: € 14 million), relating to hedge ineffectiveness on fair value hedges.

**General administrative expenses** decreased from € 17 million in 2008 to € 7 million in 2009. Administration costs of € 6 million in 2009 and € 15 million in 2008 mainly comprised recharges from other group entities for services provided.

Total assets decreased in 2009 by 9%, from € 96 billion in 2008 to € 87 billion in 2009. This decrease was mainly a result of decreases in intergroup lending and fair value movements. The Bank continues to focus on ensuring that it has a diversified and high quality asset base.

### Going concern

The existence of companies in the HRE Group including DEPPFA BANK plc and its subsidiary entities including DEPPFA ACS BANK continued to be threatened in the whole business year 2009.

The HRE Group continues to assume that it is a going concern and will continue in operation under the following described conditions (external factors/internal factors).

The financial statements are prepared on a going concern basis as the directors have assumed that the Bank will continue in operation under the conditions described as external and internal factors below.

This assumption is predicated on the fact that based on present information, the HRE Group Management Board considers it predominantly probable that these conditions are in existence or will occur.

#### External factors:

- The HRE Group will receive further essential liquidity support from SoFFin in respect of terms and total volume. Moreover, the HRE Group will receive necessary capital support from SoFFin to strengthen its capital base. These supports will be granted under reasonable conditions. No legal reservations, especially EU legal actions, will be successfully enforced.
- The capital markets environment will begin to stabilise from 2010 to 2012, particularly if there is no further serious deterioration of the financial market crisis from unforeseeable consequences, for instance triggered by external shocks such as the collapse of numerous major states or major banks, and the crisis of the real estate markets does not result in defaults of loans and securities to an extent which would pose a threat to the existence of the HRE Group.
- The interbank market and other short-term unsecured refinancing markets as well as the long-term secured and unsecured refinancing markets will start to recover from 2010. The ratings of the companies in the HRE Group will stabilise or slightly increase. The support can be covered by own funding in the following years.

#### Internal factors:

- The HRE Group further succeeds in regaining the confi-

dence of customers and successfully writes new business subject to adequate volumes and adequate margins.

- There are no significant delays or obstructions of the implementation of the restructuring of the HRE Group that aims to improve efficiency, profitability and streamlining of business processes.
- Work-out or restructuring of non-performing loans throughout the HRE Group can be implemented as currently scheduled.
- The HRE Group has been given the possibility of streamlining assets without a severe impact on value and of transferring balance sheet items by way of establishing a deconsolidated environment.
- The HRE Group is able to hire and keep staff in key positions despite specific restrictions, for example, on compensation.

On 28 March 2009, SoFFin confirmed in writing to HRE Holding and to Deutsche Pfandbriefbank AG (formerly Hypo Real Estate Bank AG) that it intended to stabilise HRE Holding in a sustainable manner by way of adequate recapitalisation and Deutsche Pfandbriefbank AG by further sufficient extensions of guarantees. SoFFin renewed its statement of intent on 6 November 2009. In particular, SoFFin has confirmed that it will provide adequate capital to ensure at least the continued existence of HRE Holding and its main subsidiaries as going concerns as well as the necessary viable business model, particularly that of Deutsche Pfandbriefbank AG. The support which the HRE Group overall receives from the German Federal Government depends on the result of a final review as to whether a deconsolidated environment will be established for non-strategic or non-performing assets of the HRE Group. In addition, SoFFin will provide further guarantees to assure the liquidity of HRE Holding. These and possible further measures are conditional on meeting the aid law requirements of the EU Commission.

As the first step towards recapitalising the HRE Group, SoFFin took up 20 million HRE Holding shares on 28 March 2009 for a legal minimum price of € 3.00 per share, with shareholders' subscription rights excluded. As the second step of recapitalisation of the HRE Group, the shareholders adopted a resolution regarding a capital increase of around € 2.96 billion in return for a cash contribution at the Extraordinary General Meeting held on 2 June 2009. 986.5 million shares were issued at the nominal value and

legal minimum price of € 3.00 specified in the articles of incorporation. Only SoFFin was permitted to take up the new shares out of the capital increase, and the statutory shareholders' subscription rights were excluded. After the registration of the capital increase on 8 June 2009, SoFFin held 90% of HRE Holding share capital. On 5 October 2009, a resolution for transferring the shares of the minority shareholder to SoFFin was adopted at an Extraordinary General Meeting. The Amtsgericht (local court) in Munich entered the transfer resolution on the commercial register on 13 October 2009, so that SoFFin became the only shareholder of HRE Holding. As a third step in the recapitalisation process, the HRE Group received a further capital contribution of a total of € 3.0 billion from SoFFin in November 2009. This tranche consists of a silent participation of € 1.0 billion to Deutsche Pfandbriefbank AG, a contribution of € 1.3 billion to the reserve of Deutsche Pfandbriefbank AG and a contribution of € 0.7 billion to the reserve of HRE Holding.

HRE Holding and Deutsche Pfandbriefbank AG have provided a commitment to SoFFin that they will take the steps necessary for implementing the recapitalisation process.

**Risks threatening the future existence of the HRE Group** The future existence of HRE Holding is contingent upon the provision of equity to HRE Holding and its significant subsidiaries sufficient to fulfil the supervisory regulations for own funds and sufficient to avoid a situation of insolvency. External liquidity support is necessary to avert insolvency due to illiquidity of the significant subsidiaries of the HRE Group or HRE Holding itself. These liquidity supports must be available until HRE Holding and its subsidiaries raise sufficient liquidity on the money and capital markets by themselves, the agreed restructuring arrangements are implemented as scheduled and the equity capital increase is performed as scheduled.

To ensure the future existence of HRE Holding and its significant subsidiaries as a going concern it is particularly necessary that:

- SoFFin continues to provide sufficient equity capital;
- SoFFin and the Deutsche Bundesbank maintain their liquidity support and, if necessary, provide further liquidity assistance until such time as HRE Holding and its principal subsidiaries raise liquidity in the capital markets themselves;

- Increased refinancing with sustainable conditions on the money and capital markets is possible;
- The restructuring arrangements will be implemented as scheduled;
- The appropriate authorities do not take regulatory actions which are unforeseen and which would not permit the HRE Group to fully implement its recovery plan; as well as
- No legal reservations (especially EU legal actions) will be successfully enforced.

### Strategy

**Organisational and legal structure of the HRE Group** In the year under review, the HRE Group structure consisted in particular of HRE Holding parent company and the operating bank subsidiaries Hypo Real Estate Bank AG and DEPFA Deutsche Pfandbriefbank AG, as well as DEPFA BANK plc and its subsidiaries including DEPFA ACS BANK. DEPFA Deutsche Pfandbriefbank AG was merged with Hypo Real Estate Bank AG on 29 June 2009, and was renamed Deutsche Pfandbriefbank AG. Since 19 May 2009, HRE Holding has also been the ultimate parent of the HRE Group for regulatory purposes. Within the current structure, the areas of responsibility are broken down into three operating segments which are largely independent of the legal breakdown into subsidiaries.

**Corporate strategy of the HRE Group** In the financial year 2009, the HRE Group operated in three operating segments throughout the HRE Group: Commercial Real Estate, Public Sector & Infrastructure Finance as well as Capital Markets & Asset Management. In the Public Sector & Infrastructure Finance segment, the HRE Group has withdrawn completely from new business for infrastructure finance. The aim is to virtually reduce the entire credit portfolio without imposing an excessive strain on existing value. The Capital Markets & Asset Management segment has virtually no further strategic importance for the future. For instance, the subsidiaries Collineo Asset Management GmbH and DEPFA First Albany Securities LLC have been sold. Capital market products for risk reduction are offered in the Commercial Real Estate and Public Sector & Infrastructure Finance segments only in connection with finance structuring.

The segment structure is being revised as part of the strategic refocusing process. The HRE Group will change over its reporting to three operating segments in the financial year 2010: Strategic business in commercial real estate financing (previously Commercial Real Estate) will in future be pooled in the Real Estate Finance segment, and strategic public sector financing (previously Public Sector & Infrastructure Finance) will be pooled in the Public Sector Finance segment. Non-strategic business will be included in the "Value Portfolio" segment and is to be reduced without imposing excessive strain on existing value. A "Consolidation & Others" line will also be introduced; in addition to accounting consolidation items, this will comprise individual items which cannot be allocated to the strategic segments or the Value Portfolio.

The "Value Portfolio" consists of the Capital Market and Asset Management segment, the Infrastructure Finance portfolio, the Corporate Centre portfolio and assets in the Public Sector Finance portfolio.

The Public Finance part of the "Value Portfolio" of the HRE Group is comprised of assets which are not eligible for the newly formed Deutsche Pfandbriefbank AG's cover pools or assets which, despite being eligible for the cover pools, exceed the desired volume of exposure. This includes all assets that reside on the balance sheets of DEPFA BANK plc, DEPFA ACS BANK and Hypo Pfandbrief Bank International S.A. as well as some non cover pool eligible assets which are booked in Deutsche Pfandbriefbank AG. All the assets in the "Value Portfolio" will be globally managed by Group employees regardless of their booking entity.

New business will be taken on only at Deutsche Pfandbriefbank AG, and only in Real Estate Finance and Public Sector Finance. In the two future target segments Real Estate Finance and Public Sector Finance, key factors of success in the new business strategy will be the numerous long-standing customer relations and the large customer base which formed the basis for new business in 2009.

DEPFA ACS BANK is considered to be part of the non-strategic business of the HRE Group and will be included in the "Value Portfolio" segment.

**Strategy for reducing credit and security portfolios without imposing an excessive strain on existing value** Following liaison with the SoFFin, the HRE Group has submitted an application to the FMSA to establish a deconsolidated environment for reducing assets without imposing an excessive strain on existing value. The HRE Group intends to transfer operations which are no longer strategically necessary for the refocusing of the HRE Group as well as further items on the balance sheet to this deconsolidated environment. The transfer is expected to take place in the second half of 2010 after approval is obtained from all necessary institutions and bodies, and is expected to comprise assets of up to € 210 billion. Loans which are no longer consistent with the strategic focus of the core bank can thus be continued without imposing an excessive strain on existing value, also in the interests of the customers. In addition, this transfer is also expected to reduce the further capital requirements of Deutsche Pfandbriefbank AG and ensure that this Company can be structured in such a way that it can be reprivatised more quickly. The FMSA is responsible for determining whether, and if so to what extent, the application for establishing the deconsolidated environment will be approved.

**Management concept** The management concept of the HRE Group aims to ensure the continued existence of the HRE Group as a going concern and to enhance the enterprise value in the long term. The focus will continue to be on assuring the liquidity and solvency and also on improving the risk early warning system. The overriding aim of liquidity management is to ensure that all payment obligations which fall due can be fulfilled at all times. As was the case last year, this objective at present can only be attained with the aid of extensive support. Solvency, in other words adequate capital backing, is managed on the basis of the regulatory parameters core capital ratio and equity ratio at the HRE Group level and at the level of individual institutions. The ratios which are prescribed by law can also be achieved only with the aid of the support. The HRE Group also manages these ratios on the basis of scenario analyses, which for instance take account of rating migrations or changes in exchange rates. With regard to the management of capital, the focus is on complying with the banking regulatory requirements as well as the requirements of the rating agencies and business partners with regard to minimum capitalisation. The risk early warning system was revised after the crisis of the HRE Group.

At the same time, strict cost discipline is necessary for ensuring the continued existence of the HRE Group as a going concern. This is monitored on the basis of absolute costs and also on the basis of the cost-income ratio. The cost-income ratio is the ratio between general administrative expenses and the operating revenues, consisting of net interest income, net fee and commission expense, net trading income, net income from financial investments, net income from hedge relationships and the balance of other operating income/expenses. The aim is to improve the cost-income ratio primarily by reducing general administrative expenses following the restructuring; a secondary aim is to improve the cost-income ratio by increasing new business. In addition, the HRE Group aims to further reduce its balance sheet total by reducing non-strategic portfolios without imposing an excessive strain on the markets.

The enterprise value is deemed to have been enhanced if the return on equity of a management unit exceeds its capital costs on a sustainable basis. In order to determine return on equity, net income according to IFRS is related to average equity (excluding AfS reserve and cash flow hedge reserve). The costs of capital constitute the theoretical costs of equity, and define the marginal cost rate for existing and future risk taking. The profitability of new business and the existing portfolio is investigated within the context of economic risk by way of comparing return on equity with the capital costs.

#### Events after 31 December 2009

On 21 January 2010, following liaison with SoFFin, the HRE Group submitted an application to the German Financial Markets Stabilisation Agency ("FMSA") for the establishment of a deconsolidated environment aimed at reducing assets in a value preserving manner. The HRE Group intends to transfer balance sheet items no longer strategically required for the HRE Group's realignment to this deconsolidated environment. The transfer, which is set to cover HRE Group assets worth up to € 210 billion, is scheduled to take place during the second half of 2010, once all necessary approvals have been obtained from the responsible corporate bodies and institutions. There is no legal right to the establishment of the deconsolidated environment. FMSA has the discretionary authority to establish it.

Apart from the above, there have been no other notable events after 31 December 2009.

#### Results

The profit for the year, and the appropriation thereof, are set out in the income statement on page 25.

#### Regulatory capital and capital adequacy ratios

Since 1 January 2008 the regulatory capital and capital adequacy ratios were produced in accordance with the Bank of International Settlements ("BIS") and the Capital Requirements Directive 2006/48/EC ("CRD").

The Bank is regulated by the Irish Financial Regulator, which applies a capital / risk framework for measuring capital adequacy based on the CRD. Both the BIS and the Irish Financial Regulator require banks to maintain a minimum Tier I Capital ratio of 4% and a Total Capital ratio of 8%.

The Financial Regulator entered into a Settlement Agreement with effect from 16 December 2009 with DEPFA ACS BANK in relation to breaches of a regulatory requirement under the Asset Covered Securities Act 2001 (as amended). DEPFA ACS BANK was required to pay a monetary penalty in the sum of € 250,000.

With a Tier I Capital Ratio of 6.8% (2008 8.6%) and a Total Capital Ratio of 12.3% (2008 14.9%) the Bank exceeds the minimum required ratios.

| <b>Regulatory Capital</b>       |              |              |
|---------------------------------|--------------|--------------|
| € million                       | 31.12.2009   | 31.12.2008   |
| Tier I Capital                  | 637          | 790          |
| Tier II Supplementary capital   | 519          | 585          |
| <b>Total Regulatory Capital</b> | <b>1,156</b> | <b>1,375</b> |

| <b>Capital Adequacy Ratios</b>           |              |              |
|--|--------------|--------------|
|  | 31.12.2009   | 31.12.2008   |
| BIS Risk Weighted Assets (€ million)     | 9,421        | 9,213        |
| Tier I Capital Ratio                     | 6.8%         | 8.6%         |
| <b>Total Capital Ratio (Tier I + II)</b> | <b>12.3%</b> | <b>14.9%</b> |

### Political donations

The Electoral Act, 1997 requires companies to disclose all political donations over € 5,079 in aggregate made during the financial year. The directors, on enquiry, have satisfied themselves that no such donations have been made by the Bank during the financial year.

### Accounting records

The Directors have taken appropriate measures to secure compliance with the Bank's obligation to keep proper books of account through the use of appropriate systems and procedures and competent persons. The books of account are kept at 1 Commons Street, IFSC, Dublin 1.

### Risk Management

**Strategy in using financial instruments** The Bank is party to various types of financial instruments in the normal course of business to reduce its own exposure to fluctuations in interest and exchange rates. These financial instruments involve to varying degrees, exposure to loss in the event of a default by a counterparty ("credit risk") and exposure to future changes in interest and exchange rates ("market risk"). In addition, the Bank is exposed to liquidity risk to the extent that it is exposed to regular calls on its available cash resources.

In the course of the Bank's banking activities, it makes significant use of financial instruments, including derivatives. The Bank purchases assets at both fixed and floating rates and for varying maturities. Where deemed appropriate, the Bank then manages the interest rate risk on these fixed rate positions, by swapping them into a floating rate exposure, using interest rate derivatives.

