DEPFA BANK

DEPFA ACS BANK

A member of Hypo Real Estate Group

Annual Report 2010

Content

Directors and other information 5

Directors' Report 6-26

Independent Auditor's Report
to the members of DEPFA ACS BANK 27-28

Income statement 29

Statement of comprehensive income 30

Statement of financial position 31

Statement of changes in equity 32

Cash flow statement 33

Notes to the financial statements 34-63

Directors and other information

Board of Directors
Dr. J. Bourke (Irish)*
Mr. C. Dunne (Irish)* (Chairman)
Ms. F. Flannery (Irish) (appointed 7 May 2010)
Mr. N. Reynolds (Irish) (appointed 15 April 2010)
Mr. S. Rio (French)
Mr. K.L. Walsh (Irish)

* Non-Executive

Audit Committee
Dr. J. Bourke

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

Directors' Report

The directors of DEPFA ACS BANK ("the Bank") present herewith the audited financial statements for the year ended 31 December 2010.

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 Bank 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 2010; 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 Central Bank of Ireland 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" or "the DEPFA 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").

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 2010.

Dividends

The directors did not pay any dividends in respect of the year ended 31 December 2010 (2009: € 160 million).

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 2010 are set out on page 5.

Directors' and Secretary's interest in the share capital

The interests of the directors and company secretary, in office at 31 December 2010 and of their spouses and minor children in the shares of the Bank or HRE Group undertakings were nil (31 December 2009: nil).

No directors held any options on HRE Holding shares at 31 December 2010 (31 December 2009: nil).

Audit Committee

Dr. J. Bourke was the only member of the audit committee during 2010. The audit committee did not meet during the year.

Major events

The very formidable challenges which DEPFA ACS BANK continued to face throughout 2010 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:

Transfer of assets and liabilities to the deconsolidated environment FMS Wertmanagement In January 2010, the HRE Group submitted an application to the Financial Markets Stabilisation Authority ("FMSA") for a stabilisation measure in accordance with section 8a (1) Clause 1 FMStFG (Establishment of a deconsolidated environment) in order to transfer certain positions of the HRE Group to a deconsolidated environment. The FMSA reached a positive decision regarding this application, and established the deconsolidated environment FMS Wertmanagement on 8 July 2010. The positions transferred consist of financial instruments as defined in IAS 39.

With effect from 1 October 2010, the HRE Group transferred (or arranged protection by way of financial guarantees of FMS Wertmanagement) loans and securities with an

outstanding nominal volume (excluding commitments which had not been utilised) of approximately € 173 billion (by way of a legal and/or economic transfer). The transfer process comprised activities which were not strategically necessary for the refocusing of the HRE Group, as well as assets and liabilities from the Public Sector Finance portfolio and the Real Estate Finance portfolio, particularly of DEPFA BANK plc and Deutsche Pfandbriefbank AG. The Public Sector Finance portfolio comprises assets of public issuers or issuers related to the public sector with a high credit quality but with a low market valuation. Most of the transferred Real Estate Finance portfolio is affected by the current difficult climate in this segment. The process also transferred assets of other HRE Group companies, in particular DEPFA ACS BANK, Dublin, Hypo Pfandbriefbank International, Luxembourg and Hypo Public Finance Bank, Dublin, as well as structured products and trading positions which are exposed to increased default risks and, where necessary, have been correspondingly impaired or whose changes in value have been included in net trading income. In total, more than 12,500 individual positions from almost 70 jurisdictions were transferred. The effects of the transfer on DEPFA ACS BANK are set out in detail in note 5 of the notes to the financial statements.

In the case of some assets, it was not possible for beneficial ownership to be transferred to FMS Wertmanagement, which meant that the criteria for derecognition were not satisfied. Furthermore in the case of derivatives, so-called back-to back transactions were used to transfer the market price risks of the derivative to FMS Wertmanagement by way of taking out a derivative with identical conditions, while the counterparty risks were retained by the Group. This meant that it was not possible for the original position to be de-recognised. Instead, the back-to-back transaction resulted in an increase of the balance sheet total.

Asset servicing for the transferred portfolio is provided by the DEPFA Group via back to back service level agreements with Deutsche Pfandbriefbank AG as the HRE Group has a co-operation agreement with FMS Wertmanagement for the servicing of the transferred portfolio. The co-operation agreement is initially due to run for a period of 3 years until 30 September 2013.

The liability securities with a volume of around € 124 billion at a HRE Group level which were guaranteed by SoFFin and issued by Deutsche Pfandbriefbank AG for obtaining liquidity were also completely transferred to FMS Wertmanagement.

The transaction was provisionally approved by the EU Commission and included in the ongoing aid proceedings. It is expected that the proceedings will be concluded by mid-2011. The transfer of assets has been the main and most important step with regard to restructuring and refocusing: in particular, the strategic core bank Deutsche Pfandbriefbank and the DEPFA Group are no longer reliant on liquidity aid as a result of the improved balance sheet structure.

Measures designed to assure liquidity The securities which are guaranteed by SoFFin and which had been issued by Deutsche Pfandbriefbank AG for obtaining liquidity had a total volume at a HRE Group level of € 124 billion by the end of September 2010. These were transferred completely to FMS Wertmanagement as part of the portfolio transfer process. There are no longer any guarantees from SoFFin to the HRE Group. Since October 2010, the HRE Group has been refinanced primarily by way of outstanding Pfandbriefe, covered bonds and unsecured issues. The following conditions were applicable for all liquidity guarantees which the HRE Group received from SoFFin: Deutsche Pfandbriefbank AG paid to SoFFin a proportionately calculated commitment commission of 0.1% per annum in relation to that part of the guarantee framework which was not utilised. A commission of 0.5% or 0.8% per annum was incurred for guarantees which were issued.

Recapitalisation measures The HRE Group received various recapitalisation measures during 2010. On 30 April 2010, it received from SoFFin a commitment for the next recapitalisation tranche of up to € 1.85 billion. On 20 May 2010, an initial amount of € 1.4 billion out of the above figure was paid into additional paid-in capital of HRE Holding; of this figure, HRE Holding forwarded € 900 million, by way of capital contributions, up to mid September 2010 to DEPFA BANK plc – primarily for fulfilling the minimum capital ratio requirements of DEPFA BANK plc. No further capital contributions were made to DEPFA BANK plc since 1 October 2010. Overall, the HRE Group has received

€ 7.42 billion capital from SoFFin in 2009 and 2010. The total capital aid promised by SoFFin amounted to a figure of up to € 9.95 billion. As part of the process of transferring sub-performing and non-strategic assets, HRE Holding AG spun off a claim of € 2.08 billion for payment into the additional paid-in capital of HRE Holding to FMS Wertmanagement. SoFFin has provided an undertaking to pay a further € 0.45 billion in the form of a contribution to the additional paid-in capital of the HRE Group or Deutsche Pfandbriefbank AG. This obligation depends on various factors, including conditions under aid law. Evidence that the criteria have been satisfied may be provided by the HRE Group up to 31 December 2011, after which time the claim to the contributions expires.

The Bank has not received any capital contributions from its parent DEPFA BANK plc during 2010 (2009: nil).

Proceedings at the European Commission The stabilisation measures provided to the HRE Group by the Federal Republic of Germany – via SoFFin – (injections of capital, guarantees as well as the transfer of risk positions and non-strategic operations to FMS Wertmanagement) are the subject of ongoing aid proceedings at the European Commission. The conclusion of these proceedings is expected by mid-2011.

Restructuring measures In 2010, three additional non-strategic locations of the HRE Group (Singapore, Mumbai and Nicosia) were closed and previously duplicate office locations in Tokyo were concentrated at one location. The business and IT transformation programme saw major projects successfully implemented in 2010, for instance a groupwide credit limit system, SAP-based personnel management software and the implementation of the accounts statistics and interest statistics requirements specified by the HRE Group regulator. The IT projects necessary for the above-mentioned transfer to FMS Wertmanagement were also implemented on time.

Ratings

The mandated rating agencies for DEPFA ACS BANK are Fitch Ratings, Moody's and Standard & Poor's.

With regard to Bank and covered bond rating, the following major rating changes took place during the business year 2010 and up to the date of signing the financial statements.

Standard & Poor's new covered bond rating methodology, which includes linking the covered bond rating to the underlying issuer rating, was implemented in April 2010 and resulted in the Asset Covered Securities ("ACS") issued by DEPFA ACS BANK being downgraded from AAA to AA and placed on credit watch developing. Standard & Poor's confirmed the AA rating for ACS with stable outlook in August 2010.

Moody's completed its review of Asset Covered Securities issued by DEPFA ACS BANK in July 2010 and downgraded the instruments by one notch from Aa2 to Aa3.

In August 2010, Fitch Ratings downgraded the short-term rating of all HRE Group Banks from F1+ to F1.

Following the transfer of assets to FMS Wertmanagement, all three rating agencies undertook a review of the HRE Group's ratings and the outcomes thereof were published in October 2010.

- Moody's downgraded the long and short-term ratings of the Banks in the DEPFA Group to Baa3 and P-3 respectively. The E+ Bank Financial Strength Rating (BFSR) was confirmed. The outlooks changed from negative to stable. The rating of the ACS was put on review for downgrade.
- Fitch Ratings downgraded the long and short-term ratings of DEPFA BANK plc and its subsidiaries by one notch to BBB+ and F2 respectively with negative outlook. The individual rating of DEPFA BANK plc was upgraded from F to D. The rating of the ACS was put on rating watch negative.
- Standard & Poor's confirmed the long and short-term ratings of the Banks in the HRE Group at BBB and A-2 respectively and removed them from credit watch positive. The outlook is now stable.

In February 2011, Moody's concluded its review of the ACS and confirmed the Aa3 rating with stable outlook. Standard & Poor's has downgraded the Lower Tier 2 ratings of DEPFA ACS BANK from BBB- to BB-.

Based on the rating methodologies applied, the DEPFA

Group entities' ratings inter alia benefit from linkages between DEPFA and FMS Wertmanagement. Under the current circumstances, the DEPFA Group consider the maximum rating level has been achieved. In general, the rating agencies continue to refine their rating methodologies and are making higher demands of issuers or rated products.

Overview of the ratings of DEPFA ACS BANK and Covered Bonds up to the date of signing the financial statements.

	Standard & Poor's	Moody's	Fitch Ratings
Long-term rating	BBB	Baa3	BBB+
Outlook	Stable	Stable	Negative
Short-term rating	A-2	P-3	F2
Asset Covered Securities	AA	Aa3	AAA(1)

(1) Rating Watch Negative

Business review

The business model of the Bank is somewhat different to that of its parent 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.

For DEPFA ACS BANK, the year 2010 marked the transition away from the processes of stabilisation and restructuring and towards a realigned entity as part of the DEPFA Group. The predominant event in the financial year 2010 was the transfer on 1 October 2010 of non-strategic positions to FMS Wertmanagement.

The results of operations substantially reflected the transfer of non-strategic positions and also other stabilisation and restructuring measures. Pre-tax loss for 2010 is negative at € -8 million (2009: € 7 million). However, these charges result from the period before the transfer of the non-strategic positions to FMS Wertmanagement. On the other hand, in the isolated fourth quarter of 2010, DEPFA ACS BANK generated pre-tax profit of € 14 million.

The development in results in 2010 compared with the previous year is detailed in the following:

€ m	2010	2009
Net interest income	56	89
Net fee and commission expense	-37	-58
Net trading income	-2	2
Net loss from financial investments	-4	-
Net income/(loss) from hedge relationships	15	-10
Other operating income	2	1
Total operating revenues	**30**	**24**
Provision for losses on loans and advances	6	-10
General administrative expenses	-44	-7
Pre-tax (loss)/income	**-8**	**7**
Taxes on income	-	-
Net (loss)/income	**-8**	**7**

Net interest income decreased by 37% to € 56 million compared with € 89 million in 2009. 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. However, there was a significant reduction in the volume of interest bearing assets due to the transfer of assets to FMS Wertmanagement. Before the transfer of assets, a significant proportion of the Bank's assets outside the cover pool were funded in the repo market, predominantly via Central

Banks or from liquidity support measures from SoFFin, channelled via its parent DEPFA BANK plc. Changes in Central Bank repo funding rates, the haircuts applied to such assets, higher costs where alternative refinancing sources had to be found for lines previously financed by the US Federal Reserve and by other central banks have impacted on the income of the Bank. Net interest income was derived primarily from the asset base of the Bank. In 2010, net interest income included € 1 million profit on sale of assets and buyback of liabilities (2009: € -8 million).

