Hypo Real Estate GROUP

Annual Report 2009

Financial Highlights

Financial Highlights

		2009	2008
Operating performance according to IFRS			
Pre-tax profit/loss	in € million	−2,221	−5,375
Net income/loss	in € million	−2,236	−5,461
Key ratios		**2009**	**2008**
Return on equity after taxes	in %	−46.8	−74.5
Cost-income ratio[1]	in %	> 100.0	> 100.0
Balance sheet figures		**31.12.2009**	**31.12.2008**
Total assets	in € billion	359.7	419.7
Equity (excluding revaluation reserve)[2]	in € billion	7.4	2.6
Equity (including revaluation reserve)[2]	in € billion	4.6	−1.5
Key regulatory capital ratios[3]		**31.12.2009**	**31.12.2008**
Core capital	in € billion	7.6	5.9
Own funds	in € billion	8.7	8.2
Risk-weighted assets[4] [5]	in € billion	81.0	95.3
Core capital ratio[4]	in %	9.4	6.2
Own funds ratio[4]	in %	10.8	8.6
Personnelv		**31.12.2009**	**31.12.2008**
Employees		1,397	1,786

[1] The cost-income ratio is the ratio of general administrative expenses and operating revenues, consisting of net interest income and similar income, net commission income, net trading income, net income from financial investments, the result of hedging relationships and the balance of other operating income/expenses
[2] Contains in 2009 hybrid capital instruments of the subsidiary DEPFA Bank plc which had to be reclassified according to IAS 32 under equity instead of under subordinated capital
[3] Before prepared annual financial statements and before result distributions
[4] Including risk-weighted credit risk positions as well as the capital requirements for market risk positions and operational risks scaled with the factor 12.5
[5] According to Basel II advanced IRB approach for authorised portfolios, otherwise Basel II standardised approach

Due to rounding, numbers presented throughout this document may not add up precisely to the totals provided and percentages may not precisely reflect the absolute figures.

Operating Structure
Ratings

Operating Structure of HRE

as of 31 December 2009

Hypo Real Estate Holding AG
Munich

Commercial Real Estate
International and German commercial real estate financing

Public Sector & Infrastructure Finance
Public sector and infrastructure financing

Capital Markets & Asset Management
Capital markets and asset management

Ratings

as of 12 March 2010		Moody's	Standard & Poor's	Fitch Rating
Deutsche Pfandbriefbank AG	Long-term	A3	BBB	A–
	Short-term	P–1	A–2	F1+
	Outlook	Negative	Credit Watch Positive	Stable
DEPFA Bank plc	Long-term	A3	BBB	A–
	Short-term	P–1	A–2	F1+
	Outlook	Negative	Credit Watch Positive	Stable

Content

2009 was the year of stabilising and restructuring the Hypo Real Estate Group (HRE) following the crisis which posed a threat to the very existence of the Group in the autumn of 2008: HRE was stabilised with external liquidity and capital support provided mainly by the Federal Government, a new business model was developed, and the structures, processes and systems were overhauled. The major results in this respect were the realignment of the ownership structure, the establishment of the new strategic core bank Deutsche Pfandbriefbank AG as well as the considerable reduction in the size and simplification of the structure of HRE. We will continue with the restructuring process in 2010, working closely with our owner. In addition we plan to establish a de-consolidated environment in order to reduce assets in a value-preserving manner, thus improving the situation for the strategic core bank and so allowing the core bank to be reprivatised more quickly. In addition, the positive completion of the EU state aid proceedings regarding support which has been provided is of key importance.

The results of operations in the financial year 2009 reflect the still difficult situation resulting from the liquidity and solvency crisis of the Group. However, there are signs of improvement compared with the previous year:

- Pre-tax profit amounted to € –2,221 million compared with € –5,375 million in the previous year.
- Operating revenues increased by € 1,004 million from € –585 million to € 419 million. This was attributable mainly to the net trading income which, at € –154 million, was much less negative and also was due to the fact that the net income from financial investments broke even. In particular, operating revenues in 2009 were severely affected by costs of € 741 million incurred in connection with guarantees in conjunction with the necessary liquidity support of SoFFin and the Federal Republic of Germany, including the result-related fee of € 229 million.
- Additions to provisions for losses on loans and advances depressed the overall result by € 2,091 million; in the year 2008, this figure amounted to € 1,656 million. In the year under review, € 1,723 million of this figure alone was attributable to individual allowances recognised in relation to real estate financing receivables. The commercial real estate markets were particularly affected by the recession. This extremely difficult market situation resulted in much higher risk provisioning in the entire sector.
- General administrative expenses fell from € 605 million to € 541 million. This reflected in particular the 18 % decline in personnel expenses. Consultancy fees, primarily in relation to legal matters and with regard to restructuring the Group were also down.

We continue to expect that the years 2010 and 2011 will have to face considerable charges on earnings resulting from further provisions for losses on loans and advances as well as costs of liquidity support and restructuring the Company. The future liquidity requirement depends very much on the establishment of a deconsolidated environment, to which we intend to transfer non-strategic assets and further items on the balance sheet, and also depends on the development of the market. On the whole, we are not assuming that we will be able to return to profitability before the year 2012.

The volume of liquidity support in the year under review peaked at € 102 billion. By means of repayments, the Group had reduced this liquidity framework to € 95 billion at the end of December 2009. Even if the refinancing conditions for the Group gradually return to normal in future, we are assuming that the process of completely repaying the liquidity support will certainly take several years.

This has now been the second year of losses, and this has had a considerable impact on the capital backing of HRE: without recapitalisation of the Group, the regulatory capital ratios would not have been met. The regulatory minimum ratios were not met in 2009 during the period between the point at which the annual financial statements 2008 were adopted on 24 April 2009 and the point at which the capital increase which was adopted at the Extraordinary General Meeting of 2 June 2009 was entered in the commercial register (completed on 8 June 2009). The relevant regulatory authorities, BaFin and the Bundesbank, were notified in plenty of time and decided not to impose sanctions – as a result of the recapitalisation activities which had already commenced. At the end of the year, the core capital ratio was 9.4 %; including the losses of 2009, it was 7.8 %.

SoFFin provided the necessary capital in several stages. The basis for this capital support was in particular the Financial Market Stabilisation Fund Act as well as the Financial Market Stabilisation Acceleration Act. In our opinion, in view of the extent of the necessary recapitalisation and the additionally necessary liquidity support, there was no realistic alternative to capital being provided by the German Government. SoFFin initially provided the Company with around € 3 billion by way of two capital increases in March and June 2009.

SoFFin provided the funds on condition that it obtained complete control over the Company. When the relevant threshold of 90 % was reached, SoFFin demanded the squeeze-out of minority shareholders in return for a reasonable cash settlement. This was adopted by the Annual General Meeting of the Company on 5 October 2009. As a result of the squeeze-out of minority shareholders having been recorded on 13 October 2009, the German Government through SoFFin now holds 100 % of the shares in Hypo Real Estate Holding AG (HRE Holding), and the Company was then delisted.

This was followed in November by a further capital injection of € 3 billion, meaning that HRE received total capital support of € 6.02 billion in the year under review. We have identified that the Group has a further capital requirement of up to € 4 billion. The SoFFin will decide on the final recapitalisation within the framework of the EU aid proceedings and after the form of a deconsolidated environment has been established.

Considerable progress made in 2009

We have made considerable progress with regard to the restructuring of the Group in 2009:

- We now concentrate on real estate financing and public sector finance which we fund mainly (but not exclusively) by means of Pfandbriefe and largely on a matching maturity basis. We work with professional real estate investors and finance selected types of real estate. In Public Sector Finance, we focus on primary customer business. We develop capital market activities only in relation to hedging transactions for our customers or the Bank itself.
  We are adjusting the size and the structure of the Group to this new business model. This has resulted in a considerable reduction in the number of employees in the year under review, namely by around 400 to 1,397 employees. However, we have also strengthened the workforce by means of new recruitment. For the year 2010, we are assuming a generally stable level of employment in the Group. We have also closed 22 out of 35 international and German locations, and have largely consolidated offices in places with several locations of the Group.
  We have also redefined the management and organisation structure, we have completed the Management Board in the divisions of Risk Management, Finance and Real Estate Finance, and have reorganised the management team at the level below the Management Board.
  We are also implementing a new IT infrastructure in a program which is due to last for several years, and have outsourced IT operations to an external service provider. The introduction of the new IT will create an environment in which we will establish our processes in a consistent and highly efficient manner on an integrated and competitive platform.
- Compared with the prior year reference date, consolidated total assets have declined considerably from € 419.7 billion by € 60 billion (14 %) to € 359.7 billion at the end of December 2009.
  The main factor in this respect were repayments of loans which exceeded the total figure attributable to new business. This reduction was also partially attributable to market movements, i.e. a decline in the fair values, triggered off by falling interest rates.
  And finally, the balance sheet total was reduced by means of active portfolio management. Some of the main transactions in the year under review were disposals of CDOs and MBS with a nominal value of € 1.3 billion as well as a portfolio of American student loans with a nominal value of € 0.5 billion. There was also a portfolio of receivables from the insolvency of Lehman Brothers with a nominal value of a further € 233 million; the sale enabled the Group to realise a book profit.
  Because of the considerable hidden charges, it was not possible for the portfolio to be reduced further by disposals in the year 2009.
- As the new core bank of the Group, Deutsche Pfandbriefbank AG has been established under company law. It was established at the end of June 2009 out of the merger between DEPFA Deutsche Pfandbriefbank AG and Hypo Real Estate Bank AG, and was subsequently renamed Deutsche Pfandbriefbank AG.

Since October 2009, the new entity has been operating under the new brand pbb Deutsche Pfandbriefbank, and has thus also been indicating the new beginning.
The new bank is already active in the field of lending and also on the refinancing markets. Despite the difficult market conditions, we have written new business in the year under review in the fields of real estate and public sector finance in Germany and other European countries. New Real Estate Finance business amounted to around € 3.3 billion, and the volume of new Public Sector Finance exposures amounted to approx. € 0.7 billion. We have extended expiring loan commitments and we have acquired selective new business on the basis of our more stringent risk management principles. Numerous new deals are lined up in both areas. Deutsche Pfandbriefbank AG has also returned to the market for syndications for Real Estate Financing. Accordingly, in the fourth quarter of 2009, we arranged one of the largest syndications since the outbreak of the financial crisis.
Deutsche Pfandbriefbank AG is not only active on the credit markets; it has also returned to the refinancing markets: in mid-September 2009, we issued our first jumbo Pfandbrief following an absence of more than one year from the market. This is a five-year Jumbo mortgage Pfandbrief with a volume of € 1.5 billion. This was followed in mid-October by a public Jumbo Pfandbrief with a volume of € 1 billion and a term of ten years. Both issues were over-subscribed, and attracted the interest of German and international investors. Overall, we raised more than € 7.5 billion debt on the market in 2009 including private placings and unsecured refinancing. We have already issued a public Jumbo Pfandbrief in the year 2010.

Strategic priorities for the year 2010

We are continuing with the restructuring of the Group. This includes the further establishment of Deutsche Pfandbriefbank AG as the strategic core bank of the Group, which we commenced in the year under review, as well as further reducing the balance sheet in a value preserving manner. Further aspects are the establishment of a deconsolidated environment which aims to achieve this balance sheet reduction and the timely conclusion of the EU state aid proceedings.

- We intend to transfer those parts of our operations which are no longer necessary for the restructuring of the Group as well as additional balance sheet items to a deconsolidated environment. The transfer is expected to take place in the second half of 2010 after approval is obtained from all responsible authorities and bodies, and is expected to comprise assets of up to € 210 billion. The establishment of such a deconsolidated environment, which is subject to the discretion of the financial market stabilisation authority, is a key milestone in the refocusing of the Group. This step will enable us to further strengthen Deutsche Pfandbriefbank AG as the core bank as we will release it from non-strategic or non-performing assets and as we will considerably reduce the balance sheet. In addition, the transfer of assets will reduce the additional capital requirement of Deutsche Pfandbriefbank AG and will enable the Company to be reprivatised more quickly. The other Group companies will in this way also become more attractive for investors.
- The entire support of the Federal Republic of Germany for HRE – guarantees and capital support as well as the establishment of a deconsolidated environment – is being reviewed as part of EU state aid proceedings. Experience with similar cases indicates that the following conclusion will be drawn: it is very likely that the EU Commission will impose conditions on the approval of the restructuring plan, for instance a considerable reduction of the balance sheet total and the fixing of a time scale for reprivatising Deutsche Pfandbriefbank AG. The Federal Government as the leading negotiator and the Company are convinced that the European Commission will approve the overall support package.

In the year 2010, HRE and the entire sector are facing further challenges: the crisis on the commercial real estate market will continue for some time to come, and even exposures to state debtors are facing increasing risks with a negative impact on Public Sector Finance business as a result of the rising levels of public sector debt. However, despite this difficult environment, we consider that there are opportunities for products and services from Deutsche Pfandbriefbank.

The successful establishment of a deconsolidated environment poses a particular challenge for HRE and the costs for implementing will additionally charge the results in 2010. This deconsolidated environment is particularly important not only for HRE, because it reduces the strain posed by non-strategic and non-performing assets on the Group. It is intended that the deconsolidated environment will minimise the burden on taxpayers resulting from the transferred portfolios.

The stabilisation and restructuring of HRE was only possible with the support received by HRE from the Federal Republic of Germany – and thus the citizens of this country – and the finance industry, as well as the exceptional commitment of our employees: I should like to thank all persons involved for their tremendous commitment.

Kind regards

A. Wieandt

Dr. Axel Wieandt
Chairman of the Management Board

The Supervisory Board of HRE Holding consisted of the following persons between 1 January 2009 and 13 August 2009: Dr. Michael Endres (Chairman; 6 December 2008 to 13 August 2009, member of the Supervisory Board; 17 November 2008 to 13 August 2009), Dr. Renate Krümmer (Deputy Chairman and member of the Supervisory Board; 25 July 2008 to 31 March 2009), Dr. h.c. Bernhard Walter (Deputy Chairman; 6 December 2008 to 13 August 2009, member of the Supervisory Board; 17 November 2008 to 13 August 2009), Dr. Günther Bräunig (member of the Supervisory Board; since 9 July 2009), J. Christopher Flowers (member of the Supervisory Board; 12 August 2008 to 27 March 2009), Bernd Knobloch (member of the Supervisory Board; 17 November 2008 to 13 August 2009), Dr. h.c. Edgar Meister (member of the Supervisory Board; 17 November 2008 to 18 May 2009), Siegmar Mosdorf (member of the Supervisory Board; 17 November 2008 to 13 August 2009), Richard S. Mully (member of the Supervisory Board; 25 July 2008 to 27 March 2009), Hans-Jörg Vetter (member of the Supervisory Board; 17 November 2008 to 13 August 2009) and Manfred Zaß (member of the Supervisory Board; 17 November 2008 to 13 August 2009). The periods of office of Dr. Endres, Dr. h.c. Walter, Dr. Bräunig, Mr. Knobloch, Mr. Mosdorf, Mr. Vetter and Mr. Zaß on the Supervisory Board of HRE Holding expired at the end of the Annual General Meeting of HRE Holding on 13 August 2009.

The Annual General Meeting of HRE Holding on 13 August 2009 elected the following persons onto the Supervisory Board of HRE Holding with effect from the end of this Annual General Meeting: Dr. Bernd Thiemann, Dagmar Kollmann, Dr. Günther Bräunig, Dr. Alexander Groß, Dr. Albert Peters and Dr. Hedda von Wedel. In the Supervisory Board meeting on 13 August 2009, Dr. Bernd Thiemann was elected as the Chairman of the Supervisory Board, and Dagmar Kollmann was elected as his Deputy.

Since 13 August 2009, the Supervisory Board of HRE Holding has consisted of the following persons: Dr. Bernd Thiemann (Chairman; since 13 August 2009), Dagmar Kollmann (Deputy Chairman; since 13 August 2009), Dr. Günther Bräunig (member of the Supervisory Board; since 9 July 2009), Dr. Alexander Groß (member of the Supervisory Board; since 13 August 2009), Dr. Markus Kerber (member of the Supervisory Board; since 5 December 2009), Dr. Albert Peters (member of the Supervisory Board; 13 August 2009 to 4 December 2009) and Dr. Hedda von Wedel (member of the Supervisory Board; since 13 August 2009).

In its meeting of 26 January 2009, the Supervisory Board elected Manuela Better as a member of the Management Board with effect from 1 February 2009. In its meeting of 15 May 2009, the Supervisory Board appointed Alexander Freiherr von Uslar-Gleichen as a member of the Management Board with effect from 1 October 2009. Pursuant to the resolution of the Supervisory Board of 10 November 2009, Dr. Bernhard Scholz was appointed as a member of the Management Board with effect from 1 January 2010.

In the period between 1 January 2009 and 31 December 2009, the Supervisory Board of HRE Holding had an Executive Committee, a Nomination Committee, an Audit Committee, and a Risk Management and Liquidity Strategy Committee.

During this period, the committees consisted of the following persons:

Executive Committee Dr. Bernd Thiemann (Chairman and committee member; since 13 August 2009), Dr. Günter Bräunig (committee member; since 13 August 2009), Dr. Michael Endres (Chairman and committee member; 6 December 2008 to 13 August 2009), J. Christopher Flowers (committee member; 22 September 2008 to 27 March 2009), Dagmar Kollmann (committee member; since 13 August 2009), Hans-Jörg Vetter (committee member; 6 December 2008 to 13 August 2009) and Dr. h.c. Bernhard Walter (committee member; 28 March 2009 to 13 August 2009)

Nomination Committee Dr. Bernd Thiemann (Chairman and committee member; since 13 August 2009), Dr. Günther Bräunig (committee member; since 13 August 2009), Dr. Michael Endres (Chairman and committee member; 6 December 2008 to 13 August 2009), J. Christopher Flowers (committee member; 22 September 2008 to 27 March 2009), Dagmar Kollmann (committee member; since 13 August 2009), Hans-Jörg Vetter (committee member; 6 December 2008 to 13 August 2009) and Dr. h.c. Bernhard Walter (committee member; 28 March 2009 to 13 August 2009)

Audit Committee Dagmar Kollmann (Chairman and committee member; since 13 August 2009), Dr. Günter Bräunig (committee member; since 13 August 2009), Dr. Michael Endres (committee member; 28 March 2009 to 13 August 2009), Dr. h.c. Edgar Meister (committee member; 6 December 2008 to 18 May 2009), Siegmar Mosdorf (committee member; 22 June 2009 to 13 August 2009), Dr. Bernd Thiemann (committee member; since 13 August 2009), Dr. Hedda von Wedel (committee member; since 13 August 2009) and Dr. h.c. Bernhard Walter (Chairman and committee member; 6 December 2008 to 13 August 2009)

Risk Management and Liquidity Committee Dr. Günter Bräunig (Chairman and committee member; since 13 August 2009), Dr. Michael Endres (committee member; 28 March 2009 to 13 August 2009), Bernd Knobloch (Chairman and committee member; 6 December 2008 to 13 August 2009), Dagmar Kollmann (committee member; since 13 August 2009), Richard S. Mully (committee member; 6 December 2008 to 27 March 2009), Dr. Bernd Thiemann (committee member; since 13 August 2009) and Manfred Zaß (committee member; 6 December 2008 to 13 August 2009)

In the year 2009, the Supervisory Board of HRE Holding held 14 meetings and three telephone conferences, and adopted six circular resolutions outside meetings. No member of the Supervisory Board missed more than half of the meetings.

The Executive Committee held seven meetings and adopted one circular resolution. The Nomination Committee did not hold any meetings. The Audit Committee held seven meetings. The Risk Management and Liquidity Strategy Committee held twelve meetings and generally discussed exposures in weekly telephone conferences.

The Rules of Procedure of the Supervisory Board of HRE Holding, the Rules of Procedure for the Audit Committee and the Rules of Procedure for the Risk Management and Liquidity Strategy Committee were changed in the Supervisory Board meeting of 26 January 2009. The Rules of Procedure for the Executive Committee and for the Nomination Committee were last changed on 6 December 2008, and have not been changed since that time.

Supervisory Board

As commenced at the end of 2008, the Supervisory Board continued with its objective of guiding the Company out of the crisis and restoring its future viability. The aim is to create an institute which focuses on Pfandbrief-eligible business in the field of Real Estate and Public Sector Finance for Germany and Europe. With the resolution of the Supervisory Board of 28 March 2009, the service agreement of Dr. Wieandt was adjusted to the requirements of the Finanzmarktstabilisierungsgesetz (Financial Market Stabilisation Act – FMStG) with effect from 1 April 2009. The Supervisory Board also focused particularly on the investigations regarding the possible misconduct of former members of the Management Board.

The Supervisory Board and Management Board have extensively discussed the measures for the liquidity and capital support provided for HRE and the restructuring of the Company. The new business model was the subject of extensive discussions. The Management Board informed the Supervisory Board regularly and promptly with regard to the economic and financial position of the Group, the business policy and planning, the strategy, the capital and liquidity situation/planning and also with regard to other important events. The Chairman of the Management Board was in constant contact with the Chairman of the Supervisory Board with regard to major developments.

The following were the subject of regular discussions: the development in lending business and group-wide lending policy, risk development, risk management, the direction of overall business policy as well as the developments and trends of the markets in lending and refinancing business.

The Supervisory Board also considered the results of internal audits, annual and multi-year planning as well as the steering and control mechanisms in lending, securities and derivatives business. The report on compliance (including Data Protection and Money Laundering Act) and the implementation of “Basel II” were discussed. In addition, the Supervisory Board adopted various resolutions, including the following: on 6 March 2009, the Supervisory Board adopted the corporate governance statement for the financial year 2008, and stated that its members are independent in accordance with point 5.4.2 of the German Corporate Governance Code. The Supervisory Board also stated that the members of the Audit Committee and in particular the Chairman of the Audit Committee possess the special qualifications required by point 5.3.2 of the German Corporate Governance Code.