The Bank also raises finance at both floating and fixed rates and for varying maturities. In a similar manner to the asset side, the Bank will manage the interest rate risk on fixed rate positions, where deemed appropriate, by converting them into a floating rate exposure, using interest rate derivatives.

#### Measurement and management of the various types of risk

The Group's comprehensive system for the identification,

measurement, early recognition and control of risk as an integral part of its business process is fully established in the Bank. In accordance with Group requirements, the Bank applies the Group policies and procedures to the management of credit risk, market risk, operational risk and liquidity risk.

#### \*Credit risk

**Definition** Credit Risk is defined as the risk of impairment and partial or total loss of a receivable due to deterioration of credit quality on the part of a counterparty. The relevant receivable may be based on traditional on-balance sheet lending business or off-balance sheet business, e.g. counterparty risk arising from derivative financial instruments.

It also comprises the counterparty, issuer and country risk, which are defined as follows:

- Counterparty and issuer risks are possible losses of value of trades which are not fulfilled, in particular derivatives, due to the default of the counterparty. The following sub-categories are defined in this respect:
  - Settlement risk is defined as the risk that, when a trade is settled, the counterparty fails to deliver.
  - Replacement risk is defined as the risk that, in the event of a counterparty default, the contract has to be replaced at current market terms.
  - Cash risk is defined as the risk that the counterparty might not repay (cash) loans which have been raised or that the counterparty might not transmit option premiums.
  - Issuer risk is the risk of the complete or partial loss of receivables from security investments due to the default of the issuer.
- Country risks are broken down into transfer and conversion risks as well as default risks. Transfer and conversion risks may arise as a result of state intervention which limits or prohibits the procurement of foreign currency or cross-border capital transfer of a solvent debtor. Counterparty risks may arise as a result of the default or downgraded rating of a country in its capacity as a debtor.

The Bank's business is focused on sovereign and sub-sovereign borrowers and public sector supported specialist entities.

\* Forms an integral part of the audited financial statements

Within the Group, on-balance sheet financial institution counterparty risk arises from securities, money market transactions, sale and repurchase agreements and derivatives.

The Group operates an independent credit approval process, which includes assessments by and formal limit recommendations from those not involved in the business areas.

The Group policies and procedures are applied to the Bank.

The Bank restricts its exposure to credit losses by entering into collateral support agreements and master netting arrangements with counterparties with which it undertakes a significant volume of transactions.

Under the terms of a Collateral Support Agreement, in the event that the value of counterparty's derivative exposure to the Bank exceeds a defined limit, the counterparty must post collateral to the amount of the excess with the Bank. In the event of a default by the counterparty, the Bank then has recourse to the collateral, up to the amount of the loss suffered. Such Collateral Support Agreements are generally mutual in nature.

Master netting arrangements do not generally result in an offset of balance sheet assets and liabilities, as transactions are usually settled on a gross basis. However, the credit risk associated with favourable contracts is reduced by a master netting arrangement to the extent that if an event of default occurs, all amounts with the counterparty are terminated and settled on a net basis. The Bank's overall exposure to credit risk on derivative instruments subject to master netting arrangements can change substantially within a short period, as it is affected by the market valuations of each transaction subject to the arrangement.

#### \*Geographical concentrations of assets, liabilities and off-balance sheet items

| € m                              | At 31 December 2009 |                   |                    | At 31 December 2008 |                   |                    |
|----------------------------------|---------------------|-------------------|--------------------|---------------------|-------------------|--------------------|
|                                  | Total assets        | Total liabilities | Credit commitments | Total assets        | Total liabilities | Credit commitments |
| Germany                          | 12,046              | 224               | 10                 | 10,386              | 6,586             | 10                 |
| Italy                            | 5,148               | -                 | -                  | 6,175               | 14                | 59                 |
| France                           | 2,896               | 107               | 50                 | 3,081               | 527               | 226                |
| Spain                            | 7,475               | -                 | -                  | 8,012               | -                 | 664                |
| Austria                          | 1,218               | -                 | -                  | 1,626               | 36                | -                  |
| Greece                           | 519                 | -                 | -                  | 480                 | -                 | -                  |
| United Kingdom                   | 5,578               | 1,500             | -                  | 4,530               | 1,547             | -                  |
| Ireland                          | 15,944              | 30,015            | -                  | 22,667              | 33,181            | 7                  |
| Other European countries         | 16,516              | 320               | 94                 | 16,618              | 310               | 211                |
| USA                              | 14,689              | 3,380             | -                  | 16,488              | 378               | -                  |
| Canada                           | 3,447               | -                 | -                  | 3,361               | -                 | -                  |
| Japan                            | 1,481               | -                 | -                  | 1,491               | -                 | -                  |
| Other countries                  | 2                   | -                 | -                  | 1,152               | -                 | -                  |
| Unallocated assets / liabilities | -                   | 50,842            | -                  | -                   | 52,773            | -                  |
| <b>Total</b>                     | <b>86,959</b>       | <b>86,388</b>     | <b>154</b>         | <b>96,067</b>       | <b>95,352</b>     | <b>1,177</b>       |

\* Forms an integral part of the audited financial statements

Assets are allocated geographically based on the location of the credit risk. Liabilities are allocated on the basis of the location of the counterparty where this can be identified. Credit risk is reported based on the location of the credit risk.

Included in unallocated liabilities are all liabilities evidenced by certificates where the counterparty cannot be specifically identified as the securities are transferable.

The amounts shown in the above tables represent what the Bank considers to be its maximum exposure to credit risk as at 31 December 2009 and 2008.

The concentration of credit risk by counterparty type for loans and advances to other banks and customers, financial investments and derivatives is summarised below:

| € m                               | At 31 December 2009 |                       |              |               |
|-----------------------------------|---------------------|-----------------------|--------------|---------------|
|                                   | Loans and advances  | Financial investments | Derivatives  | Total         |
| Public authorities                | 59,053              | 7,527                 | -            | 66,580        |
| Companies and private individuals | 897                 | -                     | -            | 897           |
| Banks and financial institutions  | 15,531              | 28                    | 3,896        | 19,455        |
|                                   | <b>75,481</b>       | <b>7,555</b>          | <b>3,896</b> | <b>86,932</b> |

| € m                               | At 31 December 2008 |                       |              |               |
|-----------------------------------|---------------------|-----------------------|--------------|---------------|
|                                   | Loans and advances  | Financial investments | Derivatives  | Total         |
| Public authorities                | 65,628              | 8,207                 | -            | 73,835        |
| Companies and private individuals | 445                 | -                     | -            | 445           |
| Banks and financial institutions  | 16,945              | 32                    | 4,717        | 21,694        |
|                                   | <b>83,018</b>       | <b>8,239</b>          | <b>4,717</b> | <b>95,974</b> |

The composition of the on balance sheet assets exposure by internal ratings category is as illustrated below.

|      | 31 December 2009 | 31 December 2008 |
|------|------------------|------------------|
| AAA  | 35%              | 38%              |
| AA1  | 12%              | 10%              |
| AA2  | 13%              | 24%              |
| AA3  | 25%              | 14%              |
| A1   | 7%               | 7%               |
| A2   | 2%               | 3%               |
| A3   | 4%               | 4%               |
| BBB2 | 2%               | -                |

The composition of the off balance sheet exposure by internal ratings category is as illustrated below.

|      | 31 December 2009 | 31 December 2008 |
|------|------------------|------------------|
| AAA  | -                | 60%              |
| AA1  | -                | 21%              |
| AA2  | 35%              | 5%               |
| AA3  | 31%              | 2%               |
| A1   | 12%              | 9%               |
| A2   | 5%               | -                |
| A3   | 14%              | 1%               |
| BBB1 | -                | 2%               |
| BB2  | 3%               | -                |

### \*Market risk

Market risk refers to the risk of potential loss arising from changes in market data such as interest rates, credit spreads, foreign currency exchange rates, equity prices, price or rate volatilities. The Bank defines its market risk as changes in fair value of financial instruments as a result of market data movements.

The Bank's market risk policies and procedures follow three core principles:

- Policy framework for all key market risk activities approved by the board;
- Market risk management is centralised in the Asset & Liability Committee (explained further in "Liquidity risk management" section of the report) and the treasury and product units, managed by specialised personnel and monitored using appropriate systems and controls;
- Market risk control function measures and monitors the risks independently of the risk-taking units.

The market risk control function has sub-categorised market risk into risk factors. The relevant risk factors for the Bank are interest rate, credit spread, foreign exchange and inflation risk. As a bank focusing on the issuance of Asset Covered Securities, the Bank is not generally exposed to equity or commodity risk. With regard to foreign exchange risk, the Group has a policy that treasury must match all foreign currency assets with liabilities in the same currency or swap out the foreign exchange exposure. Hence, the primary risk factor for the Bank is interest rate risk.

For the quantification and control of these risks, the Bank determines daily Value at Risk (VaR) figures in line with industry wide practice using the variance/covariance methodology. The VaR monitoring is based on a comprehensive risk factor set, consolidated across the Bank, as well as broken down to portfolio and desk level. A ten-day holding period with a 99% confidence interval is used to derive the calculation. Correlations and volatilities are calculated based on a history of 250 trading days. The choice of a ten-day holding period was selected to give a conservative assumption in relation to liquidating any adverse positions within the portfolio.

The Bank recognises that variance/covariance VaR has certain inherent limitations. The past may not always provide

a reliable indicator of future market movements and moreover the statistical assumptions employed may understate the probability of very large market moves. For this reason, additional management tools such as sensitivity measures and stress testing are used to supplement VaR.

Market risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements. The Board sets limits on the value at risk that may be accepted, which is monitored on a daily basis.

Two of the principal components of market risk for the Bank are currency risk and fair value interest rate risk.

\*At 31 December, the VaR of the Bank was as noted below:

| € m                  | 2009   | 2008   | 2009 | 2008 |
|----------------------|--------|--------|------|------|
|                      | 31 Dec | 31 Dec | Avg  | Avg  |
| Interest rate VaR    | 16     | 18     | 20   | 8    |
| Foreign exchange VaR | 8      | 72     | 14   | 13   |

In terms of the sensitivity of either profit or loss or equity to a move in the credit spread of the banking book assets, a 1 basis point change in the credit spread level of the banking book counterparties, would have a nil effect on profit or loss and on equity. It should be noted however, that such a calculation assumes that all assets experience a similar change in credit spread moving in the same direction and at the same time.

### Fair value interest rate risk

Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The Bank takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise.

The majority of the Bank's interest earning assets are entered into at a fixed rate of interest. The fair value interest rate risk on these positions is mitigated, where desirable from a treasury perspective, using interest rate derivatives.

Interest rate risk is managed through the setting and monitoring of VaR limits and utilisation of these limits. The VaR figures for the Bank for 2009 are as outlined above.

#### Fair value hedges:

The Bank hedges substantially all of the fixed interest rate risk in its long term financial assets and financial liabilities, through fair value hedges using a variety of interest rate derivatives. The Bank also hedges foreign exchange risk using a variety of foreign exchange derivatives. The net fair value of these derivatives at 31 December 2009 was € -1,435 million (31 December 2008: € -2,397 million). Hedge ineffectiveness resulting from the application of hedge accounting to these hedge relationships was € -10 million (2008: €14 million).

#### Cash flow hedges:

The Bank also hedges a portion of the cash flow interest rate and foreign currency risk, arising on future payments and receipts on variable rate assets and liabilities. The Bank manages this risk through the use of interest rate swaps and cross currency interest rate swaps. The net fair value of these derivatives at 31 December 2009 was € -38 million (31 December 2008: € -91 million). Hedge ineffectiveness resulting from the application of hedge accounting to these hedge relationships was € nil (2008: € nil).

#### Operational risk

Operational risk is inherent in most aspects of the Bank's activities and comprises a large number of disparate risks. Such risks must be monitored very intensively, particularly in times of problematical situations due to internal and/or external causes, such as those which have been experienced by the entire financial sector and in particular the HRE Group in the year under review.

#### Definition

The HRE Group defines operational risk as "the risk of loss resulting from inadequate or failed internal processes,

people and systems or from external events". The risk is associated with human error, systems failure, and inadequate controls and procedures. The definition includes legal risks, but excludes strategic and reputation risks.

#### Operational risk strategy

The HRE Group's primary aims are the early identification, recording, assessment, monitoring, prevention and mitigation of operational risk, as well as timely and meaningful management reporting. The HRE Group does not attempt to completely eliminate risk but to minimize unexpected loss by limiting the operational risks of the group to a reasonable level. The HRE Group's approach is to ensure that it has sufficient information to make informed decisions about risk mitigation.

#### Organisational structure

The HRE Group has established a centralised Operational Risk and MaRisk function within the HRE Group Risk Management & Control division that focuses on the coordination of consistent policy, tools and practices throughout the HRE Group for the management, measurement, monitoring and reporting of relevant operational risks. The focus of HRE Group Operational Risk and MaRisk is the proactive identification, management and mitigation of risks rather than on just risk monitoring, measurement, and reaction to risk.

#### Operational risk identification, management and report

Operational risk is controlled through a network of controls, procedures, reports and responsibilities. Within the HRE Group, each individual business area and management level takes responsibility for its own operational risks and provides adequate resources and procedures for the management of those risks.

The HRE Group uses a number of firm-wide risk processes and tools for the management, measurement, monitoring and reporting of operational risk. These include:

- Key risk indicator (KRI) reporting - provide potential early warning of increased risk associated with non-

attainment of control objectives.

- Operational risk self-assessments - based on the identification of threats to business processes, the impact of those threats and the subsequent evaluation of controls in place to mitigate the risk.
- Risk event management - the collection, reporting and analysis of internal risk event data enables the HRE Group to identify weak controls, ineffective processes or activities, and poor systems; and ensures that the HRE Group takes appropriate action to mitigate any exposures.
- New Products - The HRE Group's New Product Process is key to the assessment and management of risks pertaining to potential new products or new business initiatives and is coordinated by HRE Group Operational Risk and MaRisk.
- Targeted risk reviews – in partnership with the business, examine in depth predefined key areas of risk and provide recommendations for risk mitigation.
- MaRisk Compliance – HRE Group Operational Risk and MaRisk is responsible for co-ordinating DEPFA's compliance with the requirements of MaRisk.

The totality of this information is used to determine the operational risk profile of the HRE Group and the actions required to address specific issues. Regular reports are made to the HRE Group Chief Risk Officer, the HRE Group Risk Committee and the DEPFA Board to allow senior management to assess Group's overall operational risk profile.

HRE Group Operational Risk and MaRisk evaluates data which have been collated, advises and draws up proposals for preventing or managing operational risks together with the business units. Operational management of this risk is the responsibility of the corresponding head of the business unit.

In order to support the management of operational risks in particularly critical processes or systems, HRE Group Operational Risk and MaRisk acts on behalf of the DEPFA Board to carry out individual analyses which enable a plan of specific measures to be drawn up.

HRE Group Operational Risk and MaRisk prepares an incident and loss report for operational risks on a quarterly basis for the Board of Directors of DEPFA Bank plc. This

report shows the main risks to which the Group is exposed. A quarterly key risk indicator report is also drawn up for the Board of Directors of DEPFA Bank plc. The results of the risk self-assessment are reported to the Board of Directors of DEPFA Bank plc. after the assessment has been completed. After a specific risk analysis, the relevant member of the HRE Group Management Board receives a final report. In future, the HRE Group Risk Committee will use these reports to derive and implement suitable measures for preventing risk.

#### **Operational risk quantification**

The HRE Group has adopted the standardised approach to calculate the capital requirement under the Basel II Accord and the EU Capital Requirements Directive. For economic capital allocation the same approach is applied. The capital backing of the HRE Group in line with the Basel II regulations for operational risks is € 104 million as of 31 December 2009 (31 December 2008: € 212 million).

