



ANNUAL REPORT
2003



Pfandbrief Bank International

PBI – TIMES OF CHANGE

At this point last year, we talked about the solid foundation that every house needs to have if it is to stand firm through the storms of life. This ability to stand firm is put to the test in times of change.

Indeed, last year was just such a time of change. In all of the challenges we faced, Pfandbrief Bank International proved to be both a stable and an adaptable partner.

A solid foundation is needed to carry out change. The facelift, some of which has already been completed while some is still outstanding, opens up new opportunities and new perspectives for the future.

This includes a future-looking business model, which, together with successful partners, helps to lay the kind of foundation that you would really want to build on.



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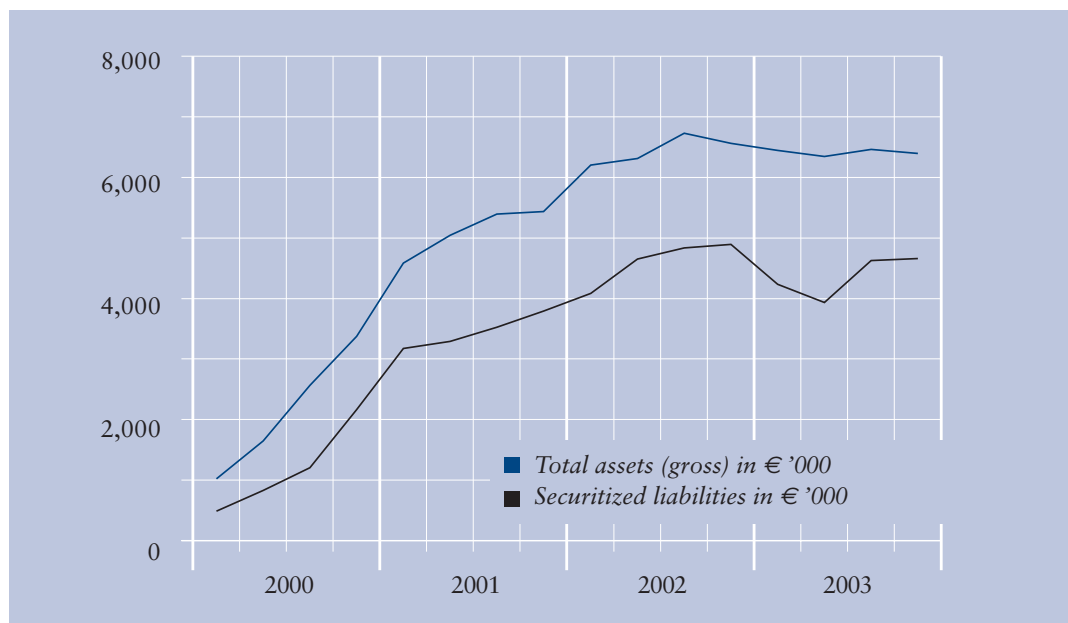
PREFACE I



Dear business friends,

the year 2003 was the year in which the war in Iraq gave rise to considerable uncertainty around the world. It was the year in which the stockmarkets experienced dramatic collapses followed by no less a dramatic recovery, not least due to this very uncertainty. Negative economic expectations worldwide allied with interest rate cuts in the United States and Europe to spark an intensive discussion on deflationary dangers and

drive interest rates to new lows. The U.S. dollar shed some 20 % of its value against the euro during the course of 2003. The weak economy coupled with high unemployment figures and demographic changes increased the need to forge ahead with reforms to European social-welfare systems and public finances, most notably in Germany, France, and Italy. Unfortunately, the pace of reform has lagged far behind the pace of

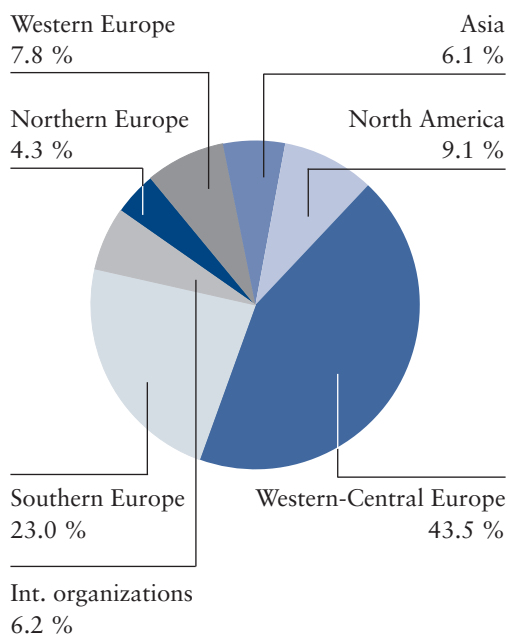


Development of total assets and securitized liabilities during the past four years

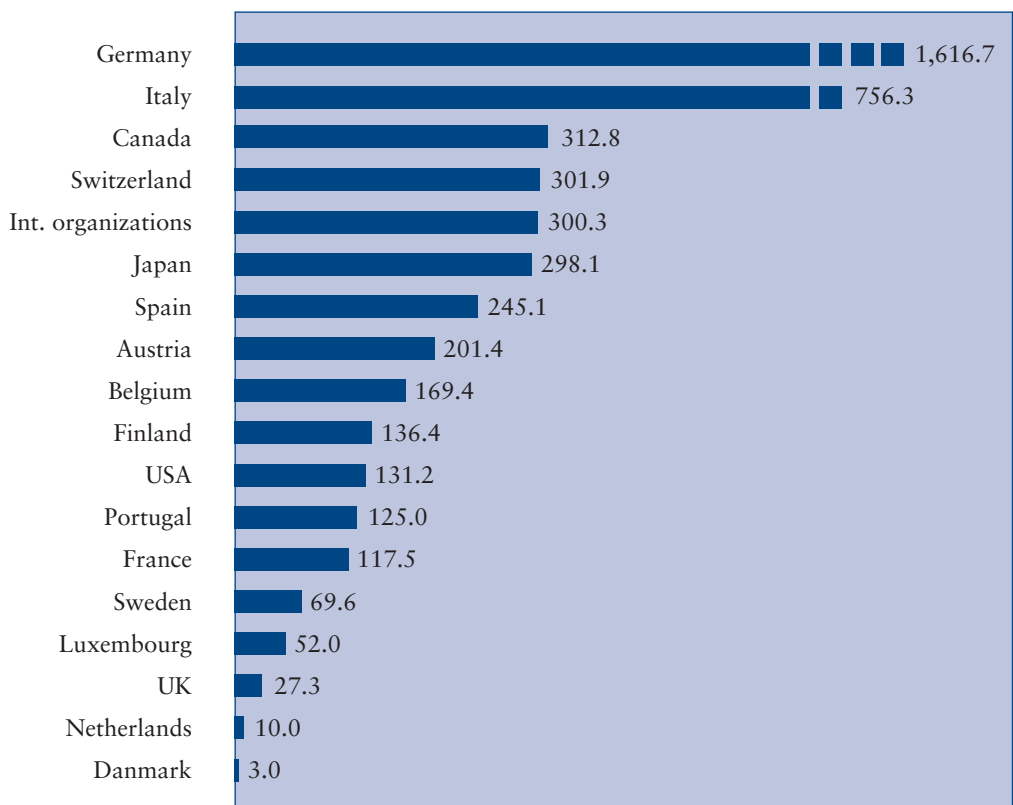
development. The pressure for reform is being raised further by the growing integration of the global economy. The associated reallocation of labor and capital was not permanently slowed by the terrorist attacks in 2001. Yet the compulsion to adapt existing structures to match the challenges of the future is not only being felt by public authorities and social-welfare systems, the same also holds true for the European banking system in general, and the German banking sys-