On 28 March 2009, the Supervisory Board approved the resolution of the Management Board with regard to agreeing to the statement of intent of SoFFin of 28 March 2009. In this statement of intent, SoFFin declared its intention to take stabilisation measures for the benefit of HRE in order to stabilise the financial market, particularly by way of ensuring adequate recapitalisation of HRE Holding and by way of issuing further guarantees. This was conditional on SoFFin or the German Government acquiring complete control over HRE Holding. On 28 March 2009, the Supervisory Board also approved the resolution of the Management Board of 23 March 2009 with regard to increasing the share capital.

On 21 April 2009, the members of the Supervisory Board of HRE Holding adopted a resolution waiving their entitlement for the year 2008 to the compensation for the Supervisory Board set out in the articles of incorporation and the compensation set out in the articles of incorporation for activities in committees of the Supervisory Board; the members of the Supervisory Board waived their entitlement to all compensation for the year 2008, and waived their entitlement to 50 % compensation for the year 2009.

In its meeting of 24 April 2009, the Supervisory Board adopted resolutions regarding the consolidated financial statements and annual financial statements 2008 of HRE Holding. In this meeting, the Supervisory Board also approved the joint comment of the Management Board and the Supervisory Board in accordance with Section 27 WpÜG regarding the takeover offer of the Federal Government (acting through SoFFin) in accordance with Section 29 WpÜG in conjunction with Article 2, Section 12 FMStErgG. The Supervisory Board also approved the agenda for the above-mentioned Annual General Meeting, the invitation to attend the above-mentioned Annual General Meeting and the proposed resolutions of the Administrative Board of the above-mentioned Annual General Meeting on 2 June 2009.

In its meeting of 2 June 2009, the Supervisory Board approved the capital increase which had been adopted on the same day by the above-mentioned Annual General Meeting and the Management Board.

The resolution of the Supervisory Board regarding the agenda, the invitation to attend and the proposed resolutions of the Administrative Board for the Annual General Meeting on 13 August 2009 is dated 22 June 2009.

On 24 and 26 August 2009, the Supervisory Board extensively deliberated the documents and criteria underlying the squeeze-out process, and in particular the transfer report of SoFFin, the appraisal of PricewaterhouseCoopers AG Wirtschaftsprüfungsgesellschaft (PwC) and the audit report of Warth & Klein GmbH Wirtschaftsprüfungsgesellschaft (Warth & Klein). On 26 August 2009, the Supervisory Board adopted the invitation to attend and the agenda of the above-mentioned Annual General Meeting of HRE Holding on 5 October 2009, which envisaged a resolution being adopted with regard to the transfer of the shares of the minority shareholders of HRE Holding to SoFFin, Frankfurt am Main, in return for the granting of an adequate cash settlement.

On 30 November 2009, the Supervisory Board approved the recapitalisation measures agreed with SoFFin, the signing of the agreement with regard to the establishment of a dormant company as well as the countersigning of the declaration of intent of the Federal Government by the Management Board. This declaration of intent comprised the adequate recapitalisation of the companies of HRE and also the assurance of the liquidity of HRE.

On 14 December 2009, the Supervisory Board took its fundamental decision regarding the establishment of a deconsolidated environment, and approved the corresponding application of the Management Board. The precise attendance at meetings is shown in the following tables:

Supervisory Board of HRE Holding

Name, place of business and function	Supervisory Board: Function	Supervisory Board: Meeting attendance[1]	Executive Committee: Function	Executive Committee: Meeting attendance[1]	Audit Committee: Function	Audit Committee: Meeting attendance[1]	Risk Management and Liquidity Strategy Committee: Function	Risk Management and Liquidity Strategy Committee: Meeting attendance[1]
Dr. Bernd Thiemann Kronberg Self-employed management consultant	Chairman (from 13.8.2009)	**7 of 7**	Chairman (from 13.8.2009)	**2 of 2**	Member (from 13.8.2009)	**2 of 2**	Member (from 13.8.2009)	**4 of 4**
Dagmar P. Kollmann Bad Homburg Chairperson of the Partners Committee of Kollmann GmbH	Deputy Chairman (from 13.8.2009)	**7 of 7**	Member (from 13.8.2009)	**2 of 2**	Chairperson (from 13.8.2009)	**2 of 2**	Member (from 13.8.2009)	**4 of 4**
Dr. Günther Bräunig Frankfurt Member of the Management Board of KfW	Member (from 9.7.2009)	**8 of 8**	Member (from 13.8.2009)	**2 of 2**	Member (from 13.8.2009)	**2 of 2**	Chairman (from 13.8.2009)	**4 of 4**
Dr. Alexander Groß Teltow Head of the Economic Policy department in the Federal Ministry for Industry and Technology	Member (from 13.8.2009)	**7 of 7**						
Dr. Markus Kerber Berlin Head of the department responsible for Fundamental Issues of Financial Policy and Economics in the Federal Ministry of Finance	Member (from 5.12.2009)	**1 of 1**						
Dr. Hedda von Wedel Andernach President of the Bundesrechnungshof, retired	Member (from 13.8.2009)	**7 of 7**			Member (from 13.8.2009)	**2 of 2**		
Dr. Michael Endres Koenigstein Chairman of the Management Board of the charitable Hertie Foundation, Frankfurt/Main	Chairman (until 13.8.2009)	**10 of 10**	Chairman (until 13.8.2009)	**5 of 5**	Member (28.3.–13.8.2009)	**2 of 3**	Member (28.3.–13.8.2009)	**4 of 4**
Dr. h.c. Bernhard Walter Bad Homburg Member of the Supervisory Board and Chairman of the Audit Committee of Daimler AG, Stuttgart	Deputy Chairman (until 13.8.2009)	**10 of 10**	Member (28.3.–13.8.2009)	**3 of 3**	Chairman (until 13.8.2009)	**5 of 5**		
Dr. Renate Krümmer Hamburg Managing Director of J.C. Flowers & Co GmbH, Hamburg	Deputy Chairperson (until 31.3.2009)	**2 of 3**						
J. Christopher Flowers New York Chairman and Chief Executive Officer of J.C. Flowers & Co. LLC, New York/USA	Member (until 27.3.2009)	**1 of 2**	Member (until 27.3.2009)	**0 of 2**				

[1] As a result of the changes to the composition of the Supervisory Board, not all members have attended all meetings; the figures relate to the attendances of a committee member in relation to the number of meetings held during his period of officek

Supervisory Board of HRE Holding

Name, place of business and function	Supervisory Board: Function	Supervisory Board: Meeting attendance[1]	Executive Committee: Function	Executive Committee: Meeting attendance[1]	Audit Committee: Function	Audit Committee: Meeting attendance[1]	Risk Management and Liquidity Strategy Committee: Function	Risk Management and Liquidity Strategy Committee: Meeting attendance[1]
Bernd Knobloch Frankfurt Member of the Management Board of the charitable Hertie Foundation, Frankfurt/Main	Member (until 13.8.2009)	**10 of 10**					Chairman (until 13.8.2009)	**8 of 8**
Dr. h.c. Edgar Meister Kronberg Member of the Supervisory Board of Commerzbank AG, Frankfurt/Main	Member (until 18.5.2009)	**5 of 6**			Member (until 18.5.2009)	**4 of 4**		
Siegmar Mosdorf Potsdam Partner of CNC AG, Berlin	Member (until 13.8.2009)	**9 of 10**			Member (22.6.–13.8.2009)	**1 of 1**		
Richard S. Mully Dublin Managing Partner Grove International Partners (UK) LLP, London/Great Britain	Member (until 27.3.2009)	**2 of 2**					Member (until 27.3.2009)	**3 of 4**
Dr. Albert Peters Berlin Head of the Tax department in the Federal Ministry of Finance	Member (13.8.–4.12.2009)	**6 of 6**						
Hans-Jörg Vetter Koenigstein Member of the Management Board of Landesbank Baden-Württemberg, Stuttgart	Member (until 13.8.2009)	**9 of 10**	Member (until 13.8.2009)	**5 of 5**				
Manfred Zaß Koenigstein Chairman of the Supervisory Board of Deutsche Euroshop AG, Hamburg	Member (until 13.8.2009)	**10 of 10**					Member (until 13.8.2009)	**4 of 4**

[1] As a result of the changes to the composition of the Supervisory Board, not all members have attended all meetings; the figures relate to the attendances of a committee member in relation to the number of meetings held during his period of office

Executive Committee

Throughout the entire reporting period, the Executive Committee extensively considered the ongoing investigations with regard to former members of the Management Board. On 17 February 2009, the Executive Committee approved the mandates held on external Supervisory Boards by the members of the Management Board which existed on that date on condition that no further mandates were taken on. On several occasions, the Executive Committee assessed candidates for being appointed to the Management Board, and submitted appropriate proposals to the Supervisory Board. In several meetings, the Executive Committee deliberated the contracts of the existing members of the Management Board and of the new members to be appointed to the Management Board, and in particular discussed their compensation. With the resolution of the Executive Committee of 14 May 2009, the service agreements of Dr. Franzmeyer and Mr. Krings were adjusted and brought into line with the requirements of the FMStG with effect from 1 April 2009. On 14 May 2009, the Executive Committee considered the organisation structure of HRE and a draft of the “framework agreement for granting stabilisation measures” between SoFFin and HRE.

Audit Committee

On 7 January 2009, the Audit Committee considered the fundamental aspects of the work of the Audit Committee, also in relation to the Risk Management and Liquidity Strategy Committee. The Audit Committee has primary responsibility for monitoring the effectiveness of risk management, and performs numerous other duties.

On several occasions, the Audit Committee discussed the extent of the scope of consolidation for the balance sheet and the scope of consolidation with regard to risk. In the course of several meetings, the Audit Committee discussed reports of internal audit and reports regarding compliance. It deliberated the effects of the Accounting Law Modernisation Act (Bilanzrechtsmodernisierungsgesetz – BilMoG).

On 26 March 2009, the Audit Committee discussed the provisional results for the period ending 31 December 2008, and also discussed the provisional audit results of the auditor of the financial statements KPMG AG Wirtschaftsprüfungsgesellschaft (KPMG). It also discussed the report of Deloitte & Touche GmbH Wirtschaftsprüfungsgesellschaft regarding the audit of the going concern assumption as well as the extrapolation of the business plan.

On 23 April 2009, the Audit Committee considered the consolidated financial statements and the annual financial statements of HRE Holding for the period ending 31 December 2008. KPMG reported on the results of the audit. The Audit Committee decided to recommend to the Supervisory Board that the consolidated financial statements be approved and that the annual financial statements be adopted. The Audit Committee also noted the information of the Management Board regarding the financial statements 2008 of Hypo Real Estate Bank AG, the present-day Deutsche Pfandbriefbank AG.

On 4 May 2009, in the presence of KPMG, the Audit Committee mainly discussed the interim report of HRE as of 31 March 2009.

In its meeting of 6 August 2009, following the report submitted by KPMG, the Audit Committee did not raise any objections to the result of the audit review of the consolidated interim statements of HRE Holding as of 30 June 2009. The committee recommended that these statements be approved. The fees of the auditor for 2008 and the fee proposal for 2009 were discussed and adopted.

The Audit Committee of the new Supervisory Board elected at the Annual General Meeting of 13 August 2009 met for the first time on 10 November 2009. In addition to discussing the current situation, the committee considered the consolidated interim statements of HRE Holding for the period ending 30 September 2009 and noted the report of KPMG regarding the audit review of these financial statements. The committee did not raise any objections. It also discussed the confirmation of the going concern assumption. The committee also considered the procedure for monitoring the effectiveness of the internal control system, the risk management system and internal audit. Statutory changes resulting from BilMoG (Accounting Law Modernisation Act) were also discussed.

In the meeting of 14 December 2009, the Audit Committee discussed various aspects, including accounting-related effects of a possible deconsolidated environment. It discussed accounting and valuation fields with regard to the annual financial statements and consolidated financial statements of HRE 2009. With KPMG, the audit was extended for 2009 et seq. to include the aspect of auditing the effectiveness of the internal control systems.

Risk Management and Liquidity Strategy Committee

The Risk Management and Liquidity Strategy Committee (RLA) pools the control responsibility of the Supervisory Board for risk and liquidity management of the Company and of the Group, monitors the risk reporting of the Management Board, and is involved in the credit approval process to the extent defined in the rules of procedure. In its meeting on 8 January 2009, the Risk Management and Liquidity Strategy Committee focused primarily on the organisation of risk management and the allocation of powers, and obtained an overview of the credit portfolio in the Commercial Real Estate and Public Sector fields and also obtained an overview of the capital markets portfolio. The Risk Management and Liquidity Strategy Committee also arranged to be informed of the market risk. In its meeting on 26 January 2009, the risk situation of DEPFA Bank plc and the market risks and strategy for liquidity risk management were discussed. The meeting on 5 March 2009 focused on the further development of the allocation of powers as well as the risk report of the Management Board, the treatment of the main Group exposures, the further development of risk organisation as well as the current development of the liquidity of the Group. In the meeting on 26 March 2009, individual loans and the creation of risk provisioning in particular were discussed. On 24 April 2009, the Risk Management and Liquidity Strategy Committee arranged for the current risk report to be explained by the Management Board. In addition, the Risk Management and Liquidity Strategy Committee considered various special issues, such as the presentation of the strategy for the so-called value business and Public Sector Finance. The Risk Management and Liquidity Strategy Committee also arranged to be provided with a report concerning risk transparency in the field of Treasury and Public Sector Finance and also with regard to the liquidity situation. In the following meetings, the Risk Management and Liquidity Strategy Committee arranged to be notified of the development in the main risk types during regular risk reporting, and also arranged to be notified regularly of the liquidity situation and the status of processing audit findings. In addition, in the meeting on 5 May 2009, the development of the non-performing loans as well as the discussion of various portfolios and structures were the main items considered in this meeting. The meeting on 22 June 2009 focused on individual exposures and particularly the US portfolio and the so-called monoliner portfolio of the Group. On 12 August, the Risk Management and Liquidity Strategy Committee discussed the concept for further developing risk reporting, and was informed of the development of risk provisioning. The meeting on 6 October 2009 considered a report regarding asset/liability management – in addition to the standard issues of the risk report and liquidity situation. In a further meeting on 10 November 2009, the Risk Management and Liquidity Strategy Committee discussed key aspects of the risk report of the third quarter 2009 and of the development in the main risk types and also considered the organisation, business processes and development of the workout segment. In addition, the Risk Management and Liquidity Strategy Committee arranged to be notified of various individual transactions and portfolios, the funding plan and the liquidity situation. On 14 December 2009, reporting and discussions in the Risk Management and Liquidity Strategy Committee focused on the risk strategy – in addition to risk reporting and the liquidity situation of the Group. The development of real estate owned by the Company was also discussed together with the preliminary results of an Audit by the Bundesbank according to section 44 KWG. In the meeting of 15 December 2009, the Risk Management and Liquidity Strategy Committee considered the impairment strategy of the Group.

In addition, the Risk Management and Liquidity Strategy Committee considered more than 200 exposures in more than 40 meetings and telephone conferences. If these have to be submitted in accordance with the rules of procedure of the RLA, they are regular resubmissions, approvals relating to change applications as well as new business.

The Supervisory Board would like to thank the Management Board and all employees of HRE for their activities in the year under review.

Financial Review

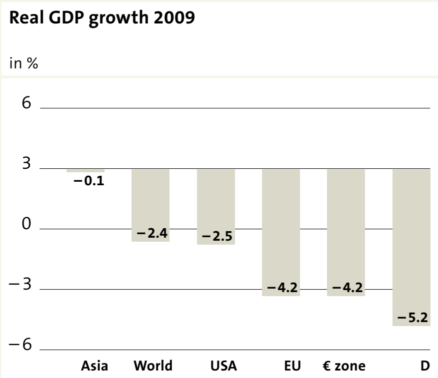
Macro-economic Conditions

The year 2009 was characterised by the continuing financial crisis. Following the insolvency of Lehman Brothers in mid-September 2008, the entire global economy was hit by a huge economic downturn in the following latter half 2008/2009. Although this downturn affected virtually all economies, not all economies were equally affected. For instance, Poland was the only country in the European Union to report slight growth in 2009. Within the OECD member states, only Australia and South Korea succeeded in reporting such an achievement. The financial and economic crisis particularly affected countries which were reliant on international capital to a significant degree. On the other hand, countries such as China and India reported only moderate declines in growth, namely to 8.2 % and 5.5 % respectively.

The declines in the real economy exceeded the expectations of all experts. Politicians responded to the severe economic problems with extensive packages of measures. In addition to traditional instruments of monetary and fiscal policy, the main measures which were taken focused on providing support to the banking sector. The provision of loans, guarantees and capital as well as new laws prevented further system-relevant banks from becoming insolvent.

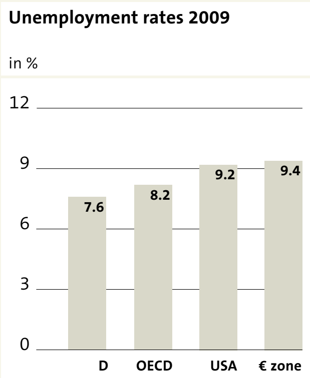
Monetary policy was initially manifested in the fact that Central Bank rates fell to all-time lows. In the USA, the federal funds target rate was fixed at 0.25 % in December 2008, and the European Central Bank has maintained the rate for the primary refinancing facility at 1 % since mid-May 2009. Numerous further measures which contributed to so-called quantitative easing were also taken. The most important measure of the European Central Bank in this respect was the unlimited provision of Central Bank funds by means of the primary refinancing facility with a term of one year (all limited only by the availability of collateral). The previously usual term was seven days.

Fiscal policy was also considerably expanded in virtually all countries. In the Eurozone, the average budget deficit was 6.4 %. Together with the economic downturn, national debt increased on average by more than 10.0 % within one year. This was applicable for instance for Spain, Ireland and Greece, whose budget deficits in 2009 ran into double digits, namely 11.2 %, 12.5 % and 12.7 % of gross domestic product (GDP) respectively. This means that these countries have far exceeded the limit of 3 % fixed in the treaty of Maastricht. In consequence, this is the first time in the history of the currency union that rate spreads have widened considerably for bonds issued by the different states in the Eurozone. Experts consider that this reflects considerable scepticism of investors, who are now again taking a more differentiated view of country risks in the Eurozone. There is also a corresponding difference between the various ratings.



Source: EIU, obtained from Datastream on 15.12.2009

Source: EIU, obtained from Datastream on 15.12.2009



Source: OECD, Economic Outlook No. 86, 11/2009

The economic downturn associated with the financial crisis ensured that inflation did not occur, despite the measures which were taken. Indeed, the rate of inflation throughout the world declined. In addition, the price of oil also fell appreciably in the year under review compared with the highs seen in mid-2008; on the other hand, these factors also did not result in deflation.

Higher unemployment is a further effect of the economic crisis triggered off by the financial crisis. The development in this respect has by no means been uniform. Accordingly, the unemployment rate in the USA virtually doubled between 2008 and 2009, whereas the number of persons unemployed in Germany declined slightly in the same period. One of the reasons for this situation was the use of short-time working.

Sector-specific Conditions

Overall situation of the banking sector

The year 2009 proved to be very mixed for the banking sector. The expansion of the financial crisis started in the autumn of 2008 and the related liquidity shortages meant that banks throughout the world required capital support in the form of loans, guarantees or state aid in order to avoid liquidity and capital shortages. Nevertheless, 140 banks in the USA had to be closed in 2009. According to calculations by the Bank of England, state support for the financial system accounted for 73 % of the gross domestic product in the USA, 74 % of GDP in Great Britain and 18 % of GDP in the Eurozone.

However, towards the end of 2009, some US and British banks were able to repay some or all of this state aid, mostly on the basis of higher profits generated with investment banking operations. On the other hand, traditional commercial or credit banks without major activities in the field of investment banking reported much worse results, due to the considerable risk provisioning requirement.

At the beginning of the crisis, considerable volumes of loans which fell due were prolonged in order to avoid immediate defaults. However, the decline in the value of collateral means that this option is virtually no longer available. The difficult macro-economic situation and also the problematical capital situation and the more stringent risk valuation requirements have also had a considerably negative impact on new business in lending.

In order to restore confidence in the banks and also in lending, governments throughout the world have developed a wide range of models. In the summer of 2009, politicians in Germany issued laws which permit the founding of so-called deconsolidated environments. This enables banks to transfer high-risk securities and loans from their balance sheets and thus to avoid any further deterioration in their equity ratios. On the other hand, in Great Britain, loans are subject to the state asset backing system. The US government has now provided collateral for securitised real estate loans and has eased the rules applicable in the event of late payment.

Real estate finance

Sources: DTZ Zadelhoff, Jones Lang Lasalle, Atis Real

The markets for commercial real estate were also affected to an increasing extent by the crisis, and some of these markets suffered huge losses in the year under review. Compared with the highs in July 2007, the markets in the USA, Great Britain, Spain and Ireland have reported declines of up to 50 % in property values.

The difficult economic situation has resulted in continuously rising vacancy rates and declining rents. Office rents in prime locations of Madrid or Paris have fallen by up to 20 % compared with the end of 2008. In London and New York, these declines have been up to 18 % and 45 % respectively. Germany has been hit relatively lightly, with an average decline of 6 %. The vacancy rate for the whole of Europe is around 11%; the corresponding figures for Germany and the USA are 10 % and 16 % respectively. This development represents a challenge particularly for highly geared investments as falling rents and rising vacancy rates would result in a lower earning rate, and such financing arrangements would accordingly be affected by shortfalls in terms of cover.

Initially, some banks prolonged loans which became due in the hope that the property values and LTVs would recover and reach a refinanceable level. It is true that the banks were able to force through higher margins and charges; however, many investors did not have a solution for unrealised losses – particularly for properties in subprime locations. The deteriorated credit portfolio quality at many institutions also meant that loans which were due to be prolonged were no longer extended as a result of lower property values, or they were prematurely called into question because it was no longer possible for the original covenants to be met. This resulted in further defaults. According to Pricewaterhouse Coopers, 38 % of all insolvency applications in Spain were submitted by companies from the construction and real estate sector, and the corresponding figure for Great Britain was 24 %. The real estate sector overall was thus the sector which was affected by most insolvencies.