#### **Operational risk mitigation and reduction**

The most effective measure to mitigate Operational Risk is an early identification of weaknesses in processes and procedures which might cause an Operational Risk event. Breaches of Key Risk Indicator limits or an unusual development of a KRI can trigger an individual analysis of the respective process or system in order to identify the source and reduce the KRI again to a normal level. Another measure of Operational Risk mitigation was the outsourcing of non-core activities such as IT servicing. The best method to reduce Operational Risk, however, is to increase the risk awareness throughout the HRE Group. This is gradually achieved on Board and upper Management Level by the regular Risk Reports and on operative level by the frequent Risk self assessment where all level of management has to assess their own risk situation at least once a year.

#### **Major operational risk in the HRE Group**

The major operational risks of the HRE Group are risks which arise as a result of the ongoing restructuring of the HRE Group, such as risks attributable to the reliance on key

personnel, technology risks arising from the large number of trade entry and processing systems which are currently being consolidated in a single IT platform, and risks associated with change management activities.

During 2009, reported losses attributable to operational risk events in the Bank amounted to € 250,000. The loss incurred is the fine imposed by the Financial Regulator in relation to the Settlement Agreement discussed in the "Regulatory capital and capital adequacy ratios" section of the Directors' Report.

#### \*Liquidity risk

Liquidity risk is defined as the risk of being unable to fulfil current or future payment obligations in full on or at the due date.

The Bank's liquidity management controls monitor the cash flow of the business in such a manner as to ensure that efficient use of cash flows is maintained. To this extent, the Bank primarily funds its assets through the issuance of Asset Covered Securities. The Bank is contractually obliged to over-collateralisation of the cover pool with respect to the securities issued at a minimum level of 5%. The Bank is also obliged to ensure that the interest payable in a given period of 12 months in respect of the issued securities is less than the total amount of interest receivable on the cover pool.

The majority of assets held inside and outside of the cover pool either pay a floating rate return or are swapped to a floating rate return through the use of derivative transactions. When outside the cover pool, these assets are financed primarily through the repurchase market with the principal counterparties being the ECB and the FED or financed by inter-company loans.

The extraordinary events in which the HRE Group found itself confronted with, serious liquidity problems that posed a threat to its very existence, are disclosed extensively in the section "Major events".

#### Liquidity risk management:

The management of the liquidity risk of the HRE Group, which encompasses the Bank, is the joint responsibility of the HRE Group asset and liability committee ("HRE Group ALCO") and the HRE Group Risk Management Committee ("HRE Group RC").

In addition to the HRE Group ALCO, the Group has also established an Asset and Liability Committee ("DEPFA ALCO"), which is responsible for the management of the liquidity risk in the Group. The DEPFA ALCO consists of the Group Chief Executive Officer, the Group Chief Financial Officer, the Group Chief Risk Officer, the Group Treasury Director, the Group Head of Treasury Americas, the Group Head of Risk Control, the Group Head of Liquidity Management and the HRE Group Head of ALM (Asset and Liability Management). The directors of DEPFA ACS BANK have mandated DEPFA ALCO to manage the liquidity position of the Bank.

With specific regard to liquidity risk, the DEPFA ALCO is responsible for:

- The development and implementation of the HRE Group's liquidity policy.
- The review and management of Group liquidity.
- The review of liquidity scenario stress testing results.
- The review and approval of contingency funding plans.
- The setting of targets for the long and short term funding mix.
- The preparation of the annual funding and liquidity plan.

The liquidity management of the Bank also complies with the liquidity requirements set down by the Irish Financial Regulator.

#### Liquidity risk management through the Bank's business model:

Aspects of the business model of the Bank, as they impact liquidity risk, are summarised through review of the following characteristics of the Bank's statement of financial position:

- Credit quality of the Bank's assets

\* Forms an integral part of the audited financial statements

## **Credit quality of the Bank's assets:**

The Bank's statement of financial position is predominantly composed of highly rated assets of high credit quality. Some 35% of the assets of the Bank as at 31 December 2009 are AAA rated using internal ratings models whilst a further 50% are AA rated. This reflects the concentration on public sector lending to the top tier of sovereigns and sub-sovereigns. In general, the higher the rating of the asset base, the better the access the Bank has to both the secured short-term funding markets, such as bilateral and tri party repo markets, and the long-term covered security market.

Please see notes to the financial statements for analysis of assets and liabilities into relevant maturity groupings based on the remaining period at balance sheet date to the contractual maturity date.

## **Takeover bids regulations**

There is only one class of shares and all of the shares are owned ultimately by Hypo Real Estate Holding AG, there are no restrictions on the transfer or voting rights of these shares. For further details please refer to note 28 to the financial statements.

## **Auditors**

The auditors, KPMG Chartered Accountants, have indicated their willingness to continue in office in accordance with section 160 (2) of the Companies Act, 1963.

## **On behalf of the Board**

**John Bourke**  
Director

**Cyril Dunne**  
Director

**Stephane Rio**  
Director

**Elaine Tiernan**  
Company Secretary

**15 March 2010**

# Independent Auditor's Report to the Members of DEPPFA ACS BANK

## Independent Auditor's Report to the Members of DEPPFA ACS BANK

We have audited financial statements ("financial statements") of DEPPFA ACS BANK ("the Bank") for the year ended 31 December 2009 which comprise the Income Statement, the Statement of Comprehensive Income, the Statement of Financial Position, the Cash Flow Statement, the Statement of Change in Shareholders' Equity and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Bank's members, as a body, in accordance with section 193 of the Companies Act 1990. Our audit work has been undertaken so that we might state to the Bank's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Bank and the Bank's members as a body, for our audit work, for this report, or for the opinions we have formed.

### Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU are set out in the Statement of Directors' Responsibilities on page 6.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view in accordance with IFRSs as adopted by the EU, and have been properly prepared in accordance with the Companies Acts 1963 to 2009. We also report to you, in our opinion whether proper books of account have been kept by the Bank; whether at the year-end date, there exists a financial situation requiring the convening of an extraordinary general meeting of the Bank; and whether the information given in the Directors' Report is consistent with the financial statements. In addition, we

state whether we have obtained all the information and explanations necessary for the purposes of our audit, and whether the financial statements are in agreement with the books of account.

We also report to you if, in our opinion, any information specified by law regarding directors' remuneration and directors' transactions is not disclosed and, where practicable, include such information in our report.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

### Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Bank's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

### Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state

## Independent Auditor's Report to the Members of DEPFA ACS BANK

of the Bank's affairs as at 31 December 2009 and of its profit for the year then ended; and

- the financial statements have been properly prepared in accordance with the Companies Acts 1963 to 2009.

**Other matters** We have obtained all the information and explanations which we consider necessary for the purposes of our audit. In our opinion proper books of account have been kept by the Bank. The Bank statement of financial position is in agreement with the books of account.

In our opinion the information given in the directors' report is consistent with the financial statements.

The net assets of the Bank, as stated in the Bank statement of financial position are not less than half of the amount of its called-up share capital and, in our opinion, on that basis there did not exist at 31 December 2009 a financial situation which under Section 40 (1) of the Companies (Amendment) Act, 1983 would require the convening of an extraordinary general meeting of the Bank.

### Emphasis of Matter – Going Concern Basis of Accounting

In forming our opinion which is not qualified we have considered the adequacy of the disclosures in the "Major events" section on page 7 and in the "Going concern" section on pages 11 and 12 and in Note 2 to the financial statements on page 31 concerning the appropriateness of going concern basis of accounting in the preparation of the financial statements of the Bank for the year ended 31 December 2009.

The financial statements have been prepared on a going concern basis which assumes that the Bank will continue in operation and meet its debts as they fall due for a minimum period of 12 months from the date of this report. Given its significance, we wish to draw the readers' attention to the underlying assumptions underpinning the application of the going concern basis of accounting to the Bank's financial statements for the year ended 31 December 2009. Set-out below in our view are the key assumptions.

- The future existence of the Hypo Real Estate Group ("HREG") depends on the assumption that sufficient equity will be provided to HREG and their subsidiaries to fulfil the supervisory regulations for own funds and sufficient to avoid a situation of insolvency. External

liquidity support is necessary to avert insolvency due to illiquidity of the significant subsidiaries of the HREG or Hypo Real Estate Holding AG ("HRE AG") itself. These liquidity supports must be available until HREG and its subsidiaries raise sufficient liquidity on the money and capital markets by themselves and the agreed restructuring arrangements are implemented as scheduled.

- To ensure the future existence of the HRE AG it is particularly necessary that:
  - The Financial Markets Stabilisation Fund ("SoFFin") continues to provide sufficient equity capital;
  - SoFFin and the Deutsche Bundesbank maintain their liquidity support and, if necessary, provide further liquidity assistance until such time as HRE AG and its principal subsidiaries raise liquidity in the capital markets themselves;
  - Increased refinancing with sustainable conditions on the money and capital markets is possible;
  - The restructuring arrangements will be implemented as scheduled;
  - The appropriate authorities do not take regulatory actions which are unforeseen and which would not permit the HREG to fully implement its recovery plan; as well as
  - no legal reservations (especially EU legal actions) will be successfully enforced.

Access to the liquidity support and to additional capital by the Bank can only be made through the Bank's ultimate parent company, HRE AG. In the absence of this continuing support from the parent Bank for both current and future funding requirements the Bank would not be in a position to continue in operational existence as a going concern. The financial statements do not include the adjustments that would result if the Bank was unable to continue as a going concern.

### KPMG

Chartered Accountants  
Registered Auditor  
1 Harbourmaster Place  
IFSC  
Dublin 1  
Ireland

15 March 2010

## Income statement

| For the year ended 31 December 2009        |      |            |            |  |
|--|------|------------|------------|--|
| € m  | Note | 2009       | 2008       |  |
| Interest and similar income                |      | 2,428      | 3,054      |  |
| Interest expense and similar expenses      |      | -2,339     | -2,918     |  |
| <b>Net interest income</b>                 | 5    | <b>89</b>  | <b>136</b> |  |
| Commission expenses                        |      | -58        | -11        |  |
| <b>Net fee and commission expense</b>      | 6    | <b>-58</b> | <b>-11</b> |  |
| Net trading income                         | 7    | 2          | -20        |  |
| Net (loss)/income from hedge relationships | 8    | -10        | 14         |  |
| Other operating income/expense             | 9    | 1          | -1         |  |
| <b>Total operating revenues</b>            |      | <b>24</b>  | <b>118</b> |  |
| Provision for losses on loans and advances | 16   | -10        | -          |  |
| General administrative expenses            | 10   | -7         | -17        |  |
| <b>Pre-tax profit</b>                      |      | <b>7</b>   | <b>101</b> |  |
| Taxes on income                            | 11   | -          | -12        |  |
| <b>Net income</b>                          |      | <b>7</b>   | <b>89</b>  |  |
| <b>Attributable to:</b>                    |      |            |            |  |
| Equity holders of the parent               |      | 7          | 89         |  |

The notes on pages 30 to 54 are an integral part of these financial statements.

**John Bourke**  
Director

**Cyril Dunne**  
Director

**Stephane Rio**  
Director

**Elaine Tiernan**  
Company Secretary

15 March 2010

# Statement of comprehensive income

## Statement of comprehensive income

| € m                                | 1 Jan – 31 December 2009 |           |           | 1 Jan – 31 December 2008 |           |           |
|------------------------------------|--------------------------|-----------|-----------|--------------------------|-----------|-----------|
|                                    | Before tax               | Tax       | After tax | Before tax               | Tax       | After tax |
| Net income                         | 7                        | -         | 7         | 101                      | -12       | 89        |
| AFS reserve movement - net         | 10                       | -1        | 9         | -86                      | 11        | -75       |
| <b>Total</b>                       | <b>17</b>                | <b>-1</b> | <b>16</b> | <b>15</b>                | <b>-1</b> | <b>14</b> |
| Attributable to the equity holders | 17                       | -1        | 16        | 15                       | -1        | 14        |

## Disclosure of components of comprehensive income

| € m  | 1 Jan – 31 Dec 2009 | 1 Jan – 31 Dec 2008 |
|--|---------------------|---------------------|
| Net income   | 7                   | 89                  |
| AFS reserve movement - net   | 9                   | -75                 |
| Gains/(losses) arising during the year                                   | 9                   | -75                 |
| Reclassification adjustments for gains/losses included in profit or loss | -                   | -                   |
| <b>Total</b>   | <b>16</b>           | <b>14</b>           |

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**John Bourke**  
Director

**Cyril Dunne**  
Director

**Stephane Rio**  
Director

**Elaine Tiernan**  
Company Secretary

15 March 2010

## Statement of financial position

| As at 31 December 2009                       |      |               |               |
|--|------|---------------|---------------|
| € m  | Note | 2009          | 2008          |
| <b>ASSETS</b>                                |      |               |               |
| Cash reserves                                | 12   | 22            | 31            |
| Trading assets                               | 13   | 1,163         | 1,301         |
| Loans and advances to other banks            | 14   | 21,675        | 25,139        |
| Loans and advances to customers              | 15   | 53,806        | 57,879        |
| Allowances for losses on loans and advances  | 16   | -10           | -             |
| Financial investments                        | 17   | 7,555         | 8,239         |
| Other assets                                 | 18   | 2,739         | 3,467         |
| Deferred tax assets                          | 19   | 9             | 11            |
| <b>Total assets</b>                          |      | <b>86,959</b> | <b>96,067</b> |
| <b>LIABILITIES</b>                           |      |               |               |
| Liabilities to other banks                   | 22   | 29,642        | 34,623        |
| Liabilities evidenced by certificates        | 23   | 50,842        | 52,773        |
| Trading liabilities                          | 24   | 1,041         | 1,388         |
| Other liabilities                            | 25   | 4,230         | 5,926         |
| Current tax liabilities                      | 26   | 1             | 13            |
| Subordinated capital                         | 27   | 632           | 629           |
| <b>Total liabilities</b>                     |      | <b>86,388</b> | <b>95,352</b> |
| <b>EQUITY</b>                                |      |               |               |
| <b>Equity attributable to equity holders</b> |      |               |               |
| Share capital                                | 28   | 510           | 510           |
| Retained earnings                            | 29   | 127           | 280           |
| Other reserves                               | 30   | -66           | -75           |
| <b>Total equity</b>                          |      | <b>571</b>    | <b>715</b>    |
| <b>Total equity and liabilities</b>          |      | <b>86,959</b> | <b>96,067</b> |

The notes on pages 30 to 54 are an integral part of these financial statements.

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Director

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Company Secretary

15 March 2010

## Statement of changes in equity

### Statement of changes in equity

| For the year ended 31 December 2009                         |               |                   |  |  |              |
|---|---------------|-------------------|--|--|--------------|
| € m   | Share capital | Retained earnings | Unrealised gains/<br>losses from<br>cash flow hedges | Unrealised gains/<br>losses from available-<br>for-sale securities | Total equity |
| <b>Balance at 1 January 2008 as<br/>previously reported</b> | <b>510</b>    | <b>187</b>        | -  | -  | <b>697</b>   |
| Effect of change in accounting policy                       | -             | 4                 | -  | -  | 4            |
| <b>Balance at 1 January 2008 restated</b>                   | <b>510</b>    | <b>191</b>        | -  | -  | <b>701</b>   |
| Profit for the year   | -             | 89                | -  | -  | 89           |
| Net change in available-for-sale<br>investments, net of tax | -             | -                 | -  | -75  | -75          |
| <b>Total comprehensive income</b>                           | -             | <b>89</b>         | -  | <b>-75</b>   | <b>14</b>    |
| <b>Balance at 31 December 2008</b>                          | <b>510</b>    | <b>280</b>        | -  | <b>-75</b>   | <b>715</b>   |
| Profit for the year   | -             | 7                 | -  | -  | 7            |
| Net change in available-for-sale<br>investments, net of tax | -             | -                 | -  | 9  | 9            |
| <b>Total comprehensive income</b>                           | -             | <b>7</b>          | -  | <b>9</b>   | <b>16</b>    |
| <b>Dividends</b>  | -             | <b>-160</b>       | -  | -  | <b>-160</b>  |
| <b>Balance at 31 December 2009</b>                          | <b>510</b>    | <b>127</b>        | -  | <b>-66</b>   | <b>571</b>   |

The notes on pages 30 to 54 are an integral part of these financial statements.