Net fee and commission expense totalled € -37 million in 2010, mostly a result of commission costs incurred for the guarantees related to the liquidity support measures (2009: € -58 million). The Bank no longer required the support of SoFFin and the German Federal Government in the fourth quarter of 2010, following the transfer of assets to FMS Wertmanagement.

Net trading income recorded a loss of € -2 million in 2010 (2009: € 2 million). This loss is due to marking to market derivatives that do not qualify for hedge accounting.

Net loss from financial investments amounted to € -4 million (2009: nil). This result is attributable to the disposal of financial assets shown under "financial investments".

Net income/(loss) from hedge relationships amounted to € 15 million (2009: € -10 million), relating to hedge ineffectiveness on fair value hedges.

Other operating income amounted to € 2 million (2009: € 1 million), which is mainly comprised of foreign currency translation effects.

Provisions for losses on loans and advances amounted to € 6 million (2009: € -10 million), and consisted of a writeback of portfolio-based allowances of € 6 million in 2010.

General administrative expenses increased substantially from € -7 million in 2009 to € -44 million in 2010. Included this year is the Bank's share of once-off costs related to the set-up of FMS Wertmanagement of € -24 million. Administration costs of € -19 million in 2010 and € -5 million in 2009 mainly comprised of recharges from other Group entities for services provided. This increase from year to year reflects both additional servicing to the Bank necessitated by transaction restructurings, projects and process improvements during the year, and the significantly higher cost base in 2010 for the support groups within the DEPFA Group and the HRE Group entities providing the servicing, primarily from substantial increases in IT and system costs, and professional and consulting fees.

The pre-tax loss amounted to € -8 million in 2010 (2009: € 7 million). This included a positive fourth quarter result of € 14 million following the transfer of the non-strategic positions to FMS Wertmanagement.

Taxes on income amounted to nil (2009: nil).

Net (loss)/income amounted to € -8 million in 2010 (2009:€ 7 million).

Development in assets

Total assets decreased in 2010 by 18%, from € 87 billion in 2009 to € 71 billion in 2010. This decrease is a result of the transfers of assets and derivatives to FMS Wertmanagement, which comprised a nominal asset volume of € 30 billion. Offsetting this, were the following effects as of the transfer date 1 October 2010, and these effects will decline in future.

In the case of some assets, it was not possible for beneficial ownership to be transferred to FMS Wertmanagement, which meant that the criteria for derecognition were not satisfied. Furthermore in the case of derivatives, so-called back-to back transactions were used to transfer the market price risks of the derivative to FMS Wertmanagement by way of taking out a derivative with identical conditions, while the counterparty risks were retained by the Bank. This meant that it was not possible for the original position to be de-recognised. Instead, the back-to back transaction

resulted in an increase in the balance sheet.

FMS Wertmanagement had to provide collaterals for the new derivatives which were taken out between FMS Wertmanagement and the Bank (back-to-back transactions); which in turn, were used to finance the collateral requirements of the original derivatives.

Furthermore, because FMS Wertmanagement does not have a banking status, the Bank currently handles certain refinancing functions for FMS Wertmanagement via DEPFA BANK plc, for instance with the ECB or in bilateral repo transactions. The refinancing funds are passed on to FMS Wertmanagement. The Bank receives a claim against DEPFA BANK plc, which in turn receives a claim against FMS Wertmanagement, which increases the balance sheet total.

The effects concerning the transfer to FMS Wertmanagement on the Bank are described in detail in note 5 of the notes to the financial statements.

Some of these compensating effects were reduced by the end of 2010. Work started on replacing back-to-back transactions by way of direct business relations between FMS Wertmanagement and the external counterparties (novation of derivatives). As a result of this novation of derivatives with simultaneous termination of back-to-back transactions, the effect of back-to-back business extending the balance sheet was reduced, and the balance sheet total was also reduced by the novation of the external derivatives. Moreover, the termination and novation had a significant effect on the collaterals provided and received for these derivatives.

Developments in financial position

Total liabilities decreased in 2010 by 19%, from € 86 billion in 2009 to € 70 billion in 2010. This decrease is mainly attributable to the buyback of ACS issuances of € 11 billion from DEPFA BANK plc and the process of transferring positions to FMS Wertmanagement which reduced the balance sheet. This reduction was offset by certain effects. For instance, the fact that back-to-back derivatives have been concluded in order to transfer the risk of items which cannot be physically transferred has resulted in an increase in the balance sheet. In addition, because FMS Wertmanagement does not have a banking status, the Bank also handles the transmission functions for central bank borrowings. This transmission of ECB refinancing or bilateral repo transactions has also increased the balance sheet. The effects concerning the transfer to FMS Wertmanagement on the Bank are discussed in detail in note 5 of the notes to the financial statements.

Liabilities evidenced by certificates decreased by € 14 billion from € 51 billion in December 2009 to € 37 billion in December 2010. This reduction reflects the run off in outstanding debt as well as the buyback of certain ACS issuance. € 240 million nominal equivalent of unlisted ACS were bought back during the fourth quarter of 2010 at prevailing market levels on a reverse enquiry basis.

Segmental review

Changes in the segmental structure

The HRE Group was re-organised for the financial year 2010 into three operating segments:

- Real Estate Finance (previously Commercial Real Estate)
- Public Sector Finance (previously included in Public Sector & Infrastructure Finance)
- Value Portfolio (previously included in Public Sector & Infrastructure Finance, Capital Markets & Asset Management, and Corporate Centre)

In the financial year 2010, the HRE Group operated new business in the two reporting segments Real Estate Finance and Public Sector Finance only. New business is written only by Deutsche Pfandbriefbank AG. The HRE Group focuses on Pfandbrief-eligible new business in Public Sector Finance and Real Estate Finance, with a regional focus on Europe.

The HRE Group has withdrawn completely from all new business in the non-strategic business segment Value Portfolio. DEPFA ACS BANK is considered to be part of the non-strategic business of the HRE Group and is included in the "Value Portfolio" segment. Non-strategic activities are to be reduced without imposing excessive strain on existing value. (For more information see Company strategy of the HRE Group section of the Directors' Report).

The DEPFA Group was organised on 1 January 2010 into the following business segments:

- Value Management Europe/Rest of World
- Value Management Americas
- Infrastructure Finance

For all years up to and including 2009, activities in DEPFA ACS BANK were attributable to only one externally reportable segment. Hence no segmental report was previously presented. For consistency in the HRE Group structure and in the DEPFA Group, DEPFA ACS BANK was re-organised for the financial year 2010 into two operating segments:

- Value Management Europe/Rest of World
- Value Management Americas

Comparative figures for 2009 in the revised segmental structure have been provided.

Value Management Europe/Rest of World		
€ m	**2010**	**2009**
Net interest income	32	51
Net fee and commission expense	-25	-29
Net trading income	1	2
Net loss from financial investments	-4	-
Net income/(loss) from hedge relationships	12	-7
Other operating income	1	1
Total operating revenues	**17**	**18**
Provision for losses on loans and advances	5	-10
General administrative expenses	-35	-5
Pre-tax (loss)/income	**-13**	**3**
Taxes on income	-	-
Net (loss)/income	**-13**	**3**

The business segment Value Management Europe/Rest of World incorporates the traditional public sector finance lending business of the Bank in the form of bond and loan financing with public sector authorities geographically located outside of the Americas. As in 2009, no new business has been conducted in this segment in 2010.

Pre-tax profit in the segment for 2010 declined to € -13 million (2009: € 3 million). The fall is mainly attributable to lower net interest income generated in 2010 and higher general administrative expenses in comparison to the prior year.

Net interest income has fallen from € 51 million in 2009 to € 32 million in 2010. Before the transfer of assets, a significant proportion of the Bank's assets outside the cover pool were funded in the repo market, predominantly via Central Banks. Changes in Central Bank repo funding rates, the haircuts applied to such assets, and the Bank's share of higher costs for SoFFin liquidity support measures have impacted on the income of the Bank. The volume held of interest bearing assets was reduced in the fourth quarter of 2010 following the transfer of assets to FMS Wertmanagement which also impacted on this result.

Net fee and commission expense in 2010 amounted to € -25 million (2009: € -29 million). This improvement reflects the fact that the liquidity support previously provided by SoFFin and the German Federal Government was no longer required by the Group in the fourth quarter of 2010, due to the transfer of assets and liabilities to FMS Wertmanagement.

Net trading income in 2010 amounted to € 1 million (2009: € 2 million) from marking to market derivatives that do not qualify for hedge accounting.

Net loss from financial investments amounted to € -4 million (2009: nil). This resulted from the disposal of 'Available-for-Sale' assets.

Hedge ineffectiveness within the range permitted under IAS 39 resulted in net income from hedge relationships of € 12 million (2009: € -7 million). The income is partly a reversal of the expense recorded in 2009.

Other operating income was € 1 million in 2010 (2009: € 1 million).

Provisions for losses on loans and advances consisted of a write-back of provisions in 2010 of € 5 million following the transfer of asset and liabilities to FMS Wertmanagement.

General administrative expenses, deteriorated from € -5 mil-

lion in 2009 to € -35 million in 2010. These expenses comprise the segment's share of once-off set-up costs for the FMS Wertmanagement entity of € -18 million.

Value Management Americas		
€ m	**2010**	**2009**
Net interest income	24	38
Net fee and commission expense	-12	-29
Net trading income	-3	-
Net income/(loss) from hedge relationships	3	-3
Other operating income	1	-
Total operating revenues	**13**	**6**
Provision for losses on loans and advances	1	-
General administrative expenses	-9	-2
Pre-tax income	**5**	**4**
Taxes on income	-	-
Net income	**5**	**4**

The business segment Value Management Americas incorporates the traditional public sector finance lending business of the Bank in the form of bond and loan financing with public sector authorities typically located in the USA and Canada. As in 2009, no new business has been conducted in this segment in 2010.

Pre-tax income for 2010 was € 5 million in comparison to the prior year result of € 4 million.

Net interest income of € 24 million in 2010 was lower than in 2009 (2009: € 38 million). Net interest income declined mainly as a result of the reduction in the volume of interest-bearing assets due to transfer to FMS Wertmanagement, and also due to maturities and sale of assets. Interest income in 2010 also suffered from higher refinancing costs, due to a significant proportion of the Bank's assets outside the cover pool being funded in the repo market in the first three quarters of 2010, and also from more expensive alternative refinancing sources.

Net fee and commission expense improved considerably from 2009, decreasing from € -29 million in 2009 to € -12 million in 2010. This improvement reflects the fact that the liquidity support previously provided by SoFFin and the German Federal Government was no longer required by the Group in the fourth quarter of 2010, following the transfer of assets and liabilities to FMS Wertmanagement.

Net trading income declined in 2010, from nil in 2009 to € -3 million for 2010 due to marking to market derivatives that do not qualify for hedge accounting.

The net income from hedge relationships amounted to € 3 million (2009: € -3 million).

Other operating income was € 1 million in 2010 (2009: nil).

Provisions for losses on loans and advances consisted of a write-back of provisions in 2010 of € 1 million following the transfer of asset and liabilities to FMS Wertmanagement.

General administrative expenses deteriorated from € -2 million in 2009 to € -9 million in 2010. These expenses comprise the segment's share of once-off set-up costs for the FMS Wertmanagement entity of € -6 million.

Going concern and risks threatening the existence of the HRE Group

The existence of companies in the HRE Group including DEPFA BANK plc and its subsidiary entities including DEPFA ACS BANK continued to be threatened throughout the whole of 2010.

The financial statements are prepared on a going concern basis as the directors have assumed that the Bank will continue in operation despite the material factors of uncertainty which are known at the date of signing and are described below.

This assumption is predicated on the fact that the HRE Group Management Board has prepared the HRE Group financial statements on a going concern basis.

With regard to the going concern assumption, material factors of uncertainty are known at the point at which the

HRE Group consolidated financial statements were prepared in connection with events and conditions which cast doubts on the ability of HRE Holding and its major subsidiaries to continue as going concerns. The continuing existence of HRE Holding and its subsidiaries including DEPFA ACS BANK as going concerns depends on the European Commission approving the support measures which have been implemented by SoFFin.