The worldwide investment volume in the year under review was also considerably lower than the corresponding previous year figures, and amounted to € 70.0 billion. Whereas the first quarter was very weak at € 0.9 billion, investments rose again as the year progressed. The fourth quarter of 2009 reported a volume of € 25.7 billion; this was the highest figure in terms of turnover since the peak of the financial crisis in September 2008. Whereas investors were relatively cautious in the first half of the year and focused primarily on their domestic markets, they became more confident in the second half of the year and started to invest again across borders. The strongest growth was reported by the markets in Central and Eastern Europe, although these have traditionally been classed as more risky compared with the Western European markets.

Public sector finance

The financial crisis has also affected the borrowing activities of public sector authorities. Countries such as Italy and France, for instance, had to take action in order to provide financial support to regional authorities. However, a considerable percentage of the liquidity available on the markets is now again being channelled into the financing of states and public sector authorities.

In our core markets of France, Germany, Italy and Spain, the availability of liquidity for financing states and regional authorities has been supported by at least one of the following factors:
- Risk-averse tendering of regional and commercial banks, which therefore increase lending to the public sector instead of to the private economy
- Rising volume of customer deposits at major commercial banks, which is reinvested in secure lending business
- Easing of the lending guidelines applicable for bonds and loans at the ECB in order to permit more favourable refinancing
- Support of the European market for covered bonds, such as the German Pfandbrief, provided by the ECB with the intention of acquiring bonds with a value of up to € 60 billion (by 8 December 2009 the ECB had acquired bonds with a value of € 28.3 billion)

Although some market players withdrew from public sector financing in the course of the reporting year, some regional banks successfully developed their domestic markets and thus ensured more intense competition particularly in the second half of the year. When demand declined for financing for central, regional and local authorities as a result of temporary measures (e.g. accelerated VAT repayment in France), pressure increased on margins.

Accordingly, the regional and local authorities in the core areas regained access to financing with comparatively lower risk premiums. One major difference between the markets is to be seen in the terms. Whereas terms of up to ten years are offered in Spain, the term for state borrowers in France and Germany is 20 to 30 years.

Although access to funding has become easier for states and central, regional and local authorities, the rating agencies have downgraded some EU countries. Portugal, for instance, was downgraded to A+ (S & P, as of January 2010), the rating of Great Britain and Spain was left unchanged at AAA, but with a negative forecast in each case, and Greece was recently downgraded to BBB+ (S & P, as of December 2009). This development is also reflected in selected credit default swaps (CDS) and the risk premiums applicable for 10-year government bonds.

Infrastructure finance

As was the case with other credit markets, the market for infrastructure finance in 2009 was affected by the shortage of refinancing funds and rising defaults. Particularly for private acquisition financing and asset-based financing for instance of ships or aircraft, the cash flows which are very important for servicing the loan obligations have fallen appreciably as a result of the weak economy, and the risks are accordingly high. This is also applicable for private transport infrastructure financing, such as airports, ports and toll roads. Infrastructure finance for public sector projects such as water works or electricity power stations are viewed less critically, because most of these projects are closely linked to the public sector and thus have constant and predictable cash flows. Because the reliance on overall economic activity is low, the situation is least difficult for exposures with public sector involvement, and in particular public private partnerships for improving the social infrastructure such as education, health and transport. There is credit demand as well as credit supply on this market, mostly from domestic banks.

Refinancing markets

The refinancing markets have continuously stabilised in the course of 2009. Increasing numbers of successful capital market issues were seen in the second half of the year. The market for covered bonds has developed a positive performance. In addition to the so-called benchmark covered bond transactions with a volume of more than € 1 billion, comparatively high volumes of private placings were also seen. The covered bond purchasing programme of the ECB also contributed to the stabilisation. Other markets have to a certain extent followed the positive development in spreads on the market for covered bonds. For instance, the markets for uncovered bank issues have also stabilised further. However, the level of risk premiums is generally still higher than was the case before the financial crisis. The money market has not yet completely recovered. The turnover volumes outside the open market transactions of the ECB are much lower than was the case before the financial market crisis.

Major legal conditions

The law concerning the continuation of financial market stabilisation issued by the German Federal Government in July 2009 enables credit institutions to transfer risk assets and non-strategic areas of operation into a deconsolidated environment. The so-called deconsolidated environment model enables problem assets to be removed from the balance sheets of banks.

The new version of the “Minimum Requirements for the Risk Management of Credit and Financial Services Institutions” (MaRisk) is also significant for the sector. The regulatory requirements applicable for stress testing, liquidity risk as well as risk concentration are particularly relevant in this respect. MaRisk now also imposes more stringent requirements in relation to group-wide risk management. They explicitly require a strategy to be developed for the entire Group, i.e. risk-bearing capacity must be guaranteed for the entire Group.

The law concerning the modernisation of accounting law (BilMoG) which came into force in May 2009 contains the accounting rules for the annual financial statements and consolidated financial statements under commercial law as well as numerous regulations concerning corporate governance. Most of the accounting regulations are the subject of mandatory adoption in the year 2010; all corporate governance regulations are applicable for the year 2009.

Company-specific Conditions

Strategy

Organisational and legal structure of the Group In the year under review, the Group structure of HRE consisted in particular of the HRE Holding parent and the operating bank subsidiaries Hypo Real Estate Bank AG and DEPFA Deutsche Pfandbriefbank AG, as well as DEPFA Bank plc. DEPFA Deutsche Pfandbriefbank AG was merged with Hypo Real Estate Bank AG on 29 June 2009, and was renamed Deutsche Pfandbriefbank AG. Since 19 May 2009, HRE Holding has also been the ultimate parent of the HRE Group for regulatory purposes (Section 16a [3] Sentence 3 KWG). Within the current structure, the areas of responsibility are broken down into three operating segments which are largely independent of the legal breakdown into subsidiaries.

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

The segment structure is being revised as part of the strategic refocusing process. HRE will change over its reporting to three operating segments in the financial year 2010: sktrategic business in commercial real estate financing (previously Commercial Real Estate) will in future be pooled in the Real Estate Finance segment, and strategic public sector financing (previously Public Sector & Infrastructure Finance) will be pooled in the Public Sector Finance segment. Non-strategic business will be included in the "Value Portfolio" segment and is to be reduced in a value-preserving manner. A "Consolidation & Others" line will also be introduced; in addition to accounting consolidation items, this will comprise individual items which cannot be allocated to the strategic segments or the Value Portfolio.

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

Real Estate Finance new business strategy Real Estate Finance focuses on real estate financing with a conservative refinancing strategy for professional investors. It focuses on financing existing properties. Development Finance is operated only on a selective and non-speculative basis. The regional focus is on markets eligible for Pfandbrief refinancing, and in particular Germany, England and France as well as other selected European regions in which Deutsche Pfandbriefbank AG had already been operating in the past. LTVs of up to 80 % are taken on. The target size for financing arrangements is around € 70 million and very selectively up to € 100 million; a minimum size of € 10 million is applicable for German SMI clients and € 20 million for professional real estate financing customers in the rest of Europe. Strategic partnerships will be concluded with other institutions with the aim of permitting higher LTVs by means of syndications and syndicate financing for customers without increasing the risk for the bank.

Public Sector Finance new business strategy New business is to focus on the primary markets, i.e. direct financing for public sector entities and with a conservative refinancing strategy. The aim is to concentrate on markets eligible for Pfandbrief refinancing with excellent country ratings. For the financial year 2009, the focus was on Germany, France, Italy and Spain. The target group for this business consists of profitable customer segments with a commensurate risk level: regions, municipalities and local authorities as well as state-guaranteed public bodies and guaranteed public private partnerships. Direct business with sovereign states is conducted only to a limited extent, because most of these use direct access to the capital markets and such arrangements permit only minor cross-selling opportunities with low or even negative margins. The aim is to provide mainly simple and customised financing solutions which are essentially classified under the category of loans and receivables with maturities of up to 12 years. A further aim is to significantly improve profitability in the Public Sector Finance segment by way of actively offering customer derivatives for risk reduction purposes but not for speculative purposes.

Strategy for reducing credit and security portfolios in a value-preserving manner Following liaison with SoFFin, HRE Holding has submitted an application to the Financial Market Stabilisation Fund (FMSA) to establish a deconsolidated environment for reducing assets in a value-preserving manner. HRE intends to transfer operations which are no longer strategically necessary for the refocusing of the Company as well as further items on the balance sheet to this deconsolidated environment. The transfer is expected to take place in the second half of 2010 after approval is obtained from all necessary institutions and bodies, and is expected to comprise assets of up to € 210 billion. Loans which are no longer consistent with the strategic focus of the core bank can thus be continued in a value-preserving manner, also in the interests of the customers. In addition, this transfer is also expected to reduce the further capital requirements of Deutsche Pfandbriefbank AG and ensure that this Company can be structured in such a way that it can be reprivatised more quickly. The FMSA is responsible for determining whether, and if so to what extent, the application for establishing the deconsolidated environment will be approved.

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

At the same time, strict cost discipline is necessary for ensuring the continued existence of the Company as a going concern. This is monitored on the basis of absolute costs and also on the basis of the cost-income ratio. The cost-income ratio is the ratio between general administrative expenses and the operating revenues, consisting of net interest income and similar income, net commission income, net trading income, net income from financial investments, net income from hedge relationships and the balance of other operating income/expenses. The aim is to improve the cost-income ratio primarily by reducing general administrative expenses following the restructuring; a secondary aim is to improve the cost-income ratio by increasing new business. In addition, HRE aims to further reduce its balance sheet total by reducing non-strategic portfolios in a value-preserving manner.

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

Major events

Measures designed to assure liquidity In the financial year 2009, HRE continued to utilise liquidity aid provided by a syndicate from the financial industry and SoFFin. The liquidity support amounted to a total of € 95.0 billion as of 31 December 2009. The development is set out in the following table.

On 4 November 2009, SoFFin initially extended the entire guaranteed line of € 52 billion for HRE until 30 June 2010. This extension was necessary because the guarantees expired as of 18 November 2009. Deutsche Pfandbriefbank AG, which belongs to the HRE Group, can continue to utilise the SoFFin guaranteed line in order to back bonds which are to be issued. The conditions are unchanged: accordingly, Deutsche Pfandbriefbank AG paid to SoFFin a prorata commitment commission of 0.1 % calculated in relation to that part of the guaranteed line which was not drawn down. A commission of 0.5 % p.a. is charged for utilisation of the guaranteed line.

SoFFin, HRE and a syndicate from the German financial industry agreed a new structure for the liquidity facility which has been in place since November 2008 for HRE with an original volume of € 50 billion. Principal repayments of € 7 billion meant that the new liquidity facility declined to € 43 billion in the course of 2009. Of this figure, the syndicate from the German finance and insurance industry provided around € 23 billion. The new facility was paid out on 23 December 2009 respectively on 30 December 2009. Deutsche Pfandbriefbank AG issued € 20 billion of securities which, as had previously been the case, were partially refinanced via central banks and also partially via the market. The facility was fully backed by means of SoFFin guarantees dated until 22 December 2010. The Federal guarantees for € 35 billion have been redeemed. The security portfolio for an original figure of € 60 billion will be largely released by 31 March 2010. The Federal guarantee as well as the security portfolio acted as collateral for the original facility of € 50 billion. The pledged shares in Deutsche Pfandbriefbank AG and DEPFA Bank plc as well as the pledged shares in subsidiaries of DEPFA Bank plc have not been released. This restructuring has resulted in lower costs for HRE for the provision of liquidity. Interest is charged on the securities taken up by the syndicate at a rate of EURIBOR + 0.10 % p.a. The SoFFin guarantees cost a commitment commission of 0.10 basis points p.a. or 0.50 % p.a. if utilised.

Liquidity support measures for HRE

Type of support	Date of granting	Date of maturity, taking account of prolongations	Original nominal amount in € billion	Nominal amount as of 31.12.2009
Issue of state-guaranteed, ECB-eligible bearer bonds (= repayment of the liquidity credit line of Deutsche Bundesbank of 13.11.2008 to 26.3.2009)	26.3.2009	30.12.2009	20.0	—
Issue of state-guaranteed ECB-eligible bearer bonds	13.11.2008	23.12.2009	15.0	—
Issue of covered bonds	13.11.2008	23.12.2009	15.0	—
Issue of SoFFin-guaranteed bearer bonds (repayment of a guaranteed line provided by the SoFFin first time at 19.4.2009)	18.11.2009	30.06.2010	52.0	52.0
Issue of SoFFin-guaranteed bearer bonds (repayment of the state-guaranteed and covered bonds from 26.03.2009 to 23.12.2009)	23.12.2009	22.12.2010[1]	23.0	23.0
Issue of SoFFin-guaranteed ECB-eligible bearer bonds (repayment of the state-guaranteed ECB-eligible bearer bonds of 26.03.2009 to 30.12.2009)	30.12.2009	22.12.2010	20.0	20.0
Total liquidity support				**95.0**

[1] Pursuant to Section 5 (1) of the terms of the bond, partial repayments of € 1.5 billion in each case are to be made as of 23.3./23.6./23.9.2010.

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

The most recent capital increase by SoFFin was carried out at the level of HRE Holding and Deutsche Pfandbriefbank AG: SoFFin has paid € 700 million into the reserve of HRE Holding. At Deutsche Pfandbriefbank AG, a figure of € 1.3 billion was paid into the reserves; € 1 billion was provided in the form of a silent contribution. In addition, in a written statement of intent provided to HRE, SoFFin again confirmed on 6 November 2009 that it will provide adequate capital to ensure at least the continued existence of HRE Holding and its main subsidiaries as going concerns as well as the necessary viable business model, particularly that of Deutsche Pfandbriefbank AG. The support which HRE overall receives from central government depends on the result of a final review as to whether a deconsolidated environment will be established for non-strategic or non-performing assets of HRE. These as well as all further measures are conditional on meeting the aid law requirements of the EU Commission.

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

Extraordinary General Meeting in June 2009 On 2 June 2009, the first Extraordinary General Meeting of HRE Holding was held in Munich with around 2,000 shareholders. The only item on the agenda was the "Adoption of a resolution concerning an increase in the share capital in accordance with Sections 182 et seq. AktG in conjunction with Section 7 FMStBG in return for cash contributions, excluding shareholders' subscription rights". Shareholder attendance amounted to 74.06 % of the share capital at the point at which the vote was held in relation to this sole item on the agenda. The shareholders agreed to accept the capital increase proposed by the Management Board and Supervisory Board with a large majority (73.95 %). Only SoFFin was permitted to take up the new shares out of the capital increase. The statutory subscription right of shareholders was excluded. SoFFin had exercised its subscription rights and taken up around 986.5 million shares for an issue amount of € 3.00. The Amtsgericht (local court) Munich, in its capacity as the relevant register court, entered the capital increase on 8 June 2009. The Company's share capital is now € 3,652,885,800, and consists of 1,217,628,600 no-par value shares. SoFFin accordingly held 90 % of the shares of HRE Holding. The Company received proceeds of around € 2.96 billion out of this capital increase.

Annual General Meeting in August 2009 On 13 August 2009, the Annual General Meeting of HRE Holding was held in Munich; it was attended by around 1,750 shareholders. The Annual General Meeting elected a new Supervisory Board as scheduled. The Annual General Meeting also approved a special audit under the Aktiengesetz (German Stock Corporation Act) which was proposed by the Supervisory Board. The subject of the audit is the transactions in connection with the acquisition of the Irish DEPFA Bank plc and liquidity management of HRE. Two further submissions for a special audit relating to the acquisition of shares in the Irish DEPFA Bank plc, possible balance sheet manipulation and misrepresentation of the net assets, financial position and results of operations of HRE, were also accepted. The Annual General Meeting decided that all special audits are to be performed by a single auditor. A further shareholder submission for a special audit concerning the issue amount of new shares on the occasion of the capital increases carried out in March and in June 2009 and also the exclusion of shareholders' subscription rights was rejected by the Annual General Meeting. The Annual General Meeting postponed ratification of the actions in the financial year 2008 of the members of the Management Board who had stepped down and the members of the Supervisory Board who had stepped down before the Annual General Meeting (with the exception of Dr. Edgar Meister, who had stepped down from the Supervisory Board in May 2009). The actions of the members of the Management Board who were in office at the time of the Annual General Meeting (and also including Dr. Edgar Meister) and who were already in office in 2008 were ratified for the financial year 2008 with a great majority. The attendance at the time of the voting amounted to around 95 % of the share capital.

Extraordinary General Meeting in October 2009 The second Extraordinary General Meeting of HRE Holding on 5 October 2009 in Munich was attended by around 1,450 shareholders. The Extraordinary General Meeting of HRE Holding adopted a resolution regarding the squeeze-out of the minority shareholders with a majority of around 95 % of the votes present. At the time of the vote, attendance was around 95 % of the share capital. The squeeze-out of the minority shareholders was carried out at the request of SoFFin which, in its capacity as the majority shareholder, held around 90% of HRE Holding shares at the time of the Extraordinary General Meeting. The shareholders received a cash settlement of € 1.30 per share. The share transfer was completed with the entry of the transfer resolution in the commercial register on 13 October 2009, and SoFFin accordingly became the complete owner of HRE Holding.

Location closures or consolidations The process of reducing and consolidating the locations is making good progress. Since January 2009, 22 locations throughout the world have been closed; these are expected to be followed by a further two closures by the end of the year 2010. In addition, at locations with several office buildings (Dublin, London, Madrid, Paris and New York) the offices have been pooled.

The process of relocating the previous Munich locations to the location in Unterschleißheim was completed in the second half of August 2009. Most of the employees who previously had been working at five locations distributed throughout Munich are now working at the new location. Only the IT subsidiary pbb Services GmbH as well as a temporary IT project have retained their two locations in Munich. The Unterschleissheim location provides offices for around 650 employees. The legal registered offices of the Company will continue to be Munich after the relocation process has been completed.

New brand pbb Deutsche Pfandbriefbank Since 2 October 2009, Deutsche Pfandbriefbank AG has been operating under the new brand "pbb Deutsche Pfandbriefbank" as well as with a new logo and new corporate design on the market. The new brand was used for the first time at the international real estate exhibition Expo Real between 5 and 7 October 2009 in Munich. With this new brand, the external presentation of the Bank has also completed the merger between DEPFA Deutsche Pfandbriefbank AG and Hypo Real Estate Bank AG to form Deutsche Pfandbriefbank AG.

Deutsche Pfandbriefbank AG has transferred operation and management of its IT infrastructure With effect from 1 November 2009, Deutsche Pfandbriefbank AG and its affiliated Group companies outsourced operation of its entire worldwide IT infrastructure to Fujitsu Services GmbH. This measure covers the operation of the data centres, the servers, the networks and other services.

Sales of security and receivables portfolios In September 2009, HRE successfully completed an auction for receivables of the Group resulting from the insolvency process of Lehman Brothers. During the auction, the Group sold virtually all of its receivables due from Lehman Brothers Holding and affiliated companies with a volume of around € 232.5 million. The Group realised a book profit as a result of the sale. In addition, in the year 2009, HRE also sold CDOs and MBS (mortgage backed securities) with a nominal value of € 1.3 billion as well as a portfolio of American student loans (with a nominal value of € 5.0 billion).

Capital market issues Deutsche Pfandbriefbank AG successfully issued a Jumbo mortgage Pfandbrief with a volume of € 1.5 billion on 8 September 2009, and also issued a public Jumbo Pfandbrief with a volume of € 1 billion on 14 October 2009. These were the first public issues of the institution for more than one year. Both issues were very positively received on the market and were oversubscribed. For the Jumbo mortgage Pfandbrief, Deutsche Pfandbriefbank AG paid a premium of 50 basis points above the current reference price in the swap market; for the public Jumbo Pfandbrief, it paid a premium of 55 basis points above the current reference price on the swap market. At the beginning of 2010, Deutsche Pfandbriefbank AG successfully issued a further public jumbo Pfandbrief with a volume of € 1 billion on 11 January 2010. The current Pfandbrief has been issued with a coupon of 3.375 % per annum, and has a term of seven years. Deutsche Pfandbriefbank AG paid a premium of 38 basis points above the current reference price on the swap market. With an issue price (re-offer price) of 99.254 %, this is equivalent to a yield of 3.497 % for the Pfandbrief. In addition, unsecured issues of € 1.6 billion were carried out in the year 2009. The issue volume of short-term deposits and commercial papers amounted to € 1.8 billion.

Personnel changes in the Management Board

There were the following personnel changes in the Management Board in the period under review. The members of Management Board, Bettina von Oesterreich, Dr. Robert Grassinger and Cyril Dunne, stepped down from the Management Board of HRE Holding as of 31 January 2009. Cyril Dunne is still serving on the Board of Directors of DEPFA Bank plc.

The Supervisory Board appointed Manuela Better to the Management Board of HRE Holding with effect from 1 February 2009. She is responsible for risk (CRO). In addition, the Supervisory Board appointed Alexander Freiherr von Uslar-Gleichen to the Management Board as of 1 October 2009. He assumed the function of Chief Financial Officer (CFO). Dr. Bernhard Scholz was appointed as a member of the Management Board by the Supervisory Board as of 1 January 2010. He is responsible for the Real Estate Finance division.

Ratings

In the financial year 2009 and until 12 March 2010, the three mandated rating agencies, with regard to bank and covered bond ratings, performed the following major rating changes:

In January 2009, ahead of the announced merger with the public sector cover pool of Hypo Real Estate Bank AG, Fitch Ratings set the rating of public sector Pfandbriefe of DEPFA Deutsche Pfandbriefbank to “Watch Negative”.

At the beginning of February 2009, Moody’s completed its review of the ratings, and downgraded the long-term rating of the banks by only one notch from A2 to A3 in anticipation of state support. The other ratings were confirmed, and the outlook for all ratings is negative. In a further rating action, Moody’s confirmed its ratings for the Pfandbriefe of Hypo Real Estate Bank AG and DEPFA Deutsche Pfandbriefbank AG and thus terminated the review for downgrade. At the same time, the rating of the asset-covered securities of DEPFA ACS Bank was lowered from Aa1 to Aa2; this rating for the time being remains under review for downgrade.

At the beginning of April 2009, Standard & Poor’s placed the bank ratings to “Credit Watch Positive” due to the expected state support.

Following the Extraordinary General Meeting on 2 June 2009, Fitch upgraded the short-term rating from F1 to F1+.