## Cash flow statement

| For the year ended 31 December 2009                              |           |             |               |
|--|-----------|-------------|---------------|
| € m  | Note      | 2009        | 2008          |
| <b>Cash flows from operating activities</b>                      |           |             |               |
| <b>Pre-tax profit</b>  |           | <b>7</b>    | <b>101</b>    |
| Adjustments for non-cash movements:                              |           |             |               |
| Foreign exchange loss  |           | -           | 1             |
| Net decrease/(increase) in accrued interest income               |           | 662         | -98           |
| Net (decrease)/ increase in accrued interest expense             |           | -691        | 98            |
| Provision for losses on loans                                    |           | 10          | -             |
| Losses on sale of investment securities and loans                |           | 8           | 11            |
| Other non cash items   |           | -3          | 8             |
| Net decrease/(increase) in loans and advances to other banks     |           | 3,567       | -9,688        |
| Net decrease/(increase) in loans and advances to customers       |           | 2,605       | -6,700        |
| Net decrease in other assets                                     |           | 45          | -             |
| Net (decrease)/increase in liabilities to other banks            |           | -5,180      | 16,828        |
| Net (decrease)/increase in liabilities evidenced by certificates |           | -1,023      | 2,325         |
| Net increase in other liabilities                                |           | 2           | 19            |
| Net increase/(decrease) in trading derivatives                   |           | 2           | -113          |
| Tax paid   |           | -12         | -             |
| <b>Net cash from operating activities</b>                        |           | <b>-1</b>   | <b>2,792</b>  |
| <b>Cash flows from investing activities</b>                      |           |             |               |
| Purchase of investment securities                                |           | -           | -3,204        |
| Sale/maturity of investment securities                           |           | 161         | 405           |
| <b>Net cash from investing activities</b>                        |           | <b>161</b>  | <b>-2,799</b> |
| <b>Cash flows from financing activities</b>                      |           |             |               |
| Dividends paid   |           | -160        | -             |
| <b>Net cash from financing activities</b>                        |           | <b>-160</b> | <b>-</b>      |
| <b>Net increase in cash and cash equivalents</b>                 |           | <b>-</b>    | <b>-7</b>     |
| <b>Cash and cash equivalents at the beginning of the year</b>    |           | <b>-</b>    | <b>7</b>      |
| Effect of exchange rate changes on cash and cash equivalents     |           | -           | -             |
| <b>Cash and cash equivalents at the end of the year</b>          | <b>12</b> | <b>-</b>    | <b>-</b>      |

Included in the cash flows for the year are the following amounts:

| € m                      | 2009  | 2008  |
|--------------------------|-------|-------|
| Interest income received | 3,090 | 2,945 |
| Interest expense paid    | 3,029 | 2,809 |

The notes on pages 30 to 54 are an integral part of these financial statements.

## Notes to the financial statements

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## 01 General information

DEPFA ACS BANK (“the Bank”) is part of the DEPFA Group (“the Group”), which comprises DEPFA BANK plc and its subsidiaries.

The Bank’s primary purpose is the issuance of Asset Covered Securities (“ACS”) in accordance with the Irish Asset Covered Securities Act, 2001 as amended by the Asset Covered Securities (Amendment) Act 2007 (“the Legislation”). Accordingly the principal activities of the Bank have been the origination and acquisition of public sector assets and the issuance and ongoing administration of ACS in accordance with the Legislation. The ACS are secured by a cover pool of public sector assets (“the cover pool”) which also includes cover asset hedge contracts. The jurisdictions of the public sector entity with the financial obligation under the assets are restricted by the Legislation to member countries of the European Economic Area, USA, Canada, Japan, Switzerland, Australia and New Zealand.

The Bank is regulated by the Irish Financial Regulator, and has a full banking licence. In addition, the Bank is a designated credit institution as defined under the Legislation.

On 2 October 2007 the entire ordinary share capital of DEPFA BANK plc, the parent of the Bank, was acquired by Hypo Real Estate Holding AG (“HRE Holding”), the parent entity of the Hypo Real Estate Group (“the HRE Group”).

As part of the recapitalisation of the HRE Group, the German Financial Markets Stabilisation Fund/German Finanzmarktstabilisierungsfonds (“SoFFin”) became the only shareholder of Hypo Real Estate Holding AG on 13 October 2009.

There has been no change in the ownership of the Bank during 2009.

## 02 Summary of significant accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below.

### Consistency

These policies have been consistently applied in accordance with the framework of IFRS as well as IAS 1 and IAS 8. In principle, in the financial year 2009 no accounting policies for recognition, measurement and disclosure were changed unless otherwise stated.

### Impact of new and amended standards

The following significant standards and amendments to standards became effective during 2009:

IAS 1 Presentation of Financial Statements - The statement

of comprehensive income is required by the revised IAS 1 that has been applied for the first time in 2009. This statement starts from profit/(loss) for the period, presents items of income and expense which were not recognised in the net profit or loss, in compliance with international financial reporting standards. These items relate to changes in the fair value and impairment of available-for-sale financial assets and changes in the currency translation reserve.

IFRS 7 Financial Measurement Disclosures - On 5 March 2009, the International Accounting Standards Board (IASB) issued Improving Disclosures about Financial Instruments: Disclosures. The amended IFRS 7 requires that for financial instruments measured at fair value on balance sheet fair value measurements are disclosed by the source of inputs, using a three level hierarchy. For detail on this requirement see note 36 Fair value of financial assets and liabilities.

### Basis of preparation

These financial statements have been prepared in accordance with European Union (EU) endorsed International Financial Reporting Standards (“IFRSs”), IFRIC interpretations and also the Companies Act, 1963 to 2009 applicable to companies reporting under IFRSs and the European Communities (Credit Institutions: Accounts) Regulations, 1992.

The financial statements are prepared on a going concern basis as the directors have assumed that the Bank will continue in operation under the conditions described as external and internal factors below and as described in the Directors’ Report in the “Major events” section on pages 7 and 8 and in the “Going concern” section on pages 11 and 12.

This assumption is predicated on the fact that based on present information, the HRE Group Management Board considers it predominantly probable that these conditions are in existence or will occur.

### External factors:

- The HRE Group will receive further essential liquidity support from SoFFin in respect of terms and total volume. Moreover, the HRE Group will receive necessary capital support from SoFFin to strengthen its capital base. These supports will be granted under reasonable conditions. No legal reservations, especially EU legal actions, will be successfully enforced.
- The capital markets environment will begin to stabilise from 2010 to 2012, particularly if there is no further serious deterioration of the financial market crisis from unforeseeable consequences, for instance triggered by external shocks such as the collapse of numerous major states or major banks, and the crisis of the real estate markets does not result in defaults of loans and securities to an extent which would pose a threat to the existence of the HRE Group.
- The interbank market and other short-term unsecured refinancing markets as well as the long-term secured and

## Notes to the financial statements

unsecured refinancing markets will start to recover from 2010. The ratings of the companies in the HRE Group will stabilise or slightly increase. The support can be covered by own funding in the following years.

### Internal factors:

- The HRE Group further succeeds in regaining the confidence of customers and successfully writes new business subject to adequate volumes and adequate margins.
- There are no significant delays or obstructions of the implementation of the restructuring of the HRE Group that aims to improve efficiency, profitability and streamlining of business processes.
- Work-out or restructuring of non-performing loans throughout the HRE Group can be implemented as currently scheduled.
- The HRE Group has been given the possibility of streamlining assets without a severe impact on value and of transferring balance sheet items by way of establishing a deconsolidated environment.
- The HRE Group is able to hire and keep staff in key positions despite specific restrictions, for example, on compensation.

On 28 March 2009, SoFFin confirmed in writing to HRE Holding and to Deutsche Pfandbriefbank AG (formerly Hypo Real Estate Bank AG) that it intended to stabilise HRE Holding in a sustainable manner by way of adequate recapitalisation and Deutsche Pfandbriefbank AG by further sufficient extensions of guarantees. SoFFin renewed its statement of intent on 6 November 2009. In particular, SoFFin has confirmed that it will provide adequate capital to ensure at least the continued existence of HRE Holding and its main subsidiaries as going concerns as well as the necessary viable business model, particularly that of Deutsche Pfandbriefbank AG. The support which the HRE Group overall receives from the German Federal Government depends on the result of a final review as to whether a deconsolidated environment will be established for non-strategic or non-performing assets of the HRE Group. In addition, SoFFin will provide further guarantees to assure the liquidity of HRE Holding. These and possible further measures are conditional on meeting the aid law requirements of the EU Commission.

As the first step towards recapitalising the HRE Group, SoFFin took up 20 million HRE Holding shares on 28 March 2009 for a legal minimum price of € 3.00 per share, with shareholders' subscription rights excluded. As the second step of recapitalisation of the HRE Group, the shareholders adopted a resolution regarding a capital increase of around € 2.96 billion in return for a cash contribution at the Extraordinary General Meeting held on 2 June 2009. 986.5 million shares were issued at the nominal value and legal minimum price of € 3.00 specified in the articles of incorporation. Only SoFFin was permitted to take up the new shares out of the capital increase, and the statutory shareholders' subscription rights were excluded. After the registration of the capital increase on 8 June 2009, SoFFin held 90% of HRE Holding share capital. On 5 October 2009, a resolution for transferring the shares of the minori-

ty shareholder to SoFFin was adopted at an Extraordinary General Meeting. The Amtsgericht (local court) in Munich entered the transfer resolution on the commercial register on 13 October 2009, so that SoFFin became the only shareholder of HRE Holding. As a third step in the recapitalisation process, the HRE Group received a further capital contribution of a total of € 3.0 billion from the SoFFin in November 2009. This tranche consists of a silent participation of € 1.0 billion to Deutsche Pfandbriefbank AG, a contribution of € 1.3 billion to the reserve of Deutsche Pfandbriefbank AG and a contribution of € 0.7 billion to the reserve of HRE Holding.

HRE Holding and Deutsche Pfandbriefbank AG have provided a commitment to SoFFin that they will take the steps necessary for implementing the recapitalisation process.

The preparation of financial statements in conformity with IFRSs requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Bank's accounting policies. The areas involving a higher degree of judgement or complexity or areas where assumptions and estimates are significant to the financial statements are disclosed in note 4.

### Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

The Bank's income and assets are entirely attributable to public sector financing. The Bank is solely located in Ireland. Therefore no segmental report is presented.

### Foreign currency translation

Currency translation is carried out in accordance with the regulations of IAS 21. On the reference date for the financial statements, monetary items in a foreign currency are translated into the functional currency. The reporting currency is the Euro. Non-monetary items which were stated in a foreign currency using historical cost of purchase are stated using the exchange rate applicable at the point they were purchased.

Income and expenditures attributable to currency translation are normally shown in the income statement under "Other operating income/expense".

## Interest income and expense

Interest income and expense are recognised in the income statement for all interest-bearing financial instruments using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

The interest element of all derivatives and financial instruments designated at fair value through profit or loss (“dFVTPL”) is included in “Net interest income”.

## Fee and commission expense

Fees and commissions which are not part of the effective interest rate calculation are generally recognised on an accruals basis when the service has been provided.

Commitment fees, together with related direct costs, for loan facilities where draw down is probable are deferred and recognised as an adjustment to the effective interest on the loan once drawn. Commitment fees in relation to facilities where draw down is not probable are recognised over the term of the commitment in “Net fee and commission expense”.

Other advisory and service fees are recognised when the service has been provided.

## Financial instruments

According to IAS 32, a financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

**Recognition and derecognition** the Bank recognises a financial asset or a financial liability on its statement of financial position when, and only when, it becomes party of the contractual provisions of the financial instrument.

The purchases or sales of financial instruments are accounted for at trade date. Premiums and discounts appear in the position “Net interest income” for the accounting period in question in line with the effective interest rate. In accor-

dance with the primary derecognition concept of IAS 39, a financial asset has to be derecognised when all risks and rewards have mainly been transferred. If the main risks and rewards associated with ownership of the transferred financial asset are neither transferred nor retained, and if the power of disposal continues to be exercised over the transferred asset, the company has to recognise the asset to the extent of the supposed continuing involvement. There are no transactions within the Bank which result in partial derecognition due to a continuing involvement.

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

**Categories pursuant to IAS 39** Initially, when a financial asset or financial liability is recognised, it is measured at its fair value.

For subsequent measurement according to IAS 39, all financial instruments have to be classified according to this standard, to be recognised in the statement of financial position and to be measured according to its categorisation.

### (a) Designated at fair value through profit or loss (“dFVTPL”)

If certain conditions are satisfied, financial assets or liabilities can be classified at their fair value through profit or loss when they are initially stated. A designation can be made if the use of the valuation category means that a recognition and valuation inconsistency is either avoided or considerably reduced, or the management and performance measurement of a portfolio of financial instruments are based on the fair values or if the instrument contains a separable embedded derivative. The Bank classifies financial assets under the dFVTPL category only for the first two cases. Financial liabilities are not allocated to this category. The portfolio of fixed-income securities and loans and advances is managed on fair value basis. In addition, open interest risk positions of the portfolio are to a large extent closed by hedging derivatives. Because changes in the value of derivatives under IAS 39 in principle have to be recognised in profit or loss, the designation of fixed income securities and loans and advances under the category dFVTPL will avoid inconsistency in terms of valuation. As a result of the designation of fixed income securities and loans and advances, the opposite movements relating to the hedged risk in the income statement cancel each other to a large extent. The accounting treatment is accordingly consistent with risk management and the investment strategy.

dFVTPL financial instruments are measured at fair value. Changes in fair value are recognised in profit or loss. The amount of change, during the period and since initial recognition, in the fair value of the loan and advance that is attributable to changes in the credit risk of the financial asset is disclosed in the notes. The amount is determined as the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risks. Hence, the amount resulting from credit risk is the difference between the total change of fair value and the change attributable to market risks. Because financial

## Notes to the financial statements

liabilities are not designated in the category dFVTPL, the Bank does not have any effect resulting from the instruments being valued with the own current credit risk. The fixed income securities under the category dFVTPL are stated under the item of “Financial investments”, the loans and advances under “Loans and advances to other customers”. Interest income from the securities and loans and advances is shown under the position “Net interest income”. The changes in value to be recognised in profit or loss (net gains and net losses from fair value option) are stated under the line “Net income from hedge relationships” in the same way as the changes in value of the corresponding derivatives.

No financial assets or liabilities were classified as dFVTPL in financial years 2009 and 2008.

**(b) Held-for-trading** A financial asset or a financial liability is held for trading if it is:

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

Held-for-trading financial instruments are measured at fair value. Changes in fair value are recognised in profit or loss. Held-for-trading financial instruments are stated under “Trading assets” and “Trading liabilities”. Interest and dividend income as well as the refinancing costs for the trading instruments are shown in “Net trading income”.

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

No financial assets or liabilities were classified as Held-for-trading in financial years 2009 and 2008.

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

Loans and receivables are recognised in the positions “Loans and advances to other banks”, “Loans and advances to customers” and “Financial investments”, and are measured at amortised cost. Interest income from loans and receivables are shown in “Net interest income”. Market price related net gains and net losses attributable to prepayment penalties and selling of loans and advances to customers and of loans and advances to other banks are

shown under the position “Net interest income”. Such net gains and net losses are shown in “Net income from financial investments” for financial investments. Reductions in value due to credit standing factors are shown under “Provisions for losses on loans and advances” for loans and advances in “Net income from financial investments” for financial investments.

**(d) Held-to-maturity (“HtM”)** investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that are quoted on an active market and that an entity has the positive intention and ability to hold to maturity. HtM financial investments are measured at amortised cost.

No financial assets were classified as HtM in financial years 2009 and 2008.

**(e) Available-for-sale (“Afs”)** assets are those non-derivative financial assets that are designated as available for sale and which are not categorised as loans and receivables, held-to-maturity investments or financial assets at fair value through profit or loss.