tem in particular. Thus 2003 was also the year in which HVB Group, of which PBI was previously a member, experienced a thorough restructuring. The outcome was a new banking corporation – the Hypo Real Estate Group – to which Pfandbrief Bank International now also belongs.

HypoVereinsbank completed the spin-off of its commercial real estate finance business, which it had sought since the start of the year, in October 2003. The move gave rise to a new banking organization – the Hypo Real Estate Group – headed by Hypo Real Estate Holding AG in Munich. HypoVereinsbank no longer holds a participating interest whatsoever in this corporate group; both banking groups are fully independent of each other, and act accordingly. Grouped under the Hypo Real Estate Holding AG umbrella are Hypo Real Estate Bank AG headquartered in Munich (the result of the merger of HVB Real Estate Bank and Westfälische Hypothekenbank AG), Württemberger Hypothekenbank AG, Stuttgart, and Hypo Real Estate Bank International, Dublin. This latter institution acquired all the shares (100 % minus one) in Pfandbrief Bank International in September 2003. At the same time, it has provided



Cover pool by region, as of December 31, 2003



Cover pool by country, as of December 31, 2003 (in millions of €)

a letter of comfort for Pfandbrief Bank International. Since PBI is now separate from HVB Group, it was necessary to make permanent changes to the IT architecture and take on other functions that were previously performed by HVB Group units. Consequently, we increased the size of the workforce again this year.

The takeover of Pfandbrief Bank International by Hypo Real Estate Bank International is reflected in the new shareholder's interest in exploiting Pfandbrief Bank International's existing market position and the special opportunities provided by the bank to achieve its objectives. PBI gains strategic significance for Hypo Real Estate Bank International from its privilege of



issuing mortgage-backed Pfandbriefe under Luxembourg law against secured real estate loans in regions like Britain, North America, and even Japan. Regions in which Hypo Real Estate Bank International does a large proportion of its business. Consequently, Pfandbrief Bank International aims to develop the mortgage-backed Pfandbrief into an additional funding option for the shareholder in the future.

Furthermore, the capital market skills and capacities of Pfandbrief Bank International are being used beyond the confines of secured funding. With this in mind, Hypo Real Estate Bank International has opened a branch office in Luxembourg, which is being operated simultaneously by PBI. The purpose of this office is to oversee the debt issuance program of Hypo Real Estate Bank International aimed at preparing, concluding, documenting, handling and administering securities issues of Hypo Real Estate Bank International.

PBI intends to continue the business of funding public-sector entities using the strategy pursued to date. To this end, the credit analysis performed for public-sector entities has been expanded further. The capital market operations of Pfandbrief Bank International and Hypo Real Estate

Bank International are being closely coordinated. Further evidence of the seamless integration of the two organizations came in the final quarter of the year under review when Pfandbrief Bank International introduced a new front-office system that is also employed by Hypo Real Estate Bank International. Far more efficient than its predecessor, the new system facilitates uniform reporting.

Unfortunately, it was not possible to make major progress on expanding our operations in the year under review, due to the transformation process at HVB Group. It proved impossible to expand the portfolio to the extent envisaged, which resulted in a slight decrease in total assets. Against this backdrop, the volume of new public-sector Pfandbrief issues, at € 1,138 m, failed to match the previous year's figure. Despite this, the liquidity profile of our credit portfolio enabled us to maintain the same level of earnings even without an increase in the lending volume. It also proved possible to exploit the beneficial interest environment to generate income from financial transactions on the back of a strictly conservative risk policy. This led to a 95.5 % increase in net income after taxes, to more than € 4.35 m. The full amount of unappropriated net income is being reinvested to reinforce our equi-



ty base with a view to meeting Hypo Real Estate Bank International's interest in expanding Pfandbrief Bank International. We have again slightly increased the volume of our cover portfolio while ensuring a regional diversified and constantly high credit quality.

No less important than this strong earnings performance, however, was the successful positioning of PBI within the new Hypo Real Estate Group. PBI's role on the capital markets is now also clear.

PBI faced extra burdens last year, not least due to its involvement in the spin-off from HVB Group. It would not have been possible for us to master these challenges without the tremendous efforts of our people, who set about the formation of Hypo Real Estate Bank International with real determination. We would like to thank all of them for hard work.

It is not only the financial markets that are changing; PBI is evolving with them. Yet no matter what the changes, PBI's strategy remains firmly based on our high aspirations in terms of the quality of our products and processes, the transparency of our risk policies, and the desire to actively shape the financial markets of the future. With all this in mind, we look forward to continuing our successful partnership with you.