In addition, the ability of HRE Holding and its subsidiaries, including DEPFA ACS BANK, to continue as going concerns is dependent upon the European Commission not imposing any conditions which would not permit HRE Holding and its subsidiaries, including DEPFA ACS BANK, to implement an economically sustainable business plan and, in particular, does not undo the regulatory effectiveness of the capital support measures.

The Management Board of the HRE Group has engaged the services of an auditing firm to carry out an independent appraisal of the going concern assumption. In its prepared report this auditing firm concludes that it is more than likely that HRE Holding and its subsidiaries will be able to continue as going concerns in the period until 30 September 2012.

On 28 March 2009, SoFFin confirmed to HRE Holding and Deutsche Pfandbriefbank AG (formerly Hypo Real Estate Bank AG) that it intends to stabilise HRE Holding by way of adequate recapitalisation, and that it also intends to stabilise Deutsche Pfandbriefbank AG by way of providing further adequate guarantees. On 6 November 2009, SoFFin renewed this declaration of intent. In particular, SoFFin has confirmed that it will provide adequate capital in order to at least ensure the continued existence of HRE Holding and its major subsidiaries as going concerns and also to ensure the necessary viable business model, particularly Deutsche Pfandbriefbank AG. The support measures are conditional on the Aid Law requirements of the European Commission being fulfilled. The positive conclusion of these proceedings is expected by mid-2011.

Although major progress has been achieved with regard to stabilising and restructuring the HRE Group since the autumn of 2008, the HRE Group companies continued to be exposed to risks threatening their very existence throughout the whole of 2010 due to the material factors detailed above.

The forecasts relating to the future development of the HRE Group represent estimates which have been made on the basis of currently available information. If the assumptions underlying these forecasts fail to materialise or if risks (such as those addressed in the section risk management) occur to an extent which has not been calculated, the actual results may differ significantly from the currently expected results.

Within the context of the transfer of assets of the HRE Group to FMS Wertmanagement, the FMSA reserves the right to impose a payment condition for the stabilisation measure in accordance with Section 8a (4) No. 8 FMStFG against the HRE Group for payment to FMS Wertmanagement; this figure must not exceed € 1.59 billion. The payment condition can also be fixed in several notices. However, the extent of the payment condition must be fixed in such a way that, after the condition has been fixed, the regulatory Tier 1 capital ratio of the bank entities within the HRE subgroups Deutsche Pfandbriefbank AG and the DEPFA Group do not fall below 15 % in each entity as of 31 March 2011. In addition, the fixing of the payment condition must not result in the sub-groups or their parent companies:

- becoming insolvent, illiquid or result in a negative going concern assumption,
- relevant regulatory capital ratios, major credit limits or other legal or regulatory requirements being violated,
- their rating falling below investment grade, or
- the purchase price, taking account of the payment condition, falling below the market value of the transferred positions.
- A possible payment obligation may have a significantly negative impact on the development in earnings of the HRE Group.

Strategy

Organisational and legal structure of the HRE Group

In the year under review, the HRE Group structure consisted of the HRE Holding parent company and the operating bank subsidiaries Deutsche Pfandbriefbank AG and DEPFA BANK plc. Since 19 May 2009, HRE Holding has also been the ultimate parent of the HRE Group for regulatory pur-

poses. 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.

Company strategy of the HRE Group

In the financial year 2010, the HRE Group operated new business in two reporting segments throughout the HRE Group: Real Estate Finance and Public Sector Finance. There is also the additional reporting segment Value Portfolio and the reporting column Consolidation and Adjustments. The Group is considered part of the non-strategic business of the HRE Group and is included in the non-strategic "Value Portfolio" segment.

New business is written only by Deutsche Pfandbriefbank AG. The HRE Group focuses on Pfandbrief-eligible new business in Public Sector Finance and Real Estate Finance, with a regional focus on Europe. The key factor of success in the new business strategy are the numerous and long-standing customer relations and the large client base which formed the basis for the new business which was written in 2010. The credit transactions are selected within the context of a conservative refinancing strategy and the resultant requirements applicable to the extent and quality of lending operations. The focus is on consistent risk analysis and concentration on business with an adequate risk-return ratio. Pro-active sales management enables the requirements of investors regarding the quality of lending business to be satisfied. Non-strategic business will be included in the "Value Portfolio" segment and is to be reduced without imposing excessive strain on existing value.

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.

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.

Company strategy of the DEPFA Group including DEPFA ACS BANK

The State Aid proceedings between the Federal Republic of Germany and 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, Hypo Real Estate Holding AG, are still ongoing. The HRE Group expects finalisation of the proceedings by mid 2011.

In this context, the DEPFA Group is considered part of the non-strategic business of the HRE Group of which the HRE Group is expected to be required to disassociate itself from. By transferring risk positions, non-strategic assets and business activities to FMS Wertmanagement, the DEPFA Group has already significantly de-risked, downsized and stabilised its activities.

The DEPFA Group is – with certain limited exceptions (see below) - not expected to be permitted to conduct any new business origination until a potential privatisation. Asset servicing for the transferred portfolio is provided by the DEPFA Group via back to back service level agreements with Deutsche Pfandbriefbank AG as the HRE Group has a co-operation agreement with FMS Wertmanagement for the servicing of the transferred portfolio. The co-operation agreement is initially due to run for a period of 3 years until 30 September 2013.

In addition, the DEPFA Group services and manages its remaining portfolio through operations globally.

The DEPFA Group strategy includes maintaining an appropriate asset / liability profile. The external liquidity support of the HRE Group was transferred to FMS Wertmanagement and therefore the HRE Group including the DEPFA Group is completely independently funded. It is currently not planned to address the capital market with further capital market transactions. Peaks in the liquidity profile of the DEPFA Group are anticipated to be steered primarily via Central Bank/ECB funding mechanisms.

In this context, the DEPFA Group may be permitted to:

- restructure existing assets in order to maintain or improve the value of the respective asset;
- execute necessary restructurings to avoid losses;
- conduct business necessary for liquidity management;
- enter into asset-swaps to meet risk strategic requirements;
- sell credit portfolios;
- manage and maintain the existing cover pools of its subsidiaries DEPFA ACS BANK (ACS) & Hypo Public Bank International (Lettre de Gage);
- conduct derivative business to manage the interest, currency or credit risk of the existing portfolio;
- conduct all business that is necessary to meet legal, regulatory or other requirements of all Group related entities, including over-collateralisation requirements for the cover pool;
- provide asset servicing or cover pool management to third parties.

As part of the European State Aid proceedings, it is also expected that the DEPFA Group as a whole or DEPFA BANK plc and its subsidiaries Hypo Public Finance Bank, Hypo Pfandbriefbank International S.A. and DEPFA ACS BANK, separately, will need to be privatised over the next few years subject to any SoFFin requirements and/ or requirements imposed by the European Commission.

Management concept

The management concept of the HRE Group focuses on ensuring the continued existence of the HRE Group as a going concern and simultaneously on enhancing the enterprise value in the long term. The main aspects of the concept are measures designed to protect the existing portfolio, assure liquidity and solvency and also improve the risk early warning system. With regard to liquidity management, the main consideration is to ensure that the HRE Group is able at all times to meet all payment obligations which become due. Solvency, i.e. adequate capital backing, is managed on the basis of the regulatory ratios, Tier 1 and Total Capital ratios. HRE 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 management of capital, the focus is on fulfilling regulatory requirements as well as the minimum capital requirements of rating agencies and business partners. In addition, the HRE Group has already transferred large parts of non-strategic assets and liabilities to FMS Wertmanagement; this has resulted in a reduction of risk-weighted assets and a corresponding increase in the capital ratios. The risk early warning system has been completely revised after the crisis of the HRE Group; it is described in detail in the risk management section of the report.

At the same time, in order to assure the ability to reprivatise the HRE Group, it is necessary for income to be generated in excess of the capital costs, and strict cost discipline is essential for this purpose. This is monitored on the basis of absolute costs and also by means 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 loss from financial investments, net income/(loss) from hedge relationships and the balance of other operating income. The cost-income ratio is to be improved by reducing the general administrative expenses following the restructuring process and also by way of increasing new business. The enterprise value is enhanced when the return on equity of a management unit exceeds the related capital costs on a sustainable basis. In order to determine the return on equity, the net income according to IFRS is related to average equity (excluding available-for-sale 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 2010

There have been no notable events after 31 December 2010.

Results

The loss for the year, and the appropriation thereof, are set out in the income statement on page 29.

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 Central Bank of Ireland, which applies a capital / risk framework for measuring capital adequacy based on the CRD. Both the BIS and the Central Bank of Ireland require banks to maintain a minimum Tier 1 Capital ratio of 4% and a Total Capital ratio of 8%.

There were no breaches by the Bank during 2010. In 2009 the Central Bank of Ireland entered into a Settlement Agreement 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 1 Capital Ratio of 18.55% (2009: 6.80%) and a Total Capital Ratio of 33.46% (2009: 12.30%) the Bank exceeds the minimum required ratios.

Regulatory Capital € million	31.12.2010	31.12.2009
Tier I Capital	629	637
Tier II Supplementary Capital	506	519
Total Regulatory Capital	**1,135**	**1,156**

Capital Adequacy Ratios	31.12.2010	31.12.2009
BIS Risk Weighted Assets (€ million)	3,392	9,421
Tier I Capital Ratio	18.55%	6.80%
Total Capital Ratio (Tier I + II)	**33.46%**	**12.30%**

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.

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

The internal control and risk management system with regard to the accounting process comprises the principles, procedures and measures designed to assure the effectiveness and efficiency of accounting and also to assure compliance with the relevant legal regulations. The aim of the risk management system with regard to the accounting process is to identify and evaluate risks which may oppose the objective of ensuring that the financial statements comply with the relevant rules, to limit risks which have been identified and to check the impact of such risks on the financial statements and also the way in which these risks are presented. The internal control system with regard to the accounting process is an integral component of the risk management system and is designed, by way of implementing controls, to guarantee adequate assurance that the financial statements which are prepared comply with the relevant rules despite the risks which have been identified.

However, an internal control and risk management system with regard to the accounting process cannot provide absolute assurance regarding success in attaining the associated objectives. As is the case with all discretionary decisions, decisions relating to the establishment of appropriate systems may also be incorrect as a result of faults, errors, changes in ambient variables or deliberate violations and criminal actions. These problems mean that it is not possible with absolute assurance to identify or prevent misstatements in the financial statements.

At DEPFA ACS BANK, the internal control and risk management system with regard to the accounting process is reflected in the structure and procedure organisation. In terms of structure organisation, the internal control and risk management system with regard to the accounting process comprises the Board of Directors, the Audit Com-

mittee and the departments which report to the DEPFA Group Chief Financial Officer ("the DEPFA Group CFO").

The directors of the Bank are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations. In conjunction with the obligation to maintain an internal control and risk management system, the Board of Directors also bear responsibility for monitoring an adequate and effective internal control and risk management system with regard to the accounting process.

The Board of Directors has established an audit committee which did not meet during 2010 as it had only one member during this time. The DEPFA Group audit committee has oversight of the Bank and operates within specific terms of reference approved by the DEPFA Group Board of Directors. The internal audit department supports the Board of Directors in its control function by way of independent audits.

The DEPFA Group CFO is responsible for ensuring that the Bank's financial statements are prepared in accordance with IFRS and that the accounting relevant capital market information is provided.

In terms of procedure organisation, the internal control and risk management system with regard to the accounting process is based on an intended far reaching standardisation of processes and software. For core activities and processes, there is a HRE Group Guideline department and a code of conduct. In addition, the four eyes principle is mandatory for major transactions. Data and EDP systems are protected against unauthorised access. In addition, certain relevant information is made available only to employees who actually require such information for their work.

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

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.

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.

* Forms an integral part of the audited financial statements

Transfer of risk positions and non-strategic assets and liabilities to FMS Wertmanagement

As described in the section major events, the HRE Group transferred risk positions and non-strategic assets and liabilities to FMS Wertmanagement with effect from 1 October 2010. As a result of the assets and liabilities being transferred, they are no longer shown in the balance sheet of the HRE Group, depending on the specific method of transfer. The balance sheet of the HRE Group and the balance sheet of FMS Wertmanagement are not consolidated. This arrangement has accordingly achieved a balance sheet reduction and structural improvements as well as a reduction of the strain imposed on capital and also an improvement in the liquidity position at both the HRE Group level and the DEPFA Group level. The use of FMS Wertmanagement also enables the losses arising from the portfolio, and thus simultaneously the losses of the HRE Group, to be limited.