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

AfS financial assets are disclosed under “Financial investments”. Interest income from AfS assets is stated under the position “Net interest income”. Net gains and net losses generated by the disposal of AfS financial instruments as well as by changes in value as a result of impairment or write-ups to be recognised in profit or loss are shown under “Net income from financial investments.”

**(f) Financial liabilities** are those non-derivative financial liabilities that are not classified at fair value through profit or loss.

Financial liabilities are measured at amortised cost. Financial liabilities that are not securitised are recognised in the positions “Liabilities to other banks”. If these financial liabilities are securitised and not subordinated, they are disclosed in “Liabilities evidenced by certificates”. Subordinated liabilities are shown in “Subordinated capital”. Interest expenses from financial liabilities are shown under the position “Net interest income”. In addition, the position “Net interest income” includes net gains and net losses attributable to repurchases or withdrawals from financial liabilities before maturity.

Financial liabilities are derecognised when they are extinguished – that is when the obligation is discharged, cancelled, or expires.

### Classes

IFRS 7 requires disclosures according to classes of financial instruments. The Bank mainly defined the IAS 39 measurement categories, irrevocable loan commitments, financial guarantees, hedging derivatives and cash reserve as classes.

### Valuation methods

Financial instruments which have to be measured at fair value are valued on the basis of stock market prices or other market prices, if existent. If a price is not available from an active market, observable market prices from comparable financial instruments were used. If prices from comparable financial instruments are not available, valuation models are used that base on observable market parameters. If these parameters are neither observable at the markets, the valuation of the financial assets is based on models with non-market-observable parameters. The used valuation models are market standard models. A description of these models and the products is given in the note “fair values of financial assets and liabilities”.

### Financial guarantee contracts

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument.

Financial guarantees are initially recognised in the financial statements at fair value on the date the guarantee was given. Subsequent to initial recognition, the Bank’s liabilities under such guarantees are measured at the higher of the initial measurement, less amortisation calculated to recognise in the income statement the fee income earned on a straight line basis over the life of the guarantee and the best estimate of the expenditure required to settle any financial obligation arising at the statement of financial position date. These estimates are determined based on experience of similar transactions and history of past losses, supplemented by the judgement of Management.

### Derivative financial instruments and hedge accounting

**Derivatives** are used for trading and hedging purposes. They include, in particular, interest rate swaps, cross-currency swaps, foreign exchange forwards, and credit derivatives.

The best evidence of the fair value of a derivative at initial

recognition is the transaction price (i.e. the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. Where such evidence exists, the Bank recognises profits or losses on day one being the difference between the price and fair value at initial recognition. Where such evidence does not exist, day one profit or loss is deferred and recognised in the income statement to the extent that it arises from a change in a factor (including time) that market participants would consider in setting a price. Straight line amortisation is used where it approximates the above. Subsequent changes in fair value are recognised immediately in the income statement without reversal of deferred day one profits or losses.

Derivatives are measured at fair value. Changes in fair value are recognised in the income statement if the derivatives are not recognised in cash flow hedge accounting. The valuation results from stand-alone derivatives are shown in “Net trading income” and from hedging derivatives in “Net income from hedge relationships”. The interest from all derivatives is disclosed in the position “Net interest income”. In the statement of financial position stand-alone derivatives are disclosed under “Trading assets” when fair value is positive and “Trading liabilities” when fair value is negative and hedging derivatives under “Other assets” when fair value is positive and “Other liabilities” when fair value is negative.

**Embedded Derivatives** Certain derivatives embedded in other financial instruments are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement.

**Hedging derivatives** The method of recognising the resulting fair value gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Bank designates certain derivatives as either:

- (a) hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedge); or
- (b) hedges of highly probable future cash flows attributable to a recognised asset or liability, or a forecasted transaction (cash flow hedge).

Hedge accounting is used for derivatives designated in this way provided certain criteria are met.

The Bank documents, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Bank also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

## Notes to the financial statements

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

If the hedge of the fair value in the course of the reporting period satisfies the criteria of IAS 39.88, the hedge is stated in the statement of financial position as follows:

- The profit or loss arising when the hedging instrument is revalued with its fair value (for a derivative hedging instrument) or the currency component of its carrying amount calculated in accordance with IAS 21 (for non-derivative hedging instruments) is recognised in profit or loss for the period.
- The carrying amount of an underlying transaction is adjusted by the profit or loss arising from the underlying transaction and attributable to the hedged risks, and is recognised in profit or loss for the period. This is applicable if the underlying transaction is otherwise stated using the costs of purchase. The profit or loss attributable to the hedged risk is recognised in profit or loss for the period if the underlying transaction is AFS financial asset. The amortisation of the hedge adjustment is started at the designation of the hedge relationship.

The Bank uses fair value hedge accounting for presenting micro-hedge relationships. Fair value hedge accounting is not used for a portfolio of interest risks. Ineffectiveness within the range permitted under IAS 39 is shown in the line “Net income from hedge relationships”. For measuring effectiveness the regression analysis is mainly used. The dollar offset method is applied in some cases for quantifying the ineffectiveness. If the hedge relationship is terminated for reasons other than the derecognition of the hedged item, the difference between the carrying amount of the hedged item at that point and the value at which it would have been carried, had the hedge never existed (the unamortised fair value adjustment), is amortised to the income statement over the remaining term of the original hedge. If the hedged item is derecognised, e.g. due to sale or repayment, the unamortised fair value adjustment is recognised immediately in the income statement.

**(b) Cash flow hedge** The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement.

Amounts accumulated in equity are recycled to the income statement in the periods in which the hedged item will affect profit or loss (for example, when the forecast sale that is hedged takes place). The transfer is to the income statement line item which includes the hedged item.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast trans-

action is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

### Derivatives that do not qualify for hedge accounting

Some derivatives, while being economic hedges, do not meet the detailed hedge accounting criteria under IFRSs. Derivatives that do not qualify for hedge accounting are accounted for as part of the trading portfolio.

### Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

### Impairment of financial assets

According to IAS 39.58 a financial asset must be tested for impairment. At each statement of financial position date the Bank assesses on a case-by-case basis whether there is objective evidence for impairment. The criteria used to determine if there is such objective evidence included:

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

Two types of impairment allowances are in place: individual allowances and portfolio-based allowances. Allowances for loans and advances are disclosed in a separate account “Allowances for losses on loans and advances” rather than directly reducing the carrying amount of the assets. The expense is shown under “Provision for losses on loans and advances” in the income statement. Individual allowances on AFS financial investments as well as individual allowances and portfolio-based allowances on LaR financial assets are directly deducted from the carrying amount of the assets. The expense is shown under “Net income from financial investments” in the income statement. Where subsequent measurement of financial assets is based on fair value through profit or loss, an impairment is implied in the fair value.

The Bank records an impairment on loans and advances as well as financial investments whose terms have been renegotiated if there is objective evidence for impairment.

In determining allowances on individually assessed accounts, the following factors are especially considered:

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

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

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

#### Cash and cash equivalents

For the purposes of the cash flow statement, “Cash and cash equivalents” comprise of cash reserves including balances with central banks other than mandatory reserve deposits.

#### Employee benefits

**(a) Pension scheme** The Bank operates a defined contribution scheme. A defined contribution scheme is a pension plan under which the Bank pays fixed contributions into a separate fund. In these plans the Bank has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods.

The Bank pays contributions to privately administered pension insurance plans on a mandatory, contractual or voluntary basis. The Bank has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

**(b) Share compensation scheme** In 2002 the Group established an incentive compensation programme under which share awards were made to employees and directors of the Group for no cash consideration. The incentive compensa-

tion programme no longer operates. All shares due under the award scheme were vested to employees of the Group in the second quarter 2009. As of 31 December 2009 no company of the Group has provided a commitment for share-based compensation.

#### Income tax

Current income tax payable on profits, based on the applicable tax law, is recognised as an expense in the period in which profits arise. The tax effects of income tax losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.

Deferred income tax is provided in full on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the statement of financial position date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting, nor taxable profit or loss.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax related to the fair value re-measurement of available-for-sale investments and cash flow hedges, which are charged or credited directly to equity, is also credited or charged directly to equity and is subsequently recognised in the income statement together with the deferred gain or loss.

#### Comparatives

Where necessary, comparative figures have been adjusted to conform with changes in presentation in the current year.

#### Trading assets

Trading assets comprise positive market values of stand-alone derivatives in the banking book.

Trading assets are stated with their fair value. In the case of derivative and original financial transactions which are not listed on an exchange, internal price models based on cash value considerations and option price models are used as the basis of calculating the statement of financial position value. Valuation and realised profits and losses

## Notes to the financial statements

attributable to trading assets are stated under net trading income in the income statement.

### Loans and advances

“Loans and advances to other banks” and “Loans and advances to customers” are disclosed under IAS 39 with their amortised cost of purchase if they are not categorised dFVTPL or AfS or an underlying transaction of a fair value hedge. dFVTPL financial instruments are measured at fair value. Changes in fair value are recognised in profit or loss. As of 31 December 2009, and as of 31 December 2008, the Bank did not have loans and advances which are categorised as AfS.

Allowances for losses on loans and advances are shown under a separate line item “Provisions for losses on loans and advances” in the income statement. All other income and expenses from loans and advances including net gains and net losses are shown under the position “Net interest income” in the income statement.

### Financial investments

dFVTPL, LaR and AfS securities are stated under “Financial investments”. dFVTPL and AfS financial assets are stated with their fair value. Changes in the fair value are taken to the income statement in case of dFVTPL financial assets. Changes in fair value of AfS financial assets are recognised in a separate item of equity (AfS reserve) not affecting income statement until the asset is sold, withdrawn, disposed of, or if an impairment is established for the financial asset in accordance with IAS 39.58 et seq. in which case the cumulative profit or loss previously recorded under equity is now taken to the income statement. Individual allowances on AfS financial assets are directly deducted from the carrying amount of the assets. Portfolio-based allowances on AfS financial assets must not be created for AfS financial assets. AfS financial assets which are hedged efficiently against market price risks are recognised within the framework of fair value hedge accounting. LaR financial investments are measured at amortised cost. Individual allowances and portfolio-based allowances on LaR financial investments are directly deducted from the carrying amount of the assets. In the financial years 2009 and 2008, the Bank did not have any HtM financial assets.

### Allowances for losses on loans and advances and provisions for contingent liabilities and other commitments

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

**Individual allowances** For all recognisable default risks, the extent of the allowance for losses on loans and advances is calculated as the difference between the carrying amount of the asset and the present value of the expected future cash flow. The latter is calculated on the basis of the original financial effective interest rate in case of fixed income instruments and on the basis of the interest rate at impairment date in case of variable income instruments. Market rate changes do not have any effect in this respect. The increase in the present value of an adjusted receivable (so-called unwinding) which occurs over a period of time is shown as interest income.

**Portfolio-based allowances** Under IAS 39.64, loans for which there is no objective indication for the need of an allowance are grouped together to form risk-inherent portfolios. Portfolio-based allowances are set aside for these portfolios; these allowances are calculated on current events and information with regard to significant changes with detrimental consequences which have occurred in the technology, market, economic or legal environment, as well as historical default rates.

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

### Other assets

“Other assets” mainly contains positive fair values from derivative financial instruments (hedging derivatives).

### Liabilities

Liabilities other than underlying transactions of an effective fair value hedge and which are not classified as dFVTPL are stated at amortised cost. Discounts and premiums are recognised on a pro rata basis. Interest-free liabilities are stated with their cash value. The Bank has not designated any liabilities under the category dFVTPL. All income and expenses from liabilities including net gains and net losses resulting from redemption of liabilities are shown under the position “Net interest income” in the income statement.

### Sale and repurchase agreements

Securities sold subject to repurchase agreements (“repos”) are carried as assets in the financial statements when the transferee has the right by contract or custom to sell or repledge the collateral; the counterparty liability is included in “Liabilities to other banks” or “Liabilities to customers”, as appropriate. Securities purchased under agreements to resell (“reverse repos”) are recorded as “Loans and advances to other banks” or “Loans and advances to customers”, as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method.

### Trading liabilities

Refinancing positions of the trading portfolio measured at fair value are stated under trading liabilities. In addition, trading liabilities also include negative market values of trading derivatives and of stand-alone derivatives of the bank book. Trading liabilities are recognised with their fair values. Valuation and realised profits and losses attributable to trading liabilities are stated under “Net trading income” in the income statement.

### Other liabilities

Besides negative fair values from derivative financial instruments (hedging derivatives), accrued liabilities are one of the items stated under other liabilities. This includes future expenditures, which are uncertain in terms of actual extent or timing, but less uncertain than is the case with provisions. These are liabilities for products or services which have been received or supplied and have not yet been paid for, invoiced by the supplier or formally agreed. This also includes short-term liabilities to employees, for instance flexi time credits and vacation entitlements. The accrued liabilities have been stated in the amount likely to be utilised.

If the obligations listed at this point cannot be quantified more precisely on the reference date for the financial statements and if the criteria specified in IAS 37 for establishing provisions are satisfied, these items have to be stated under provisions.

### Subordinated capital

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

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

### Share capital

(a) **Share issue costs** Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds.

(b) **Dividends on ordinary shares** Dividends on ordinary shares are recognised in equity in the period in which they are approved by the Company’s shareholders or paid (if declared by the directors). Dividends for the year that are declared after the statement of financial position date are dealt with in the events after the reporting date note.

### Standards, amendment, and interpretations effective in 2009

The following relevant standards, amendments and interpretation have been endorsed by the EU but are not effective for the year ended 31 December 2009 and have not been applied in preparing the financial statements:

- Revised IFRS 3: Business Combinations and Amended IAS 27: Consolidated and Separate Financial Statements. Effective date – 1 July 2009;
- Amendments to IAS 39 Eligible Hedged Items. Effective date – 1 July 2009;
- IFRIC 17: Distributions of Non-cash Assets to Owners: Effective date – 1 July 2009
- IAS 32 Amendment: Classification of Rights Issues: Effective date – 1 February 2009

The impact of the above amendments and interpretations are not expected to have a material impact on the Bank.

## 03 Risk management

The risk management disclosures are contained as noted in the “Risk management” section of the Directors’ Report.

## 04 Critical accounting estimates

The Bank believes that of its significant accounting policies and estimates, the following may involve a higher degree of judgement and complexity.

## Notes to the financial statements

### Going concern

These financial statements have been prepared on a going concern basis. The reasoning behind why the directors have prepared the accounts on a going concern basis and a description of the factors that have given rise to this concern are contained in the Basis of preparation in Note 2.

### Fair value of financial and derivative instruments

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

### Future-related assumptions and estimation of uncertainties

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

### Allowances for losses on loans and advances

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

### Standards which are not the subject of early adoption

New standards that are issued or existing standards, which have been revised and are not the subject of early adoption, may result in changes in the accounting treatment and valuation as well as the statement of assets and liabilities

when they are applied for the first time. The standards that are not the subject of early adoption are described in detail in Note 2.

### Embedded derivatives

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

### Hedge accounting

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

The establishment of the effectiveness of the risk hedge and the assessment of the probability of occurrence of future cash flows depend on risk measuring methods, the parameters which are used and assumptions relating to the probability of occurrence. These methods and parameters are continuously developed in line with the risk management objectives and strategies, which means that a review in subsequent years may result in an assessment which differs from the original assessment.

## 05 Net interest income

| € m  | 2009          | 2008          |
|--|---------------|---------------|
| <b>Interest and similar income</b>           |               |               |
| Lending and money-market business            | 2,155         | 2,861         |
| Fixed-income securities                      | 273           | 193           |
|  | <b>2,428</b>  | <b>3,054</b>  |
| <b>Interest expense and similar expenses</b> |               |               |
| Deposits                                     | -769          | -1,180        |
| Liabilities evidenced by certificates        | -1,498        | -1,605        |
| Derivatives (net interest income)            | -52           | -100          |
| Subordinated capital                         | -20           | -33           |
|  | <b>-2,339</b> | <b>-2,918</b> |
| <b>Net interest income</b>                   | <b>89</b>     | <b>136</b>    |

Interest income on impaired loans was € nil (2008: € nil). Net interest income also includes gains less losses from

financial assets, assets classified as loans and receivables, of € -8m in 2009 (2008: € -11m).