Ralph Brödel

Martin Schulte

Gerhard M. Kainz

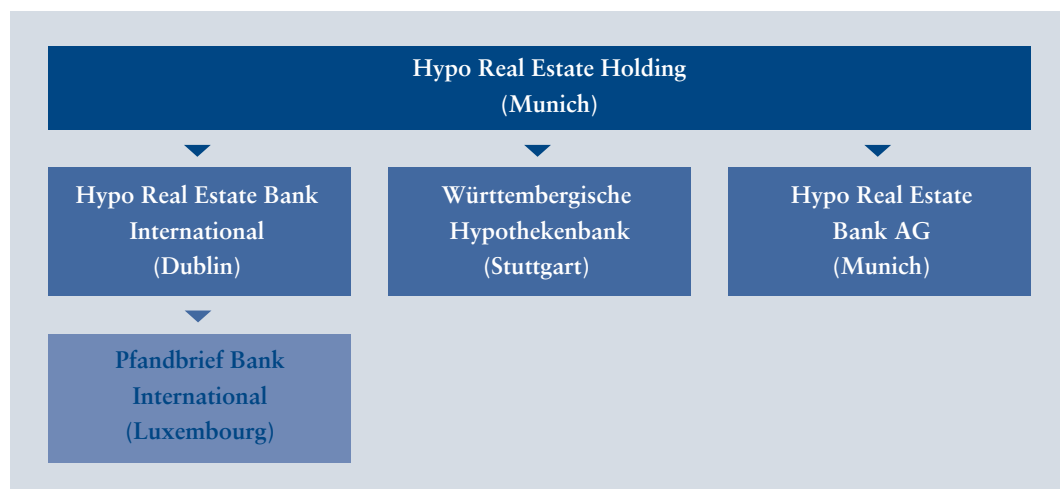
MANAGEMENT REPORT

Pfandbrief Bank International was heavily affected by HVB Group’s transformation process last year. All of the shares in Pfandbrief Bank International were transferred to Hypo Real Estate Bank International, Dublin, as part of the spin-off of the commercial real estate business, which also included all the mortgage banking activities of HVB Group. At the same time, Pfandbrief Bank International was incorporated in the strategy of Hypo Real Estate Bank International. Even though the role of the bank within the corporate group was not always transparent on the markets last year, we succeeded in almost completely replacing the funding re-

sources falling due, boosting reported net income by around 95 %, and completing the tasks associated with the spin-off on schedule. Not only does this include the necessary adjustments to the IT infrastructure, it also encompasses the introduction of a new trading system and active involvement in the creation of Hypo Real Estate Bank International.

It remains our function and our objective to press ahead with the further development of both our Bank and the “Luxembourg Pfandbrief” product. We consider the new corporate group to be an enhanced platform for achieving this and for

The following chart shows the new corporate structure:





exploiting for exploiting the corresponding chances and legal opportunities arising from the international presence of the group members. In addition to the existing function of funding public-sector entities, we are working on being able to issue mortgage-backed Pfandbriefe (“lettres de gage hypothécaires”) in the near future as a further instrument for funding the operations of Hypo Real Estate Bank International.

Apart from these fundamental realignments, we have largely achieved our targets in our day-to-day operations. We have updated our existing Programme for the Issuance of Debt Instruments as scheduled. This program is used to handle longer-term issues.

Standard & Poor’s has confirmed the triple-A rating for our public-sector Pfandbriefe. As in the past, we have used every opportunity to enhance relationships with our business partners. We held conferences and presentations to explain the quality of the Pfandbrief known as “lettres de gage”. A further central issue was of course to outline the planned strategy and division of responsibilities in the new corporate group. We are convinced that this will open up tremendous opportunities to develop the Luxembourg Pfandbrief.

The Board of Directors of PBI met four times during the year to discuss and make decisions on matters that fall under the Board’s competence in accordance with our Articles of Association and Management Regulations. In particular, such matters include decisions regarding credit limits and staff changes. The Board also considered the strategic positioning and development of PBI as well as market trends.

In addition to the capital-raising measures effected in 2002, we continue to pursue a policy of organically reinforcing our capital base with a view to implementing the ambitious goals we have for the future and creating the equity base required to do this. Consequently, this year’s profits will be reinvested in full.

All in all, we have made good progress on the development of Pfandbrief Bank International and toward achieving our long-term objectives, even during a time of deep restructuring on the part of our shareholders.

Lending operations

We acquired placements, loans and advances worth € 1,055 m (2002: € 1,484 m) in 2003, including € 915 m (2002 € 1,037 m) of securities

issued by public-sector borrowers. Where appropriate, we employed derivative financial instruments to hedge the exposure arising from market changes. Securities totaling € 923 m fell due for scheduled redemption (2002: € 405 m). Loans and advances in the amount of € 135 m (2002: € 31 m) were redeemed on schedule. As in 2002, no loans or advances were pledged as collateral and no unscheduled redemptions were made.

Funding operations

Covered bearer and registered public-sector Pfandbriefe (“lettres de gage publiques”) were issued with a total amount of € 1,138 m (2002: € 2,325 m). As in 2002, no loans were taken out. Bearer debt securities not requiring cover were issued in an amount of € 50 m (2002: none). Subordinated debt instruments were issued in the form of the transformation of a silent partner’s contribution totaling € 9 m (2002: new issues of € 10 m).

Alongside drawings denominated in euros, we also used securities denominated in Swiss francs and Japanese yen. The bearer issues were launched within the framework of our MTN program (Programme for the Issuance of Debt Instruments).

Of the issues outstanding, seven issues with a total amount of € 826 m (2002: 15 issues with a total amount of € 1,213 m) fell due for scheduled redemption in 2003, while no issues were redeemed in advance of maturity (2002: three issues with a total amount of € 84 m).

As in 2002, we did not repurchase any of our own issues for price maintenance purposes. Of the own issues we held, we placed € 60 m (2002: € 50 m) back in the market.

At year-end 2003, we had used € 140 m (2002: € 615 m) out of the limit on our commercial paper program. The average maturity of the CP issues during the year was 86 days. We issued commercial paper denominated in euros and U.S. dollars.

Assets and earnings

Total assets amounted to € 6,391 m, representing a 2.5 % decline compared with 2002 (€ 6,553 m).

Loans and advances, including securities, amounted to € 6,096 m, reflecting a 2.7 % fall compared with 2002 (€ 6,267 m).

Funding (refinancing) resources totaled € 6,056 m, 2.2 % down on 2002 (€ 6,193 m).

Earnings did well against the backdrop of the developments and market conditions described. By exploiting the liquidity profile of our lending portfolio efficiently, we were able to boost net interest and commission income by 33 % over the prior year. At the same time, the beneficial interest environment in the first months of this fiscal year helped us to generate additional income from financial transactions while applying a very conservative risk policy.

We intend to transfer the reported complete net income to reserves in order to reinforce our equity base.

Net income and appropriation of profit

We earned net income after taxes of € 4,350 k (2002: € 2,225 k), corresponding to a 95.5 % increase over the prior year.

At the Annual General Meeting of Shareholders, we will propose transferring € 250 k to the statutory reserve and € 4,100 k to retained earnings.