Specific selection transfer criteria have been used for transferring assets of the HRE Group and the DEPFA Group to FMS Wertmanagement. For instance, the credit risk has been reduced by transferring some of the critical assets which have already been classified as "Watchlist", "Restructuring" and "Workout". Other selection criteria for reducing the credit risk for instance identified object classes with a fundamentally higher level of risk as well as standard risk parameters (e.g. loss-given default, rating, rating migration) with increased risk values. The selection also focused on assets as part of concentration risks as well as positions with an extremely long remaining term or positions which are denominated in currencies other than the euro. In addition, assets which are not eligible for repo purposes and not eligible for ECB funding purposes as well as transactions in countries which are not eligible for use as cover funds or which lead to excessive collateral requirements due to uncertainty regarding the development in ability to service debt have been selected in order to optimise liquidity.

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.

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

	At 31 December 2010			At 31 December 2009		
€ m	Total assets	Total liabilities	Credit commitments	Total assets	Total liabilities	Credit commitments
Germany	12,948	2,925	10	12,046	224	10
Italy	3,192	-	-	5,148	-	-
France	3,352	350	-	2,896	107	50
Spain	3,716	2	-	7,475	-	-
Austria	780	-	-	1,218	-	-
Greece	-	-	-	519	-	-
United Kingdom	1,666	1,565	-	5,578	1,500	-
Ireland	25,581	27,343	-	15,944	30,015	-
Other European countries	9,455	548	6	16,516	320	94
USA	7,484	208	-	14,689	3,380	-
Canada	1,549	-	-	3,447	-	-
Japan	841	-	-	1,481	-	-
Other countries	158	-	-	2	-	-
Unallocated assets / liabilities	-	37,183	-	-	50,842	-
Total	**70,722**	**70,124**	**16**	**86,959**	**86,388**	**154**

* Forms an integral part of the audited financial statements

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 2010 and 2009.

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

	At 31 December 2010			
€ m	**Loans and advances**	**Financial investments**	**Derivatives**	**Total**
Public authorities	32,988	5,404	-	38,392
Companies and private individuals	163	-	-	163
Banks and financial institutions	24,605	372	7,147	32,124
	57,756	**5,776**	**7,147**	**70,679**

	At 31 December 2009			
€ m	**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
	75,481	**7,555**	**3,896**	**86,932**

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

	31 December 2010	31 December 2009
AAA	29%	35%
AA1	51%	12%
AA2	-	13%
AA3	3%	25%
A1	-	7%
A2	17%	2%
A3	-	4%
BBB2	-	2%

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

	31 December 2010	31 December 2009
AAA	35%	-
AA1	49%	-
AA2	-	35%
AA3	-	31%
A1	-	12%
A2	14%	5%
A3	2%	14%
BBB2	-	3%

The exposure includes receivables from FMS Wertmanagement (repos, back-to-back derivatives and compensation claims) as well as exposure which has been transferred synthetically via financial guarantee to FMS Wertmanagement.

*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 general strategy of the Bank and the DEPFA Group is to hedge foreign currency risks as far as possible.

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:

	2010	2009	2010	2009
€ m	31 Dec	31 Dec	Avg	Avg
Interest rate VaR	13	16	17	20
Foreign exchange VaR	15(1)	8	10(1)	14

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.

* Forms an integral part of the audited financial statements
(1) Value is calculated pre-FMS Wertmanagement

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 2010 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 2010 was € 796 million (31 December 2009: € -1,435 million). Hedge ineffectiveness resulting from the application of hedge accounting to these hedge relationships was € 15 million (2009: € -10 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 2010 was € -8 million (31 December 2009: € -38 million). Hedge ineffectiveness resulting from the application of hedge accounting to these hedge relationships was nil (2009: nil).

Operational risk

Definition

DEPFA Group defines operational risk as "the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events". The definition includes legal risks, but excludes strategic and reputation risks.

Operational risks are associated with most aspects of DEPFA Group's business activities, and comprise numerous widely differing risks.

Strategy for operational risks

DEPFA 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. DEPFA Group does not attempt to completely eliminate risk but to minimise unexpected loss by limiting the operational risks of the Group to a reasonable level. DEPFA Group's approach is to ensure that it has sufficient information to make informed decisions about risk mitigation.

Organisation of operational risk management

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

Risk reports, monitoring and management of operational risks

Operational risk is controlled through a network of controls, procedures, reports and responsibilities. Within DEPFA 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.

DEPFA uses the following Group-wide processes and method for management, measurement, monitoring and reporting of operational risks:
- 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; Mitigation plans for high-rated risks are monitored by the Operational Risk department;

- Risk event management - the collection, reporting and analysis of internal risk event data enables DEPFA Group to identify weak controls, ineffective processes or activities, and poor systems; and ensures that DEPFA Group takes appropriate action to mitigate any exposures;
- New Products - DEPFA 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 Operational Risk department;
- Targeted risk reviews – in partnership with the business, examine in depth predefined key areas of risk and provide recommendations for risk mitigation.

The consolidated information is used in order to determine the operational risk profile of DEPFA and any required measures in relation to mitigation of identified risks.

Risk measurement

The DEPFA Group has adopted the standardised approach to calculate the capital requirement under the Basel II Accord and the EU Capital Requirements Directive. The capital backing of the DEPFA Group in line with the Basel II regulations for operational risks is € 41 million as of 31 December 2010 (31 December 2009: € 104 million).

Major operational risks of the DEPFA Group

The main operational risks are essentially attributable to the ongoing process of restructuring and repositioning the DEPFA Group. This includes the provision of services to FMS Wertmanagement which commenced on 1 October 2010.

Major operational risks are attributable to the high number of manual processes as well as the high number of different processing and monitoring systems. The systems are being consolidated at present. Until the consolidation process has been completed, there will be an increased level of susceptibility to errors with regard to the manual processes and controls which are carried out for ensuring data consistency.

There is also a significant reliance on key staff for execution of the restructuring and performance of regular processes and controls. This is particularly important given the environment of processing systems and manual processes and controls. The loss of know-how represents a significant level of risk in the current situation of the DEPFA Group, and the level of staff turnover within the DEPFA Group during 2010 remains high.

In the course of the financial year 2010, the Bank reported operational risk losses of € 2.3 million. These primarily related to manual errors in performing control processes.

Process and control improvements have been implemented in order to remedy the underlying causes of the losses which have occurred.

*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".

* Forms an integral part of the audited financial statements

Directors' Report

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, the DEPFA Group Treasurer 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 Central Bank of Ireland.

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

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 29% of the assets of the Bank as at 31 December 2010 are AAA rated using internal ratings models whilst a further 54% 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 31 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	Cyril Dunne	Noel Reynolds	Elaine Tiernan
Director	Director	Director	Company Secretary

21 March 2011

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

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

We have audited financial statements (''financial statements'') of DEPFA ACS BANK ("the Bank" or "the Company") for the year ended 31 December 2010 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 Company'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 Company'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 Company and the Company'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 Company; whether at the year-end date, there exists a financial situation requiring the convening of an extraordinary general meeting of the Company; 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 Company'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.

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

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 of the Company's affairs as at 31 December 2010 and of its loss 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 Company. The Company 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 Company, as stated in the Company 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 2010 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 Company.

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 "Going Concern and risks threatening the existence of the HRE Group" section of the Directors Report on page 14 and note 2 to the financial statements on page 37 concerning the appropriateness of the going concern basis of accounting in the preparation of the financial statements of the Bank for the year ended 31 December 2010.

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 key material uncertainties relating to the application of the going concern basis of accounting to the Bank's financial statements for the year ended 31 December 2010. The key material uncertainties are as follows:
- the continuing existence of the Bank is dependent upon the European Commission approving the support measures which have been implemented by the German Financial Markets Stabilisation Fund/German Finanzmarktstabilisierungsfonds ("SoFFin") (as set out in note 2 to the financial statements).
- the ability of the Bank to continue as a going concern is dependent upon the European Commission not imposing any conditions which would not permit the Bank to implement an economically sustainable business plan and, in particular, does not undo the regulatory effectiveness of the capital support measures.

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

21 March 2011

Income statement

Income statement

For the year ended 31 December 2010			
€ m	**Note**	**2010**	**2009**
Interest and similar income		1,957	2,428
Interest expense and similar expenses		-1,901	-2,339
Net interest income	6	**56**	**89**
Commission expenses	7	-37	-58
Net fee and commission expense		**-37**	**-58**
Net trading income	8	-2	2
Net loss from financial investments	9	-4	-
Net income/(loss) from hedge relationships	10	15	-10
Other operating income	11	2	1
Total operating revenues		**30**	**24**
Provision for losses on loans and advances	18	6	-10
General administrative expenses	12	-44	-7
Pre-tax (loss)/income		**-8**	**7**
Taxes on income	13	-	-
Net (loss)/income		**-8**	**7**
Attributable to:			
Equity holders of the parent		-8	7

The notes on pages 34 to 63 are an integral part of these financial statements.

John Bourke
Director

Cyril Dunne
Director

Noel Reynolds
Director

Elaine Tiernan
Company Secretary

21 March 2011

Statement of comprehensive income

Statement of comprehensive income

€ m	2010			2009		
	Before tax	Tax	After tax	Before tax	Tax	After tax
Net (loss)/income	-8	-	-8	7	-	7
AfS reserve movement - net	40	-5	35	10	-1	9
Total	**32**	**-5**	**27**	**17**	**-1**	**16**
attributable to:						
Equity holders of the parent	32	-5	27	17	-1	16

Disclosure of components of comprehensive income

€ m	2010	2009
Net (loss)/income	-8	7
AfS reserve movement - net	35	9
Gains/losses arising during the year	35	9
Total	**27**	**16**

The notes on pages 34 to 63 are an integral part of these financial statements.

John Bourke
Director

Cyril Dunne
Director

Noel Reynolds
Director

Elaine Tiernan
Company Secretary

21 March 2011

Statement of financial position

Statement of financial position

As at 31 December 2010			
€ m	Note	2010	2009
ASSETS			
Cash reserves	14	34	22
Trading assets	15	3,504	1,163
Loans and advances to other banks	16	27,129	21,675
Loans and advances to customers	17	30,627	53,806
Allowances for losses on loans and advances	18	-1	-10
Financial investments	19	5,776	7,555
Other assets	20	3,649	2,739
Deferred tax assets	21	4	9
Total assets		**70,722**	**86,959**
LIABILITIES			
Liabilities to other banks	24	23,280	29,642
Liabilities to customers	25	2,513	-
Liabilities evidenced by certificates	26	37,183	50,842
Trading liabilities	27	3,500	1,041
Other liabilities	28	3,010	4,230
Current tax liabilities	29	1	1
Subordinated capital	30	637	632
Total liabilities		**70,124**	**86,388**
EQUITY			
Equity attributable to equity holders			
Share capital	31	510	510
Retained earnings	32	119	127
Other reserves - AfS	33	-31	-66
Total equity		**598**	**571**
Total equity and liabilities		**70,722**	**86,959**

The notes on pages 34 to 63 are an integral part of these financial statements.

John Bourke
Director

Cyril Dunne
Director

Noel Reynolds
Director

Elaine Tiernan
Company Secretary

21 March 2011

Statement of changes in equity

Statement of changes in equity

For the year ended 31 December 2010 € m	Share capital	Retained earnings	Unrealised gains/ losses on available-for-sale securities	Total equity
Balance at 1 January 2009	**510**	**280**	**-75**	**715**
Profit for the year	-	7	-	7
Net change in available-for-sale investments, net of tax	-	-	9	9
Total comprehensive income	**-**	**7**	**9**	**16**
Dividends	-	-160	-	-160
Balance at 31 December 2009	**510**	**127**	**-66**	**571**
Loss for the year	-	-8	-	-8
Net change in available-for-sale investments, net of tax	-	-	-3	-3
Change due to FMS Wertmanagement	-	-	38	38
Total comprehensive income	**-**	**-8**	**35**	**27**
Balance at 31 December 2010	**510**	**119**	**-31**	**598**

The notes on pages 34 to 63 are an integral part of these financial statements.