#### 06 Net fee and commission expense

| € m                               | 2009       | 2008       |
|-----------------------------------|------------|------------|
| <b>Fee and commission expense</b> |            |            |
| From lending operations           | -58        | -11        |
|                                   | <b>-58</b> | <b>-11</b> |

Net fee and commission expense totalled € -58 million in 2009, mostly a result of commission costs incurred for the guarantees related to the liquidity support measures (2008: € -11m).

None of the above fees arose on either trust or fiduciary activities that result in the holding or investing of assets on behalf of individuals, trusts, retirement benefit plans, and other institutions.

#### 07 Net trading income

| € m  | 2009     | 2008       |
|--|----------|------------|
| From interest rate instruments and related derivatives | 2        | -20        |
|  | <b>2</b> | <b>-20</b> |

The result for interest rate instruments and related derivatives includes profits from trading interest-related transactions. Trading instruments in this context include interest derivatives such as interest rate swaps.

#### 08 Net (loss)/income from hedge relationships

| € m  | 2009       | 2008      |
|--|------------|-----------|
| <b>Result from fair value hedge accounting</b> |            |           |
| Result from hedged items                       | -1,031     | 1,504     |
| Result from hedging instruments                | 1,021      | -1,490    |
|  | <b>-10</b> | <b>14</b> |

#### 09 Other operating income/expense

| € m   | 2009     | 2008      |
|---|----------|-----------|
| <b>Other operating income</b>               |          |           |
| Recharge income from other group companies  | 1        | -         |
| Total other operating income                | <b>1</b> | <b>-</b>  |
| <b>Other operating expense</b>              |          |           |
| Net foreign exchange losses                 | -        | -1        |
| Total other operating expense               | <b>-</b> | <b>-1</b> |
| <b>Total other operating income/expense</b> | <b>1</b> | <b>-1</b> |

#### 10 General administrative expenses

| € m  | 2009      | 2008       |
|--|-----------|------------|
| <b>Personnel expenses</b>                    | <b>-1</b> | <b>-2</b>  |
| Wages and salaries                           | -1        | -2         |
| <b>Other general administrative expenses</b> | <b>-6</b> | <b>-15</b> |
|  | <b>-7</b> | <b>-17</b> |

Other general administrative expenses also include auditors' remuneration of € 200,000 (2008: € 200,000).

The average number of persons employed by the Bank during the year was 7 (2008: 7).

#### 11 Taxes on income

| € m         | 2009     | 2008       |
|-------------|----------|------------|
| Current tax | -        | -12        |
|             | <b>-</b> | <b>-12</b> |

| € m   | 2009     | 2008       |
|---|----------|------------|
| Profit before tax                                 | 7        | 101        |
| Applicable (legal) tax rate in %                  | 12.5%    | 12.5%      |
| Tax calculated at a tax rate of 12½% (2008: 12½%) | -1       | -13        |
| Tax effects:                                      |          |            |
| Arising from prior years                          | 1        | 1          |
| <b>Income tax expense</b>                         | <b>-</b> | <b>-12</b> |

The deferred tax asset relates to the following items:

| € m  | 2009     | 2008      |
|--|----------|-----------|
| Financial investments                      | 9        | 11        |
| <b>Total deferred tax assets (note 19)</b> | <b>9</b> | <b>11</b> |

#### 12 Cash reserves

| € m   | 2009      | 2008      |
|---|-----------|-----------|
| Balances with central banks other than mandatory reserves | -         | -         |
| Mandatory reserve deposits with central banks             | 22        | 31        |
|   | <b>22</b> | <b>31</b> |

Cash and cash equivalents comprise of cash reserves with central banks other than mandatory reserve deposits.

#### 13 Trading assets

| € m  | 2009         | 2008         |
|--|--------------|--------------|
| Stand-alone derivatives (non-trading book) | 1,163        | 1,301        |
|  | <b>1,163</b> | <b>1,301</b> |
| Of which due from group companies          | 988          | 1,105        |

## Notes to the financial statements

Standalone derivatives include mainly derivatives which are economically hedging but which do not meet the detailed hedge accounting criteria under IFRS.

### 14 Loans and advances to other banks

Loans and advances to other banks are broken down by type of business as follows:

| € m                               | 2009          | 2008          |
|-----------------------------------|---------------|---------------|
| Public sector loans               | 4,794         | 5,624         |
| Other loans and advances          | 16,881        | 19,515        |
|                                   | <b>21,675</b> | <b>25,139</b> |
| Of which due from group companies | 14,508        | 18,060        |

Loans and advances to other banks are broken down by maturity as follows:

| € m                     | 2009          | 2008          |
|-------------------------|---------------|---------------|
| Repayable on demand     | 44            | 231           |
| With agreed maturities  |               |               |
| Up to 3 months          | 10,130        | 12,816        |
| from 3 months to 1 year | 2,152         | 2,492         |
| from 1 year to 5 years  | 4,077         | 2,461         |
| from 5 years and over   | 5,272         | 7,139         |
|                         | <b>21,675</b> | <b>25,139</b> |

There are no assets past due but not impaired and no assets impaired.

The book value on these loans represents the maximum exposure to credit risk on these assets.

### 15 Loans and advances to customers

Loans and advances to customers are broken down by type of business as follows:

| € m                               | 2009          | 2008          |
|-----------------------------------|---------------|---------------|
| Public sector loans               | 53,806        | 57,879        |
|                                   | <b>53,806</b> | <b>57,879</b> |
| Of which due from group companies | -             | -             |

Loans and advances to customers are broken down by maturity as follows:

| € m                     | 2009          | 2008          |
|-------------------------|---------------|---------------|
| With agreed maturities  |               |               |
| Up to 3 months          | 554           | 524           |
| from 3 months to 1 year | 792           | 1,520         |
| from 1 year to 5 years  | 9,050         | 7,352         |
| from 5 years and over   | 43,410        | 48,483        |
|                         | <b>53,806</b> | <b>57,879</b> |

### Loans and advances to customers – past due but not impaired

At 31 December 2009, the following amounts were noted as being past due. However, no impairment provision was made against these past due amounts as the Bank does not consider that there is any significant issue regarding their recoverability. The total book value in relation to the amounts has also been disclosed to put the size of the amounts in question into context.

| € m   | 2009       | 2008       |
|---|------------|------------|
| <b>Assets: past due but not impaired (due amount)</b>       |            |            |
| Past due but not impaired less than 90 days                 | -          | 1          |
| Past due but not impaired between 3 months and 6 months     | -          | -          |
| Past due but not impaired between 6 months and 1 year       | 96         | 1          |
| Past due but not impaired greater than 1 year               | -          | -          |
| <b>Total</b>  | <b>96</b>  | <b>2</b>   |
| <b>Assets: past due but not impaired (total investment)</b> |            |            |
| Past due but not impaired less than 90 days                 | 13         | 76         |
| Past due but not impaired between 3 months and 6 months     | -          | -          |
| Past due but not impaired between 6 months and 1 year       | 96         | 67         |
| Past due but not impaired greater than 1 year               | -          | -          |
| <b>Total</b>  | <b>109</b> | <b>143</b> |

As at the date of signing the financial statements, the Bank had not received the above outstanding amounts in the 6 months to 1 year category. The full amount in the less than 90 days time period had been received.

### 16 Allowances for losses on loans and advances

Movement in allowance for losses on loans and advances:

| € m   | 2009       | 2008 |
|---|------------|------|
| Collective provision for losses on loans and advances |            |      |
| <b>At January 1</b>                                   | -          | -    |
| Additions to collective provision                     | -10        | -    |
| <b>At December 31</b>                                 | <b>-10</b> | -    |

The total allowance for losses on loans and advances is made up as follows:

| € m                 | 2009       | 2008 |
|---------------------|------------|------|
| Public sector loans | -10        | -    |
|                     | <b>-10</b> | -    |

| € m   | 2009       | 2008 |
|---|------------|------|
| <b>At January 1</b>                         | -          | -    |
| Provisions for losses on loans and advances | -10        | -11  |
| Recovery on guarantee                       | -          | 11   |
| <b>At December 31</b>                       | <b>-10</b> | -    |

In 2008 provisions for losses on loans and advances relates to specific provisions for 2 impaired loans. The Bank has recovered this amount by means of a guarantee from DEPFA BANK plc.

## 17 Financial Investments

| € m   | 2009         | 2008         |
|---|--------------|--------------|
| <b>Available-for-sale financial investments</b>   | <b>48</b>    | <b>48</b>    |
| Debt securities and other fixed-income securities | 48           | 48           |
| <b>LaR financial investments</b>                  | <b>7,507</b> | <b>8,191</b> |
| Debt securities and other fixed-income securities | 7,507        | 8,191        |
|   | <b>7,555</b> | <b>8,239</b> |

### Financial investments, broken down by maturities

| € m                     | 2009         | 2008         |
|-------------------------|--------------|--------------|
| With agreed maturities  |              |              |
| Up to 3 months          | 16           | 58           |
| from 3 months to 1 year | 182          | 99           |
| from 1 year to 5 years  | 1,019        | 1,035        |
| from 5 years and over   | 6,338        | 7,047        |
|                         | <b>7,555</b> | <b>8,239</b> |

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

On 30 September 2008, the Bank reclassified retrospectively as of 1 July 2008 trading assets out of the category available-for-sale of € 4.18 billion.

Since the date of reclassification, the Bank's financial assets with a (reclassified) carrying amount of approximately € 0.1 billion became due.

The reclassification of AfS assets did not cause a disclosure change of current interest income as it is still shown under net income from financial investments.

In 2009 Bank securities with a reclassified carrying amount of € 0.01 billion were sold due to the decided reduction of portfolios. Thereby a net loss of € 0.2 million was realised.

At the date of reclassification the effective interest rate for the AfS assets of the Bank was between 6.85% and 1.56% (2008: 6.85% and 1.56%).

The following table summarises the carrying amounts and fair values as of 31 December 2009 as well as fair value gains and losses that would have been recognised in 2009 if the financial assets had not been reclassified.

| 2009 Reclassifications    |              |                                   |                   |   |                           |
|---------------------------|--------------|-----------------------------------|-------------------|---|---------------------------|
| € m                       | Reclass date | Into: Financial investments (LaR) |                   | Effect in reporting period if no assets had been reclassified |                           |
|                           |              | 31 December 2009                  |                   | 2009  | AfS Reserve (after taxes) |
| <b>Out of:</b>            |              | <b>Carrying Amount</b>            | <b>Fair Value</b> | <b>Income Statement</b>                                       |                           |
| AfS financial investments | 1 July 2008  | 4,620                             | 4,181             | -   | 331                       |

| 2008 Reclassifications    |              |                                   |                   |   |                           |
|---------------------------|--------------|-----------------------------------|-------------------|---|---------------------------|
| € m                       | Reclass date | Into: Financial investments (LaR) |                   | Effect in reporting period if no assets had been reclassified |                           |
|                           |              | 31 December 2008                  |                   | 2008  | AfS Reserve (after taxes) |
| <b>Out of:</b>            |              | <b>Carrying Amount</b>            | <b>Fair Value</b> | <b>Income Statement</b>                                       |                           |
| AfS financial investments | 1 July 2008  | 4,896                             | 3,997             | -   | -787                      |

### Securities listed on stock exchange

| € m          | 2009  |              | 2008  |              |
|--------------|---|--------------|---|--------------|
|              | Debt securities and other fixed-income securities | Total        | Debt securities and other fixed-income securities | Total        |
| Listed       | 6,266   | 6,266        | 6,788   | 6,788        |
| Unlisted     | 1,289   | 1,289        | 1,451   | 1,451        |
| <b>Total</b> | <b>7,555</b>                                      | <b>7,555</b> | <b>8,239</b>                                      | <b>8,239</b> |

## Notes to the financial statements

### Development of financial investments

| € m                                       | 2009   |              | 2008   |              |
|---|--|--------------|--|--------------|
|   | Available-for-sale and LaR debt securities and other fixed income securities | Total        | Available-for-sale and LaR debt securities and other fixed income securities | Total        |
| <b>At 1 January</b>                       | <b>8,239</b>   | <b>8,239</b> | <b>4,135</b>   | <b>4,135</b> |
| Exchange differences on monetary assets   | -135   | -135         | 461  | 461          |
| Additions                                 | -  | -            | 3,204  | 3,204        |
| Disposals (sale and redemption)           | -161   | -161         | -405   | -405         |
| Gains/(losses) from changes in fair value | -388   | -388         | 844  | 844          |
| <b>At 31 December</b>                     | <b>7,555</b>   | <b>7,555</b> | <b>8,239</b>   | <b>8,239</b> |

### Breakdown of financial investments at 31 December by counterparty type:

| € m                              | 2009         | 2008         |
|----------------------------------|--------------|--------------|
| <b>Bonds and debt securities</b> |              |              |
| By public issuers                | 7,555        | 8,239        |
|                                  | <b>7,555</b> | <b>8,239</b> |

The carrying amount of the financial investments that are neither past due nor impaired is € 7.6 billion (2008: € 8.2 billion). The past due but not impaired and the impaired financial investments are not collateralised.

### 18 Other assets

| € m   | 2009         | 2008         |
|---|--------------|--------------|
| <b>Positive fair values from derivative financial instruments</b> |              |              |
| Hedging derivatives   | 2,733        | 3,416        |
| Other assets  | 6            | 51           |
|   | <b>2,739</b> | <b>3,467</b> |
| Of which due from group companies                                 | 1,953        | 2,701        |

### 19 Deferred tax assets

| € m                           | 2009     | 2008      |
|-------------------------------|----------|-----------|
| Deferred tax assets (note 11) | 9        | 11        |
|                               | <b>9</b> | <b>11</b> |

### 20 Subordinated assets

| € m                             | 2009       | 2008       |
|---------------------------------|------------|------------|
| Included in:                    |            |            |
| Loans and advances to customers | 459        | 459        |
| Financial investments           | 23         | 23         |
|                                 | <b>482</b> | <b>482</b> |

### 21 Repurchase agreements

As a pledgor under repurchase agreements, the Bank has pledged assets with a book value of € 13.8 billion (2008: € 20.5 billion). The assets are not derecognised. The consid-

erations which have been received amount to € 12.1 billion (2008: € 15.6 billion) and are recognised under liabilities and thereof are mainly classified as "Liabilities to other banks".

### 22 Liabilities to other banks

| € m                             | 2009          | 2008          |
|---------------------------------|---------------|---------------|
| Liabilities to other banks      | 29,642        | 34,623        |
|                                 | <b>29,642</b> | <b>34,623</b> |
| Of which due to group companies | 24,637        | 24,703        |

#### Liabilities to other banks are broken down by maturity as follows:

| € m                     | 2009          | 2008          |
|-------------------------|---------------|---------------|
| Repayable on demand     | -             | 20            |
| With agreed maturities  |               |               |
| Up to 3 months          | 18,135        | 30,754        |
| from 3 months to 1 year | 10,033        | 2,524         |
| from 1 year to 5 years  | 3             | 4             |
| from 5 years and over   | 1,471         | 1,321         |
|                         | <b>29,642</b> | <b>34,623</b> |

Included under liabilities to other banks are amounts due under repurchase agreements (Note 21).