The merger of DEPFA Deutsche Pfandbriefbank AG into Hypo Real Estate Bank AG (now trading as Deutsche Pfandbriefbank AG) which took place as of 29 June 2009 did not have an impact on the ratings.

At the end of November 2009, Fitch Ratings completed its continuous review of the public sector Pfandbriefe of Deutsche Pfandbriefbank AG and confirmed the AAA rating.

Ratings of Group companies and covered bonds

as of 31 December 2009	Standard & Poor’s[1]	Moody’s	Fitch Rating
Long-term rating	BBB	A3	A–
Outlook	Credit Watch Positive	Negative	Stable
Short-term rating	A–2	P–1	F1+
Public sector Pfandbriefe	AAA[2]	Aaa	AAA
Mortgage Pfandbriefe	AAA[2]	Aa3	AA+[2]
Asset-covered securities	AAA[2]	Aa2[2]	AAA
Lettres de Gage	AAA[2]	—	—

[1] Hypo Pfandbrief Bank International S.A. and its Lettres de Gage are only rated by Standard & Poor’s.
[2] Review for downgrade

HRE as an employer

The implementation of the strategic refocusing and restructuring of HRE adopted in 2008 resulted in extensive reorganisation actions in 2009, leading to a streamlining of the organisation structure and consequently also considerable job losses; some locations were also merged and closed. At the same time, despite increasing competition on the market, new and highly qualified employees were recruited to strengthen strategically important staff and operating functions as part of the process of assuring the future competitiveness of the Bank.

Changes in the organisational structure and persons appointed to key functions Immediately after the strategic refocusing and restructuring of the Group were announced in December 2008, a systematic review was carried out with regard to the organisational structure and also the persons appointed to key positions. As part of the refocusing process, the need to ensure optimum appointments to the second management tier was considered to be a particularly critical factor of success in the process of renewing the Group. The aim was to ensure that the decisions relating to the new appointments were as transparent and objective as possible, and it was also necessary to ensure the reliable quality of the decisions. The management assessment was carried out together with an external consultant, and was validated by personnel discussions with the Management Board. In total, 77 manager evalu-ations were carried out. The process was completed in the first quarter 2009 and, as a result of the process, the new structure organisation and the persons appointed to the second management tier were communicated in March 2009.

Job cuts, location closures and consolidation as part of the restructuring process The necessary negotiations regarding reconciliation of interests have been conducted as the basis for carrying out the restructuring measures in Germany. In addition, Management and the central Works Council in Germany have signed a framework agreement which specifies the measures following the restructuring process and which describes the rules of implementation for the restructuring process. The social plans which are also applicable for the entire duration of the restructuring process have also been agreed with the corresponding Works Council bodies.

In total, the number of employees worldwide declined in 2009, from 1,786 at the end of 2008 to 1,397 at the end of 2009. So far, the job cuts have been largely implemented in a socially acceptable manner and on a voluntary basis with the affected employees. Until now, it has been possible to avoid compulsory redundancies as a result of restructuring in Germany.

The sale of DEPFA First Albany Securities LLC by DEPFA Bank plc to the New York investment bank Jefferies & Company Inc. was completed on 27 March 2009. This deal affected 70 employees in ten offices in the United States, and it was possible for their jobs to be saved as a restructuring of this sale.

With the merger between DEPFA Deutsche Pfandbriefbank AG and Hypo Real Estate Bank AG in June 2009, the employment contracts of the employees were continued unchanged at the new employer. In addition, the employment agreements from most of the employees of HRE Holding were transferred to Deutsche Pfandbriefbank AG in 2009 by way of a Group transfer process. Partial secondments of employees of Deutsche Pfandbriefbank AG assured the functions which are necessary for the Holding as the ultimate parent company of the Group.

With effect from 1 November 2009, Deutsche Pfandbriefbank AG and its affiliated Group companies outsourced all operations of the worldwide IT infrastructure of the Group to Fujitsu Services GmbH. This measure covers the operation of the data centres, the servers and the networks. The outsourcing arrangement also included “end user computing”, i.e. support for the workplace PCs and their application as well as general support. Overall, 48 internal employees who previously had been employed in the IT infrastructure of the Group were taken over by Fujitsu Services GmbH at their existing locations as of 1 November 2009.

The consolidation and relocation of the Group’s headquarters to Unterschleißheim in August 2009 was a further sign of the new beginning and a further contribution towards the long-term reduction of structural costs. Previously spread over five inner-city locations in Munich, approx. 650 employees relocated to a modern building complex. This has resulted in a considerable improvement in internal communication, and has also accelerated and improved working processes. Only the IT subsidiary pbb Services GmbH as well as a temporary IT project have retained their two locations in Munich. In a separate social plan with a reconciliation of interests, Management and the Works Council in Munich regulated the process of merging the locations in Munich and the relocation to the new facility, and agreement was reached with regard to compensation for disadvantages.

The adjusted fluctuation in HRE in 2009 amounted to 13.54 %; the figures for Deutsche Pfandbriefbank AG and DEPFA Bank plc were 14.69 % and 11.40 % respectively (adjusted fluctuation due to employment agreement being terminated by the employee or the Bank and due to the expiry of temporary agreements, excluding persons leaving the Company as a result of death, retirement, early retirement, a cancellation agreement or Group transfer).

Compensation report

The compensation report follows the recommendations of the Public Corporate Governance Code, and comprises the details required in accordance with German commercial law or the International Financial Reporting Standards (IFRS). It provides a detailed overview of the individual components of the compensation of the Management Board and Supervisory Board. In the course of the financial year 2009, the Supervisory Board considered the subject of Management Board compensation on several occasions, and in particular also focused on the new legal aspects of the law regarding the adequacy of Management Board compensation (VorstAG). The content of the circular 22/2009 of 21 December 2009 “Regulatory requirements applicable to the compensation systems of institutions” has been and still is the subject of extensive deliberations of the Supervisory Board. The Management Board has already established a Compensation Committee at the Company. In addition, individualised details have also been published for the compensation of each individual member of the Management Board and the Supervisory Board for the financial year 2009. The total compensation received by the members of the Management Board in the Group in financial 2009 is published. No separate compensation is paid for Supervisory Board or Administrative Board mandates which are held by individual members of the Management Board within the Group. The compensation report is an integral part of the certified Group management report. The information explained in the following has therefore not been additionally presented in the notes or the consolidated financial statements.

Management Board **Principle** The purpose of defining compensation for the members of the HRE Management Board is to ensure performance-linked payment, and reflects the international activity and size of the Company. Due consideration is given to a comparison of compensation for Management Boards at corresponding companies in Germany and abroad and the economic and financial situation of the Group. These criteria are taken into consideration by the Supervisory Board when discussing the structure and extent of compensation for the Management Board. In connection with the granting of stabilisation measures in accordance with the Financial Market Stabilisation Act (FMStG), the members of the reorganised Management Board approved a reduction in the annual compensation for each member of the Management Board to max. € 500,000 per annum (pro rata), for the period after 1 April 2009 for the duration of the stabilisation measures or for any other period specified by the Financial Market Stabilisation Fund. Variable compensation will not be paid for the period defined above. Accordingly, the principle of performance-linked payment will not be used for this period. After the process of restructuring the Company has been completed, and by no later than the point at which the service agreement is terminated, the Company has indicated the prospect of a one-off bonus being paid. The changed employment agreements of the members of the Management Board have accordingly taken account of the requirements of the Financial Market Stabilisation Fund. The new employment agreements have replaced the originally agreed employment agreements with effect from 1 April 2009. Members of the Management Board who joined the Company after 1 April 2009 have received analogous agreements.

In connection with the signing of his new employment agreement, Dr. Axel Wieandt waived his entitlement to extensive vested pension rights to the benefit of the Company (the Company’s pension obligations have declined by approx. € 3.8 million as a result of this waiver); in return, Dr. Axel Wieandt was granted a one-off payment of € 500,000 by the Supervisory Board of HRE Holding. In addition, for the period between 1 January 2009 and 31 March 2009, and on the basis of the service agreements which were valid until 31 March 2009, Dr. Axel Wieandt is entitled to guaranteed pro-rata variable compensation of € 375,000 for the year 2009, and Dr. Kai Wilhelm Franzmeyer and Frank Krings each had a guaranteed entitlement to € 325,000. Dr. Axel Wieandt, Frank Krings and Dr. Kai Wilhelm Franzmeyer have agreed that they will not enforce the payment of the above-mentioned claims until after the process of restructuring and refocusing HRE has been completed or before the end of their respective service agreements if the restructuring and refocusing process has not been completed.

Compensation components The following compensation elements result from the employment agreements signed with the members of the Management Board:

- Fixed compensation including compensation in kind
- Performance-linked variable compensation
- Pension commitment

Fixed compensation The fixed compensation is reviewed and where appropriate adjusted at regular intervals on the basis of an external market comparison. The figure is not automatically adjusted. In accordance with the new statutory regulations of the VorstAG, the Supervisory Board has reviewed the application of Section 87 AktG, and will continue to do so in future. In addition, the Company grants additional benefits to members of the Management Board to a normal extent. These benefits include the provision of a company car, including payment of all costs incurred in this connection. Corresponding insurance has also been taken out for the members of the Management Board via group accident insurance. The tax applicable to the equivalent cash benefit for these benefits is borne by the members of the Management Board. In addition, the company also pays the costs of a medical diagnostic examination every two years.

Variable compensation Due to the granting of stabilisation measures in accordance with the Financial Market Stabilisation Act (FMStG), the Management Board will not receive any discretionary variable compensation for the financial year 2009. This is not applicable for the above-mentioned guaranteed payments for the period 1 January to 31 March 2009 for the new members of the Management Board who joined the Company in October 2008.

In principle, the variable compensation of the Management Board is defined by the Supervisory Board at its discretion, taking account of several factors. Before the beginning of a financial year, the Supervisory Board defines overall targets for the Management Board as well as individual targets for each member of the Management Board within the framework of the overall strategy. After the end of the financial year, the Supervisory Board makes a decision with regard to the extent of the bonus on the basis of an extensive discussion. The success of the Company as well as the personal performance of the member of the Management Board are assessed. The individual criteria in the personal assessment are: strategic and quantitative success in meeting objectives, personal contribution and commitment as well as the exercising of entrepreneurial responsibility and team behaviour in the Management Board. As part of the overall review, the Supervisory Board pays attention to the correlation between the success of the Company and personal achievement and thus the adequacy of the variable bonus.

Group payments to members of the Management Board of HRE Holding	**1.1.–31.3.2009**				**1.4.–31.12.2009**				**2009**	**2008**
in € thousand	Fixed payments	Guaranteed components payment postponed until further notice[1]	Other payments	Total	Fixed payments	Profit-related com-mponents	Total	Benefits in kind[2]	**Total**	Total
Dr. Axel Wieandt[3], Chairman	188	375	500	1,063	375	—	375	54	1,492	602
Manuela Better (from 1.2.2009)	83	—	—	83	375	—	375	24	482	—
Dr. Kai Wilhelm Franzmeyer	150	325	—	475	375	—	375	—	850	458
Frank Krings	150	325	—	475	375	—	375	14	864	448
Alexander Freiherr von Uslar-Gleichen (from 1.10.2009)	—	—	—	—	125	—	125	3	128	—
Former members of the Management Board	—	—	—	—	—		—	—	2,429	4,922
Total[4]	**571**	**1,025**	**500**	**2,096**	**1,625**	**—**	**1,625**	**95**	**6,245**	**6,430**

[1] The guaranteed components are a fixed contractual entitlement; total payments are limited to max. € 500,000 per annum starting 1 April 2009; Dr. Axel Wieandt, Frank Krings and Dr. Kai Wilhelm Franzmeyer have waived their entitlement to the components which are guaranteed for the period after 1 April 2009, and have also agreed that they will not enforce the payment of the entitlements of the first quarter of 2009 until the process of restructuring and refocusing of HRE has been completed or before the end of their respective service agreements or the termination of their respective appointments to the Management Board (see also the comments in the text under "Management Board [principle]", final sentence)

[2] Including: normal cost of materials for ancillary services, subject to taxation and (abroad) social insurance

[3] When the employment agreement was signed, Dr. Wieandt received a one-off payment in return for waiving his entitlement to extensive pension rights; these are shown under "Other payments"

[4] There are also commitments in individual agreements regarding retirement benefits in the amount of 1% of the annual fixed payments

Pension commitments The current members of the Management Board as well as Dr. Robert Grassinger each have individual contracts regarding retirement benefit commitments starting with their 60th birthday and to cover occupational incapacity and disability. The retirement benefit commitments of Georg Funke, Dr. Markus Fell, Bo Heide-Ottosen and Frank Lamby were revoked by the Executive Committee of the Supervisory Board with the resolution of 20 January 2008.

The following is applicable with regard to the extent of the retirement benefits of the members of the Management Board. The Chairman of the Management Board receives retirement benefits equivalent to 30 % of the unreduced fixed compensation. This is increased by 1.66 % for each complete year of service as a member of the Management Board, up to a maximum of 60 %. For the other members of the Management Board, the cap is defined as 30 % of the unreduced fixed compensation. The retirement benefit shall be increased by one percentage point for each completed year of service as a member of the Management Board, up to a maximum of 50 %. The following is ap-plicable in the case of Manuela Better: her previous pension commitment, according to which she receives an annual pension contribution of € 30,000.00 from the Company, will be continued until 31 January 2010. On 1 February 2010, this commitment will be replaced by a commitment which is applicable for the other members of the Management Board. The pension commitments of Dr. Axel Wieandt, Dr. Kai Wilhelm Franzmeyer and Frank Krings became contractually vested one year after they joined the Company. The pension commitments of Manuela Better and Alexander von Uslar-Gleichen are contractually vested after the end of one year. The benefit commitment of Dr. Bernhard Scholz becomes contractually vested after the end of two years as a member of the Management Board. A reinsurance policy has been taken out for these pension commitments, as is the case for the other pension obligations of the Company. The claims arising from this reinsurance policy are pledged to the members of the Management Board.

Section 16 of the Company Pensions Act is applicable with regard to the adjustment of pension payments after the beneficiary retires; this means that an adjustment is made every three years on the basis of the consumer price index.

In the event of the death of a member of the Management Board, the surviving widow/widower receives 60 % of the retirement pension entitlement of the wife/husband. In addition, benefits are paid to orphans who have lost one parent (Halbwaisen) or both parents (Vollwaisen) before they celebrate their 21st or 18th birthday respectively. If a child is still undergoing vocational training after celebrating his/her 21st or 18th birthday, the orphan benefits are paid until the vocational training has been completed, but no longer than the point at which the orphan celebrates his/her 25th birthday. As long as the surviving widow receives surviving dependant benefits, the total amount received by the orphans who have lost one parent (Halbwaisen) must not exceed 30 % of the retirement benefits of the deceased parent. Orphans who have lost both parents (Vollwaisen) together receive up to 60 % of the retirement benefit of the deceased parent.

A surviving widow/widower and children from a marriage which the member of the Management Board enters into after retiring do not have any entitlement to a widow's/widower's pension and orphan's benefits.

Pension entitlements of the members of the Management Board of Hypo Real Estate Holding AG

in € thousand	2009				2008
	Present value of pension claims vested	Interest expense	Outstanding past service cost	DBO as of 31.12.2009	
Dr. Axel Wieandt[1], Chairman	158	151	–3,671	2,873	6,218
Manuela Better (from 1.2.2009)	73	109	—	2,084	—
Dr. Kai Wilhelm Franzmeyer	81	126	—	2,406	2,031
Frank Krings	68	106	—	2,017	1,637
Alexander Freiherr von Uslar-Gleichen (from 1.10.2009)	63	95	—	1,815	—
Dr. Robert Grassinger (until 31.1.2009)	—	—	—	1,219	1,414
Bettina von Oesterreich[2] (until 31.1.2009)	—	—	–1,383	—	—
Total	**443**	**587**	**–5,054**	**12,414**	**11,300**

[1] Change to pension entitlement after 1 April 2009
[2] There are no pension entitlements, because the vesting criteria have not been satisfied

Other rulings For cases in which the service relationship is prematurely terminated by the Company for no compelling reason, the employment agreements of the members of the Management Board contain a clause according to which they receive a severance payment equivalent to one year's salary in addition to compensation for the remaining term. For the employment agreements, the contractually envisaged compensation is limited to max. two years salary (settlement cap).

The following agreements have been reached with the members of the Management Board who stepped down from the Management Board in the course of 2009:

Cyril Dunne Cyril Dunne laid down his mandate on the Management Board of HRE Holding with effect from 31 January 2009. The employment agreement between Cyril Dunne and the Company was also terminated as of 31 January 2009. Because Cyril Dunne has continued to act as the Chief Executive Officer of DEPFA BANK plc in Dublin since 1 February 2009, no severance payment was agreed.

Dr. Robert Grassinger Dr. Robert Grassinger laid down his office as a member of the Management Board of HRE Holding as of 31 January 2009. His contract with HRE Holding regarding his mandate on the Management Board was terminated by way of a cancellation agreement as of 31 January 2009. The employment agreement of Dr. Robert Grassinger with the former Hypo Real Estate Bank AG was terminated as of 31 March 2009 by way of a cancellation agreement. Compared with the other members of the Management Board who stepped down from their position on the Management Board, the agreements with Dr. Robert Grassinger were a special feature. The material conditions of the cancellation agreement had been agreed with the former Supervisory Board in the summer of 2008. At that time, Dr. Robert Grassinger was given a written commitment that, upon termination, the fixed payments as well as the ancillary payments would be paid for the remainder of the term (€ 1,326,800 gross). In the cancellation agreement, it was agreed that other payments from self-employment, employment or other activities which Dr. Robert Grassinger acquires until 30 June 2010 will be offset against the settlement in accordance with Section 615 Sentence 2 BGB. The settlement will be paid out in quarterly instalments after the end of three months, and the first payment will be made on 30 April 2009. There is no bonus entitlement for 2008 or (on a prorata basis) for 2009. In addition, as a result of his past service, Dr. Robert Grassinger has acquired a legally vested entitlement to benefits from the Company pension scheme after his 60th birthday.

Bettina von Oesterreich At the end of December 2008, the Supervisory Board and Bettina von Oesterreich agreed by way of a cancellation agreement that the employment agreement would be terminated prematurely as of 31 March 2009. As agreed, she stepped down from her office as a member of the Management Board as of 31 January 2009 when the question of her successor had been settled. The employment agreement was terminated prematurely as of 31 March 2009 by way of a cancellation agreement. As compensation for her claims arising from the employment agreement which had been signed to cover the period until 31 January 2010, Bettina von Oesterreich received a severance payment of € 400,000 (gross). This figure is equivalent to one year's fixed salary. There was no bonus entitlement for the year 2008 or (on a prorata basis) for 2009. In the cancellation agreement, Bettina von Oesterreich waived her entitlement to the bridging payment of € 950,000 (gross) which had been promised to her in her service agreement. There is no vested entitlement to benefits from the Company pension scheme because the vesting date had not yet been attained.

Supervisory Board The Supervisory Board receives compensation as defined in Section 11 of the articles of incorporation. For 2009 the members of the Supervisory Board will, accordingly receive an annual basic compensation of € 70,000, the Chairman of the Management Board will receive two and a half times this basic compensation, and his deputy will receive one and a half times this basic compensation. Compensation of € 10,000 will be paid for activity in the Executive Committee, and compensation of € 20,000 will be paid for the Audit Committee as well as the Risk Management and Liquidity Strategy Committee. The Chairman of a committee will receive twice this amount. The entitlement to such payment is applicable on a prorata basis for the actual period of the activity. The Supervisory Board of which the period of office ended at the end of the Annual General Meeting decided on 21 April 2009 to make a contribution to the restructuring process, and therefore decided to waive its entitlement to half of its compensation for the year 2009. The Supervisory Board which has been in office since 13 August 2009 also decided on 14 December 2009 to waive its entitlement to half of its compensation for the year 2009.

The Company reimburses travelling expenses, but fees for attending meetings are not paid. Apart from the compensation detailed above and defined in the articles of incorporation, the Company has not provided the members of the Supervisory Board with any further compensation or benefits for personally provided services. The Supervisory Board has decided that the members of the Supervisory Board will receive their compensation on the day after the day on which their actions are ratified by the Annual General Meeting and not after the end of each financial year. Because this rule is applicable for the financial year 2008, the members of the Supervisory Board have not yet received their compensation for 2008; however, a corresponding provision has been created. The following table sets out the itemised statement of the compensation for the members of the Supervisory Board.

Consolidated remuneration paid to members of the Supervisory Board 2009 in € thousand	**Supervisory Board**			**Executive Committee**		**Audit Committee**		**Risk Management Committee**		**Nomination Committee**					
	Chairman	Deputy Chairman	Member	Chairman	Member	Chairman	Member	Chairman	Member	Chairman	Member	Compensation in subsidiaries	Subtotal	Value added tax 19 %	**Total**
Remuneration p.a.	**175**	**105**	**70**	**20**	**10**	**40**	**20**	**—**	**—**	**—**	**—**				
Dr. Bernd Thiemann[1] (Chairman from 13.8.2009)	36	—	—	4	—	—	4	—	—	—	—	4	49	9	58
Dagmar P. Kollmann[1] (Deputy Chairman from 13.8.2009)	—	22	—	—	2	8	—	—	—	—	—	4	36	7	43
Dr. Günther Bräunig[1] (from 9.7.2009)	—	—	18	—	2	—	4	—	—	—	—	4	28	5	33
Dr. Alexander Groß[1] (from 13.8.2009)	—	—	15	—	—	—	—	—	—	—	—	—	15	3	17
Dr. Markus Kerber[1] (from 5.12.2009)	—	—	3	—	—	—	—	—	—	—	—	—	3	1	3
Dr. Hedda von Wedel[1] (from 13.8.2009)	—	—	15	—	—	—	4	—	—	—	—	4	23	4	27
Dr. Michael Endres[1] (Chairman until 13.8.2009)	58	—	—	7	—	—	7	—	—	—	—	7	79	15	94
Dr. h.c. Bernhard Walter[1] (Deputy Chairman until 13.8.2009)	—	35	—	—	3	13	—	—	—	—	—	—	52	10	61
Dr. Renate Krümmer (Deputy Chairman until 31.3.2009)	—	26	—	—	—	—	5	—	—	—	—	—	31	6	37
J. Christopher Flowers (until 27.3.2009)	—	—	18	—	3	—	—	—	—	—	—	—	20	4	24
Bernd Knobloch[1] (until 13.8.2009)	—	—	23	—	—	—	—	—	—	—	—	7	30	6	36
Dr. Edgar Meister[1] (until 18.5.2009)	—	—	15	—	—	—	4	—	—	—	—	4	23	4	27
Sigmar Mosdorf[1] (until 13.8.2009)	—	—	23	—	—	—	—	—	—	—	—	—	23	4	28
Richard S. Mully (until 27.3.2009)	—	—	18	—	—	—	—	—	—	—	—	—	18	3	21
Dr. Albert Peters[1] (13.8 to 4.12.2009)	—	—	15	—	—	—	—	—	—	—	—	—	15	3	17
Hans-Jörg Vetter[1] (until 13.8.2009)	—	—	23	—	3	—	—	—	—	—	—	7	34	6	40
Manfred Zaß[1] (until 13.8.2009)	—	—	23	—	—	—	—	—	—	—	—	3	26	5	31
Total	**95**	**83**	**207**	**11**	**13**	**22**	**28**	**—**	**—**	**—**	**—**	**44**	**503**	**96**	**599**

[1] Has waived entitlement to 50 % of compensation for 2009 set out in articles of incorporation

Employees **Variable compensation 2009** Because of the still difficult situation on the financial markets, the fact that the results of the Group are still negative and also because the support is still necessary, the Management Board does not plan to prepare a budget for 2009 for discretionary variable compensation in the relevant local legal framework, nor does it plan to make any payment in this respect. As was the case in 2008, this is applicable for all Group companies and locations.