Cash flow statement

Cash flow statement

For the year ended 31 December 2010 € m	2010	2009
Cash flows from operating activities		
Pre-tax (loss)/profit	**-8**	**7**
Adjustments for non-cash movements:		
Foreign exchange gain	-2	-
Net (increase)/decrease in accrued interest income	-44	662
Net decrease in accrued interest expenditure	-38	-691
Provisions for losses on loans	-6	10
Losses on sale of investment securities and loans	36	8
Other non cash items	-48	-3
Net (increase)/decrease in loans and advances to other banks	-5,773	3,567
Net decrease in loans and advances to customers	20,294	2,605
Net decrease in other assets	1	45
Net decrease in liabilities to other banks	-1,812	-5,180
Net increase in amounts due to customers	1,741	-
Net decrease in liabilities evidenced by certificates	-15,786	-1,023
Net increase in other liabilities	131	2
Net increase in trading derivatives	2,755	2
Tax paid	-	-12
Net cash from operating activities	**1,441**	**-1**
Cash flows from investing activities		
Purchase of investment securities	-1,689	-
Sale/maturity of investment securities	248	161
Net cash from investing activities	**-1,441**	**161**
Cash flows from financing activities		
Dividends paid	-	-160
Net cash from financing activities	**-**	**-160**
Net increase/(decrease) in cash and cash equivalents	**-**	**-**
Cash and cash equivalents at the beginning of the year	**-**	**-**
Effect of exchange rate changes on cash and cash equivalents		
Cash and cash equivalents at the end of the year (Note 14)	**-**	**-**

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

€ m	2010	2009
Interest income received	2,829	3,090
Interest expense paid	-2,855	3,029

The notes on pages 34 to 63 are an integral part of these financial statements.

Notes to the financial statements

01 General information

DEPFA ACS BANK (“the Bank”) is part of the DEPFA Group (“the Group“ or the “DEPFA 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 Central Bank of Ireland 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 2010.

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.

IFRS and interpretations applied for the first time as well as changes of standards and interpretations

In the financial year 2010 the following new or revised standards and interpretations were initially applied:

- IFRS 1 (revised) First-time Adoption of IFRS
- IFRS 3 (revised) Business Combinations and IAS 27 (revised) Consolidated and Separate Financial Statements
- IAS 24 (revised) Related Party Disclosures
- IFRIC 12 Service Concession Arrangements
- IFRIC 17 Distributions of Non-Cash Assets to Owners
- Amendment to IFRS 2 Group Cash-settled Share-based Payment Transactions
- Amendment to IAS 39 Financial Instruments: Recognition and Measurement: Eligible Hedged Items
- Amendment to IFRS 1 Additional Exemptions for First-time Adopters
- Annual Improvements to IFRSs 2009

On 10 January 2008 the IASB published the standards IFRS 3 (revised) Business Combinations and IAS 27 (revised) Consolidated and Separate Financial Statements. IFRS 3 (revised) revises, amongst others, the application of the acquisition method for business combinations. Major revisions to IAS 27 (revised) Consolidated and Seperate Financial Statements concern the accounting of transactions in which an entity retains control as well as transactions in which control is lost. Both standards have to be adopted initially and applied prospectively for business combinations and transactions within financial years beginning on or after 1 July 2009. There have not been any impacts on the Bank so far, and any such impacts will depend in future on potential business combinations respectively on potential transactions.

IFRS 5 Non-current Assets Held for Sale and Discontinued Operations has been amended in connection with IFRIC 17. The requirements of IFRS in relation to recognition, measurement and disclosure are applicable as well as in relation to assets which meet the criteria for being classified as held for distribution to owners.

The standard IAS 24 (revised) Related Party Disclosures remedies inconsistencies regarding the definitions of a related entity and a related person. In addition, it is necessary to disclose information only about significant transactions with government-controlled entities which are controlled or significantly influenced by the same government. The standard has to be adopted initially and applied prospectively for financial years beginning on or after 1 January 2011. Earlier adoption is permitted. The Bank exercised the option to already adopt IAS 24 (revised) in full for the financial year beginning on 1 January 2010.

The other initially applicable standards and interpretations as well as their revisions and amendment did not have any material impacts on the Bank or are not relevant for the Bank.

Published and endorsed standards and interpretations respectively their revisions and amendments, whose initial adoption is not mandatory and which are not adopted earlier

The following material amended and endorsed standards and interpretations have not been applied earlier by the Group:

- IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments
- Amendment to IAS 32 Financial Instruments Presenta-

tion on Classification of Rights Issues
- Amendment to IFRS 1 Limited Exemptions from Comparative IFRS 7 Disclosures for First-time Adopters
- Amendment to IFRIC 14 Prepayments of a Minimum Funding Requirement

IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments clarifies the accounting when an entity issues equity instruments to extinguish all or parts of a financial liability. The interpretation has to be applied prospectively for financial years beginning on or after 1 July 2010. Impacts on the Bank will depend on future transactions.

The Amendment to IAS 32 Financial Instruments: Presentation on Classification of Rights Issues addresses the accounting for rights, options and warrants to acquire a fixed number of an entity's own equity instruments that are denominated in a currency other than the functional currency of the issuer. The amendment has to be applied prospectively for financial years beginning on or after 1 February 2010. As the Bank has not issued any such rights, at the moment, the amendment will not have any impacts on the Bank.

Amendment to IFRS 1 Limited Exemptions from Comparative IFRS 7 Disclosures for First-time Adopters has to be applied prospectively for financial years beginning on or after 1 July 2010. The amendment will not have any impacts on the Bank.

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

Published standards and interpretation respectively their revisions and amendments, which are not endorsed on Balance Sheet Date

The following new or material amended standards and interpretations have not been applied earlier by the HRE Group. These standards and interpretations are not mandatorily applicable yet and are not endorsed by the European Commission:
- IFRS 9 Financial Instruments
- Amendment to IFRS 7 Financial Instruments: Disclosures
- Amendment to IFRS 1 Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters
- Amendment to IAS 12 Deferred Taxes on Investment Property
- Amendments in Line with the Annual Improvement Projects 2010

The IASB is replacing the standard IAS 39 by IFRS 9 Financial Instruments in several project phases. The IASB published new policies in 2009 and 2010 for the first project phase Classification and Measurement. On the other hand, finally adopted standard parts are not yet available for the two other project phases Impairment Methodology and Hedge Accounting. With regard to the classification of the financial instruments, the Classification and Measurement part now only provides the two categories measurement at fair value and measurement at amortised cost. Financial debt instruments are classified on the assets side of the balance sheet depending on the business model of the entity for managing financial assets and the characteristics of the contractual cash flows of the financial asset. On the other hand, equity instruments and dFVTPL assets generally have to be measured at fair value. On the liabilities side of the balance sheet, all non-derivative liabilities which are not used for trading purposes or which are not designated for measuring at fair value have to be measured at amortised cost. In the case of the dFVTPL liabilities, changes in value which are attributable to the change in the entity's own credit risk have to be recognised directly in equity. The initial application of the new standard IFRS 9 Financial Instruments, which is envisaged or financial years beginning on or after 1 January 2013, will probably have a material impact for the Bank. In future, it will be necessary for some assets and liabilities which have previously been measured at amortised cost presumably to be measured at fair value, and vice versa. However, it will only be possible to make a definitive assessment of this impact when all parts of IFRS 9 Financial Instruments have been completely published.

Amendment to IFRS 7 Financial Instruments: Disclosures shall enhance the qualitative characteristics of financial statements, in particular regarding transactions with the objective of transferring financial assets (for example securitisations and factoring). The amendment will have no impact on recognition and measurement. However, supplemental disclosures will have to be added to the notes.

The main amendments to IFRS 1 Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters concern entities, which adopt IFRS for the first time and whose functional currency was effected by hyperinflation. These amendments are not relevant for the Bank.

By means of the amendment to IAS 12 Deferred Taxes on Investment Property the IASB clarifies, that temporary tax differences concerning investment properties will reverse generally solely in the course of disposal. The Bank currently does not hold any investment properties. Therefore, impacts on the Bank will depend on future transactions.

In the course of the project Business Combination Phase II the following standards and interpretations were amended and were combined in Annual Improvements to IFRSs 2010:
- IFRS 3 (revised) Business Combinations
- IAS 27 (revised) Consolidated and Separate Financial Statements
- IAS 21 The Effects of Changes in Foreign Exchange Rates
- IAS 28 Investment in Associates
- IAS 31 Interests in Joint Ventures

Additionally, Annual Improvements to IFRSs 2010 comprises the amendments of the following standards and interpretations:

- IFRS 1 First-time Adoption of International Financial Reporting Standards
- IFRS 7 Financial Instruments: Disclosures
- IAS 1 Presentation of Financial Statements
- IAS 34 Interim Financial Reporting
- IFRIC 13 Customer Loyalty Programmes

The majority of the amendments are applicable for financial years beginning on or after 1 January 2011. Annual Improvements to IFRSs 2010 will probably not have material impacts on the Bank.

Basis of preparation

These financial statements have been prepared in accordance with European Union (EU) endorsed International Financial Reporting Standards ("IFRSs"), IFRIC interpretations as endorsed by the European Union (EU) and also the Companies Acts, 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 despite the material factors of uncertainty which are known at the date of signing and are described below.

This assumption is predicated on the fact that the HRE Group Management Board has prepared the HRE Group financial statements on a going concern basis.

With regard to the going concern assumption, material factors of uncertainty are known at the point at which the consolidated financial statements were prepared in connection with events and conditions which cast doubts on the ability of HRE Holding and its major subsidiaries to continue as going concerns. The continuing existence of HRE Holding and its subsidiaries including DEPFA ACS BANK as going concerns depends on the European Commission approving the support measures which have been implemented by SoFFin.

In addition, the ability of HRE Holding and its subsidiaries including DEPFA ACS BANK to continue as going concerns is dependent upon the European Commission not imposing any conditions which would not permit HRE Holding and its subsidiaries including DEPFA ACS BANK to implement an economically sustainable business plan and, in particular, does not undo the regulatory effectiveness of the capital support measures.

The Management Board of the HRE Group has engaged the services of an auditing firm to carry out an independent appraisal of the going concern assumption. In its prepared report this auditing firm concludes that it is more than likely that HRE Holding and its subsidiaries will be able to continue as going concerns in the period until 30 September 2012.

On 28 March 2009, SoFFin confirmed to HRE Holding and Deutsche Pfandbriefbank AG (formerly Hypo Real Estate Bank AG) that it intends to stabilise HRE Holding by way of adequate recapitalisation, and that it also intends to stabilise Deutsche Pfandbriefbank AG by way of providing further adequate guarantees. On 6 November 2009, SoFFin renewed this declaration of intent. In particular, SoFFin has confirmed that it will provide adequate capital in order to at least ensure the continued existence of HRE Holding and its major subsidiaries as going concerns and also to ensure the necessary viable business model, particularly of Deutsche Pfandbriefbank AG. The support measures are conditional on the Aid Law requirements of the European Commission being fulfilled. The positive conclusion of these proceedings is expected by mid 2011.

Although major progress has been achieved with regard to stabilising and restructuring the HRE Group since the autumn of 2008, the HRE Group companies continued to be exposed to risks threatening their very existence throughout the whole of 2010 due to the material factors detailed above.

The forecasts relating to the future development of the HRE Group represent estimates which have been made on the basis of currently available information. If the assumptions underlying these forecasts fail to materialise or if risks (such as those addressed in the section risk management) occur to an extent which has not been calculated, the actual results may differ significantly from the currently expected results.

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. For all years up to and including 2009, activities in DEPFA ACS BANK were attributable to only one externally reportable segment. Hence no segmental report was previously presented. For consistency in the

HRE Group structure and in line with DEPFA BANK plc organisational structure, DEPFA ACS BANK was re-organised for the financial year 2010 into two operating segments:

- Value Management Europe/Rest of World
- Value Management Americas

Foreign currency translation

Currency translation is carried out in accordance with the requirements of IAS 21. On the relevant date for the financial statements, monetary items in a foreign currency are translated into the functional currency. 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".

The reporting currency is euro.

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 rate 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 accordance with the derecognition requirements of IAS 39, a financial asset is derecognised when substantially all risks and rewards have mainly been transferred. If the significant 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 Bank 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 arising due to a continuing involvement.

In case of repurchase agreements and synthetic securitisations the assets transferred do not qualify for derecognition because the 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 an accounting mismatch 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.

No financial assets or liabilities were classified as dFVTPL in financial years 2010 and 2009.

(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 2010 and 2009.

(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 line items "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 is 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. Impairments are shown under "Provisions for losses on loans and advances" for loans and advances and 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 2010 and 2009.