Income statement in report form

(in thousands of €)	2003	2002
Net interest income	7,700	6,024
Net commission income	39	- 245
Net income from financial transactions	1,113	514
Personnel expenses	1,758	1,139
Other administrative expenses	2,014	1,824
Depreciation of property, plant and equipment	115	586
Current expenses	3,887	3,549
Balance of other operating income and expenses	23	105
Operating result before risk provision	4,910	2,849
Balance of write-downs and write-ups on securities	917	233
Risk provision	100	50
Operating result after risk provision	5,727	3,032
Taxes	1,377	807
Net income for the year	4,350	2,225



Risk Report

Our Risk Control unit, which reports directly to management, has kept pace with the Bank's growth and continually refined its risk measurement and management systems in response to the constantly evolving internal and external demands. The core functions of this unit are:

- to measure and monitor risk on a daily basis, employing the value-at-risk approach for market, credit, counterparty, and liquidity risk,
- to calculate economic performance on a daily basis,
- to independently monitor the parameters used to measure risk and performance and
- to refine and execute our control strategies.

Effective risk control is assured by continually improving the risk measurement and management tools we use and by integrating our systems into the risk-control system of Hypo Real Estate Group.

We have instituted appropriate reporting paths and control measures to monitor and manage individual risks. The following measures are listed by way of example:

Liquidity risk

We maintain relationships with a number of capable banks to ensure that short-term liquidity needs can be met. A list of all future cash flows and cumulative balances, broken down by individual currency, is generated every day to facilitate the management of short-term payment obligations. To assure short-term management and limitation of liquidity risk, as well as medium-term and long-term planning, we analyze our assets and liabilities every day on the basis of so-called liquidity classes and time buckets.

Counterparty risk (credit and country risk)

Our exposure to counterparty and credit risk is exclusively with public-sector borrowers and OECD banks. The counterparty default risk arising from our derivative operations is assessed regularly on the basis of gross replacement costs. These are positive net present values determined on the basis of the marked-to-market method. The utilization levels of all credit facilities are available for review online, both for each individual counterparty and aggregated on an intraday basis, based on market values.

Market risk

As part of our asset-liability management, we assess the interest rate risk for the Bank's total po-

sition on a daily basis. The Risk Control unit assesses the risk position and economic performance, and verifies compliance with the pre-established limits. Management is informed about these risks and results every day. To manage and quantify interest rate risk, we employ risk sensitivities and the value-at-risk concept in use throughout the corporate group, which is based on a 99 % confidence level for an assumed ten-day holding period. The average exposure to interest rate risk amounted to € 4,484 k.

There were no significant currency risks. All assets, liabilities and off-balance sheet transactions are included in the risk calculations.

Credit Research

In addition to the Risk Control unit, which focuses on market risk, counterparty risk, liquidity risk, and operational risk, our Credit Research Public-Sector unit constantly analyzes credit quality in the public sector, the attractiveness of potential public-sector borrowers on the basis of criteria that go beyond mere creditworthiness considerations, as well as region-specific and level-specific financing solutions in the OECD area. Creditworthiness is assessed on the basis of a scoring model, which takes into account political, economic and budgetary factors as well as regulatory conditions and qualitative aspects of

the borrower unit. The internal assessment of the (potential) borrowers is supported by continuous monitoring of credit-relevant information in order to identify potential risks and credit trends at an early stage.

Thus the Credit Research unit supplies information about the potential credit risks in the Bank's portfolio. At the same time, it also provides a good basis for pricing possible new credit commitments by the Treasury unit on the level of countries, government tiers, and products as part of portfolio management. The organization of our credit, information, and decision-making processes has been set up to comply with the Minimum Requirements for the Credit Business of Credit Institutions that have been introduced in Germany.

Other information

Hypo Real Estate Bank International has provided a letter of comfort for Pfandbrief Bank International. We are fully consolidated in the consolidated financial statements of Hypo Real Estate Holding prepared in accordance with IAS through Hypo Real Estate Bank International.



Outlook

Given the communicated strategic orientation of Hypo Real Estate Bank International, Pfandbrief Bank International represents an important pillar of the corporate group. It rounds out the funding tools available to the new banking group. Since the underlying statutory framework provides perfect conditions for funding part of the international real estate finance business, Pfandbrief Bank International will make use of its privilege of issuing Pfandbriefe to fund the portion of the business eligible for cover. Furthermore, a seamlessly coordinated capital market presence will be ensured for the two banks by

close collaboration with the new parent. At the same time, we will continue to provide funding for public-sector borrowers in line with our expectations in terms of credit quality and contribution to earnings.

No events of particular significance for the assets, liabilities, and earnings situation of the past fiscal year have occurred after the balance sheet date.

Business activities and earnings have continued to develop according to expectations since December 31, 2003.

BALANCE SHEET AT DECEMBER 31, 2003

ASSETS	2003	2002
	€	€
Cash on hand, balances with central banks and on postal giro accounts	34,002,571	1,305,198
Placements with, and loans and advances to, other banks	912,421,207	768,629,387
Municipal loans and loans guaranteed by public institutions	529,123,542	418,040,846
Other loans and advances	383,297,665	350,588,541
<i>of which: Repayable on demand</i>	393,706	59,656,585
Loans and advances to customers	555,933,929	658,833,035
Municipal loans and loans guaranteed by public institutions	555,933,929	658,833,035
Debt securities and other fixed-income securities	4,627,881,600	4,840,429,859
Public-sector issuers	2,239,270,077	2,258,594,254
Other issuers	2,322,669,705	2,455,119,287
Own issues	65,941,818	126,716,318
Property, plant and equipment	199,949	227,489
Other assets	341,206	252,300
Accruals and deferrals	260,451,119	283,143,041
Total assets	6,391,231,581	6,552,820,309



LIABILITIES

		2003	2002
		€	€
Amounts owed to banks		1,243,175,411	1,184,697,425
Registered public-sector Pfandbriefe issued	20,000,000		20,000,000
Other amounts owed	1,223,175,411		1,164,697,425
<i>of which: Repayable on demand</i>	2,244,464		856,610
<i>of which: With agreed maturity</i>			
<i>or period of notice</i>	1,240,930,947		1,183,840,815
Amounts owed to customers		162,200,000	120,200,000
Registered public-sector Pfandbriefe issued	162,200,000		120,200,000
<i>of which: With agreed maturity</i>			
<i>or period of notice</i>	162,200,000		120,200,000
Securitized liabilities		4,650,789,539	4,888,560,265
Issued debt securities	4,510,788,259		4,273,560,265
Public-sector Pfandbriefe	4,460,788,259		4,273,560,265
Other debt securities	50,000,000		0
Other	140,001,280		615,000,000
Other liabilities		175,638	134,538
Deferred income		207,526,228	237,380,131
Provisions		2,994,765	1,797,950
Deferred taxes	2,444,295		1,467,511
Other	550,470		330,439
Subordinated liabilities		34,000,000	34,000,000
Subscribed capital		66,000,000	66,000,000
Additional paid-in capital		15,000,000	15,000,000
Reserves		5,020,000	2,825,000
Net income for the year		4,350,000	2,225,000
Total liabilities		6,391,231,581	6,552,820,309