However, the Management Board is currently liaising with major interest groups in order to determine that a voluntary one-off payment is to be made instead of variable compensation. With regard to the planned substitute solution, the Management Board has emphasised the need to assure operational stability and avoid operational risks, and focused thereby on management and motivation of key staff in the critical phase of restructuring.

The purpose, legal background, extent and contents of this payment differ from the discretionary variable compensation in the past. With regard to such a substitute solution, the payment can therefore be made only to employees who in return have waived their entitlement to any payment of discretionary variable compensation for the year 2009 in a legally effective manner.

With regard to the form of this "strategic solution 2009", the planned compensation payment is to be based on standard and regionally differentiated compensation modules which are linked to the employee's basic salary, with due consideration being given to a contribution and performance weighting. For the contribution and performance weighting, the contributions and performance of the employee with regard to the stabilisation, restructuring and repositioning of the Group are to be taken into account on an overall basis. Some of the payment is to be postponed for certain employees.

The Supervisory Board and the owner have been notified and involved with regard to the "strategic solution 2009". The co-determination rights of the employees' representatives in Germany will be safeguarded.

Remuneration Committee The Management Board set up a Remuneration Committee on 22 January 2010 as a result of the BaFin circular 22/2009 "Regulatory requirements applicable for the remuneration systems of institutions" which was published on 21 December 2009. The Remuneration Committee consists of representatives from Personnel, the Sales units as well as the Value Portfolio, Risk Controlling and Management, Compliance/Corporate Governance, Finance as well as – as a member without voting rights within the framework of his duties – a representative of Internal Audit. In order to emphasise the special role of the Remuneration Committee, Frank Krings, in his capacity as Chief Operating Officer and in his role as Personnel Director, has been nominated as the Chairman of the Remuneration Committee.

The major tasks of the Remuneration Committee have so far been:

- Intense involvement with and appraisal of the "strategic solution 2009" in the context of the legal/regulatory requirements.
- The development of a proposal for the applicability of the special requirements set out in Section 4 of the BaFin circular (positive self-assessment).
- In conjunction with the interpretation of Section 4 of the BaFin circular, the development of a proposal for defining the risk-related functions ("risk taker") for which the special requirements of Section 4 of the BaFin circular are applicable.

Only the Managing Directors of the companies of HRE Holding and of Deutsche Pfandbriefbank AG have been proposed as risk-related positions (risk taker) for the year 2009. In addition, it has also been recommended that the Executive Directors of DEPFA Bank plc should also be treated as risk takers for the year 2009 – beyond the requirements which result directly from the BaFin circular. The Management Board of HRE Holding AG, Deutsche Pfandbriefbank AG as well as the Executive Board of DEPFA BANK plc have approved the proposal of the Remuneration Committee and have adopted the corresponding resolutions in this respect. This decision recognises that the overriding objective of the Group for the year 2009 was to reduce risks as well as to restructure and reposition the Group. In addition, in the year 2009, the Management Board was responsible for all major decisions in connection with key risk positions.

Introduction of a new compensation system starting in 2010 In line with the regulatory requirements (long-term nature, sustainability, transparency and adequacy) and also in view of the interests of the public "stakeholders", it is necessary for a new compensation system to be introduced starting in 2010. For this purpose, major preparatory work was carried out in 2009, in particular a thorough classification and allocation of employee functions and a comprehensive regionally differentiated salary study. Key structure elements of the new compensation system have been developed, and the Supervisory Board was notified extensively of the status of the work. There are plans for further liaison with the various interest groups to be completed in the first half of 2010.

Sustainability

Corporate culture The promotion of an open corporate culture is a key element of the corporate culture. In addition to the economic focus, non-financial factors are also taken into consideration. For instance, the general credit principles of HRE define ethical principles for extending loans which are consistent with the code of conduct which is applicable for all members of staff.

In addition, the corporate culture also aims to promote and maintain an environment in which life is worth living. Care is taken to ensure that manufacturers and suppliers meet the defined environmental protection requirements and that they are correspondingly certified. Internally, this requirement is satisfied in various ways, e.g. by way of procedures which use reduced volumes of paper or by way of using modern energy-saving equipment.

Social commitment HRE continued to meet its social responsibility in the year 2009 mainly by way of its two foundations: the Hypo Real Estate Foundation, Munich as well as the Foundation for Art and Science of the former Hypo Real Estate Bank International AG, Stuttgart. Since they were originally established in 1968 and 1987 respectively by the predecessor institutions of Deutsche Pfandbriefbank AG, the foundations have had independent capital which is not linked in any way to the Bank. This capital is used exclusively for fulfilling the aims of the foundation. In this way, despite the special financial situation of the Group in the year under review, HRE was still able to meet its social responsibility with regard to promoting art, culture and science. The two foundations do not have any of their own personnel. The foundation work is provided free-of-charge to the foundations in the form of ongoing personnel support of Deutsche Pfandbriefbank AG.

The **Hypo Real Estate Foundation** supports concepts and exhibitions. On the other hand, with its architecture prize which enjoys nationwide recognition, it takes the initiative itself for improving the architectural culture of commercial properties in Germany. Beyond the architecture prize, the foundation also awards grants in the fields of music and art.

The **Foundation for Art and Science** of the former Hypo Real Estate Bank International AG supports intellectual and artistic work particularly in the fields of literature, painting, sculpture, music, the theatre, architecture/design, regional and cultural studies as well as customs and traditions – focusing on Baden-Württemberg. It also awards a foundation prize in these areas every one to two years.

Sustainability indices In order to ensure that the efforts of the HRE Group with regard to sustainability are made transparent, the Group regularly participates in surveys of the following sustainability rating agencies: Dow Jones Indexes/STOXX Ltd./SAM, SiRi Global Profile, Vigeo, Carbon Disclosure Project.

Development in Earnings

HRE

In the financial year 2009, the development in earnings of HRE was affected by the specific situation of the Group and the continued difficult situation in lending and particularly in real estate financing. In consequence, pre-tax profit amounted to € –2,221 million and was negative as expected. This loss was attributable to considerable impairments, which mainly affected loans on real estate financings. In addition, net commission income was depressed in the amount of € –741 million incurred for external liquidity support, without which, however, it would not have been assured for HRE to continue as a going concern.

The pre-tax profit of 2008 was affected to an even greater extent by the crisis at HRE and the situation on the difficult markets; the figure of € –5,375 million was lower than the current figure. The main reasons for the very negative figure for 2008 were the goodwill impairments and impairments of other intangible assets (€ 2,482 million). In addition, it was necessary in the prior year for significant impairments and reductions in value to be recognised in the income statement in relation to trading assets and financial assets in the form of Collateralised Debt Obligations (CDOs) and Mortgage Backed Securities (MBS) as well as considerable provisions for losses on loans and advances. The development in figures for the financial year 2009 compared with the corresponding prior year figures is shown in the following:

Key financials

		2009	2008	Change
Operating performance				
Operating revenues	in € million	419	–585	1,004
Net interest income and similar income	in € million	1,396	1,633	–237
Net commission income	in € million	–642	32	–674
Net trading income	in € million	–154	–1,009	855
Net income from financial investments	in € million	–1	–1,409	1,408
Net income from hedge relationships	in € million	–117	86	–203
Balance of other operating income/expenses	in € million	–63	82	–145
Provisions for losses on loans and advances	in € million	2,091	1,656	435
General administrative expenses	in € million	541	605	–64
Impairments on goodwill and DEPFA's intangible assets	in € million	—	2,482	–2,482
Balance of other income/expenses	in € million	–8	–47	39
Pre-tax profit	in € million	–2,221	–5,375	3,154
Taxes on income	in € million	15	86	–71
Net income/loss	in € million	–2,236	–5,461	3,225
Key ratios				
Cost-income ratio	in %	> 100.0	> 100.0	
Return on equity after taxes	in %	–46.8	–74.5	

Operating revenues Operating revenues amounted to € 419 million, and were thus € 1,004 million higher than the corresponding figure for 2008, when operating revenues amounted to € –585 million. The increase is solely attributable to net trading income and net income from financial investments which were by far less negative, due mainly to stabilising capital and financial markets.

Net interest income of € 1,396 million was lower than the corresponding prior year figure of € 1,633 million. The decline is attributable to higher exceptional factors in the prior year and also to the process of reducing interest-bearing assets which was carried out consistently throughout 2009. Impairments recognised in relation to some subordinated capital instruments resulted in income of € 138 million in 2009 (prior year: € 353 million). In addition, the one-off revenues attributable to sales of receivables, premature repayment penalties as well as repurchasing and redemptions of financial liabilities also declined compared with the prior year (2009: € 25 million, 2008: € 79 million). Furthermore, net commission income was affected by the declining portfolio holding as well as the default of borrowers and the associated interest defaults. So-called "unwinding", i.e. the extrapolation of the cash value of expected future cash flows, compensates to some extent for the effect attributable to the default of borrowers. In the first half of 2009, a positive effect was achieved as a result of income from money market operations as well as drawn US customer liquidity facilities. As a result of falling interest rates on the money market, HRE was able to take advantage of lower refinancing expenses in conjunction with constant revenues on the assets side of the balance sheet. The drawn US customer liquidity facilities have had a positive impact on net interest income as a result of their high interest rates. Both factors were felt primarily in the first half of 2009. Since mid-2009, they have not had a significantly positive impact on the net interest income of HRE because interest rates are now stable and because most of the receivables attributable to drawn US American customer liquidity facilities have been repaid.

Net commission income amounted to € –642 million compared with € 32 million in the previous year. The decline is primarily attributable to expenses of € –741 million incurred for the guarantees in connection with the liquidity support provided by SoFFin and the German Federal Government. In the prior year, such expenses were only incurred in the fourth quarter (€ –92 million). The expenses for liquidity support of the current year contain a profit-related fee. In December 2009 as expected the syndicate from the financial sector abandoned the profit-related fee in the course of the restructuring of the liquidity support granted in November 2008. In contrast, the federal government in its capacity as guarantor has not yet waived the profit-related fee. Therefore a liability of € 229 million was recognised, whereof € 27 million were related to the months of November and December 2008.

The net trading income of € –154 million reported for 2009 was much less negative than the corresponding prior year figure (€ –1,009 million). However, the development of the portfolios and assets was unequal. The valuation losses of € –58 million in relation to the holdings of embedded derivatives in synthetic CDOs which have to be separated were significantly less negative compared to the prior year level (2008: € –395 million). Furthermore, valuation losses of € –29 million incurred in relation to the Halcyon and Pegasus portfolio were lower than in the previous year (2008: € –237 million). The holdings are measured using an internal model. A positive factor was the lower probability of default in connection with the restructuring of a US monoline insurer. In contrast, the latent default risk inherent in customer derivatives increased. For this, HRE creates provisioning, a so-called counterparty risk adjustment, in line with the increasing probability of default of credit receivables. These additions amounted to € –228 million in 2009 (2008: € –33 million). In the prior year, an expense of € –150 million was incurred in the prior year as a result of derivative positions with regard to Lehman Brothers Inc. Claims against Lehman Brothers Inc. were sold with a slight book profit in 2009.

Impairments and write-ups in relation to securities as well as results from the disposal of securities are shown under net income from financial investments. In 2009, these activities virtually broke even (€ –1 million). The substantial losses of the prior year were mainly attributable to impairments recognised in relation to cash CDOs (2008: € –762 million including a partial reversal of € 70 million of the model reserve created in the year 2007) and in relation to MBS (2008: € –528 million). In contrast, in the year 2009 impairments on cash CDOs amounted to € –77 million (including a partial reversal of € 12 million of the model reserve created in the year 2007) and impairments on MBS of € 131 million were reversed. In addition, the portfolio-based allowances in relation to LaR financial assets were increased by € – 10 million (2008: € – 24 million) and a building impaired by € – 33 million.

The net income from hedge relationships was negative at € – 117 million, and was thus lower than the corresponding prior year figure of € 86 million. The net income from hedge relationships includes hedge inefficiencies of € – 111 million (2008: € 162 million) within the range of 80 % to 125 % permitted under IAS 39 as well as the valuation result of € – 6 million (2008: € – 76 million) resulting from "designated at Fair Value through Profit or Loss" (dFVTPL) assets and related derivatives. The hedge inefficiencies resulted mainly from the volatility of short-term interest rates. This had a positive impact on net interest income in the period under review, and had a negative impact on the net income from hedge relationships. The fair values of the dFVTPL assets hedged against interest risks have changed primarily as a result of the credit spread movements on the market.

The balance of other operating income/expenses amounted to € – 63 million (2008: € 82 million), and resulted primarily from currency translation effects (in particular: US $) of € – 56 million (2008: € 96 million). The currency translation effect is mainly due to impairments on foreign currency assets.

Provisions for losses on loans and advances As was the case in the prior year, considerable additions to provisions for losses on loans and advances were again necessary in 2009 as a result of the deterioration in the situation on the commercial real estate markets. Overall, provisions for losses on loans and advances amounted to € 2,091 million (2008: € 1,656 million). Of the individual loan loss provisions of € 1,896 million which were recognised, real estate loans predominantly accounted for € 1,723 million and infrastructure and public sector financings accounted for € 132 million.

The significant increase in provisions for losses on loans and advances for real estate financings was due to the further deterioration in regional economic conditions of real estate markets, particularly in North America, Southern Europe, Great Britain and, to an increasing extent, Germany. The difficult economic conditions, due to the increasing vacancy rates and illiquid markets, have resulted in declines in the value of real estate and thus, indirectly, in increasing levels of loan defaults. In particular, the lower values of real estate have had an impact on financing arrangements without any direct possibility of recourse to the ultimate debtor, which account for most of the Group's financing arrangements, as well as junior financing tranches.

The worldwide recession was also having an impact on the utilisation of infrastructure assets such as motorways, airports or transportation systems. Provisions for losses on loans and advances have also been recognised in relation to these financing arrangements, because they frequently also do not provide any possibility of recourse in relation to the ultimate debtor.

Portfolio-based allowances increased by € 194 million (2008: addition of € 501 million). The expected losses of the holdings have again increased, due to the deterioration in the credit standing of some debtors and the related increase in probability of default. In accordance with IAS 39, portfolio-based allowances are created only for receivables for which there are no indications of an individual impairment. With respect to the period between the occurrence and the identification of an impairment the accounting estimates were adjusted due to the improved credit processes. Further adjustments compared to the prior year were done to reflect the economic cycle as this is reflected in the historic loss rates. Due to the changed parameters the portfoliobased provisions decreased by € 323 million.

General administrative expenses General administrative expenses have declined to € 541 million, compared with € 605 million in the prior year. Personnel expenses have declined from € 260 million to € 213 million as a result of the reduced workforce, to 1,397 employees, compared with a figure of 1,786 employees as of 31 December 2008. Other general administrative expenses of € 328 million were also below the level of the prior year (€ 345 million). Lower office and operating expenses as well as lower depreciation and amortization were, however, partly compensated by higher expenses for IT. The higher IT expenses resulted primarily from the New Evolution project for aligning the processes and IT infrastructure. Additional consultancy costs have been incurred starting in the fourth quarter of 2009 for the project involving the outsourcing of non-strategic assets to a deconsolidated environment. As general administrative expenses exceeded operating revenues the cost-income ratio, i.e. the ratio between general administrative expenses and operating revenues, was higher than 100 % as in the previous year.

Balance of other income/expenses A restructuring provision of € 225 million was created in the fourth quarter of 2008 in connection with the strategic refocusing and restructuring of HRE. The calculation of the restructuring provision was updated during 2009, and the provision was increased by € 15 million. One of the factors in this respect is that some locations were closed sooner than originally planned, and thus payments have been made due to current rental agreements for unused properties. Restructuring provisions of € 52 million were used in 2009. In 2008, the balance of other income/expenses included an amount of € 180 million for the mandatory convertible bond which was issued for financing the DEPFA acquisition and which has since been converted.

Impairments on goodwill and intangible assets of DEPFA In the financial year 2008, the capitalised goodwill, the brand names and customer relationships were completely written down, and the software was partially written down. No equivalent expenses were incurred in the current financial year.

Pre-tax profit/loss Pre-tax result was negative at € –2,221 million in 2009 (2008: € –5,375 million).

Taxes on income Current tax expenses of € 53 million were opposed by deferred tax income of € 38 million, thus resulting in a total tax expense of € 15 million for the business year 2009 (2008: tax expense of € 86 million). The current tax expense was incurred mainly in countries in which HRE generate positive pre-tax results.

Net income/loss Net income after taxes amounted to € –2,236 million in 2009 (2008: € –5,461 million).

Business segment Commercial Real Estate

The operating segment Commercial Real Estate comprises German and international business in commercial real estate financing and includes the commercial real estate financing activities of Deutsche Pfandbriefbank AG.

In the financial year 2009, pre-tax profit amounted to € –1,457 million, and was lower than the corresponding previous year figure of € –350 million. The decline is attributable primarily to lower operating revenues and higher provisions for losses on loans and advances.

Operating revenues Operating revenues declined to € 587 million, compared with € 876 million in the prior year. Net interest income fell to € 632 million (2008: € 756 million). The decline is attributable to the constant reduction in loans. In addition, net interest income was negatively affected by the default of borrowers and the related defaults in interest payments. This is to some extent offset over a period of time by way of "unwinding", i.e. the process of extrapolating the present value of expected future cash flows. The prior year figure also included profits of € 10 million from the disposal of borrowers' note loans. Net commission income of € 97 million was unchanged compared with the corresponding prior year figure (2008: € 95 million). Lower income from the reduced portfolio holdings was offset by commissions which were not syndicated as originally planned, and which therefore started to be recognised in the income statement. In addition, the income from taking out hedges for customers was slightly above the prior year (€ 23 million in 2009 compared with € 18 million in 2008). Net trading income of € –151 million was attributable to the latent default risk of customer derivatives, for which a position had been created. In the prior year, the net trading income of € –45 million was attributable to interest positioning. Net income from financial investments in the prior year (€ 58 million) was attributable to profits generated by the disposal of securities. In 2009, only a very limited amount of such disposal profits was realised. Because the changes in the value of the underlyings were mainly offset by the hedging instruments, there was no income from hedge relationships (as was the case in the prior year). The balance of other operating income/expenses amounted to € 6 million (2008: € 12 million).

Provisions for losses on loans and advances In the years 2008 and 2009, there was a dramatic deterioration in the situation on the commercial real estate markets. The solvency of customers, which in many cases depends to a considerable extent on the cash flows generated by the financed properties, was very negatively affected by rising vacancy rates and the difficulty of marketing in particular new properties and refurbished properties. These problems mainly affected real estate financing for hotels, office properties and retail properties. In line with the negative development on the real estate markets in Great Britain, Spain and the USA, exposures in these regions were particularly hard hit. Material impairments recognised in relation to individual properties in Germany also had an impact as a result of their significance in relation to the overall portfolio. Provisions for losses on loans and advances amounted to € 1,866 million for the whole of 2009; of this figure, individual allowances accounted for € 1,723 million and portfolio-based allowances for € 142 million. Last year, allocations to provisions for losses on loans and advances amounted to € 1,066 million.

General administrative expenses General administrative expenses (€ 177 million) were higher than the level of the previous year (€ 155 million). The increase is mainly due to the shift of activities of HRE Holding into the business segments. Because operating revenues declined and general administrative expenses increased, the cost-income ratio deteriorated to 30.2 % (2008: 17.7 %).

Key financials

		2009	2008	Change
Operating performance				
Operating revenues	in € million	587	876	–289
Net interest income and similar income	in € million	632	756	–124
Net commission income	in € million	97	95	2
Net trading income	in € million	–151	–45	–106
Net income from financial investments	in € million	3	58	–55
Net income from hedge relationships	in € million	—	—	—
Balance of other operating income/expenses	in € million	6	12	–6
Provisions for losses on loans and advances	in € million	1,866	1,066	800
General administrative expenses	in € million	177	155	22
Balance of other income/expenses	in € million	–1	–5	4
Pre-tax profit	in € million	–1,457	–350	–1,107
Key ratio				
Cost-income ratio	in %	30.2	17.7	

Business segment Public Sector & Infrastructure Finance

Key financials

		2009	2008	Change
Operating performance				
Operating revenues	in € million	148	609	−461
Net interest income and similar income	in € million	683	730	−47
Net commission income	in € million	−477	−39	−438
Net trading income	in € million	34	−124	158
Net income from financial investments	in € million	−7	13	−20
Net income from hedge relationships	in € million	−86	26	−112
Balance of other operating income/expenses	in € million	1	3	−2
Provisions for losses on loans and advances	in € million	203	420	−217
General administrative expenses	in € million	89	75	14
Balance of other income/expenses	in € million	3	−8	11
Pre-tax profit	in € million	−141	106	−247
Key ratio				
Cost-income ratio	in %	60.1	12.3	

The Public Sector & Infrastructure Finance segment comprises public sector and infrastructure finance arrangements.