(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 in other comprehensive income is now reclassified to the income statement. If the objective evidence for the impairment of an AfS debt instrument is no longer present, 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 through 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 loss 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 expense from financial liabilities is shown under the line item "Interest expense and similar expenses". In addition, the line item "Net interest income" includes net gains and net losses attributable to repurchases or extinguishments 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 they exist. 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 certain non-market-observable parameters. The valuation models used 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 as determined 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 utilised 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. Hedging derivatives are discussed 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.

(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 has 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 to 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 non-AfS hedged item is adjusted by the fair value change attributable to the hedged risks, and is recognised in profit or loss for the period. If the underlying transaction is an AfS financial asset, the fair value change attributable to hedged risk is re-classified from other comprehensive income to profit or loss.

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 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 other comprehensive income. The gain or loss relating to the ineffective portion is recognised immediately in the income statement.

Amounts accumulated in other comprehensive income are reclassified 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 other comprehensive income at that time remains in other comprehensive income and is recognised when the forecast transaction 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 other comprehensive income is immediately reclassified 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

Where financial assets are not fair-valued through profit and loss, they 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;
- probability that the borrower will enter bankruptcy or other financial reorganisation;
- renegotiations due to economic problems; and
- when available, the market price of the asset indicating evidence of impairment.

Two types of impairment allowances are established: 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. The impairment charge 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's aggregate exposure to the customer;
- the amount and timing of expected interest and redemption payments;
- the realisable value of collateral and likelihood of successful repossession;
- the likely deduction of any costs involved in recovering amounts outstanding; 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 updated 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 compensation 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 2010 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 through other comprehensive income, is also credited or charged directly to other comprehensive income and may be subsequently recognised in the income statement together with the related gain or loss.

Trading assets

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

Trading assets are stated at 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 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 2010 and 31 December 2009, 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 at 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 other comprehensive income 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. Portfolio-based allowances are not 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 2010 and 2009, 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 as to the need of an allowance on an individual basis 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 such as 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. 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 at 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 Bank'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.

03 Risk management

The risk management disclosures are contained 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:

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 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, as described below, 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 cash flows. 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

Relationships between underlyings and hedging instruments can be presented in hedge accounting. A relationship 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 Transfer of positions to FMS Wertmanagement

In January 2010, the HRE Group submitted an application to the FMSA for a stabilisation measure in accordance with section 8a (1) Clause 1 FMStFG (establishment of a deconsolidated environment) in order to transfer assets and liabilities of the HRE Group and its direct and indirect subsidiaries to a deconsolidated environment. This application was approved by the FMSA, and the deconsolidated environment FMS Wertmanagement was established on 8 July 2010. The transferred positions mainly comprise financial instruments as defined in IAS 39.

At the end of September, the HRE Group concluded the agreements necessary for the transfer with FMS Wertmanagement; previously, the European Commission had provisionally approved the transaction within the framework of the on-going aid proceedings. The positions were transferred to FMS Wertmanagement with legal and/or economic effect as of 1 October 2010; however, no legal and/or economic transfer was originally intended for some of the positions to be transferred. On the contrary, they have been backed by a financial guarantee of FMS Wertmanagement; any legal and/or economic transfer in this respect will only take place at a later date. The transfer is a non-cash transaction between companies under common control.

The positions were transferred to FMS Wertmanagement by way of a spin-off for inclusion in an existing company in accordance with Section 8a (8) FMStFG in conjunction with Section 123 (2) No. 1 as follows: Deutsche Pfandbriefbank AG and also HRE Holding AG have each spun off parts of their assets to FMS Wertmanagement and have received compensation claims in return; in addition, SoFFin – as a further consideration – has also received a stake in the share capital of FMS Wertmanagement of € 1 million.

The assets and liabilities of the subsidiaries were transferred to HRE Holding AG by way of singular succession (Einzelrechtsnachfolge), and the resultant pending agreements were subsequently spun off to FMS Wertmanagement.

Whereas most of the transferred positions have resulted in a derecognition at the HRE Group due to the transfer of at least economic ownership to FMS Wertmanagement, this is not applicable for the positions which are merely backed by way of the financial guarantee and also in the case of the real estate loans which are recorded in the mortgage cover pool assets and which enjoy special protection in favour of the Pfandbrief holders due to considerations of Pfandbrief Law. The collateralised lending transactions have also not resulted in a derecognition.

In addition, the HRE Group has also concluded so-called back-to-back derivatives with FMS Wertmanagement; these have been used to transfer the market risks of existing derivatives, whereas the so-called counterparty risk was retained by the HRE Group. These back-to-back derivatives have resulted in a significant increase in the derivative position of the HRE Group as of 1 October 2010.

A so-called "upgrade" of the transfer methods is being considered for the transactions which have so far not resulted in a derecognition, in order to meet the derecognition requirements at a later date.

Each of the positions were transferred at the corresponding carrying amount of the transferor company in accordance with the accounting requirements which were applicable for the individual financial statements of the respective company with the exception of AfS and former AfS assets which are transferred at their corresponding carrying amount adjusted for the related AfS revaluation reserve balance in equity.

The amount of the compensation claim which the HRE Group as well as the other transferring subsidiaries received from FMS Wertmanagement as of 1 October 2010 is calculated as the difference between the carrying amount of the assets transferred by the respective company and the transferred liabilities.

The transfer resulted in capital effects recognised in equity as of 1 October 2010. The effect was attributable to deconsolidation effects and also to valuation differences between the carrying amounts shown in the IFRS financial statements and the corresponding carrying amounts shown in the separate financial statements prepared in accordance with local accounting regulations.

In the published condensed interim report as of 30 June 2010, the Bank disclosed all positions transferred to FMS Wertmanagement in the note disposal group. The current financial statements as of 31 December 2010 are no longer affected by the amendments to IFRS 5 described above because the disposal group was transferred on 1 October 2010.

The transfer of non-strategic positions to FMS Wertmanagement as of 1 October 2010 impacted the statement of financial position of the Bank as follows:

Transfer of positions to FMS Wertmanagement

€ m	Balance Sheet as of 30.09.2010	Transfer of Assets and Liabilities	Transfer of Allowances for total lendings	Compensa-ting Opposite Effects	Pro forma Balance Sheet after transfer to FMS Wert-management	Change in Compensa-ting opposite Effects Until 31.12.2010	Pro forma Balance Sheet as of 31.12.2010	Other Changes	Balance Sheet as of 31.12.2010
ASSETS									
Cash reserve	39	-	-	-	39	-	39	-5	34
Trading assets	1,195	-	-	4,075	5,270	-1,403	3,867	-363	3 ,504
Loans and advances to other banks	21,774	-939	-	-	20,835	1 5,859	36,694	-9,565	2 7,129
Loans and advances to customers	54,437	-27,187	-	23,800	51,050	-21,700	29,350	1,277	3 0,627
Allowances for losses on loans and advances	-24	-	3	-	-21	-	-21	20	-1
Financial investments	8,511	-5,124	-	-	3,387	-	3,387	2,389	5 ,776
Other assets	4,609	-	-	-69	4,540	-	4,540	-891	3 ,649
Deferred tax assets	9	-4	-	-	5	-	5	-1	4
Total	**90,550**	**-33,254**	**3**	**27,806**	**85,105**	**-7,244**	**77,861**	**-7,139**	**7 0,722**
Compensation Claim	-	33,292	-3	-30,105	3,184	-3,184	-	-	-
Total assets	**90,550**	**38**	**-**	**-2,299**	**8 8,289**	**-10,428**	**77,861**	**-7,139**	**70,722**
LIABILITIES									
Liabilities to other banks	30,142	-	-	-6,332	23,810	-7,582	16,228	7,052	2 3,280
Liabilities to customers	-	-	-	3,955	3,955	-1,442	2,513	-	2 ,513
Liabilities evidenced by certificates	51,390	-	-	-	51,390	-	51,390	-14,207	3 7,183
Trading liabilities	909	-	-	4,001	4,910	-1,404	3,506	-6	3 ,500
Other liabilities	6,910	-	-	-3,923	2,987	-	2,987	23	3 ,010
Income tax liabilities	1	-	-	-	1	-	1	-	1
Subordinated capital	644	-	-	-	644	-	644	-7	6 37
Total liabilities	**89,996**	**-**	**-**	**-2,299**	**87,697**	**-10,428**	**77,269**	**-7,145**	**7 0,124**
EQUITY									
Share capital	510	-	-	-	510	-	510	-	5 10
Retained Earnings	105	-	-	-	105	-	105	14	1 19
Other reserves - AfS	-61	38	-	-	-23	-	-23	-8	-31
Total equity	**554**	**38**	**-**	**-**	**592**	**-**	**592**	**6**	**5 98**
Compensation Claim	-	-	-	-	-	-	-	-	-
Total equity and liabilities	**90,550**	**38**	**-**	**-2,299**	**88,289**	**-10,428**	**77,861**	**-7,139**	**70,722**

As part of the process of transferring the positions, Deutsche Pfandbriefbank AG also assumed responsibility for managing the transferred portfolios for FMS Wertmanagement as part of a co-operation agreement, whereby Deutsche Pfandbriefbank AG also uses services of other subsidiaries of the HRE Group for rendering this service. The co-operation agreement is initially due to run for a period of 3 years until 30 September 2013.

In addition, Deutsche Pfandbriefbank has provided a commitment to FMS Wertmanagement that it will implement certain IT functionalities. Companies of the HRE Group are also considering whether to transfer legal and economic ownership of certain portfolios to FMS Wertmanagement for those cases in which the transfer to FMS Wertmanagement has so far not resulted in a derecognition.

For these obligations in connection with the transfer of the positions, the Bank has recognised costs at 31 December 2010 for IT and reporting adjustments (€ 6 million), setting up FMS Wertmanagement (€ 3 million) and the provisions for transfer taxes (€ 1 million).

Notes to the financial statements

06 Net interest income

€ m	2010	2009
Interest and similar income		
Lending and money-market business	1,731	2,155
Fixed-income securities and government subscribed debt	226	273
	1,957	**2,428**
Interest expense and similar expenses		
Deposits	-616	-769
Liabilities evidenced by certificates	-1,311	-1,498
Derivatives (net interest income)	43	-52
Subordinated capital	-17	-20
	-1,901	**-2,339**
Net interest income	**56**	**89**

Interest income on impaired loans was nil (2009: nil). Net interest income also includes gains less losses from financial assets, assets classified as loans and receivables, of € 1 million in 2010 (2009: € -8 million).

07 Net fee and commission expense

€ m	2010	2009
Fee and commission expense		
From lending operations	-37	-58
	-37	**-58**

Net fee and commission expense totalled € -37 million in 2010, mostly as a result of commission costs incurred for the guarantees related to the liquidity support measures (2009: € -58 million).

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.

08 Net trading income

€ m	2010	2009
From interest rate instruments and related derivatives	-2	2
	-2	**2**

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

09 Net loss from financial investments

€ m	2010	2009
Loss on sale of financial investments	-4	-
	-4	**-**

10 Net income/(loss) from hedge relationships

€ m	2010	2009
Result from fair value hedge accounting		
Result from hedged items	1,612	-1,031
Result from hedging instruments	-1,597	1,021
	15	**-10**

11 Other operating income

€ m	2010	2009
Other operating income		
Recharge income from other group companies	-	1
Foreign exchange gains	2	-
	2	**1**

12 General administrative expenses

€ m	2010	2009
Personnel expenses	**-1**	**-1**
Wages and salaries	-1	-1
Other general administrative expenses	**-43**	**-6**
	-44	**-7**

Other general administrative expenses also include auditors' remuneration of € 200,000 (2009: € 200,000).

General administrative expenses increased substantially from € -7 million in 2009 to € -44 million in 2010. Included this year is the Bank's share of once-off costs related to the set-up of FMS Wertmanagement of € -24 million. Administration costs of € -19 million in 2010 and € -5 million in 2009 mainly comprised recharges from other Group entities for services provided. This increase from year to year reflects both additional servicing to the Bank necessitated by transaction restructurings, projects and process improvements during the year, and the significantly higher cost base in 2010 for the support groups within the DEPFA Group and HRE Group entities providing the servicing, primarily from substantial increases in IT and system costs, and professional and consulting fees.

The average number of persons employed by the Bank during the year was 8 (2009: 7).