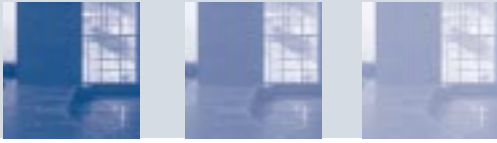
INCOME STATEMENT FOR THE PERIOD
FROM JANUARY 1 TO DECEMBER 31, 2003

EXPENSES	2003 €	2002 €
Interest and similar expenses	565,826,758	624,622,624
Fee and commission expenses	518,737	508,689
General administrative expenses	3,772,696	2,963,005
Personnel expenses	1,758,241	1,138,722
of which: Wages and salaries	1,607,228	1,027,227
of which: Expenses for social security	109,881	89,701
<i>of which: For pensions</i>	77,431	63,350
Other administrative expenses	2,014,455	1,824,283
Amortization and depreciation of intangible assets and property, plant and equipment	114,861	586,170
Write-downs on and provisions for placements, loans and advances, and additions to provisions for contingent liabilities and credit risks	100,000	50,000
Write-downs on and allowances for securities held as investments, participating interests and shares in affiliated companies	15,300	13,319
Other operating expenses	8,238	66
Taxes on income from ordinary activities	1,376,785	506,805
Taxes not included in the items above	0	300,000
Net income for the year	4,350,000	2,225,000
Total expenses	576,083,375	631,775,678



I N C O M E

	2003	2002
	€	€
Interest and similar income	573,526,946	630,647,057
of which: From fixed-income securities	259,665,300	278,759,236
Fee and commission income	479,441	263,179
Net income from financial transactions	1,113,163	513,578
Other operating income	31,068	105,360
Income from the reversal of write-downs on securities held as investments, participating interests and shares in affiliated companies	932,757	246,504
of which: Net gains on the sale of fixed-income securities held as investments	932,757	246,504
Total income	576,083,375	631,775,678



AUDITOR'S REPORT

Following our appointment by the Board of Directors we have audited the attached annual accounts of Pfandbrief Bank International S.A. for the year ended December 31, 2003, and have read the related management report. These annual accounts and the management report are the responsibility of the Board of Directors. Our responsibility is to express an opinion on these annual accounts based on our audit and to check the consistency of the management report with them.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the annual accounts are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the annual accounts. An audit also includes assessing the accounting principles used and significant estimates made by the Board of Directors, as well as evaluating the overall annual accounts presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the attached annual accounts give, in conformity with the Luxemburg legal and regulatory requirements, a true and fair view of the financial position of Pfandbrief Bank International S.A. as of December 31, 2003 and of the results of its operations for the year then ended.

The management report is in accordance with the annual accounts.

Luxembourg, March 5, 2004

KPMG Audit

Réviseurs d'Entreprises

Thomas Feld

I. GENERAL INFORMATION

Pfandbrief Bank International S.A. (“PBI” or the “Bank”) was formed in Luxembourg on July 27, 1999. On September 14, 1999 the Finance Minister of the Grand Duchy of Luxembourg granted a license allowing the Bank to operate as a mortgage bank under Luxembourg law (“banque d’émission de lettres de gage”).

The entry in the Register of Companies was made on August 16, 1999 under the number 71104 (Section B). The legal rules and regulations underlying the operation of a mortgage bank can be found in Sections 12-1 to 12-9 of the Law of April 5, 1993 on the Finance Sector (as amended).

The Bank was originally formed by Bayerische Hypo- und Vereinsbank AG and its German mortgage banking subsidiaries, each one of which holding an equal equity interest, in the form of a holding company construction.

As part of the reorganization of HVB Group, the commercial real estate business was spun off and pooled with all other mortgage banking activities in the Hypo Real Estate Group. All the shares in PBI were transferred to Hypo Real Estate

Bank International, Dublin, as part of this transformation process.

The equity shares in the Bank are now held in full by Hypo Real Estate Bank International, Dublin, apart from one share which is held by a trustee. The subscribed capital of the Bank is fully paid-up.

Pfandbrief Bank International S.A. will be included in the consolidated financial statements of Hypo Real Estate Holding AG to be prepared for the first time. The consolidated financial statements may be obtained from the parent company’s head office in Munich.

2. ACCOUNTING AND VALUATION METHODS

The accounting and valuation methods of the Bank are in compliance with the regulations applicable in the Grand Duchy of Luxembourg and specifically with the Law of June 17, 1992 concerning the annual financial statements and consolidated financial statements of financial institutions.

The Bank's reporting currency is the euro (€).

2.1 Non-current assets

Property, plant and equipment

Property, plant and equipment is carried on the balance sheet at acquisition or production cost less accumulated depreciation. Items of property, plant and equipment are subject to value depletion over time, which must be accounted for by way of scheduled depreciation. Depreciation charges are determined on the basis of the customary useful lives of the assets in question.

The depreciation rates applied at the balance sheet date are detailed in the table below.

Purchased assets with acquisition or production costs of not more than € 868, or for which the useful life is less than one year, are written off in full in the year of acquisition.

	Depreciation rate	Method
Office and business equipment	20.00 %	Straight-line
Data processing equipment	33.33 %	Straight-line



Investments

The debt securities and other fixed-income securities held to maturity for operating purposes and meeting the requirements of the bank regulatory authority are valued at acquisition cost, or, if there is likely to be a permanent decline in value, at the lower market price. Some of these securities are hedged by interest rate swaps (asset swaps).

The remaining fixed-income securities are valued at the lower market price.

Accruals and deferrals are created for issue premiums and discounts, and are expensed on a pro rata basis over the remaining life of the securities.

2.2 Current assets

Debt securities and other fixed-income securities

Debt securities and other fixed-income securities not classified as long-term investments are carried at acquisition cost and are attributed to the liquidity portfolio.

These securities are valued strictly at the lower of cost or market in accordance with the “principle of retention.” They are valued at the lower

market price on the balance sheet date, or if such a market price cannot be determined, at the probable sale value or the price that best reflects the value of the securities.

Own debt securities repurchased and hedged by means of an asset swap are valued at acquisition cost.

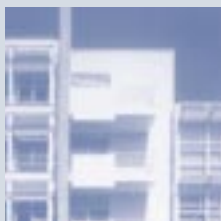
Placements, loans and advances

Placements, loans and advances are carried at their nominal values. Accrued interest not yet payable is shown under accruals and deferrals on the assets side of the balance sheet. Accruals and deferrals are established for issue premiums and discounts in accordance with the respective maturities.