Pre-tax profit in the segment declined to € −141 (2008: € 106 million). The decline is mainly attributable to negative net income from hedge relationships and less positive net commission income.

Operating revenues Operating revenues have fallen from € 609 million in the prior year to € 148 million in the current year. The net interest income declined from € 730 million in 2008 to € 683 million in 2009. This decline is attributable to the constant reduction in the volume of interest-bearing assets. In addition, net income generated from sales or disposals of receivables as well as the redemption of liabilities was also lower than the corresponding prior year figure. On the other hand, higher income was generated with money market operations and with US customer liquidity facilities drawn by customers. Both factors were felt primarily in the first half of 2009. Since mid-2009, they have not had a significantly positive impact on net interest income because interest rates are now stable and because most of the receivables attributable to drawn US American customer liquidity facilities have been repaid. Net commission income was affected by the costs of the guarantees in connection with the liquidity support provided by SoFFin and the Federal Government. It amounted to € −477 million, compared with € −39 million in 2008. Net trading income (2009: € 34 million, 2008: € −124 million) includes valuation profits of stand-alone derivatives and a book profit from the sale of the almost completely impaired and revalued claims against the American investment bank Lehman Brothers Inc. which has filed for creditor protection. In the prior year, costs of € −120 million were incurred as a result of re-hedging and valuing derivative positions with regard to Lehman Brothers Inc. Net income from financial investments amounted to € −7 million (2008: € 13 million). In particular, hedge inefficiencies within the range permitted under IAS 39 caused negative net income from hedge relationships of € −86 million (2008: € 26 million). The expense is partly a reversal of the corresponding income in 2008. The balance of other operating income/expenses amounted to € 1 million (2008: € 3 million).

Provisions for losses on loans and advances Additions to provisions for losses on loans and advances amounted to € 203 million (2008: € 420 million), and consisted of additions to individual allowances (€ 132 million) and portfolio-based allowances (€ 71 million). The individual additions were necessary primarily for infrastructure financing arrangements, for instance finance for motorways, airports and means of transport as well as for public sector finance in the USA.

General administrative expenses General administrative expenses increased from € 75 million in the prior year to € 89 million. The increase is mainly due to the shift of activities of HRE Holding into the business segments. Because operating revenues decreased and general administrative expenses increased, the cost-income ratio deteriorated to 60.1 % compared with 12.3 % last year.

Business segment Capital Markets & Asset Management

Key financials

		2009	2008	Change
Operating performance				
Operating revenues	in € million	31	−506	537
Net interest income and similar income	in € million	65	73	−8
Net commission income	in € million	−73	5	−78
Net trading income	in € million	—	−518	518
Net income from financial investments	in € million	33	−61	94
Net income from hedge relationships	in € million	6	−5	11
Balance of other operating income/expenses	in € million	—	—	—
Provisions for losses on loans and advances	in € million	—	—	—
General administrative expenses	in € million	26	32	−6
Balance of other income/expenses	in € million	—	—	—
Pre-tax profit	in € million	5	−538	543
Key ratio				
Cost-income ratio	in %	83.9	> 100.0	

This segment comprises the capital markets and asset management operations of the Group.

The recovery on the international financial markets was reflected in the result of the Capital Markets & Asset Management segment. In consequence, pre-tax profit last year was positive again (€ 5 million), whereas it had been negative in the prior year (€ −538 million).

Operating revenues The positive pre-tax profit resulted from higher operating revenues of € 31 million (2008: € −506 million). Net interest income of € 65 million was lower than the corresponding prior year figure (2008: € 73 million). Net interest income declined as a result of the constant reduction in the volume of interest-bearing assets. Particularly as a result of the costs incurred for the guarantees in connection with the liquidity support, net commission income fell from € 5 million in 2008 to € –73 million in 2009. In addition, commission income declined after the sale of DEPFA First Albany Securities LLC. Net trading income amounted to € 0 million, and was thus considerably higher than the prior year figure of € –518 million. The improvement was attributable to valuation losses in the Halcyon and Pegasus portfolio described in the Risk Report, which at € –29 million was considerably lower than the corresponding prior year figure of € –237 million. A positive factor was the lower probability of default in connection with the restructuring of a US monoline insurer. In addition, the year 2008 very much reflected the widening of credit spreads in holdings, whereas the credit spreads in 2009 narrowed slightly. The net income from financial investments amounted to € 33 million as a result of write-ups recognised in relation to MBS. The net income from hedge relationships amounted to € 6 million (2008: € –5 million). As was the case in the prior year, the balance of other operating income/expenses amounted to € 0 million.

General administrative expenses As a result of the streamlining of the workforce and the deconsolidation of DEPFA First Albany Securities LLC, general administrative expenses declined from € 32 million in 2008 to € 26 million in 2009. The cost-income ratio improved to 83.9 % (2008: > 100 %).

Corporate Center

The Corporate Center includes the contributions to earnings made by the non-strategic portfolios such as the CDO portfolio. It also includes contributions to earnings from HRE Holding as well as the costs of major Group functions.

The changed situation of HRE and the problems arising from the crisis on some markets had a significant impact in the Corporate Center. In consequence, pre-tax profit was very negative at € –628 million. The prior year figure of € –4,593 was affected by the impairments recognised in relation to goodwill and intangible assets of DEPFA as well as structured products.

Operating revenues Provisions for losses on loans and advances amounted to € –347 million (2008: € –1,564 million). Net interest income amounted to € 16 million. Impairments recognised in relation to some subordinated capital instruments resulted in income of € 138 million in 2009 (prior year: € 353 million). In addition, the net interest income in 2009 included less income from sales of receivables than was the case in 2008. Without these two factors, net interest income would have increased compared with the prior year, as it was possible for liabilities to be repaid after the capital increases had been carried out. Net commission income was affected by the costs of the guarantees in connection with the liquidity support provided by SoFFin and the Federal Government and declined from € –29 million in the year 2008 to € –189 million in the year 2009. Net trading income of € –37 million (2008: € –322 million) was considerably less affected by changes in the value of synthetic CDOs recognised in the income statement (2009: € –58 million, 2008: € –395 million). In addition, net trading income was boosted by changes in the market value of derivatives, which had to be valued on a stand-alone basis after the hedge criteria were no longer applicable. Net income from financial investments of € –30 million (2008: € –1,419 million) mainly included impairments recognised in relation to financial investments. However, the impairments recognised in relation to cash CDOs (€ –77 million) were considerably lower than in the corresponding prior year (€ –762 million). In addition, impairments in relation to MBS of € 131 million were reversed whereas impairments of € –528 million were necessary in the prior year. In addition, a building was impaired by € –33 million. Hedge inefficiencies within the range permitted under IAS 39 caused negative net income from hedge relationships of € –37 million (2008: € 65 million). The balance of other operating income/expenses mainly comprised negative effects attributable to currency translation.

Provisions for losses on loans and advances Provisions for losses on loans and advances amounted to € 22 million compared with € 170 million in the prior year. They consisted of allocations to individual allowances (€ 41 million) and reversals of portfolio-based allowances (€ –19 million). In accordance with IAS 39, portfolio-based allowances are created only for receivables for which there are no indications of an individual impairment.

General administrative expenses General administrative expenses amounted to € 249 million; this was lower than the corresponding prior year figure (€ 343 million) and was mainly attributable to the reduction of HRE Holding activities as well as the streamlined workforce.

Balance of other income/expenses The balance of other income/expenses was attributable to additional allocations to provisions for the strategic refocusing and restructuring of HRE. The expenses for the prior year were also attributable to allocations to restructuring provisions. This was partially offset by income of € 180 million resulting from the derivative embedded in the mandatory convertible bond.

Key financials

		2009	2008	Change
Operating performance				
Operating revenues	in € million	–347	–1,564	1,217
Net interest income and similar income	in € million	16	74	–58
Net commission income	in € million	–189	–29	–160
Net trading income	in € million	–37	–322	285
Net income from financial investments	in € million	–30	–1,419	1,389
Net income from hedge relationships	in € million	–37	65	–102
Balance of other operating income/expenses	in € million	–70	67	–137
Provisions for losses on loans and advances	in € million	22	170	–148
General administrative expenses	in € million	249	343	–94
Impairments on goodwill and DEPFA's intangible assets	in € million	—	2,482	–2,482
Balance of other income/expenses	in € million	–10	–34	24
Pre-tax profit	in € million	–628	–4,593	3,965

Development in Assets

Assets in € million	31.12.2009	31.12.2008
Cash reserve	1,824	1,713
Trading assets	10,749	17,287
Loans and advances to other banks	37,521	49,409
Loans and advances to customers	198,344	222,048
Allowances for losses on loans and advances	−3,898	−2,277
Financial investments	94,808	108,740
Property, plant and equipment	15	32
Intangible assets	44	40
Other assets	15,399	17,396
Income tax assets	4,870	5,266
Current tax assets	146	132
Deferred tax assets	4,724	5,134
Total assets	**359,676**	**419,654**

Total assets of HRE declined continuously in the year under review, and amounted to € 359.7 billion as of 31 December 2009; this represents a decline of 14 % compared with last year (2008: € 419.7 billion). The considerable decline was attributable to several factors: portfolios declined because repayments exceeded new business and the drawings of old commitments. Portfolios were also reduced as a result of a deliberate strategy of streamlining non-strategic assets. Particular mention has to be made in this respect of the sale of CDOs and MBS (nominal value of € 1.3 billion in total), student loans (€ 0.5 billion) as well as receivables from the Lehman Brothers insolvency. On-balance-sheet holdings declined as a result of exchange rate factors and the impact of the lower level of interest rates on the market values of the derivatives. These factors were reflected primarily in the items loans and receivables, financial investments and trading assets. Under loans and receivables, the main decline related to holdings of municipal loans, because selective new business was opposed by high repayments. Under financial investments, holdings of debt securities and other fixed-income securities declined. Under trading assets and other assets, the main decline related to the positive market values of the stand-alone derivatives of the bank book and the hedging derivatives. Total assets also declined as a result of the impairments recognised in relation to receivables and securities and as a result of the deconsolidation of special purpose entities after the sale of the held tranches.

The contingent liabilities which are attributable to the overall volume of lending declined to € 0.8 billion as of 31 December 2009 mainly as a result of the deletion of performance guarantees and indemnities (31 December 2008: € 1.3 billion). The total volume of lending, which comprises loans and advances to customers (excluding investments), loans and advances to other banks (excluding investments) as well as the contingent liabilities, declined by 12 % from € 267.3 billion as of the end of 2008 to € 236.2 billion as of 31 December 2009.

Development in the Financial Position

Equity and liabilities

in € million	31.12.2009	31.12.2008
Liabilities to other banks	137,349	146,878
Liabilities to customers	13,259	15,936
Liabilities evidenced by certificates	156,376	197,978
Trading liabilities	11,391	17,236
Provisions	249	352
Other liabilities	29,250	33,835
Income tax liabilities	3,976	4,163
Current tax assets	113	161
Deferred tax assets	3,863	4,002
Subordinated capital	3,217	4,784
Liabilities	**355,067**	**421,162**
Subscribed capital	3,649	633
Hybrid capital instruments[1]	1,043	—
Silent participation[2]	999	—
Additional paid-in capital	8,351	6,352
Retained earnings	−4,368	1,085
Revaluation reserve	−2,829	−4,117
AfS reserve	−2,267	−3,115
Cash flow hedge reserve	−562	−1,002
Consolidated loss/profit 1.1.–31.12.	−2,236	−5,461
Equity	**4,609**	**−1,508**
Total equity and liabilities	**359,676**	**419,654**

[1] Hybrid capital instruments of the subsidiary Depfa Bank plc which had to be reclassified according to IAS 32 under equity instead of under subordinated capital (non-controlling interest)
[2] Silent participation of SoFFin to the subsidiary Deutsche Pfandbriefbank AG (non-controlling interest)

Equity (excluding revaluation reserve) amounted to € 7.4 billion as of 31 December 2009, compared with € 2.6 billion as of 31 December 2008. Including the revaluation reserve, equity accordingly amounted to € 4.6 billion as of 31 December 2009 (31 December 2008: € −1.5 billion).

Following the recapitalisation of HRE by SoFFin, subscribed capital increased by € 3.0 billion in 2009. In the first quarter of 2009, SoFFin utilised the authorised capital to take up 20 million shares of HRE Holding for the price of € 3.00 per share. In June 2009, SoFFin took up around 986.5 million shares as part of a capital increase which was adopted by the Extraordinary General Meeting of the Company on 2 June 2009. HRE Holding received proceeds of around € 2.96 billion out of this second capital increase. In November 2009, SoFFin paid a silent participation of € 1.0 billion to the subsidiary Deutsche Pfandbriefbank AG. This silent participation is reported in a separate line under equity. In addition, in November 2009, SoFFin paid a figure of € 0.7 billion into the reserve of HRE Holding, and a figure of € 1.3 billion into the reserve of Deutsche Pfandbriefbank AG. These payments are shown under additional paid-in capital.

In line with the regulations of IAS 32, the expenses of € 8 million which are attributable directly to the capital increases are shown directly in equity.

Since the first quarter of 2009, certain hybrid issues of DEPFA Bank plc have had to be recognised as equity instruments in accordance with IAS 32.16. The classification of financial instruments as capital instruments or debt instruments does not depend on the company law regulations. Instead, it depends on whether the Company has a contractual obligation to make payments from an issued financial instrument. DEPFA Bank plc has issued subordinated debt in the form of perpetual bonds via its issuance vehicles DEPFA Funding II LP, DEPFA Funding III LP and DEPFA Funding IV LP. These hybrid capital instruments only have to make interest payments if creditors of equal ranking receive an interest payment. After the last equal ranking liability with interest claims was repaid in the first quarter of 2009, the Company no longer has a contractual obligation to make interest payments after this time. Accordingly, it was necessary for the carrying amount of these hybrid capital instruments (€ 1,043 million) to be reclassified under equity (instead of under subordinated liabilities).

The revaluation reserve amounted to € –2.8 billion (31 December 2008: € –4.1 billion). The AfS reserve improved to € –2.3 billion as of 31 December 2009, compared with € –3.1 billion as of 31 December 2008. This development is attributable to improvements in credit spreads. In addition, the AfS reserve was also less negative as a result of the impairments and amortisation of securities which were reclassified in the course of the financial year 2008 in accordance with the IAS 39 amendment “Reclassification of Financial Assets” which was adopted by the IASB in October 2008 and endorsed by the EU. HRE had reclassified available-for-sale assets with a carrying amount of € 76.1 billion as loans and receivables with retroactive effect as of 1 July 2008. Without this reclassification, the AfS reserve after taxes in 2009 would have been € 2.7 billion higher. Since the date of reclassification, the AfS reserve after taxes would have been lower by a total of € –4.3 billion without this reclassification. The cash flow hedge reserve amounted to € –0.6 billion, compared with € –1.0 billion at the end of last year. The change was mainly attributable to maturities of derivatives and the lower level of interest rates in the course of the year.

Total Group liabilities amounted to € 355.1 billion as of 31 December 2009, compared with € 421.2 billion as of 31 December 2008.

The liabilities declined in all positions compared with the end of 2008, particularly under liabilities evidenced by certificates. A figure of € 7 billion was repaid in the financial year 2009 in relation to the liquidity facility of € 50 billion granted in November 2008. The draw-down of the liquidity support is reflected primarily in liabilities evidenced by certificates and liabilities to other banks. Subordinate capital declined as a result of maturities and as a result of the fact that hybrid issues of DEPFA Bank plc were reclassified as equity. In addition, as a result of the merger between the former DEPFA Deutsche Pfandbriefbank AG and Hypo Real Estate Bank AG, the instruments of profit-participating rights of the former DEPFA Deutsche Pfandbriefbank AG have become subordinated liabilities because the holders of the instruments were granted co-equal rights. These rights comprise modifications with regard to dividend distributions and participation in losses. They were reclassified on the basis of these modifications, as this more closely reflects the economic intent of the agreements. The trading liabilities and other liabilities declined because the negative market values of the trading and hedging derivatives declined as a result of the lower level of market interest rates.

The other commitments declined to € 8.1 billion compared with € 13.2 billion at the end of last year. The loans which were not paid out or which were not completely paid out are reflected in irrevocable loan commitments, and amounted to € 5.9 billion as of 31 December 2009, compared with € 11.3 billion as of 31 December 2008. The decline in irrevocable loan commitments is attributable to the higher drawing rate and the decline in commitments for real estate and public sector finance. On the other hand, the issued customer liquidity facilities increased from € 1.9 billion as of 31 December 2008 to € 2.2 billion. These customer liquidity facilities comprise products which are distributed on the US market and which are linked to the issues of tax-exempt municipal bonds. Some of the original loan commitment (liquidity facility) was revived after the draw-down had been repaid.

Regulatory indicators according to German Solvency Regulation[a]

According to German regulatory standards, the calculation of own funds for the due dates 31 December 2009 and 31 December 2008 had to happen without the respective year end result, due to the fact that at the time of the Solvency Reporting to the Supervisors, the prepared annual financial statement did not exist. This would have been the pre-requisite to include the annual result.

For HRE the capital for regulatory purposes (according to German Solvency Regulation [SolvV]) is as follows:

Own funds[1]

in € million	31.12.2009[2]	31.12.2009[3]	31.12.2008[2]	31.12.2008[3]
Core capital (Tier I)	7,614	6,260	5,897	2,928
Supplementary capital (Tier II)	1,133	2,213	2,275	2,069
Equity capital	**8,747**	**8,473**	**8,172**	**4,997**
Tier III capital	—	—	—	—
Total	**8,747**	**8,473**	**8,172**	**4,997**

[1] Consolidated pursuant to section 10a German Banking Act (KWG)
[2] Before prepared annual financial statements and before result distribution
[3] Pro forma as per prepared annual financial statements and after result distribution

The regulatory capital ratios were calculated on the basis of the definition for regulatory capital according to SolvV and risk-weighted assets according to Basel II. The resulting capital ratios as of 31 December 2009 and as of 31 December 2008 were thus as follows:

Key capital ratios

in %	31.12.2009[1]	31.12.2009[2]	31.12.2008[1]	31.12.2008[2]
Core capital ratio[3]	9.4	7.8	6.2	3.4
Equity capital ratio[4]	11.2	11.0	9.0	6.0
Own funds ratio (overall indicator)[3]	10.8	10.6	8.6	5.7

[1] Before prepared annual financial statements and before result distribution
[2] Pro forma as per prepared annual financial statements and after result distribution
[3] Including risk-weighted credit risk positions as well as the capital requirements for market risk positions and operational risks scaled with the factor 12.5
[4] Including risk-weighted credit risk positions as well as the capital requirements for operational risks scaled with the factor 12.5

[a] To calculate the regulatory figures, the definition of capital according to SolvV was utilised. The risk-weighted assets were also calculated on the basis of SolvV. For these credit risks, the amounts were calculated according to the Advanced Internal Rating-Based Approach for those portfolios, for which HRE has received the approval from the German Federal Financial Supervisory Authority. This applies primarily to the portfolios of the former Hypo Real Estate Bank AG, the former Hypo Public Finance Bank and Hypo Pfandbriefbank International S.A. For the entities of the former DEPFA Group, the risk-weighted assets were calculated according to the standardised approach. For calculating the capital requirements for operational risks, the standardised approach was applied across the entire Group.

Summary

The income statement for 2009 very much reflected the specific and extremely difficult situation of HRE as well as the crisis on the real estate markets. It was necessary for significant impairments to be recognised primarily in relation to commercial real estate financings, and also in relation to other receivables and securities. In addition, results of operations were depressed by the expenses of the support measures which were provided. Overall, pre-tax result was negative at € –2,221 million.

Events after 31 December 2009

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

Deutsche Pfandbriefbank AG issued a public sector Jumbo Pfandbrief amounting to € 1 billion on 11 January 2010. The seven year Pfandbrief has a 3.375 % coupon.

Apart from the above, no other notable events have taken place after 31 December 2009.

The situation on the capital markets increasingly stabilised in individual markets in the course of 2009 (with the exception of spreads for government bonds in some Southern European countries). In many rating groups and maturities, the credit spreads were considerably lower than the levels seen at the end of 2008.

On the real estate markets, the rate of the downward trend in prices for commercial real estate has slowed down, and there are indications of the situation stabilising in certain areas. However, prices are still down compared with previous year levels. There is, however, still further room for reversals due to the high, partly still increasing vacancy rates of the commercial real estate market.

In the course of 2009, the refinancing situation of HRE stabilised as a result of the liquidity and capital support measures which are extensively detailed in the chapter entitled “Major events” in the management report. The second half of 2009 was the first time since the beginning of the crisis that Deutsche Pfandbriefbank AG was able to place the initial private placings and benchmark transactions on the market.

However, the Group is again reliant on the liquidity facilities being extended in the year 2010. There are plans for market placings of Pfandbriefe and unsecured transactions; however these will only be able to reduce the liquidity support to a very limited extent.

Organisation and Principles of Risk and Capital Management

Organisation and committees

The Management Board of HRE Holding is responsible for the group-wide risk management system, and is responsible for taking decisions relating to all strategies and the main issues of risk management and organisation. The risk management system is a system which covers all business activities of the Group, and comprises the plausible and systematic identification, analysis, valuation, management, documentation and communication of all major risks and related monitoring on the basis of a defined risk strategy which is revised annually. The group-wide risk management system of HRE has been improved and further group-wide harmonised in 2009.

The following list sets out key components which are the responsibility of the Management Board:

- Defining, updating and communicating business and risk strategies as the basis of business activities and risk acceptance for all units in the Group
- Defining and improving organisation structures for the Group and in particular for risk management, which ensures that all major risks are managed and monitored
- Adopting credit competence guidelines as a decision-making framework along the credit processes
- Taking decisions regarding (portfolio) management measures outside the competences which have been transferred

The Management Board informs the Supervisory Board of the HRE Holding changes in group-wide business and risk strategies, the risk profile of HRE and the specific business and risk strategies at the level of the operating subsidiary banks.