13 Taxes on income

€ m	2010	2009
(Loss)/Profit before tax	-8	7
Applicable (legal) tax rate in % in Ireland	12.50%	12.50%
Tax calculated at a tax rate of 12.5% (2009: 12.5%)	1	-1
Tax effects:		
Arising from the non-application of deferred tax	-1	-
Arising from prior years	-	1
Income tax expense	**-**	**-**

The differences between the expected (computed) taxes on income and the taxes on income actually shown are outlined in the following reconciliation:

Development of deferred taxes € m	2010	2009
Deferred taxes recognised in the statement of financial position	4	9
Difference to prior year		
therof:		
Recognised in income statement	-	-
Recognised in equity	-	-1
Disposals	-5	-

The deferred tax liabilities or deferred tax assets relate to the following items:

€ m	2010	2009
Financial investments	4	9
Total deferred tax assets (note 21)	**4**	**9**

14 Cash reserves

€ m	2010	2009
Balances with central banks other than mandatory reserves	-	-
Mandatory reserve deposits with central banks	34	22
	34	**22**

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

15 Trading assets

€ m	2010	2009
Stand-alone derivatives (non-trading book)	3,504	1,163
Total trading assets	**3,504**	**1,163**
Of which due from group companies	788	988

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

16 Loans and advances to other banks

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

€ m	2010	2009
Public sector loans	5,762	4,794
Other loans and advances	21,367	16,881
	27,129	**21,675**
Of which due from group companies	21,367	14,508

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

€ m	2010	2009
Repayable on demand	974	44
With agreed maturities		
Up to 3 months	21,264	10,130
from 3 months to 1 year	434	2,152
from 1 year to 5 years	3,433	4,077
from 5 years and over	1,024	5,272
	27,129	**21,675**

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.

17 Loans and advances to customers

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

€ m	2010	2009
Public sector loans	30,627	53,806
	30,627	**53,806**

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

€ m	2010	2009
With agreed maturities		
Up to 3 months	270	554
from 3 months to 1 year	1,259	792
from 1 year to 5 years	7,707	9,050
from 5 years and over	21,391	43,410
	30,627	**53,806**

Loans and advances to customers – past due but not impaired

At 31 December 2010, 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	2010	2009
Assets: past due but not impaired (due amount)		
Past due but not impaired less than 90 days	-	-
Past due but not impaired between 3 months and 6 months	-	-
Past due but not impaired between 6 months and 1 year	-	96
Past due but not impaired greater than 1 year	-	-
Total	**-**	**96**
Assets: past due but not impaired (total investment)		
Past due but not impaired less than 90 days	-	13
Past due but not impaired between 3 months and 6 months	-	-
Past due but not impaired between 6 months and 1 year	-	96
Past due but not impaired greater than 1 year	-	-
Total	**-**	**109**

18 Allowances for losses on loans and advances

Movement in allowance for losses on loans and advances:

€ m	2010	2009
Collective provision for losses on loans and advances		
At January 1	**-10**	**-**
Reductions in collective provision	6	-10
Change due to transfer to FMS Wertmanagement	3	-
At December 31	**-1**	**-10**

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

€ m	2010	2009
Public sector loans	-1	-10
	-1	**-10**

19 Financial Investments

€ m	2010	2009
Available-for-sale financial investments	**47**	**48**
Debt securities and other fixed-income securities	47	48
LaR financial investments	**5,729**	**7,507**
Debt securities and other fixed-income securities	5,729	7,507
Total	**5,776**	**7,555**

Financial investments, broken down by maturities

€ m	2010	2009
With agreed maturities		
Up to 3 months	113	16
from 3 months to 1 year	309	182
from 1 year to 5 years	2,949	1,019
from 5 years and over	2,405	6,338
Total	**5,776**	**7,555**

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 € 0.288 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 2010 Bank securities with a reclassified carrying amount of € 1.913 billion were transferred to FMS Wertmanagement. A net loss of € 2.6 million was realised on its sold securities.

At the date of reclassification the effective interest rate for the AfS assets of the Bank was between 5.93% and 1.56% (2009: 6.85% and 1.56%).

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

2010 Reclassifications	Into: Financial investments (LaR)			Effect in reporting period if no assets had been reclassified	
€ m	Reclass date	31 December 2010		Date of reclassification to 31 Dec 2010	
Out of:		Carrying Amount	Fair Value	Income Statement	AfS Reserve (after taxes)
AfS financial investments	1 July 2008	2,549	2,376	-	29

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

Securities listed on stock exchange

€ m	2010		2009	
	Debt securities and other fixed-income securities	Total	Debt securities and other fixed-income securities	Total
Listed	4,243	4,243	6,266	6,266
Unlisted	1,533	1,533	1,289	1,289
Total	**5,776**	**5,776**	**7,555**	**7,555**

Breakdown of financial investments at 31 December by counterparty type:

€ m	2010	2009
Bonds and debt securities		
By public issuers	5,776	7,555
	5,776	**7,555**

The carrying amount of the financial investments that are neither past due nor impaired is € 5.8 billion (2009: € 7.6 billion). The past due but not impaired and the impaired financial investments are not collateralised.

20 Other assets

€ m	2010	2009
Positive fair values from derivative financial instruments		
Hedging derivatives	3,643	2,733
Other assets	6	6
	3,649	**2,739**
Of which due from group companies	2,799	1,953

21 Deferred tax assets

€ m	2010	2009
Deferred tax assets (note 13)	4	9
	4	**9**

22 Subordinated assets

€ m	2010	2009
Included in:		
Loans and advances to customers	95	459
Financial investments	-	23
	95	**482**

23 Repurchase agreements

As a pledgor under repurchase agreements, the Bank has pledged assets with a book value of € 0.8 billion (2009: € 13.8 billion). The assets are not derecognised.

The Group currently handles certain refinancing functions for FMS Wertmanagement, for instance repurchase agreements with the ECB and bilateral repurchase transactions. The refinancing funds are passed on to FMS Wertmanagement and in return the Group receives a claim against FMS Wertmanagement.

In this regard, FMS Wertmanagement has pledged assets to DEPFA ACS BANK in respect of € 17 billion of Repo liabilities which is in turn pledged by the Group to Repo counterparties.

The considerations which have been received amount to € 18.1 billion (2009: € 12.1 billion) and are recognised under liabilities and thereof are mainly classified as "Liabilities to other banks".

Notes to the financial statements

24 Liabilities to other banks

€ m	2010	2009
Liabilities to other banks	23,280	29,642
Total	**23,280**	**29,642**
Of which due to group companies	5,618	24,637

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

By maturity € m	2010	2009
Repayable on demand	1,900	-
With agreed maturities		
Up to 3 months	20,473	18,135
from 3 months to 1 year	436	10,033
from 1 year to 5 years	460	3
from 5 years and over	11	1,471
	23,280	**29,642**

Included under liabilities to other banks are amounts due under repurchase agreements (note 23).

25 Liabilities to customers

Liabilities to customers by maturities € m	2010	2009
Repayable on demand	2,513	-
With agreed maturities		
Up to 3 months	-	-
from 3 months to 1 year	-	-
from 1 year to 5 years	-	-
from 5 years and over	-	-
	2,513	**-**
Of which due to group companies	-	-

26 Liabilities evidenced by certificates

By type of business € m	2010	2009
Public sector covered bonds	37,183	50,842
Total	**37,183**	**50,842**

By maturity € m	2010	2009
With agreed maturities		
up to 3 months	2,066	796
from 3 months to 1 year	1,492	3,585
from 1 year to 5 years	14,917	15,567
from 5 years and over	18,708	30,894
Total	**37,183**	**50,842**

27 Trading liabilities

€ m	2010	2009
Stand-alone derivatives (non-trading book)	3,500	1,041
	3,500	**1,041**
Of which due from group companies	2,401	803

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

28 Other liabilities

€ m	2010	2009
Negative fair values from derivative financial instruments		
Hedging derivatives	2,855	4,206
Other liabilities	155	24
	3,010	**4,230**
Of which due to group companies	2,127	2,946

29 Current tax liabilities

€ m	2010	2009
Current tax liabilities	1	1
	1	**1**

30 Subordinated capital

Breakdown € m	2010	2009
Subordinated liabilities	**637**	**632**
Of which due to group companies	637	632

Broken down by maturities € m	2010	2009
With agreed maturities		
from 5 years and over	637	632
	637	**632**

The subordinated debt instruments are analysed below:

€ m		2010 Nominal	2009 Nominal
Subordinated liabilities			
DEPFA Finance NV	Euribor + 0.885%	50	50
DEPFA Finance NV	6.55%	60	60
DEPFA Ireland Holding Limited	Euribor + 0.425%	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 + 0.325%	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 (2009: nil).

31 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 in issue	Ordinary Shares (€ m)	Share Premium (€ m)	Total (€ m)
At 31 December 2009	510,000,000	510	-	510
At 31 December 2010	510,000,000	510	-	510

32 Retained earnings

€ m	2010	2009
At January 1	**127**	**280**
Net (loss)/profit for year	-8	7
Dividends	-	-160
At December 31	**119**	**127**

33 Other reserves

€ m	2010	2009
Unrealised losses from available-for-sale investment securities	-31	-66
At December 31	**-31**	**-66**

€ m	2010	2009
Unrealised gains/losses from cash flow hedges		
At January 1	-	-
Net gains/loss from changes in fair value, net of tax	17	-4
Net loss transferred to income statement, net of tax	-17	4
At December 31	**-**	**-**

€ m	2010	2009
Unrealised losses from available-for-sale investment securities		
At January 1	-66	-75
Net gain/loss from changes in fair value, net of tax	-3	9
Net gain/loss from transfer to FMS Wertmanagement, net of tax	38	-
At December 31	**-31**	**-66**

34 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	2010	2009
Foreign currency assets		
USD	9,074	18,771
JPY	3,976	4,259
GBP	-292	6,189
Others	7,900	6,741
	20,658	**35,960**
Foreign currency liabilities		
USD	9,083	18,806
JPY	3,986	4,203
GBP	-283	6,186
Others	7,908	6,764
	20,694	**35,959**

35 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.

36 Derivative financial instruments

€ m	2010	2009
Assets		
Trading assets (note 15)	3,504	1,163
Other assets (note 20)	3,643	2,733
	7,147	**3,896**
Liabilities		
Trading liabilities (note 27)	3,500	1,041
Other liabilities (note 28)	2,855	4,206
	6,355	**5,247**

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 exchangetraded 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 2010	Notional amount				Fair value	
	Remaining maturities					
€ m	Less than 1 year	1 to 5 years	More than 5 yrs	Total	Positive Fair Values	Negative Fair Values
Interest-based transactions						
Interest rate swaps	6,374	33,600	49,526	89,500	5,825	5,476
Call options	-	-	10	10	1	-
Other interest rate contracts	-	50	105	155	19	-
Total	**6,374**	**33,650**	**49,641**	**89,665**	**5,845**	**5,476**
Foreign currency based transactions						
Interest rate/currency swaps	3,959	5,447	6,867	16,273	1,302	708
Spot and forward currency transactions	722	-	-	722	-	171
Total	**4,681**	**5,447**	**6,867**	**16,995**	**1,302**	**879**
Other transactions						
OTC products	**-**	-	**-**	**-**	**-**	**-**
Credit derivatives	-	-	-	-	-	-
Total	**-**	**-**	**-**	**-**	**-**	**-**
Total	**11,055**	**39,097**	**56,508**	**106,660**	**7,147**	**6,355**

31 December 2009	Notional amount				Fair value	
	Remaining maturities					
€ m	Less than 1 year	1 to 5 years	More than 5 yrs	Total	Positive Fair Values	Negative Fair Values
Interest-based transactions						
Interest rate swaps	5,368	23,409	47,248	76,205	2,779	4,218
Total	**5,368**	**23,409**	**47,248**	**76,205**	**2,779**	**4,218**
Foreign currency based transactions						
Interest rate/currency swaps	396	3,476	19,448	23,320	1,117	1,029
Spot and forward currency transactions	-	-	-	-	-	-
Total	**396**	**3,476**	**19,448**	**23,320**	**1,117**	**1,029**
Other transactions						
OTC products	**-**	**-**	**-**	**-**	**-**	**-**
Credit derivatives	-	-	-	-	-	-
Total	**-**	**-**	**-**	**-**	**-**	**-**
Total	**5,764**	**26,885**	**66,696**	**99,525**	**3,896**	**5,247**

Derivatives Counterparties

€ m		2010		2009
	Fair values		Fair values	
	Positive	Negative	Positive	Negative
OECD financial institutions	7,147	6,355	3,896	5,247
Total	**7,147**	**6,355**	**3,896**	**5,247**

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.