Provisions for current assets

The Bank generally applies a policy of establishing specific loan-loss provisions to cover the risk of loss or default on existing placements, loans and advances.

A general loan-loss provision has been established for latent risks. Such provisions are deducted directly from the respective asset items.



2.3 Liabilities and provisions

Liabilities are stated at their nominal or repayment amounts, and provisions are established in the necessary amount according to the exercise of sound business judgment.

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

The Bank applies the weighted average price method when determining acquisition costs.

2.5 Currency translation

Assets and liabilities not denominated in euros are translated to the reporting currency at the median spot exchange rate on the balance sheet date.

Income and expenses denominated in foreign currencies are translated to the reporting currency at the respective daily exchange rates.

Foreign exchange losses resulting from the application of these valuation principles are recognized in the income statement.

The imparity principle is applied to valuation results from uncovered positions. Covered spot or forward positions are valued without effect on the income statement.

2.6 Valuation of financial derivatives

Derivative financial instruments are recorded as off-balance sheet items on the trade date. At year-end, they are valued at market prices unless they serve to hedge the overall interest rate position of the Bank.

3. NOTES TO ASSETS

3.1 Assets at December 31, 2003

Maturity schedule

(in thousands of €)	Placement with, and loans and advances to, other banks (including balances with central banks)		Loans and advances to customers	
	Dec. 31, 2003	Prior year	Dec. 31, 2003	Prior year
Repayable on demand	34,396	60,962	–	–
Up to 3 months	385,460	290,932	–	–
From 3 months to 1 year	4,602	22,556	20,452	42,038
From 1 year up to 5 years	285,179	125,575	117,854	52,267
More than 5 years	236,787	269,909	417,628	564,528
Total	946,424	769,934	555,934	658,833
of which: Subordinated loans and advances	–	–	–	–

Placements with, and loans and advances to, other banks repayable on demand include balances with the central bank totaling € 34,003 k. Placements with, and loans and advances to, other banks include claims for return of lent securities totaling € 282,420 k.

3.2 Loans and advances, or debt securities and other fixed-income securities, to affiliated companies or companies in which a participating interest is held

(in thousands of €)	Affiliated companies		Companies in which a participating interest is held	
	Dec. 31, 2003	Prior year	Dec. 31, 2003	Prior year
Placements with, and loans and advances to, other banks	100,484	361,476	–	–
Loans and advances to customers	–	–	–	–
Debt securities and other fixed-income securities	223,362	303,363	–	–
Total	323,846	664,839	–	–
of which: Own debt securities	65,942	126,716	–	–
of which: Subordinated loans and advances	–	–	–	–

3.3 Breakdown by standardized risk-weighting classes

On-balance-sheet risk volume (in thousands €)	Nominal amount	Risk weighting	Risk equivalent
Assets secured by cash deposits internally	250,000	0 %	0
Secured by local authorities in Zone A (20 % eligibility)	20,286	20 %	4,057
Due from central governments and central banks in Zone A	1,815,914	0 %	0
Due from regional and local governments (0% eligibility)	1,533,303	0 %	0
Due from regional and local governments (20% eligibility)	1,031,278	20 %	206,256
Due from other banks in Zone A ≤ 1 year	261,254	20 %	52,251
Due from other banks in Zone A ≥ 1 year	293,622	20 %	58,724
Debt securities of banks	718,758	10 %	71,876
Due from multilateral development bank	264,498	20 %	52,900
Collection items	317	20 %	63
Accruals and deferrals	54,402	50 %	27,201
Property, plant and equipment	195	100 %	195
Total	6,243,827		473,523



Derivatives (in thousands of €)	Nominal amount	Risk weighting	Risk equivalent
Transactions without netting			
Interest rate transactions ≤ 1 year to maturity	0	20 %	0
Interest rate transactions >1 ≤ 5 years to maturity	1,321	20 %	264
Interest rate transactions > 5 years to maturity	5,743	20 %	1,149
Foreign exchange transactions ≤ 1 year to maturity	722	20 %	144
Foreign exchange transactions >1 ≤ 5 years to maturity	0	20 %	0
Foreign exchange transactions > 5 years to maturity	22,664	20 %	4,533
Transactions with netting	59,744	20 %	11,949
Total	90,194		18,039

3.4 Information on credit risk

The following table shows the breakdown of placements, loans and advances, and debt securities and other fixed-income securities (before deduction of provisions and write-downs) at the balance sheet date:

(in thousands of €)	Remaining maturity				Total
	≤ 1 year	> 1 year ≤ 5 years	> 5 years ≤ 10 years	> 10 years	
Banks					
Europe	573,452	814,813	893,701	54,993	2,336,959
Japan	–	51,957	56,873	–	108,830
USA	11,000	10,999	19,947	–	41,946
Subtotal	584,452	877,769	970,521	54,993	2,487,735
Public-sector borrowers (excluding banks)					
Europe	83,275	596,524	896,568	1,164,406	2,740,773
Japan	47,570	149,083	97,056	97,218	390,927
Canada	37,044	40,694	106,135	226,637	410,510
USA	13,685	69,265	9,939	7,709	100,598
Subtotal	181,574	855,566	1,109,698	1,495,970	3,642,808
Total	766,026	1,733,335	2,080,219	1,550,963	6,130,543



3.5 Debt securities and other fixed-income securities, and participating interests

(in thousands of €)	Dec. 31, 2003	Prior year
Exchange-listed securities	4,476,585	4,721,082
Non-listed securities	151,297	119,348
Total	4,627,882	4,840,430

The debt securities and other fixed-income securities due for redemption in the following year amount to € 358,886 k.

Debt securities of a members state of the European Union using the euro eligible for refinancing with a central bank in the euro-zone amount to a nominal € 1,411 m at the balance sheet date.

The following table shows the breakdown of debt securities (after deduction of write-downs):

(in thousands of €)	Dec. 31, 2003	Prior year
Securities carried as long-term investments	4,561,940	4,713,714
Securities carried in liquidity portfolio	65,942	126,716
Total	4,627,882	4,840,430

At the balance sheet date, accumulated premiums totaled € 3,656 k and accumulated discounts totaled € 2,738 k. Repurchase obligations under repurchase agreements totaled € 656,550 k.

3.6 Accruals and deferrals

This item primarily contains accrued interest and amortized premiums and discounts on debt issues and loans.