The Risk Management and Liquidity Strategy Committee (RLA) of the Supervisory Board is mainly responsible for controlling the overall risk situation and for monitoring, establishing and improving an efficient risk management system, and is also responsible for the liquidity management and assurance of the Group. The Management Board notifies this committee of all increases to individual allowances and the creation of new individual allowances in excess of € 5 million and, since the beginning of 2009, has also notified this committee on a weekly basis of major exposures with higher levels of risk.

Risk management of HRE is organised centrally and – as shown in the following diagram – comprises the Management Board and Supervisory Board as well as several committees which have been established by the Management Board of HRE Holding and the Management Board of the subsidiaries:

Organisation of risk management of HRE Holding

as of 31 December 2009

The **Risk Committee** (RC) of HRE consists of the Chief Risk Officer (CRO; Chairman), the Chief Financial Officer (CFO), the Chief Operating Officer (COO), the Chief Credit Officers (CCOs) of the operating segments as well as the Heads of Risk Management & Control and Global Workout. In general, the committee meets on a monthly basis and adopts guidelines/policies (policies and guidelines have to be approved by the Management Board), methods for risk measurement, the related parameters as well as methods of monitoring all risk types. It submits decision-making proposals to the Management Board of HRE Holding and the Management Board of the relevant subsidiaries with regard to risk strategies and limits for all risk types.

The RC monitors the development of economic capital, the risk cover funds, the credit portfolio and the compliance with limits. It takes decisions with regard to suitable measures of credit risk management.

Adaptation and implementation of the decisions which are taken are the responsibility of the organisation structure of the CROs and CCOs of Deutsche Pfandbriefbank AG and DEPFA Bank plc respectively Treasury and Liquidity Management.

The **Asset and Liability Committee** (ALCO) of HRE is chaired by the member of the Management Board responsible for Treasury and Public Finance, and comprises the CRO, the CFO, the Head of Treasury as well as the heads of Asset Liability Management, Finance, Risk Management & Control. It meets on a monthly basis. Its tasks comprise liquidity management, management of the balance sheet structure as well as market risk management and management of the regulatory capital ratios. This committee is also responsible for preparing decision-making proposals for liquidity and refinancing strategies. After discussions in the Risk Committee, these proposal, as well as proposals for acquisitions and disinvestments, are submitted for decision in the Management Board.

At the level of the individual subsidiary banks, the **Credit Committee** comprises the CRO (Chairman), the CCOs of the operating segments and the Senior Credit Executive. The front office representatives have the right to attend and vote within the framework of front office/back office responsibility. In general, the committee meets at least once every week, and is responsible for credit decisions in line with the schedule of powers for new business, prolongations and material changes in the credit relationship. It also votes on all credit decisions which come under the responsibility of the Management Board of the subsidiary institutions or which have to be approved by the Supervisory Board. The Credit Committee ensures that the credit decisions are consistent with the prevailing business and risk strategy.

The **Watchlist Committee** meets on a monthly basis; it is chaired by one of the CCOs of the operating segments, and comprises the Senior Credit Executive, the head of Global Workout, optionally the CRO, as well as the relevant heads of Credit Risk Management. All exposures identified by the early warning system are discussed and further individual measures are adopted by this body which meets every month; these measures are subsequently implemented by the relevant departments. This committee is also responsible for taking any decisions for forwarding an exposure to Global Workout, which is responsible for taking the necessary restructuring and workout steps. All necessary credit decisions are taken by the persons with appropriate responsibility in line with the allocation of credit powers or in the Credit Committee.

If impairment triggers have been activated, the result after an impairment test is presented to the **Risk Provisioning Committee**, and any necessary resolution is adopted. The committee meets on a regular basis, and comprises the CRO (Chairman), the CFO, the heads of the regional workout segments as well as the CCOs of the operating segments. Within the overall schedule of powers, it is responsible for taking decisions with regard to the creation and reversal of risk provisioning as well as any necessary acquisitions through foreclosures. Any decisions which exceed the allocated powers are taken, upon the recommendation of the committee, by the Management Board of the relevant subsidiaries, which also generally have a right of veto in relation to decisions of the committee for their area of responsibility.

Chief Risk Officer (CRO) In addition to the above-mentioned committees, the following organisation units of the CRO form an integral part of the risk management system:

Organisation of Chief Risk Officer of HRE Holding

as of 31 December 2009

Group CRO

- Risk Management & Control
- Credit Officer Real Estate
- Credit Officer Public Sector, Financial Institutions & Value Portfolio
- Global Workout
- Credit Quality Control
- Property Analysis & Valuation Germany/Property Analysis Europe

The organisation of the CRO function comprises the following monitoring and back office entities:

- The Risk Management & Control unit which is also responsible for monitoring and managing group-wide market, counterparty, operational and liquidity risks and which are also responsible for group-wide uniform risk-measuring methods, risk reports and credit processes
- The **Credit Officer Real Estate and Credit Officer Public Sector, Financial Institutions & Value Portfolio** unit (which also comprises Infrastructure Finance, the structured products as well as Capital Markets/Asset Management business), each of which is responsible for portfolio management and analysing the selective new business
- The **Global Workout unit,** which is responsible for the Group-wide restructuring and workout of all critical exposures in the Real Estate Financing segment. The various Credit Risk Management (CRM) segments are responsible for processing in the Public Sector, Infrastructure Asset Finance Group and Structured Products segments
- The **Credit Quality Control** unit, which is currently being set up and which will be responsible mainly for quality control of the credit process and the risk analyses for HRE
- The **Property Analysis & Valuation Germany/Property Analysis Europe unit,** which is responsible for analysing and uniformly valuing the secured properties.

In addition to the CRO function, the risk management system of HRE is also complemented by Group Compliance as well as Group Internal Audit, which constantly monitors MaRisk conformity of the Group by means of regular audits of processes and systems. Risk management is also supported by Group Legal.

Risk strategy and policies

On the assumption of adequate recapitalisation, the risk strategy is based on the risk-bearing capacity analysis and on the risk strategy. It comprises the definition of the risk propensity of HRE on the basis of the economic capital, with due consideration being given to risk cushions and an intended A-rating.

In the third quarter of 2009, the risk strategy was amended on the basis of the updated business strategy. The risk strategy was adopted in October 2009 in the HRE Holding Management Board and was presented to the Risk Management and Liquidity Strategy Committee of the Supervisory Board to be noted at the beginning of November 2009. It is applicable throughout the Group, and the parts relevant for the subsidiaries Deutsche Pfandbriefbank AG and DEPFA Bank plc were adopted separately by the respective management boards.

The risk strategy reflects the strategic refocusing of the Group as a specialist real estate and state financier in Germany and Europe with Pfandbrief-oriented refinancing; it is integrated in the business planning process of HRE and is updated every year.

The adopted, conservative risk strategy of HRE sets out how quality of financing can be improved, e.g. by way of assets which are almost exclusively eligible for Pfandbrief refinancing, conservative refinancing of new business (largely by way of Pfandbrief issues). The strategy concretises the long-term goal of HRE to become the competence centre for financing combined with servicing of the public sector and professional real estate finance operations in Germany and Europe.

The strategy is reflected in the following core points:

- Focusing of new business on the primary market for Pfandbrief-eligible issues in Public Sector operations and Pfandbrief-eligible loans in Real Estate Finance operations
- Provision of financing structures of low complexity in the primary market, secondary market transactions do not form part of the Group's core operations
- Risk-oriented portfolio management of new and existing business supported by syndication and securitisation activities
- The non-strategic existing portfolio will be reduced without a major impact on results
- Conservative refinancing of operations primarily by way of Pfandbrief issues

The risk strategy is broken down into strategies for the intended new business and the strategic and non-strategic portfolio business for the new Public Sector and Real Estate Finance segments. Sub-strategies for the main risk types of the Group are set out in further detail in the relevant chapters.

Implementation of this strategy is the responsibility of the sub-Groups Deutsche Pfandbriefbank AG and DEPFA Bank plc. A crucial factor of success in this respect is the review, which was requested on 21 January 2010 and which is currently being carried out, of the process of transfering parts of the portfolio of DEPFA Bank plc, Dublin, together with non-performing loans or loans which are no longer consistent with overall strategy from the Real Estate Finance segment into a new Public Sector body to be established with partial legal capacity. This body, which is known as a deconsolidated environment, is a separate legal entity reporting to the FMSA; it is in the discretion of the FMSA to establish such a deconsolidated environment. For further details, please refer to chapter "Major events" of this financial review.

Operational specification of the risk strategy at HRE is carried out via risk policies for the individual operating segments as well as for all major risk types (credit risk, market risk, liquidity risk and operational risk); these risk policies describe risk measurement, risk monitoring, risk management, the limit process as well as the escalation process if a limit is exceeded. The policies are regularly reviewed and updated where necessary.

Risk reporting

In the financial year 2009, the entire risk reporting system was thoroughly revised, and the quality was considerably improved – also within the context of the additional requirements in accordance with MaRisk 2010. The regular reports addressed to the Management Board of HRE and the Management Boards of the subsidiary institutions include the following:

- Daily liquidity risk report for the liquidity position and preview
- Weekly summary of the markets, the market risk development as well as relevant management information
- Monthly, short Group risk report concerning major parameters relevant for management purposes
- Quarterly Group risk and credit risk report

The CRO and the member of the Management Board responsible for Treasury and Public Sector also receive market risk reports on a daily basis.

These reports provide the Management Board with a comprehensive overview as well as detailed information concerning the risk situation for each risk type and Company. In addition, special reports are prepared on an ad hoc basis or at the request of the Management Board or Supervisory Board; these special reports consider specific and acute risk aspects, for instance in relation to critical markets, products or counterparties.

In the individual committees described above, the members of the Management Board receive further detailed reports concerning the risk position with specific management information and recommendations.

The Supervisory Boards or the Risk Management and Liquidity Strategy Committee of the Supervisory Board of HRE Holding as well as the Supervisory Boards of the subsidiary institutions are informed about the portfolio structure, the risk situation and specific risk-relevant issues at regular intervals, at least quarterly and at short notice, if necessary.

They receive the following on a regular basis:

- Monthly: the short group risk report for major parameters which are relevant for management purposes
- Quarterly: the group risk and credit risk report

Since the beginning of 2009, the Risk and Liquidity Strategy Committee of the Supervisory Board of HRE Holding has been notified of all major exposures as well as all major individual allowances.

Risk quantification, risk management

At the portfolio level, the value at risk (VaR) approach is used for quantifying risk and also for determining the economic capital for the main risk types apart from the liquidity risk. The individual calculation methods are described extensively in the chapters for the individual risk types.

Further risk types which are considered to be major as part of the regular internal risk assessment, such as strategic risks, reputation risks, regulatory risks as well as pension risks, are not measured quantitatively; instead, they are managed and limited by way of regular detailed reports and clear specifications, e.g. the regulations concerning compliance and corporate governance.

At the portfolio level and at the level of individual transactions, risk in the Group is managed by:

1. Monitoring the risk-bearing capacity on the basis of the comparison of economic capital and the risk cover funds of HRE at the portfolio level, with due consideration also being given to newly developed stress tests
2. Monitoring the risk-weighted assets (RWA) at the portfolio level by way of new stress tests implemented in 2009, the purpose of these tests is to ensure that the total capital ratio does not fall below 8.5 %
3. Operational risk management via
   - The use of Basel-II-compliant risk parameters in the lending business. The Basel-II-compliant management approach shows the average expected loss at the borrower level, and is therefore a major component in risk early recognition and ongoing profitability monitoring. The parameters are reviewed and recalibrated annually. This approach was implemented in the first half of 2009 as part of the process whereby the IRBA approach was also introduced in the DEPFA entities, and is scheduled to be assessed in the second quarter of 2010 by the Bundesbank.
   - An improved limit system for counterparty and issuer risks on the basis of a standard application with a uniform risk-measuring method throughout the Group which has been tried-and-tested in the market, which was developed in 2009 and which is to be introduced throughout the Group in the first quarter of 2010.
   - Intense monitoring and management of individual counterparties, also with the support of an early warning system which was improved in 2009
   - Monitoring the risk of losses by way of appropriate impairment triggers in accordance with IAS 39

Risk management of HRE will be further improved in the course of 2010 by integrating the economic capital in the business planning process.

Economic capital and monitoring the risk-bearing capacity

HRE has established an internal risk-bearing capacity analysis which is based on the Internal Capital Adequacy Assessment Process (ICAAP), in order to ensure that the Group's risk position is consistent with the information in its report concerning its willingness to take on risk. The audit of internal capital adequacy is based on the concept of economic capital. The provision of economic capital at HRE is specifically designed to meet the demand and requirements of business at HRE and to comply with the pillar-2 criteria under Basel II for banks and the corresponding specific integration in the German MaRisk which prescribe adequate internal capitalisation.

Economic capital is defined as "the quantity of capital required by a bank in order to cover the largest potential total loss with a defined probability over a time horizon of one year". The measure of loss probability used by HRE is the probability of loss associated with its intended long-term credit rating (A). The figure calculated on the basis of the estimate of the rating agency Standard & Poor's for the long-term probability of default of primary unsecured obligations with an A rating is currently 0.05 % (unchanged since the end of 2008). The confidence level used as the basis for calculating the economic capital is thus 99.95 %.

The economic capital is calculated by aggregating the economic capital for credit risk, market risk, operational risk and other risks, taking account of customary correlation assumptions. The calculation of economic capital is based in most cases on a Value-at-Risk approach. The VaR quantifies the maximum amount which will not exceeded within a given time period and with a certain probability. VaR models are based on historical data and assume that the future developments will follow a similar pattern. The limitations of a VaR model can be summarised as follows:

- The defined time period reflects the holding period of a risk position. Thus it is assumed that the respective position can be closed down or hedged within this time-frame.
- The defined probability, the confidence level, e.g. 99.95 %, leaves a statistical probability that the loss might exceed within the defined time period the calculated VaR.
- The consideration of historical data might not include all possible scenarios, especially extraordinary cases, which might happen in the future.
- VaR is dependent on both the risk position and the volatility of market price.

The VaR is nonetheless an important factor to calculate economic capital and for business management in the market risk section. The quality of the VaR models is continuously monitored by back-testing the P & L results and improved, if necessary.

The individual VaR calculation methods are described in greater detail in the corresponding chapters. As is normal for the sector, economic capital is not calculated for the liquidity risk; however, the risk is taken into consideration in stress scenarios.

In order to evaluate the capital backing of HRE, the amount of economic capital is compared with the financial resources available to the Bank within one year. The definition of the available risk cover funds for one year comprises customary components such as essentially the shareholders' equity in accordance with IFRS, components similar to shareholders' equity (subordinate capital and hybrid capital) as well as the planned result for the next twelve months. These components are suitable for alleviating the impact of potential losses and for maintaining a corresponding risk buffer. The totality of these capital components (risk cover funds) must always be greater than a potential loss which might occur (economic capital).

On the basis of the ICAAP, the main risk measured in terms of the economic capital (excluding explicit recognition of liquidity risk) is the credit risk, which accounts for more than 80 % of economic capital followed by market risk, operational and business risk.

In terms of economic capital, HRE has been undercapitalised since the third quarter of 2008 – particularly as a result of the widening of credit spreads. Various measures such as the planned reduction of risk, the reported planned transfer of major sub-portfolios to a deconsolidated environment as well as the takeover and planned further recapitalisation by the government should restore the risk-bearing capacity.

The results of the economic capital and the stress tests are regularly presented to the Central Management Board and the Risk Committee, where they are discussed and any management measures are defined.

For the year 2010, there are plans for a significant adjustment of the ICAAP method to the changed business strategy of the Group. A corresponding project was commenced in the fourth quarter of 2009 with external support, and will probably be implemented by the first quarter of 2010. The strategic refocusing will be explicitly taken into consideration in the model with a much stronger focus on assets held to maturity, the new ownership structure, the changed funding profile as well as the plans to spin off the deconsolidated environment.

Parts of the planned adjustment have already been implemented in the calculation of the credit risk VaR as of year end 2009.

Major projects in risk management

Limit system The year 2009 saw the development of a Group-wide limit system which takes account of all borrowers and products of all consolidated legal entities of the Group. The final implementation of the system in the risk management process of HRE will be completed in the first quarter of 2010. Further finetuning and configurations are expected to follow.

Market data system With the implementation of a Group-wide market data system, a quality-assured consistent market data supply system was groupwide introduced in 2009 throughout the Group in order to ensure uniform measurement of all risk positions.

Management Information System MIS In 2009, the Group-wide reporting platform “MIS/Risk Cockpit” was further expanded and standardised, thus providing prompt and transparent data supplies for reporting the key credit risk parameters. This uniform platform will noticeably improve the data quality and consistency of the individual reports. The year 2010 will see continuous finetuning as well as a further configuration stage with additional information and a higher degree of automation for preparing the reports.

Standardisation of market risk As part of the first phase of Group-wide standardisation of market risk management, work in 2009 focused on the uniform measurement of loans and liabilities. Further project phases are planned in the following releases within the context of the New Evolution programme – TOPP 2011.

Basel II/DEPFA For the DEPFA Group, the preparations for Basel-II-IRBA approval were completed and the audit application was submitted to the regulatory authorities. The audit will be carried out starting in April 2010.

If the mentioned projects are affected by a major delay or they fail, this might result in inappropriate management signals.

Internal control and risk management system relating to the accounting process

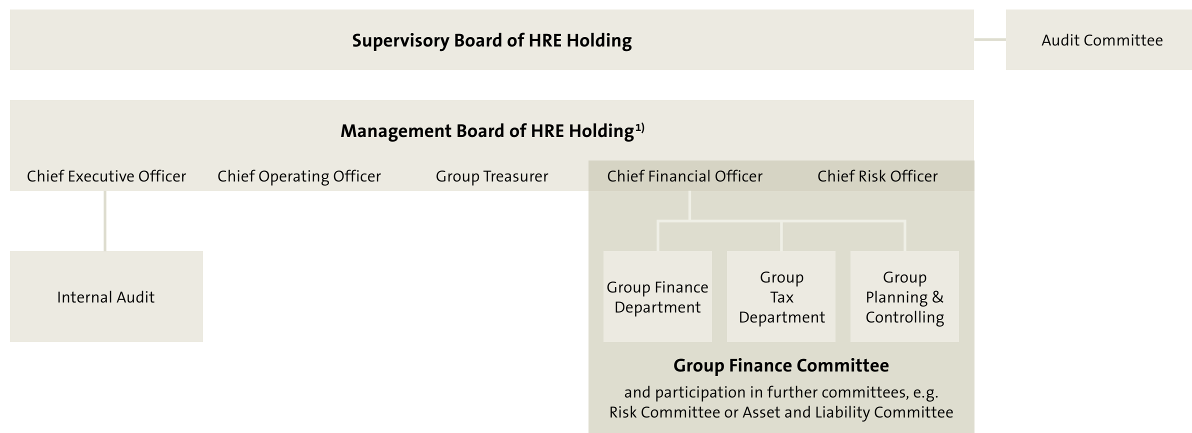
Concept The internal control and risk management system relating to the accounting process comprises the principles, procedures and measures designed to assure the effectiveness and efficiency of accounting and also for ensuring compliance with the relevant legal regulations. The aim of the risk management system in relation to the accounting process is to identify and evaluate risks which might not be consistent with the aim of ensuring that the financial statements comply with the relevant regulations; it also aims to limit identified risks and analyse the impact of these risks on the financial statements and the way in which these risks are presented. The internal control system relating to the accounting system is an integral component of the risk management system; its aim is to implement controls and provide adequate assurance that financial statements comply with the appropriate regulations despite the risks which have been identified.

However, an internal control and risk management system relating to the accounting process cannot provide absolute certainty with regard to meeting the relevant objectives. As is the case with all decisions involving discretion, such decisions for setting up appropriate systems may also be affected by faults, errors, changes in variables or deliberate violations and criminal actions. These problems mean that it is not possible to identify or prevent misstatements in the financial statements with absolute certainty.

At HRE, the internal control and risk management system relating to the accounting process is reflected in the structure and procedure organisation. In terms of structure organisation, the internal control and risk management system relating to the accounting process mainly comprises the Management Board, the Supervisory Board in its capacity as the controlling body responsible for monitoring the Management Board, the Audit Committee which is set up by the Supervisory Board, the entities which report to the Chief Financial Officer (CFO), the Group Finance Committee and Internal Audit.

Structure organisation of the internal control and risk management system relation to the Group accounting processes

as of 31 December 2009



[1)] on 1 January 2010 added to by Chief Real Estate Finance

In its capacity as the legal representative of HRE Holding, the Management Board is required to prepare consolidated financial statements and a Group management report in accordance with Section 290 HGB (German Commercial Code). In conjunction with the obligation to introduce a group-wide internal control and risk management system, the Central Management Board of HRE Holding is also responsible for the form, i.e. the concept, implementation, maintenance and monitoring of an adequate and effective internal control and risk management system relating to the accounting process. The central Management Board takes its decisions relating to all strategies in response to the proposal of the Chief Financial Officer (CFO).

The Supervisory Board is responsible for monitoring the Management Board. For this purpose, the Supervisory Board may specify that management measures require the approval of the Supervisory Board. In addition, the Supervisory Board also has audit obligations and reporting obligations. The Supervisory Board of HRE has set up an Audit Committee in order to support its activity. In accordance with Section 100 (5) AktG (German Stock Corporation Act), at least one member of the Supervisory Board and of the Audit Committee must be an expert in terms of accounting and auditing.

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

The CFO heads the three entities Finance, Tax as well as Planning and Controlling. In the area of responsibility of the CFO, the consolidated financial statements are prepared in accordance with IFRS and the accounting-relevant capital market information is provided. The companies of HRE prepare their financial statements in accordance with the relevant local legal requirements. For Group accounting purposes, the financial statements are harmonised and reflect uniform accounting and valuation methods in accordance with IFRS. Each incorporated Company then reports the balance sheet, income statement and the corresponding disclosures in the notes to a central department in Group Accounting via the consolidation software. In Group Accounting, the data of the foreign currency companies are converted into euros by means of the consolidation software. In addition, the data are also checked for plausibility, analysed and consolidated.