37 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	2010	2009
up to 1 month	-	-59
from 1 month to 3 months	-	-52
from 3 months to 1 year	-3	-33
from 1 year to 2 years	-8	-4
from 2 years to 5 years	-95	-21
from 5 years and over	-108	-179

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.

38 Assets assigned or pledged as security for own liabilities

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

Own liabilities		
€ m	2010	2009
Liabilities to other banks	18,120	12,057
Liabilities to customers	-	-
Total	**18,120**	**12,057**

The Group currently handles certain refinancing functions for FMS Wertmanagement, for instance repurchase agreements with the ECB and bilateral repurchase transactions. The refinancing funds are passed on to FMS Wertmanagement and in return the Group receives a claim against FMS Wertmanagement.

In this regard, FMS Wertmanagement has pledged assets to DEPFA ACS BANK in respect of € 17 billion of Repo liabilities which is in turn pledged by the Group to Repo counterparties.

In addition to the assets pledged by FMS Wertmanagement in relation to the above liabilities, the following assets (recorded on the statement of financial position) were pledged as security for certain of the above liabilities at 31 December.

Pledged assets		
€ m	2010	2009
Loans and advances to other banks	-	1,851
Loans and advances to customers	-	7,655
Financial investments	798	4,287
Total	**798**	**13,793**

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 5 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 5 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."

39 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	
	2010	2009	2010	2009
FINANCIAL ASSETS				
Cash reserve	34	22	34	22
Trading assets	3,504	1,163	3,504	1,163
Loans and advances to other banks	27,129	21,675	27,040	21,517
Loans and advances to customers	30,626	53,796	28,396	47,811
Financial investments	5,776	7,555	5,499	6,859
Other assets	3,649	2,739	3,649	2,739
Deferred tax assets	4	9	4	9
Total assets	**70,722**	**86,959**	**68,126**	**80,120**
FINANCIAL LIABILITIES				
Liabilities to other banks	23,280	29,642	23,278	29,642
Liabilities to customers	2,513	-	2,513	-
Liabilities evidenced by certificates	37,183	50,842	32,497	46,876
Trading liabilities	3,500	1,041	3,500	1,041
Other liabilities	3,010	4,230	3,010	4,214
Current tax liabilities	1	1	1	1
Subordinated capital	637	632	183	632
Total liabilities	**70,124**	**86,388**	**64,982**	**82,406**

The change in hidden reserves or hidden charges of the HRE Group is mainly attributable to the transfer of positions to FMS Wertmanagement which took place as of 1 October 2010.

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

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.

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	2010	2009
Loans and receivables	63,485	82,988
Available-for-sale	47	48
Cash reserves	34	22
Derivatives	7,147	3,896
Other assets	9	5
Total assets	**70,722**	**86,959**
Financial liabilities at amortised cost	62,476	80,484
Derivatives	6,855	5,247
Other liabilities	793	657
Total liabilities	**70,124**	**86,388**

Notes to the financial statements

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 € m	31 December 2010			
	Total	Level 1	Level 2	Level 3
Assets				
Trading assets	3,504	-	3,364	140
Hedging derivatives	3,643	-	3,643	-
Financial investments	47	-	47	-
Total	**7,194**	**-**	**7,054**	**140**
Liabilities				
Trading liabilities	-3,500	-	-3,360	-140
Hedging derivatives	-2,855	-	-2,848	-7
Total	**-6,355**	**-**	**-6,208**	**-147**

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

In 2010 AfS-investments with a carrying amount of € 47 million were transferred from Level 1 to Level 2 because quoted prices in active markets for identical financial assets were no longer available.

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

The following table presents the changes in Level 3 instruments for the business year ended 31 December 2010:

Changes in Level 3 financial assets	Financial assets	
€ m	Trading assets	Total
Balance at 1 January 2010	**-**	**-**
Total gains/(losses) recognised in income statement	17	17
Purchases	123	123
Sales	-	-
Settlements	-	-
Transfers into Level 3	-	-
Balance at 31 December 2010	**140**	**140**

Changes in Level 3 instruments		
€ m	Financial assets	Total
Balance at 1 January 2009	**2**	**2**
Comprehensive income		
Income statement	-2	-2
Balance at 31 December 2009	**-**	**-**

Changes in Level 3 financial liabilities	Financial liabilities		
€ m	Trading liabilities	Hedging derivatives	Total
Balance at 1 January 2010	**-**	**7**	**7**
Total gains/(losses) recognised in income statement	-	1	1
Purchases	-	-	-
Sales	-	-1	-1
Settlements	-	-	-
Transfers into Level 3	140	-	140
Balance at 31 December 2010	**140**	**7**	**147**

Changes in Level 3 instruments		
€ m	Financial liabilities	Total
Balance at 1 January 2009	**-5**	**-5**
Comprehensive income		
Income statement	-1	-1
Purchases	-1	-1
Balance at 31 December 2009	**-7**	**-7**

Although the Group believes that its estimates of fair value are appropriate, using reasonably possible alternative input factors changes the fair value. The following tables shows the fair value sensitivities of the Level 3 instruments as of 31 December 2010 and 31 December 2009, which have been quantified on the basis of the specified valuation parameters taking account of standard scenarios.

Sensitivities of Level 3 instruments	2010	
€ m	Favourable changes	Unfavourable changes
Hedging derivatives	-	-
	-	**-**

Sensitivities of Level 3 instruments	2009	
€ m	Favourable changes	Unfavourable changes
Hedging derivatives	2	-3
	2	**-3**

As part of the process of transferring positions to FMS Wertmanagement, significant holdings of derivatives were transferred synthetically to FMS Wertmanagement by way of concluding opposite back-to-back transactions. As a result of their contractual opposite nature, these products have been combined in a separate IFRS 7 category within which the sensitivities of the original transactions cancel out those of the back-to-back transactions. In view of this aspect and also in order to present the economic context of the impact of risks on the net assets, financial position and results of operations, transactions which mirror each other have not been taken into consideration with regard to the beneficial and detrimental changes to Level 3 instruments.

The asset items transferred by means of back-to-back transactions had a carrying amount to nil as of 31 December 2010. The carrying amount of liability items hedged in this way was € -140 million as of 31 December 2010.

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

Further 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 paragraphs, 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.

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

40 Undiscounted cash flows of financial liabilities

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

€ m	2010	2009
up to 3 months	**27,685**	**20,523**
Of which from derivatives	500	1
Of which from non derivatives	27,185	20,522
from 3 months to 1 year	**3,694**	**15,917**
Of which from derivatives	1,028	1,306
Of which from non derivatives	2,666	14,611
from 1 year to 5 years	**22,303**	**24,226**
Of which from derivatives	4,405	4,553
Of which from non derivatives	17,898	19,673
from 5 years and over	**33,789**	**49,610**
Of which from derivatives	9,518	10,684
Of which from non derivatives	24,271	38,926

41 Dividends per share

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

No dividends were paid during the year (2009: € 160 million).

No further dividend is proposed for the year ended 2010.

42 Related party transactions

Key management compensation € m	2010	2009
Short term employee benefits	1	1
Post employee benefits	-	-
Share based payments	-	-
Directors' fees	-	-
	1	**1**

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 2010 and 2009, nor are there any loans outstanding to members of the Board at 31 December 2010 (2009: nil).

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

Transactions with group companies consisted of:

€ m	2010	2009
Interest and similar income	102	191
Interest expense and similar expenses	-239	-390
Net income from financial investments	-	-
Net fee and commission expense	-	-
Other operating income	-	1
General administrative expenses	-41	-4

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 7. 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.

HRE has various relationships with the sister company FMS Wertmanagement for example due to the fulfilment of funding function for FMS Wertmanagement or due to the synthetic transfer of positions. The relationships are described in note 5.

43 Characteristics of the asset pool as at 31 December 2010

The following table analyses the countries where the public credit assets included in the pool are located, the num-

ber 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	9,642	96	25.58%
USA	6,668	167	17.69%
Spain	3,805	64	10.09%
France	2,696	104	7.15%
Supranational	2,288	73	6.07%
Italy	2,234	65	5.92%
Belgium	1,838	20	4.88%
Canada	1,448	26	3.84%
Netherlands	1,410	159	3.74%
Poland	1,042	8	2.76%
Japan	826	8	2.19%
Austria	771	11	2.05%
Sweden	591	42	1.57%
Slovenia	532	8	1.41%
Finland	488	33	1.29%
United Kingdom	434	3	1.15%
Ireland	231	24	0.61%
Switzerland	221	5	0.59%
Malta	203	4	0.54%
Czech Republic	116	2	0.31%
Norway	100	1	0.27%
Denmark	70	4	0.18%
Slovakia	37	2	0.10%
Estonia	8	1	0.02%
Grand Total	**37,699**	**930**	**100%**

44 Contingent liabilities and commitments

Other commitments		
€ m	2010	2009
Irrevocable loan commitments	16	154

Transfer of non-strategic positions to FMS Wertmanagement

- Within the context of the transfer of assets of the HRE Group to FMS Wertmanagement, the FMSA reserves the right to impose a payment condition for the stabilisation measure in accordance with Section 8a (4) No. 8 FMStFG against the HRE Group for payment to FMS Wertmanagement; this figure must not exceed € 1.59 billion. The payment condition can also be fixed in several notices. However, the extent of the payment condition must be fixed in such a way that, after the condition has been fixed, the regulatory Tier 1 capital ratio of the bank entities within the HRE subgroups Deutsche Pfandbriefbank AG and the DEPFA Group do not fall below 15 % in each entity as of 31 March 2011. In addition, the fixing of the payment condition must not result in the subgroups or their parent companies:
  - becoming insolvent, illiquid or result in a negative going concern assumption,
  - relevant regulatory capital ratios, major credit limits or other legal or regulatory requirements being violated,
  - their rating falling below investment grade, or
  - the purchase price, taking account of the payment condition, falling below the market value of the transferred positions.
  - A possible payment obligation may have a significantly negative impact on the development in earnings of the HRE Group.

45 Segmental reporting

The Bank's income and assets are entirely attributable to public sector financing. For all years up to and including 2009, activities in DEPFA ACS BANK were attributable to only one externally reportable segment. Hence no segmental report was previously presented. For consistency in the HRE Group structure and in line with DEPFA BANK plc organisational structure, DEPFA ACS BANK was re-organised for the financial year 2010 into two operating segments:

- Value Management Europe/Rest of World
- Value Management Americas

	1 January - 31 December 2010		
€ m	**Value Management Europe and Rest of World**	**Value Management Americas**	**Total**
Net interest income	32	24	56
Net fee and commission expense	-25	-12	-37
Net trading income	1	-3	-2
Net loss from financial investments	-4	-	-4
Net income from hedge relationships	12	3	15
Other operating income	1	1	2
Total operating revenues	**17**	**13**	**30**
Provision for losses on loans and advances	5	1	6
General administrative expenses	-35	-9	-44
Pre-tax loss	**-13**	**5**	**-8**
Taxes on income	-	-	-
Net (loss)/income	**-13**	**5**	**-8**

	1 January - 31 December 2009		
€ m	**Value Management Europe and Rest of World**	**Value Management Americas**	**Total**
Net interest income	51	38	89
Net fee and commission expense	-29	-29	-58
Net trading income	2	-	2
Net loss from financial investments	-	-	-
Net income from hedge relationships	-7	-3	-10
Other operating income	1	-	1
Total operating revenues	**18**	**6**	**24**
Provision for losses on loans and advances	-10	-	-10
General administrative expenses	-5	-2	-7
Pre-tax loss	**3**	**4**	**7**
Taxes on income	-	-	-
Net (loss)/income	**3**	**4**	**7**

46 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.

47 Exchange rates as at 31 December 2009

European Central bank exchange rates at 31 December 2010 were:

Great Britain	1€ = GB£	0.8608
Japan	1€ = JP¥	108.6500
United States	1€ = US$	1.3362

48 Auditor's fee

	2010	2009
	€ '000	€ '000
Audit of individual company accounts	200	200
Other assurance services	-	-
Tax advisory services	-	-
Other non-audit services	-	-
	200	**200**

49 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 Central Bank of Ireland (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 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.

50 Events after the reporting date

There have been no notable events after 31 December 2010.

51 Approval of financial statements

The financial statements were approved by the directors on 21 March 2011.

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