4. NOTES TO LIABILITY ITEMS

4.1 Liabilities at December 31, 2003

Maturity schedule

(in thousands of €)	Amounts owed to banks		Amounts owed to customers	
	Dec. 31, 2003	Prior year	Dec. 31, 2003	Prior year
Repayable on demand	2,244	856	–	–
Up to 3 months	1,165,931	1,103,841	–	–
More than 3 months up to 1 year	55,000	30,000	–	–
More than 1 year up to 5 years	–	30,000	28,000	28,000
More than 5 years	20,000	20,000	134,200	92,200
Total	1,243,175	1,184,697	162,200	120,200

Of the amounts owed to banks, € 725,890 k relates to repurchase agreements.

(in thousands of €)	Securitized liabilities at December 31, 2003			
	Public-sector Pfandbriefe	Other debt securities	Other	Total
Repayable on demand	–	–	–	–
Up to 3 months	90,300	–	111,000	201,300
More than 3 months up to 1 year	1,100,000	–	29,001	1,129,001
More than 1 year up to 5 years	2,893,912	–	–	2,893,912
More than 5 years	376,576	50,000	–	426,576
Total	4,460,788	50,000	140,001	4,650,789

The securitized liabilities due in the following year amount to € 1,330,301 k.

4.2 Amounts owed to affiliated companies or companies in which a participating interest is held

There were no amounts owed to affiliated companies.

4.3 Deferred income

This item consisted mainly of deferred interest, premiums, and discounts.

4.4 Provisions

The other provisions stated on the balance sheet consisted mainly of outstanding invoices relating to business conducted in the past fiscal year.

4.5 Subordinated liabilities

At December 28, 2000 the Bank accepted a “silent partner’s contribution” in the amount of € 9,000 k. The term is indefinite and the interest is dependent on profits. For bank regulatory purposes, this silent partner’s contribution is classified as upper Tier II capital.

Effective January 1, 2003 the silent partner’s contribution was converted into a subordinated debt issue. Interest is still dependent on profits, the term is indefinite and the regulatory classifi-

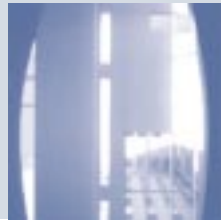
cation is upper Tier II capital. In 2003, interest in the amount of € 758 k was charged to the income statement.

On May 18, 2001 the Bank issued subordinated debt in the amount of € 15,000 k. The final principal repayment on this subordinated debt, repayable in installments beginning May 18, 2017, is scheduled for May 18, 2026. The interest rate is 6.8 % p.a. At January 30, 2002 the subordinated debt was increased by € 10,000 k to € 25,000 k under identical loan conditions. In 2003, interest in the amount of € 1,697 k was charged to the income statement. For bank regulatory purposes, the subordinated debt is classified as lower Tier II capital.

4.6 Equity

The subscribed capital totals € 66,000 k and is divided into 66,000 non-par bearer shares. There is no authorized capital.

Pursuant to the Luxembourg Law of August 10, 1915 on Commercial Companies, the Bank must allocate at least 5 % of its annual net income to a statutory reserve every year until such time as this reserve reaches 10 % of the subscribed cap-



ital. No distributions may be made from the statutory reserve. At the balance sheet date, the statutory reserve totaled € 375 k and retained earnings totaled € 4,645 k.

The Bank exercises the capital tax credit option allowed under tax law. Retained earnings contain € 2,700 k for the capital tax credit. For 2003, a similar allocation to this reserve will be effected.

In accordance with the profit appropriation proposal, an amount of € 250 k will be allocated to the statutory reserve and € 4,100 k to retained earnings.

4.7 Assets deposited as collateral for own liabilities

Assets with a nominal amount of € 95,500 k have been deposited as collateral with the central bank.

5. NOTES TO OFF-BALANCE SHEET ITEMS

The Bank engages in transactions involving derivative financial instruments in the OTC market exclusively for hedging purposes as part of its asset-liability management program. No trading activities involving derivatives were conducted. As a general rule, the Bank has entered into netting agreements with its trading partners in the derivatives business to reduce the associated risks.

In 2003, the Bank included a small number of interest rate and currency swaps in the cover pool. The Bank entered into contractual agreements with the respective counterparties to govern the relevant information and cooperation duties. The procedure has been approved by the regulatory authorities and trustee.

At year-end 2003, the notional volume of off-balance sheet transactions totaled € 9,542 m, of which € 58 m was with affiliated companies. The counterparty risks resulting from derivatives were determined on the basis of gross replacement costs, among other factors. At year-end 2003, the counterparty risk (maximum default risk) defined in this way totaled € 206 m, or 2.1 % of the outstanding notional volume.

Taking into account netting agreements, counterparty risk declines to € 78 m.

When add-ons and risk weighting are additionally applied for potential future risks in accordance with bank regulatory standards, the counterparty risk according to the marked-to-market method amounted to € 18 m at year-end 2003. In the future, the Bank will continue to pay strict attention to its counterparty risk, keeping it within narrow limits by means of active management. Its counterparties for derivative transactions are exclusively OECD banks.



(in millions of €)	Notional amount RM* up to 1 year	Notional amount RM* 1 to 5 years	Notional amount RM* more than 5 years	Total notional amount	Positive market values	Counter-party risks
Interest rate derivatives						
Interest rate swaps (same currency)	1,657	3,047	3,046	7,750	129	
Interest rate options – purchased	27	121	117	265	1	
Interest rate options – written	0	20	25	45	0	
Other interest rate contracts	0	0	0	0	0	
Currency derivatives						
Foreign exchange swaps	541	0	0	541	5	
Cross-currency swaps	75	488	378	941	71	
Total	2,300	3,676	3,566	9,542	206	18

* RM = remaining maturity

6. NOTES TO THE INCOME STATEMENT

6.1 Geographical origin of income

Most of the Bank's income is generated from business relationships with counterparties based in Europe.

6.2 Balance of expenses/income from financial transactions

This item contains the net income/expense from securities attributed to the liquidity portfolio (included the allocation to write-downs and income from the reversal of write-downs).

7. OTHER INFORMATION

7.1 Personnel

The average number of employees during 2003 was as follows:

- Management: 3.0
- Other employees: 14.2

At the end of 2003, management comprised three people. Apart from this, there were 16 further employees.

7.2 Compensation and loans to managing directors and members of the Board of Directors (Verwaltungsrat)

No loans were extended to executive boards (managing directors) or other members of the Board of Directors.

Compensation totaling € 567 k was paid to the managing directors in 2003.