### 23 Liabilities evidenced by certificates

| By type of business         | 2009          | 2008          |
|-----------------------------|---------------|---------------|
| € m                         |               |               |
| Public sector covered bonds | 50,842        | 51,430        |
| Other debt securities       | -             | 1,289         |
| Money market securities     | -             | 54            |
|                             | <b>50,842</b> | <b>52,773</b> |

| By maturity             | 2009          | 2008          |
|-------------------------|---------------|---------------|
| € m                     |               |               |
| With agreed maturities  |               |               |
| up to 3 months          | 796           | 519           |
| from 3 months to 1 year | 3,585         | 1,659         |
| from 1 year to 5 years  | 15,567        | 18,242        |
| from 5 years and over   | 30,894        | 32,353        |
|                         | <b>50,842</b> | <b>52,773</b> |

**24 Trading liabilities**

| € m  | 2009         | 2008         |
|--|--------------|--------------|
| Stand-alone derivatives (non-trading book) | 1,041        | 1,388        |
|  | <b>1,041</b> | <b>1,388</b> |
| Of which due from group companies          | 803          | 1,160        |

Standalone derivatives include mainly derivatives which are economically hedging but which do not meet the detailed hedge accounting criteria under IFRS.

**25 Other liabilities**

| € m  | 2009         | 2008         |
|--|--------------|--------------|
| Negative fair values from derivative financial instruments |              |              |
| Hedging derivatives  | 4,206        | 5,904        |
| Other liabilities  | 24           | 22           |
|  | <b>4,230</b> | <b>5,926</b> |
| Of which due to group companies                            | 2,946        | 4,049        |

**26 Current tax liabilities**

| € m                     | 2009     | 2008      |
|-------------------------|----------|-----------|
| Current tax liabilities | 1        | 13        |
|                         | <b>1</b> | <b>13</b> |

**27 Subordinated capital**

| € m                             | 2009       | 2008       |
|---------------------------------|------------|------------|
| Subordinated liabilities        | 632        | 629        |
|                                 | <b>632</b> | <b>629</b> |
| Of which due to group companies | 632        | 629        |

| By maturity            |            |            |
|------------------------|------------|------------|
| € m                    | 2009       | 2008       |
| With agreed maturities |            |            |
| from 5 years and over  | 632        | 629        |
|                        | <b>632</b> | <b>629</b> |

The subordinated debt instruments are analysed below:

| € m                             |   | 2009 Nominal | 2008 Nominal |
|---------------------------------|---|--------------|--------------|
| <b>Subordinated liabilities</b> |   |              |              |
| DEPFA Finance NV                | Euribor + 0.88%                               | 50           | 50           |
| DEPFA Finance NV                | 6.55%   | 60           | 60           |
| DEPFA Ireland Holding Limited   | Euribor + 0.42%                               | 130          | 130          |
| DEPFA Ireland Holding Limited   | Euribor + 0.72%                               | 60           | 60           |
| DEPFA Ireland Holding Limited   | Euribor + 0.29%                               | 75           | 75           |
| DEPFA Finance NV                | 5.099% until 2017, thereafter Euribor + 1.94% | 170          | 170          |
| DEPFA BANK plc                  | Euribor + 0.32%                               | 70           | 70           |

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

The Bank has not had any defaults of principal, interest or redemption amounts during the period on its subordinated capital (2008: nil).

## Notes to the financial statements

### 28 Share capital

The authorised share capital at year end was 1,000,000,000 ordinary shares of € 1 each. 510,000,000 shares were issued at par and are fully paid.

|                     | Number of Shares<br>in issue | Ordinary Shares (€ m) | Share Premium (€ m) | Total (€ m) |
|---------------------|------------------------------|-----------------------|---------------------|-------------|
| At 31 December 2008 | 510,000,000                  | 510                   | -                   | 510         |
| At 31 December 2009 | 510,000,000                  | 510                   | -                   | 510         |

### 29 Retained earnings

| € m                     | 2009 | 2008 |
|-------------------------|------|------|
| At January 1            | 280  | 191  |
| Net profit for the year | 7    | 89   |
| Dividends               | -160 | -    |
| At December 31          | 127  | 280  |

### 30 Other reserves

| € m   | 2009 | 2008 |
|---|------|------|
| Unrealised losses from available-for-sale investment securities | -66  | -75  |
| Total other reserves at December 31                             | -66  | -75  |

| € m  | 2009 | 2008 |
|--|------|------|
| Unrealised losses from cash flow hedges              |      |      |
| At January 1   | -    | -    |
| Net loss from changes in fair value, net of tax      | -4   | -29  |
| Net loss transferred to income statement, net of tax | 4    | 29   |
| At December 31                                       | -    | -    |

| € m   | 2009 | 2008 |
|---|------|------|
| Unrealised losses from available-for-sale investment securities |      |      |
| At January 1  | -75  | -    |
| Net gain/loss from changes in fair value, net of tax            | 9    | -75  |
| At December 31  | -66  | -75  |

### 31 Foreign currency assets and liabilities

The Bank takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Bank sets limits on the level of exposure by currency and in total for both overnight and intra-day positions, which are monitored daily. The table below summarises the Bank's exposure to foreign currency exchange rate risk at 31 December.

| € m                                 | 2009          | 2008          |
|-------------------------------------|---------------|---------------|
| <b>Foreign currency assets</b>      |               |               |
| USD                                 | 18,771        | 21,108        |
| JPY                                 | 4,259         | 3,756         |
| GBP                                 | 6,189         | 3,465         |
| Others                              | 6,741         | 4,580         |
|                                     | <b>35,960</b> | <b>32,909</b> |
| <b>Foreign currency liabilities</b> |               |               |
| USD                                 | 18,806        | 21,089        |
| JPY                                 | 4,203         | 3,770         |
| GBP                                 | 6,186         | 3,462         |
| Others                              | 6,764         | 4,553         |
|                                     | <b>35,959</b> | <b>32,874</b> |

### 32 Notes to the items in the cash flow statement

The cash flow statement shows the cash flows of the financial year broken down into cash flows attributable to operating activities, investing activities and financing activities.

Operating activities are defined broadly, and correspond to operating result. Cash flow from operating activities includes payments (inflows and outflows) attributable to loans and advances to other banks and customers as well as trading assets and other assets. Inflows and outflows attributable to liabilities to other banks and customers, liabilities evidenced by certificates and other liabilities are also included under operating activities. The interest and dividend payments resulting from operating activities are shown under cash flow from operating activities.

Cash flow from investing activities comprises payments for investment and security holdings.

Cash flow from financing activities comprises outflows for dividends paid out.

**33 Derivative financial instruments**

| € m                           | 2009         | 2008         |
|-------------------------------|--------------|--------------|
| <b>Assets</b>                 |              |              |
| Trading assets (note 13)      | 1,163        | 1,301        |
| Other assets (note 18)        | 2,733        | 3,416        |
|                               | <b>3,896</b> | <b>4,717</b> |
| <b>Liabilities</b>            |              |              |
| Trading liabilities (note 24) | 1,041        | 1,388        |
| Other liabilities (note 25)   | 4,206        | 5,904        |
|                               | <b>5,247</b> | <b>7,292</b> |

Derivatives are contracts or agreements whose values are determined on the basis of changes in an underlying variable, such as interest rates, foreign exchange rates, securities prices, financial and commodity indices or other variables. The timing of cash receipts and payments for derivatives is generally determined by contractual agreement. Derivatives are either standardised contracts traded on exchanges or over-the-counter (OTC) contracts agreed individually by the parties to the contract. Futures and certain options are examples of standard exchange-traded derivatives. Forwards, swaps, and other option contracts are examples of OTC derivatives. OTC derivatives are not freely tradable. In the normal course of business, however, they may be terminated or assigned to another counterparty if the current party to the contract agrees.

Derivatives may be used for trading purposes or for risk management purposes. The Bank uses derivative financial instruments primarily as a means of hedging the risk associated with asset/liability management in the context of interest bearing transactions. Interest rate derivatives are primarily entered into to hedge the fair value interest rate risk in fixed-rate assets and liabilities. Derivatives are also

entered into, to a lesser extent, for the purpose of hedging foreign currency risks. Foreign exchange risks are primarily hedged by means of suitable fair value hedges for available-for-sale securities, loans extended and debt securities in issue. However, some derivatives used for risk management purposes do not qualify for hedge accounting and are therefore classified as part of the “trading portfolio” in the Bank’s financial statements.

Derivatives used by the Bank include:

- Interest rate and cross currency swaps
- Forward foreign exchange contracts

Interest rate swaps involve the exchange of fixed and variable rate interest payments between two parties at specified times based on a common nominal amount and maturity date. The nominal amounts are normally not exchanged.

Cross currency swaps have nominal amounts in two different currencies. The interest is paid in these two currencies. An exchange of the nominal amount often takes place at the beginning and at the end of the contract.

Forward foreign exchange contracts involve an agreement to exchange two currencies at a specific price and date agreed in advance. Exposure to changes in foreign currency exchange rates and foreign interest rates and the counterparty default risk are the primary risks associated with forward foreign exchange contracts.

The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised on the statement of financial position but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the Bank’s exposure to credit or price risks. The derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in market factors such as interest rates or foreign exchange rates relative to their terms. The aggregate contractual or notional amount of derivative financial instruments on hand, the extent to which instruments are favourable or unfavourable, and thus the aggregate fair values of derivative financial assets and liabilities, can fluctuate significantly from time to time. The fair values of derivative instruments held are set out below.

**Volume of derivatives**

| 31 December 2009                           | Notional amount      |               |                 |               | Fair value   |              |
|--|----------------------|---------------|-----------------|---------------|--------------|--------------|
|  | Remaining maturities |               |                 |               | Positive     | Negative     |
|  | Less than 1 year     | 1 to 5 years  | More than 5 yrs | Total         | Total        | Total        |
| € m  |                      |               |                 |               |              |              |
| <b>Interest-based transactions</b>         |                      |               |                 |               |              |              |
| Interest rate swaps                        | 5,368                | 23,409        | 47,248          | 76,025        | 2,779        | 4,218        |
| <b>Total</b>                               | <b>5,368</b>         | <b>23,409</b> | <b>47,248</b>   | <b>76,025</b> | <b>2,779</b> | <b>4,218</b> |
| <b>Foreign currency based transactions</b> |                      |               |                 |               |              |              |
| Interest rate/currency swaps               | 396                  | 3,476         | 19,448          | 23,320        | 1,117        | 1,029        |
| Spot and forward currency transactions     | -                    | -             | -               | -             | -            | -            |
| <b>Total</b>                               | <b>396</b>           | <b>3,476</b>  | <b>19,448</b>   | <b>23,320</b> | <b>1,117</b> | <b>1,029</b> |
| <b>Total</b>                               | <b>5,764</b>         | <b>26,885</b> | <b>66,696</b>   | <b>99,345</b> | <b>3,896</b> | <b>5,247</b> |

## Notes to the financial statements

| 31 December 2008                           | Notional amount      |               |                 |                | Fair value   |              |
|--|----------------------|---------------|-----------------|----------------|--------------|--------------|
|  | Remaining maturities |               |                 |                | Positive     | Negative     |
|  | Less than 1 year     | 1 to 5 years  | More than 5 yrs | Total          | Total        | Total        |
| € m  |                      |               |                 |                |              |              |
| <b>Interest-based transactions</b>         |                      |               |                 |                |              |              |
| Interest rate swaps                        | 9,250                | 25,216        | 54,838          | 89,304         | 3,503        | 6,075        |
| <b>Total</b>                               | <b>9,250</b>         | <b>25,216</b> | <b>54,838</b>   | <b>89,304</b>  | <b>3,503</b> | <b>6,075</b> |
| <b>Foreign currency based transactions</b> |                      |               |                 |                |              |              |
| Interest rate/currency swaps               | 317                  | 3,688         | 18,872          | 22,877         | 1,213        | 1,217        |
| Spot and forward currency transactions     | 1                    | -             | -               | 1              | 1            | -            |
| <b>Total</b>                               | <b>318</b>           | <b>3,688</b>  | <b>18,872</b>   | <b>22,878</b>  | <b>1,214</b> | <b>1,217</b> |
| <b>Total</b>                               | <b>9,568</b>         | <b>28,904</b> | <b>73,710</b>   | <b>112,182</b> | <b>4,717</b> | <b>7,292</b> |

## Derivatives Counterparties

| € m                         | 2009         |              | 2008         |              |
|-----------------------------|--------------|--------------|--------------|--------------|
|                             | Fair values  |              | Fair values  |              |
|                             | Positive     | Negative     | Positive     | Negative     |
| OECD financial institutions | 3,896        | 5,247        | 4,717        | 7,292        |
|                             | <b>3,896</b> | <b>5,247</b> | <b>4,717</b> | <b>7,292</b> |

Fair values appear as sum of positive and negative amounts per contract, from which no pledged security has been deducted and no netting agreements have been taken into consideration.

## 34 Cash flows from hedge accounting

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

| € m                      | 2009 | 2008 |
|--------------------------|------|------|
| up to 1 month            | -59  | -1   |
| from 1 month to 3 months | -52  | -26  |
| from 3 months to 1 year  | -33  | -450 |
| from 1 year to 2 years   | -4   | -150 |
| from 2 years to 5 years  | -21  | -14  |
| from 5 years and over    | -179 | -186 |

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

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

## 35 Assets assigned or pledged as security for own liabilities

The following liabilities had assets pledged as security at 31 December:

| Own liabilities            | 2009          | 2008          |
|----------------------------|---------------|---------------|
| € m                        |               |               |
| Liabilities to other banks | 12,057        | 15,606        |
|                            | <b>12,057</b> | <b>15,606</b> |

The following assets were pledged as security for the above liabilities at 31 December:

| Pledged assets                    | 2009          | 2008          |
|-----------------------------------|---------------|---------------|
| € m                               |               |               |
| Loans and advances to other banks | 1,851         | 2,415         |
| Loans and advances to customers   | 7,655         | 13,953        |
| Financial investments             | 4,287         | 4,131         |
|                                   | <b>13,793</b> | <b>20,499</b> |

At the end of 2008, within the framework of the liquidity support from a syndicate from the German finance sector and the Bundesbank with the participation of the German Federal Government as well as from SoFFin, the Bank has transferred or assigned almost all of their freely available assets with a total nominal value of € 1 billion as collateral to the security trustee of the lenders.

In addition, at the statement of financial position date, restricted assets consisting of investment securities and loans in the amount of € 53.4 billion (2008: € 52.9 billion) were entered on a trustee register as collateral for covered bonds.

During 2010, DEPFA ACS BANK migrated to the TARGET 2 system, which is a wholesale payment infrastructure for credit institutions across Europe. TARGET 2 is a real time gross settlement system for large volume interbank payments in euro. The following disclosures relate to the charges arising as a result of the migration to TARGET 2.

■ On 5th February 2010, a first floating charge was placed in favour of the Central Bank and Financial Services Authority of Ireland ("CBFSAI") over all of DEPFA ACS BANK's right, title, interest and benefit, present and future, in and to the balances then or at any time standing to the credit of DEPFA ACS BANK's account held as a TARGET 2 participant with the CBFSAI (the "Charged Account Property").

This floating charge contains a provision whereby during the subsistence of the security, otherwise than with the prior written consent of the CBFSAI, DEPFA ACS BANK shall:

- (a) not create or attempt to create or permit to arise or subsist any encumbrance on or over the Charged Account Property or any part thereof; or
- (b) not, otherwise than in the ordinary course of business, sell, transfer, lend or otherwise dispose of the Charged Account Property or any part thereof or agree to do so whether by means of one or a number of transactions related or not and whether at one time or over a period of time.

■ On 5th February 2010, a first floating charge was placed in favour of the CBFSAI over all DEPFA ACS BANK's right, title, interest and benefit, present and future, in and to certain segregated securities (the "Charged Securities Property") listed in an Eligible Securities Schedule kept by DEPFA ACS BANK for the purpose of participating in TARGET 2.

This floating charge contains a provision whereby during the subsistence of the security, otherwise than with the prior written consent of the CBFSAI, DEPFA ACS BANK shall:

- (a) not create or attempt to create or permit to arise or subsist any encumbrance on or over the Charged Securities Property or any part thereof; or
- (b) not, otherwise than in the ordinary course of business, sell, transfer, lend or otherwise dispose of the Charged Securities Property or any part thereof or attempt or agree to do so whether by means of one or a number of transactions related or not and whether at one time or over a period of time."

### 36 Fair values of financial assets and liabilities

The following table summarises the carrying amounts and fair values of those financial assets and liabilities presented on the Bank's statement of financial position.