8. ANALYSIS OF NON-CURRENT ASSETS

(in thousands €)	Acquisition cost	Additions 2003	Disposals 2003
Office and business equipment	2,270.7	86.8	- 53.9
of which: data processing equipment	1,967.9	65.4	- 53.9
Securities held as investments	4,713,913.6	268,304.5	- 420,278.3
Total	4,716,184.3	268,391.3	- 420,332.2



7.3 Deposit insurance system

The Bank is a member of the “Association pour la Garantie des Dépôts, Luxembourg” (AGDL), which is the deposit insurance association for the banking sector in the Grand Duchy of Luxembourg. It was not necessary to establish a provision for this purpose.

7.4 Items not denominated in the reporting currency

The total amount of assets denominated in foreign currencies (excluding € currencies) was € 1,382,486 k.

Liabilities denominated in foreign currencies totaled € 1,643,877 k at the end of 2003.

Depreciation 2003	Depreciation disposals	Accumulated on depreciation	Book value 12/31/03	Book value 2002
114.9	- 53.9	2,103.6	200.0	227.5
53.3	- 53.9	1,902.7	76.7	64.0
0	0	0	4,561,939.8	4,713,913.6
114.9	- 53.9	2,103.6	4,562,139.8	4,714,141.1

9. OTHER DISCLOSURES

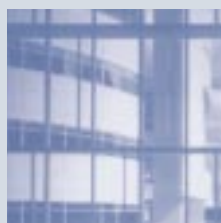
Statement of cover assets for required cover pursuant to Sections 12-1 to 12-9 of the Law of April 5, 1993 on the Financial Sector

The information below is limited to public-sector Pfandbriefe. No mortgage-backed Pfand-

briefe were issued. Derivative financial instruments with a total value of € 19,015 k were used for cover at the balance sheet date.

9.1 Statement of cover assets for public-sector Pfandbriefe

(in €)		
Value of cover assets		4,873,876,184
Other items eligible as cover	Securities	0
	Bank balances	0
Total cover		4,873,876,184
Issues outstanding	Bearer securities	4,392,500,854
	Registered securities	180,706,913
Total issues outstanding (requiring cover)		4,573,207,767
Surplus cover		300,668,417



9.2 Other breakdowns

9.2.1 Cover assets

Standard cover assets	(in €)
Placements with, and loans and advances to, other banks	
Municipal loans or loans guaranteed by public-sector institutions	469,070,241
Loans and advances to customers	
Municipal loans or loans guaranteed by public-sector institutions	555,933,930
Debt securities of public-sector issuers or guaranteed by public-sector institutions	3,133,049,523
Covered public-sector Pfandbriefe	696,807,541
Derivative products	19,014,949
Subtotal	4,873,876,184
Other eligible cover assets	
Other placements with, and loans and advances to, other banks	0
Debt securities pursuant to Section 42 (3) UCITS Act	0
Cash	0
Total	4,873,876,184

9.2.2 Cover pool for municipal loans

Breakdown by size

	Number	(in €)
up to € 10 million	31	164,508,248
up to € 25 million	28	506,114,357
more than € 25 million	126	4,203,253,579
Total		4,873,876,184



9.2.3 Cover pool for municipal loans

Breakdown by country

	(in €)	in %
Germany	1,616,733,511	33.2
Italy	756,291,141	15.5
Canada	312,764,558	6.4
Switzerland	301,855,072	6.2
Int. organizations	300,257,602	6.2
Japan	298,093,934	6.1
Spain	245,078,992	5.0
Austria	201,442,778	4.1
Belgium	169,441,641	3.5
Finland	136,376,556	2.8
USA	131,225,071	2.7
Portugal	125,000,000	2.5
France	117,458,244	2.4
Sweden	69,621,704	1.4
Luxembourg	52,000,000	1.1
UK	27,279,264	0.6
Netherlands	9,998,605	0.2
Denmark	2,957,511	0.1
Total	4,873,876,184	100

9.2.4 Statement of cover assets by net present value

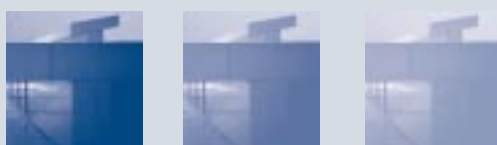
Beyond the statutory and regulatory requirements, the Bank also calculates the cover assets in terms of net present value. This calculation yields the following result:

(in millions of €)	Cover assets	Public-sector Pfandbriefe requiring cover*	Surplus cover	in %
Nominal	4,874	4,573	301	6.6
Net present value	5,325	4,690	635	13.5
Net present value if yield curve shifts				
+ 100 bp	5,121			
- 100 bp	5,579			

**(lettres de gage publiques)*

9.3 Accruals and deferrals

(in €)	
Assets: Prepayments and accrued income	
Accrued interest	228,096,989
From issuing and lending activities	19,382,322
Other	12,971,808
Total	260,451,119
Liabilities: Accruals and deferred income	
Deferred interest	187,279,668
From issuing and lending activities	4,129,613
Other	16,116,947
Total	207,526,228



9.4 Own public-sector Pfandbriefe repurchased

In 2003, the Bank did not repurchase any of its own public-sector Pfandbriefe for price maintenance purposes. On the other hand, the Bank placed € 60 m of its own debt securities back in the market. At the balance sheet date, the book value of the portfolio was € 65,942 k (nominal € 65,000 k). Further re-placements are planned in the future whenever market conditions warrant such an action.

9.5 Interest arrears

The interest due on loans and securities in 2003 was paid in full.

No arrears exist and no write-downs or allowances were established for interest payable.

BOARD OF DIRECTORS

Theodor Knepper

Member of the Board of Directors,
Hypo Real Estate Bank AG (Germany), Riemerling
(Chairman of the Supervisory Board until September 30, 2003)

Eckehard Dettinger-Klemm

Member of the Board of Directors,
Hypo Real Estate Bank International, Gräfelfing
since September 1, 2003
(Chairman of the Supervisory Board since October 1, 2003)

Dr. Paul Eisele

Member of the Board of Directors,
Württembergischen Hypothekenbank AG, Göppingen
until August 31, 2003

Jürgen Töniges

Member of the Board of Directors,
Westfälischen Hypothekenbank AG, Dortmund
until August 31, 2003

Dr. Markus Fell

Member of the Board of Directors,
Hypo Real Estate Holding AG, Grünwald
since September 1, 2003

Ralph Brödel

Administrateur-Délégué, Trier
since September 1, 2003

Gerhard M. Kainz

Administrateur-Délégué, Luxembourg

Martin Schulte

Administrateur-Délégué, Trier
since September 1, 2003

MANAGING DIRECTORS

Ralph Brödel

Gerhard M. Kainz

Martin Schulte

RÉVISEUR SPÉCIAL

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