Bid prices are used to estimate fair values of assets, whereas offer prices are applied for liabilities.

| € m   | Carrying Value |               | Fair Value    |               |
|---|----------------|---------------|---------------|---------------|
|   | 2009           | 2008          | 2009          | 2008          |
| <b>Financial assets</b>                     |                |               |               |               |
| Cash reserves                               | 22             | 31            | 22            | 31            |
| Trading assets                              | 1,163          | 1,301         | 1,163         | 1,301         |
| Loans and advances to other banks           | 21,675         | 25,139        | 21,517        | 24,962        |
| Allowances for losses on loans and advances | -10            | -             | -10           | -             |
| Loans and advances to customers             | 53,806         | 57,879        | 47,811        | 50,931        |
| Financial investments                       | 7,555          | 8,239         | 6,859         | 6,945         |
| Other assets                                | 2,739          | 3,467         | 2,739         | 3,467         |
| Deferred tax assets                         | 9              | 11            | 9             | 11            |
|   | <b>86,959</b>  | <b>96,067</b> | <b>80,110</b> | <b>87,648</b> |
| <b>Financial liabilities</b>                |                |               |               |               |
| Liabilities to other banks                  | 29,642         | 34,623        | 29,642        | 34,623        |
| Liabilities evidenced by certificates       | 50,842         | 52,773        | 46,876        | 48,484        |
| Trading liabilities                         | 1,041          | 1,388         | 1,041         | 1,388         |
| Other liabilities                           | 4,230          | 5,926         | 4,214         | 5,926         |
| Current tax liabilities                     | 1              | 13            | 1             | 13            |
| Subordinated capital                        | 632            | 629           | 632           | 629           |
|   | <b>86,388</b>  | <b>95,352</b> | <b>82,406</b> | <b>91,063</b> |

#### a) Loans and advances to other banks and customers

Loans and advances are net of provisions for impairment. The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received. Expected cash flows are discounted at current market interest rates as adjusted for movements in credit to determine fair value. As many of these positions are not traded on an active market, judgement is

required as to the appropriate credit adjustment.

#### b) Liabilities to other banks

The fair value of floating rate placements and overnight deposits is their carrying amount. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and remaining maturity.

## Notes to the financial statements

### c) Liabilities evidenced by certificates

The aggregate fair values are calculated based on quoted market prices. For those notes where quoted market prices are not available, a discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity for a similar credit rating.

### d) Subordinated capital

The estimated fair value of deposits with no stated maturity, which includes non-interest-bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest-bearing deposits and other borrowings without quoted market price is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

### Assets and liabilities according to measurement categories:

| € m                                     | 2009          | 2008          |
|---|---------------|---------------|
| Loans and receivables                   | 82,988        | 91,209        |
| Available-for-sale                      | 48            | 48            |
| Cash reserves                           | 22            | 31            |
| Derivatives                             | 3,896         | 4,717         |
| <b>Total assets</b>                     | <b>86,954</b> | <b>96,005</b> |
| Financial liabilities at amortised cost | 80,484        | 87,396        |
| Derivatives                             | 5,247         | 7,292         |
| <b>Total liabilities</b>                | <b>85,731</b> | <b>94,688</b> |

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

As per the amendment to IFRS 7 “Financial Instruments: Disclosures” issued in March 2009 all financial assets and liabilities of HRE that are measured at fair value should be grouped into the fair value hierarchies. The three-level

hierarchy is based on the degree to which the input for the fair value measurement is observable.

**Level 1** – quoted priced (unadjusted) in active markets for identical financial assets or financial liabilities.

**Level 2** – inputs that are observable either directly or indirectly, other than quoted prices included within Level 1.

**Level 3** – valuation techniques that include inputs that are not based on observable market data (unobservable inputs).

The following table shows financial assets and financial liabilities measured at fair value grouped into the fair value hierarchy:

| Fair value hierarchy<br>€ m | 31 December 2009 |           |               |           |
|-----------------------------|------------------|-----------|---------------|-----------|
|                             | Total            | Level 1   | Level 2       | Level 3   |
| <b>Assets</b>               |                  |           |               |           |
| Trading assets              | 1,163            | -         | 1,163         | -         |
| Hedging derivatives         | 2,733            | -         | 2,733         | -         |
| Financial investments       | 48               | 48        | -             | -         |
| <b>Total</b>                | <b>3,944</b>     | <b>48</b> | <b>3,896</b>  | <b>-</b>  |
| <b>Liabilities</b>          |                  |           |               |           |
| Trading liabilities         | -1,041           | -         | -1,041        | -         |
| Hedging derivatives         | -4,206           | -         | -4,199        | -7        |
| <b>Total</b>                | <b>-5,247</b>    | <b>-</b>  | <b>-5,240</b> | <b>-7</b> |

In 2009 AfS-investments with a carrying amount of € 48 million were transferred from Level 2 to Level 1 because quoted prices in active markets for identical financial assets became regularly available.

There have been no transfers from Level 1 to Level 2 in the period.

The following table presents the changes in Level 3 instruments for the business year ended 31 December 2009:

| Changes in Level 3 instruments<br>€ m | Financial assets | Total    |
|---------------------------------------|------------------|----------|
| <b>Balance at 1 January 2009</b>      | <b>2</b>         | <b>2</b> |
| Comprehensive income                  |                  |          |
| Income statement                      | -2               | -2       |
| <b>Balance at 31 December 2009</b>    | <b>-</b>         | <b>-</b> |

| Changes in Level 3 instruments<br>€ m | Financial liabilities | Total     |
|---------------------------------------|-----------------------|-----------|
| <b>Balance at 1 January 2009</b>      | <b>-5</b>             | <b>-5</b> |
| Comprehensive income                  |                       |           |
| Income statement                      | -1                    | -1        |
| Purchases                             | -1                    | -1        |
| <b>Balance at 31 December 2009</b>    | <b>-7</b>             | <b>-7</b> |

Although the Bank believes that its estimates of fair value are appropriate, using reasonably possible alternative input factors significantly changes the fair value. The following table shows the fair value sensitivity of Level 3 measurements to reasonably possible alternative assumptions:

| Sensitivities of Level 3 instruments<br>€ m | Favourable changes | Unfavourable changes |
|---|--------------------|----------------------|
| Hedging derivatives                         | 2                  | -3                   |
|   | <b>2</b>           | <b>-3</b>            |

The above favourable and unfavourable changes are calculated independently from each other. No alternative fair values were determined for derivatives used in cash flow hedge accounting, as these derivatives hedges interest rate risks (future variable interest payments are swapped for fixed payments).

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

The methods and valuation techniques used for the purpose of measuring fair value are unchanged compared to the previous reporting period.

In the following, the valuation methods on the level of product classes are described in detail:

The fair values of certain financial instruments reported at nominal values are almost identical to their carrying amounts. These include for example cash reserve, receivables and liabilities without fixed interest rates or maturity respectively mature in the short-term. Differences between the carrying amount and the fair value of these financial instruments are not material.

Quoted market prices are applied for market securities and derivatives as well as for quoted debt instruments. The fair value of the original debt instruments for which no active market price is available is determined as the present value for future expected cash flows on the basis of related benchmark interest curves and credit spreads.

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

Widely accepted standard models are used for credit derivatives, e.g. credit default swaps. Credit risk is considered when valuing credit derivatives, interest rate derivatives and currency derivatives.

Gaussian copula models which are usual in the market and appropriate adjustments thereof are used for determining fair values for structured credit products. In parallel the expected loss of the respected papers was calculated on the basis of the underlyings and the subordination. A detailed separate credit analysis was performed for the tranches being held in case of significant expected losses.

Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost according to IAS 39.46. The Bank is able to reliably establish the fair value for all other financial instruments.

## Notes to the financial statements

### 37 Undiscounted cash flows of financial liabilities

The contractual undiscounted cash flows of the financial liabilities are analysed into the following remaining maturities:

| € m                            | 2009          | 2008          |
|--------------------------------|---------------|---------------|
| <b>up to 3 months</b>          | <b>20,523</b> | <b>33,079</b> |
| Of which from derivatives      | 1             | -194          |
| Of which from non derivatives  | 20,522        | 33,273        |
| <b>from 3 months to 1 year</b> | <b>15,917</b> | <b>5,630</b>  |
| Of which from derivatives      | 1,306         | 774           |
| Of which from non derivatives  | 14,611        | 4,856         |
| <b>from 1 year to 5 years</b>  | <b>24,226</b> | <b>23,932</b> |
| Of which from derivatives      | 4,553         | 1,646         |
| Of which from non derivatives  | 19,673        | 22,286        |
| <b>from 5 years and over</b>   | <b>49,610</b> | <b>43,062</b> |
| Of which from derivatives      | 10,684        | 3,890         |
| Of which from non derivatives  | 38,926        | 39,172        |

### 38 Dividends per share

Final dividends are not accounted for until they have been ratified at the Annual General Meeting.

Dividends of € 160m were paid during the year (2008: nil).

No further dividend is proposed for the year ended 2009.

### 39 Related party transactions

| Key management compensation<br>€ m | 2009     | 2008     |
|------------------------------------|----------|----------|
| Short term employee benefits       | 1        | 1        |
| Post employee benefits             | -        | -        |
| Share based payments               | -        | -        |
| Directors' fees                    | -        | -        |
|                                    | <b>1</b> | <b>1</b> |

Key management consists solely of directors of the Bank.

### Loans to directors of DEPFA ACS BANK

There have been no loans to members of the Board in 2009 and 2008, nor are there any loans outstanding to members of the Board at 31 December 2009 (2008: € nil).

Balances due to and from group companies are disclosed in the notes to the financial statements.

Transactions with group companies consisted of:

| € m                                   | 2009 | 2008 |
|---------------------------------------|------|------|
| Interest and similar income           | 191  | 209  |
| Interest expense and similar expenses | -390 | -674 |
| Net income from financial investments | -    | -    |
| Net fee and commission expense        | -    | -9   |
| Other operating income                | 1    | -    |
| General administrative expenses       | -4   | -13  |
| Recovery on guarantee (note 16)       | -    | 11   |

The amounts above arise on intercompany borrowings and lending, and transfers of assets between the Bank and other group entities, as well as recharges for certain services provided.

### Other related party transactions

As a result of HRE Holding being controlled by SoFFin, the Bank is considered a state-controlled entity and a related party with other enterprises which are subject to the control, joint control or significant influence of the Federal Republic of Germany. Fees payable in respect of liquidity support facilities provided by SoFFin, the Deutsche Bundesbank and the German Financial Sector are disclosed in Note 6. In addition, much of the funding provided by the Bank's ultimate parent has been advanced to the HRE Group under the SoFFin liquidity facilities.

#### 40 Characteristics of the asset pool as at 31 December 2009

The following table analyses the countries where the public credit assets included in the pool are located, the number of public credit assets located in these countries, the nominal amount of the public credit assets in Euro and, based on the amount of those assets outstanding, the percentage of public credit assets located in those countries. The amount is the nominal amount of the asset adjusted for any un-amortised premium/discount.

| Country        | € m           | Number of assets | Percentage  |
|----------------|---------------|------------------|-------------|
| Germany        | 10,847        | 144              | 20.30%      |
| Italy          | 3,293         | 66               | 6.16%       |
| Spain          | 5,705         | 90               | 10.68%      |
| USA            | 10,272        | 242              | 19.22%      |
| France         | 1,762         | 118              | 3.30%       |
| Netherlands    | 3,955         | 218              | 7.40%       |
| Belgium        | 2,111         | 21               | 3.95%       |
| Austria        | 1,111         | 19               | 2.08%       |
| Greece         | 461           | 5                | 0.86%       |
| Portugal       | 640           | 10               | 1.20%       |
| Canada         | 2,152         | 35               | 4.03%       |
| Finland        | 570           | 41               | 1.07%       |
| Poland         | 1,208         | 13               | 2.26%       |
| Switzerland    | 456           | 9                | 0.85%       |
| United Kingdom | 3,425         | 267              | 6.41%       |
| Hungary        | 686           | 11               | 1.28%       |
| Sweden         | 695           | 51               | 1.30%       |
| Iceland        | 557           | 35               | 1.04%       |
| Ireland        | 537           | 80               | 1.00%       |
| Malta          | 138           | 2                | 0.26%       |
| Estonia        | 16            | 2                | 0.03%       |
| Latvia         | 141           | 8                | 0.26%       |
| Slovakia       | 21            | 1                | 0.04%       |
| Supranational  | 687           | 33               | 1.29%       |
| Denmark        | 168           | 7                | 0.32%       |
| Slovenia       | 883           | 13               | 1.65%       |
| Czech Republic | 117           | 2                | 0.22%       |
| Japan          | 810           | 10               | 1.52%       |
| Cyprus         | 12            | 1                | 0.02%       |
| <b>Total</b>   | <b>53,436</b> | <b>1,554</b>     | <b>100%</b> |

#### 41 Commitments

| € m                          | 2009 | 2008  |
|------------------------------|------|-------|
| Irrevocable loan commitments | 154  | 1,177 |

#### 42 Segmental reporting

The Bank's income and assets are entirely attributable to public sector financing. The Bank is solely located in Ireland. Therefore no segmental report is presented.

#### 43 Ultimate parent company

DEPFA BANK plc, a company registered in Ireland, is the parent company of the Bank. The largest group into which the results of the Bank are consolidated is that headed by Hypo Real Estate Holding AG. The smallest group into which the results of the Bank are consolidated is that headed by DEPFA BANK plc. DEPFA BANK plc is a wholly owned subsidiary of Hypo Real Estate Holding AG, a company registered in Germany. Copies of the financial statements of DEPFA BANK plc can be obtained from The Secretary, DEPFA BANK plc, 1 Commons Street, IFSC, Dublin 1, Ireland. Copies of the financial statements of Hypo Real Estate Holding AG can be obtained from The Secretary, Hypo Real Estate Holding AG, Freisinger Str. 5, 85716 Unterschleisseim, Germany.

#### 44 Exchange rates as at 31 December 2009

European Central bank exchange rates at 31 December 2009 were:

|               |           |           |
|---------------|-----------|-----------|
| Great Britain | 1€ = GB£  | 0.88810   |
| Japan         | 1€ = JPY  | 133.16000 |
| United States | 1€ = US\$ | 1.44060   |

#### 45 Capital management

The Bank's objectives when managing capital, which is a broader concept than "equity" on the statement of financial position, are:

- to comply with the capital requirements set by the regulators of the banking markets where the Bank operates;
- to safeguard the Bank's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders; and
- to maintain a strong capital base to support the development of its business.

Capital adequacy and the use of regulatory capital is monitored by the Group's management, employing techniques based on the guidelines developed by the Basel Committee and the European Community Directives, as implemented by the Financial Regulator (the authority), for supervisory purposes. The required information is filed with the authority on a quarterly basis.

The authority requires each bank or banking group to: (a) hold the minimum level of the regulatory capital of € 6 million, and (b) maintain a ratio of total regulatory capital to the risk-weighted asset (the "Total capital ratio") at or above the internationally agreed minimum of 8%. In addition, those individual banking subsidiaries or similar financial institutions not incorporated in the European Union are directly regulated and supervised by their local

## Notes to the financial statements

banking supervisor, the requirements which may differ from country to country.

The Bank's regulatory capital as managed by its central Group Treasury is divided into two tiers:

- Tier 1 capital: share capital and retained earnings; and
- Tier 2 capital: qualifying subordinated loan capital and unrealised gains arising on the fair valuation of equity instruments held as available-for-sale.

The risk-weighted assets are measured using the Basel II Standardised Approach. The calculation reflects an estimate of credit, market and other risks associated with each asset and counterparty taking into account any eligible collateral or guarantees and the contingent nature of the potential losses.

During the year, the Bank has complied with externally imposed capital requirements.

### **46 Events after the reporting date**

There have been no notable events after 31 December 2009.

### **47 Approval of financial statements**

The financial statements were approved by the directors on 15 March 2010.



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