At the Group level, the Management Board has set up a Group Finance Committee (GFK) which makes recommendations to the Management Board. These include responsibility for defining and monitoring the guidelines and procedures for accounting and reporting for all entities of the HRE Group and the consolidated financial statements as well as for all segments of the HRE. In order to ensure efficient communication with other entities, the CFO or the heads of the CFO entities are also participants in other committees, such as the Risk Committee with its sub-committees or the Asset and Liability Committee (ALCO).

In terms of procedure organisation, the internal control and risk management system relating to the accounting process is based on processes and software which are intended to be as standardised as possible. Guidelines and a code of conduct exist for core activities and processes. The four-eyes principle is also 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 require such information for their work. Where necessary, results are agreed across all entities and companies.

Implementation For preparing the consolidated financial statements and the Group management report, HRE has implemented the concept of the internal control and risk management system relating to the accounting process in various measures for identifying, evaluating and limiting the risks. The structure organisation measures relate to the committees of HRE and the CFO entities. To a large extent, the same people serve on the committees of the main Group companies, thus permitting uniform management. For instance, the members of the Management Board of HRE Holding are also the members of the Management Board of Deutsche Pfandbriefbank AG; most of them are also executive or non-executive members of the Board of Directors of DEPFA Bank plc.

There is a clear segregation of functions within the area of responsibility of the CFO; this is for instance reflected in separate departments for processing IFRS accounting policies and preparing financial statements. In addition, the processes of preparing the consolidated financial statements and the separate financial statements are structured in individual groups. The GFK and further committees as well as department discussions form links between the various functions. In addition, executive, accounting and administrative activities, such as the payment and recording of the payment, are clearly segregated or are subject to the four-eyes principle. In addition, the entities included in the consolidated financial statements report the data to a central department within the Group, thus ensuring that further processing is carried out in a uniform process.

Within the procedure organisation, there are automated or system-based and manual or non-system-based measures for managing the risks and for internal controls. Among the system-based measures, standard software for recording, reconciling, checking and reporting the data is used as far as possible in order to avoid errors. This is also applicable for consolidation, which is carried out with software which is widespread on the market. The consolidation software provides technical support for reconciling the intra-group relations in a clearly regulated process in order to ensure that these intra-group relations are completely and correctly eliminated. The data of the incorporated entities are reported in a uniform standardised position plan. Automated plausibility checks are for instance used for reporting the data of the subsidiaries for consolidation purposes. System support is provided for checking the balances carried forward. As protection against loss, the data of the consolidation software are backed up daily, and the back-up data is sourced on tape. In general, the software of HRE is protected against unauthorised access by means of clearly regulated administration and approval of authorisations.

In addition to the system-based measures, HRE has also implemented manual or non-system-based measures. Accordingly, a standardised process is used for assuring that the reported data are correct and complete. For this purpose, variance analyses are carried out, including variance analyses in the form of budget-actual comparisons. In addition, the consolidated balance sheet and income statements are prepared on a monthly basis, and some positions are even prepared on a daily basis. Extrapolations and planning statements are also prepared. A better understanding is achieved as a result of the frequent and continuous process of analysing figures. Accounting principles which have to be applied throughout the Group are defined and communicated in various ways, including the form of a manual. These accounting principles comprise the analysis and interpretation of the new and existing IFRS standards and interpretations in order to permit uniform accounting and measurement throughout the Group. Generally accepted measurement methods are used. The methods which are used as well as the underlying parameters are regularly revised and adjusted where necessary. Deadlines are also defined, so that timely action can be taken in the event of deadline problems.

In order to improve the quality of control, various entities are involved in certain processes and are obliged to take part in the harmonisation process. For instance, the purpose of the division-wide new-product process and the revision of existing products with a right of veto by the Finance entity is to ensure that the accounting presentation of the products is uniform and systematic. A further example of division-wide harmonisation is the process for preparing the annual reports and interim reports. All entities which are involved have to confirm these reports before the financial statements are prepared by the Management Board (so-called sub-certification process), thus providing a further control stage for the products to be disclosed. Ahead of this process, all affected divisions agree the contents of the annual reports and interim reports in editorial meetings.

In the risk management system in relation to the accounting process, HRE takes measures designed to avert fraudulent actions and deliberate violations to the detriment of HRE. Theft, embezzlement or misappropriation, are examples of fraudulent actions to the detriment of HRE. In relation to the accounting process, deliberate misstatement is also defined as a fraudulent action. HRE identifies and evaluates the risks, and puts measures in place to avert such fraudulent actions and deliberate violations. A newly developed system-based concept also provides training in compliance regulations to employees.

Maintenance Where necessary, HRE revises and improves its internal control and risk management system relating to the accounting process continuously in the course of the meetings of the Management Board, the GFK and division-internally in order to ensure that risks are identified, evaluated and limited in a manner which is as correct and comprehensive as possible. In consequence, the internal control and risk management system relating to the accounting process is also adjusted to new circumstances such as changes in the structure and business model of the Group or new legal requirements.

The risk of fraudulent actions and deliberate violations is regularly analysed in order to enable appropriate action to be taken. Due consideration is given to various aspects in this respect, including unusual events and changes in the situation of HRE and individual employees.

HRE has to comply with legal requirements. If there are any changes in legal requirements, e.g. in the form of new or amended IFRS standards, the changes have to be implemented. The necessary adjustments to the processes and IT systems are implemented department-wide and with clear functional allocation, where appropriate in separate projects. As part of the implementation process, the risk management system in relation to the accounting process is also adjusted and brought into line with the changed regulations, for instance for revising the process of hedge accounting.

As part of the restructuring process at HRE, companies have been liquidated and merged, branches closed and the workforce reduced. HRE limits the risk in relation to the process of preparing the consolidated financial statements by means of clear functional allocations, the centralisation of project management for restructuring and close cooperation between the various entities.

The IT system landscape of HRE is of a heterogeneous nature primarily as a result of the acquisition of DEPFA Bank plc in 2007 and numerous intra-group mergers of companies. Accordingly, the systems and processes will be harmonised as far as possible in the course of the New Evolution project during the next few years.

Monitoring Internal Audit is responsible for assessing the adequacy of transactions and is also responsible for identifying inefficiencies, irregularities or manipulation. In accordance with the rules of Minimum Requirements for Risk Management (MaRisk), Internal Audit also assesses the effectiveness and adequacy of risk management and the internal control system in a risk-oriented manner, and identifies any weaknesses in the processes of identifying, evaluating and reducing the risks. This also includes an audit of the IT systems of HRE as well as the processes and controls in the CFO functions of the reporting entities and Group Accounting. Plans of specific measures with specific deadlines are prepared and followed up in order to process the errors which are identified. Internal Audit reports directly to the CEO and is not integrated in the work procedure, nor is it responsible for the results of the process to be audited. In order to enable it to carry out its duties, Internal Audit has a complete and unrestricted right to receive information regarding the activities, processes as well as the IT systems.

In accordance with Section 111 (2) AktG (German Stock Corporation Act), the Supervisory Board is able to inspect and audit the accounts and the Company's assets in its capacity as the control and advisory body of the Management Board. In addition, the Management Board also reports regularly to the Supervisory Board. The internal control and risk management system relating to the accounting process is the subject of the Supervisory Board meetings. The Supervisory Board engages the auditor for auditing the annual financial statements and consolidated financial statements in accordance with Section 290 HGB (German Commercial Code). The Supervisory Board approves the consolidated financial statements which has been prepared by the Management Board and certified by the independent auditor, and also approves the Group management report. The Supervisory Board has set up an Audit Committee to relieve the Supervisory Board of its responsibility for the task of extensively and promptly auditing the consolidated financial statements, the Group management report as well as the proposal for the appropriation of the cumulative profit; essentially, the Audit Committee operates only on a preparatory basis. The Audit Committee is responsible primarily for monitoring the accounting process, the effectiveness of the internal control system, the risk management system and the internal audit system as well as the external audit of the financial statements, and in particular the independence of the external auditor and the services additionally provided by the external auditor.

The external auditor attends the meetings of the Supervisory Board and of the Audit Committee, and reports on the main results of its audit, in particular major weaknesses of the internal control and risk management system relating to the accounting process. The external auditor also reports without delay on all findings and events which are essential for the duties of the Supervisory Board and which are identified in the course of the audit. The Supervisory Board discusses the main aspects of the audit with the external auditor in advance.

Major Risk Types

HRE distinguishes the following major risk types for its business activities:

- Credit risk
- Market risk
- Liquidity risk
- Operational risk

The following are also major risk types which are taken into consideration for calculating the economic capital:

- Business risk
- Risks attributable to the Bank's own equity participation and real estate holdings

Economic capital is calculated for all risk types, apart from liquidity risk. However, liquidity risk scenarios are also taken into account in the course of stress tests in connection with the review of risk-bearing capacity at the HRE Group level.

The following are major risk types which are not quantified but which are limited by means of suitable reports, guidelines and policies:

- Strategic risks
- Reputational risks
- Regulatory risks
- Pension risks

Credit Risk

Definition

Credit risk is defined as the risk of the loss of value of a receivable or the partial or complete default of a receivable due to the default or downgrading of the rating of a business partner. The credit risk also comprises the counterparty, issuer and country risk, which are defined as follows:

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

Credit risk strategy and principles

As part of the restructuring process, HRE has broken down the overall credit portfolio into a strategic portfolio and a value portfolio. The new portfolio structure will probably be implemented in credit risk reporting in the first quarter of 2010. The adopted risk strategy already reflects the new structure:

- The strategic portfolio comprises major parts of the real estate portfolio as well as the Public Sector portfolio of Deutsche Pfandbriefbank AG.
  - New business in real estate business focuses on Pfandbrief-eligible financing of commercial real estate with sustainable cash flow in Europe, with the main emphasis on Germany, France and England. The main target customers of these operations are professional investors, institutional clients, real estate funds and selective developers. The intended range of products comprises less complex loan structures, selectively extended to include derivative hedging products.
  - In the Public Sector, new business of HRE will focus on low-risk Pfandbrief-eligible financing of sovereigns and sub-sovereigns in Western Europe, particularly in Germany, France, Spain and Italy, as well as state-guaranteed public private partnerships (PPPs). New business is to be refinanced largely via Pfandbrief issues with matching maturities.
- The value portfolio, which is essentially attributable to DEPFA Bank plc and which mainly comprises the portfolio of Infrastructure Finance, Capital Markets, the Corporate Center, major parts of the public sector portfolio as well as a small part of the real estate portfolio, mainly comprises business which is not Pfandbrief-eligible and business which, in terms of volume and risk profile, is not consistent with the overall strategy. There are no plans for business activities to be expanded in this respect; instead, the focus is on streamlining the portfolio whilst maintaining value and imposing minimum strain on capital, for instance by
  - Reducing high-risk and complex assets with maximum priority
  - Reducing long-dated assets with poor returns over a period of time
  - Where appropriate, sales of individual assets
  - Reduction by adjusting conditions

Discussions are being held with regard to spinning off parts of the strategic portfolio and parts of the value portfolio into an deconsolidated environment, described in greater detail in the chapter “Major events”.

Organisation of credit risk management

The organisation of the CRO, as back-office entities for credit risk management, covers all areas which are listed in the previous part under the chapter "Chief Risk Officer" and which are described in the major tasks. In line with the requirements of MaRisk, the back-office entities which are mentioned are organisationally independent of the sales entities right through to the Management Board.

Credit risk reports

In the financial year 2009, reporting on credit risks was thoroughly revised – also taking account of the additional requirements in accordance with MaRisk.

- In the quarterly credit risk report, details concerning the portfolio and risk parameters are extensively reported at the group level and also at the level of the subsidiary institutes; they are discussed in the Management Board and are notified to the Risk Management and Liquidity Strategy Committee of the Supervisory Board. Major parameters which are relevant for management purposes, such as the development of the EaD, the EL and the credit VaR, are integrated in the monthly Group risk report, which is also discussed in the Management Board.
- For decisions relating to new business and adjustments of conditions, major parameters, contents and analyses are presented to the Credit Committee and discussed.
- In the current month, further regular reports support operational management with regard to the management and timely recognition of risks at the sub-portfolio level.
- Unusual developments which might result in a major deterioration in the risk position of an individual exposure are reported to a wider group by way of so-called "credit issue notes".

Credit risk quantification via economic capital

Credit portfolio model HRE uses a credit portfolio model for determining the credit risk VaR. The credit risk of a borrower changes, or the borrower is considered to have defaulted, when certain limits are exceeded. These limits are determined on the basis of the rating of the borrower, a migration mix or the default vector and the volatility of a rating index via an internal loan portfolio model based on the fundamental principles of Credit Metrics. The creditworthiness is modelled by means of a stochastic process, which comprises systematic and specific components and which takes account of the internal rating of the borrowers. The correlations are modelled over the systematic components of the rating index and a ten-year history of relevant time series. The migration matrix for modelling rating changes is determined by S&P and reflects a history of more than 30 years. Beyond the fundamental concept of Credit Metrics, the potential loss of value for the available-for-sale positions is taken into account by considering the maximum historic spread increases which have occurred within one year. Credit spread changes in the IFRS category Fair Value through P&L are recognised in the market risk model.

For a risk level of 99.95 % and a time horizon of one year, disregarding diversification effects with regard to other risk types, the economic capital for credit risks calculated using the credit portfolio model is about € 7.9 billion (December 2008: € 5.9 billion). During the reporting year of 2009, the credit spreads particularly in the public sector narrowed appreciably compared with December 2008, resulting in an increase in the valuation of assets of the Group. The increase in economic capital is mainly a consequence of modelling much larger credit spread scenarios in Public Sector business. The change from an anti-cyclical view to the above-mentioned largest 1-year spread increase for available-for-sale positions has significantly overcompensated the exclusion of Loans and Receivables positions in credit spread modelling due to the hold-to-maturity strategy and different funding situation compared to the previous year. It has not been possible to compensate for this increase by reducing the exposure, particularly in the non-strategic Public Sector business, Infrastructure Finance and CM & AM.

Stress tests In addition to the integrated stress tests for risk-bearing capacity which were newly developed in 2009 and which also cover scenarios of credit risk (see chapter on economic capital and assessment of risk-bearing capacity), stress tests check the impact of the following on the credit risk VaR as well as the available risk cover funds:

- A rating downgrade of all borrowers by one rating notch in each case
- Assumption of the failure of the ten largest borrowers from the Real Estate Finance segment

In addition to the stress tests for economic capital, the year 2009 saw the development of so-called RWA reverse stress tests, which consider the extent to which a certain risk parameter (e.g. rating, LGD, currency) can change before the minimum capital ratio (currently 8.5 %) is no longer met. Tolerance change levels have been defined for all tested risk parameters; these levels must not be violated if the test is to be successfully completed.

Credit risk quantification according to Basel II

All subsidiary institutions of the Group – apart from DEPFA Bank plc, ACS Bank and the former DEPFA Deutsche Pfandbriefbank AG (which is now part of the merged Deutsche Pfandbriefbank AG) – which receive regulatory approval have to apply the so-called Advanced Internal Rating-Based Approach (Advanced-IRBA) for determining the regulatory capital backing. At the end of June 2009, the Group submitted the formal application – including all necessary documents – to the bank regulator for introducing the Advanced-IRBA at DEPFA Bank plc, DEPFA ACS Bank and the former DEPFA Deutsche Pfandbriefbank AG. The regulatory audit will probably start in the second quarter of 2010.

Credit risk management and monitoring

Credit risk management At the portfolio level, the intended portfolio structure is defined in the risk strategy by means of structure components. The limits are also based on the available risk cover funds, and include:

- Limiting of country risks
- Definition of strategic risk parameters (e.g. target customers, regions, financing duration)

The following reports and measures are key elements for monitoring compliance with the defined limits and the intended risk and return parameters at the portfolio level and also at the level of individual transactions:

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

The credit competence guideline also defines the decision-making powers of the individual credit risk managers for prolongations in existing business, depending on the counterparty group and expected loss class. In the period under review, new business is signed exclusively at the Management Board level.

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

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

In response to an enquiry of sales, the credit risk management entities (Credit Officer Real Estate and Credit Officer PS, FI & Value Portfolio) carry out the initial risk analysis for new business and annual risk analysis for existing business. Basel-II-compliant PD and LGD rating tools, which are developed by Credit Risk for Risk Management and Control (RMC) and annually validated and calibrated, are used for valuation purposes and for preparing the credit decision in new and prolongation business. Property Analysis & Valuation Germany / Property Analysis Europe provides support for analysing and valuing the securities. The application is checked by the relevant credit risk management entity.

The Legal department, where appropriate together with external lawyers/lawyers' offices, are responsible for the contract and collateral organisation.

Defined early warning indicators are regularly analysed by Credit Risk Management (CRM). In the event of any irregularities, a credit reassessment (e.g. rating, collateral) is carried out for the corresponding cases, and appropriate measures are initiated. The cases are also included in a monthly monitoring cycle and presented in the Watchlist Committee.

In conjunction with the Global Workout entity (currently only CRE exposures; CRM is responsible for all other exposures), the impairment triggers (please also refer to the chapter concerning the watchlist and non-performing loans) are analysed and necessary impairment calculations are carried out. The Risk Provisioning Committee (please also refer to the overview concerning organisation and committees) takes decisions with regard to the result of the impairment tests.

Global Workout (only CRE) or CRM draw up a restructuring plan or a workout plan for critical and impaired exposures. The decision regarding restructuring or workout takes account of scenario analyses of the potential developments of the borrower, the collateral or the relevant market. These are presented and approved in the Risk Provisioning Committee.

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

Hedging and minimising risk by collateral

At HRE, property collateral in the field of Commercial Real Estate and assets in Infrastructure Finance is particularly important. In addition, other financial securities and guarantees are also accepted as collateral (e.g. credit insurances, guarantees, fixed-income securities, etc.), particularly in the Public Sector field.

The value of the collateral is reviewed as part of the regular (annual) rating assessment of borrowers performed by the credit officers; external or internal appraisals are also used in the case of collateral in the form of property.

Credit portfolio

The entire credit portfolio of HRE was calculated using a standard method in line with the Basel II-compliant Exposure at Default (EaD) for the first time as of 31 December 2009. In order to enable a better comparison to be made with previous year figures, the "exposure" as well as the "EaD" are reported for the total amount of receivables and also for the relevant operating segments. The comments relating to the risk development are based on the previous logic – i.e. EaD for Commercial Real Estate Finance and exposure for the total amount of the credit portfolio as well as all other operating segments.

The term "exposure" comprises the current utilisation, committed credit lines, derivatives (current market value plus a regulatory add-on) and guarantees less hedging instruments used for the credit risk.

The Basel-II-compliant term "Exposure at Default" (EaD) recognises the current utilisation as well as prorata credit interest in relation to which a borrower may default before an exposure is defined as having defaulted (max. default of 90 days), as well as those credit commitments which a borrower will still be able to utilise in future despite a major deterioration in creditworthiness. In the case of derivatives, the EaD – as is the case with exposure – is defined as the sum of the current market value and the regulatory add-on, which constitutes a cushion for future potential increases of the market value.

The group-wide exposure of the credit portfolio amounted to around € 339 billion as of 31 December 2009, and is thus considerably lower than the corresponding figure applicable as of December 2008 (€ 403 billion). The total decline of € 64 billion exposure is mainly attributable (€ 46 billion) to the Public Sector & Infrastructure Finance segment (PS & IF), and is explained in greater detail in the chapter on the PS & IF operating segment. In the Capital Markets & Asset Management (CM & AM) operating segment, around € 9 billion particularly of derivative positions were reduced in the course of the year in line with overall strategy. In the Corporate Center, the exposure has been reduced by a total of € 5 billion, particularly in the field of the structured products in the bank book and the consolidated special-purpose vehicles. Apart from the selective sales of individual assets or sub-portfolios, the reduction in group-wide exposure was characterised by the narrowing of credit spreads and thus a reduction in counterparty risks in repo transactions as well as a reduction in the amount of collateral to be provided.

New business comprising a total of € 4.0 billion commitments in the operating segments described in the following mainly comprised Commercial Real Estate Finance business (€ 3.3 billion). Of this figure, € 2.6 billion is attributable to selected prolongations of existing business. The remaining new business of € 0.7 billion is attributable to the Public Sector Finance operating segment.

Overview of the total exposure of HRE: exposure € 339 billion; EaD: € 347 billion The credit portfolio is mainly broken down into the following operating segments

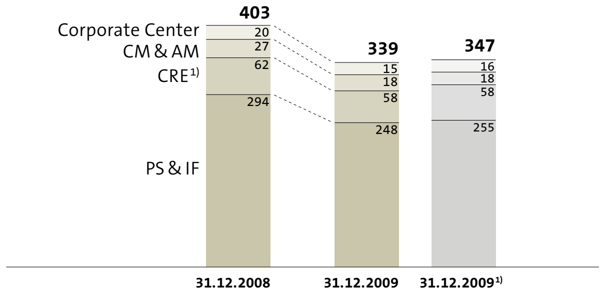
- Public Sector & Infrastructure Finance (PS & IF)
- Commercial Real Estate (CRE)
- Capital Markets & Asset Management (CM & AM).

In addition to the operating segments, the Corporate Center comprises non-strategic positions totalling € 15 billion (December 2008: € 20 billion). The structure of the portfolio is explained in greater detail in the chapter "Corporate Center".

The overall portfolio is dominated by Public Sector & Infrastructure Finance with € 248 billion exposure (73 %; December 2008: 73 %, unchanged to December 2008).

Overall exposure: exposure/EaD according to segments

in € billion



1) EaD

Risk parameters The expected loss (EL), which is calculated from the annual probability of default (PD), the loss-given default (LGD) and the exposure at default (EaD), amounted to € 1.1 billion as of 31 December 2009 using the parameters specified by Basel II (December 2008: € 0.5 billion).

The significant increase in the sum of the expected loss in Commercial Real Estate activities is mainly attributable to the strong growth in the "watchlist", i.e. the non-performing loans in commercial real estate business which have not been impaired (see chapter "Watchlist and non-performing loans"). In addition, the risk parameters were recalibrated in the third quarter; this resulted in an increase of € 95 million in the expected loss.

The expected loss in the Public Sector & Infrastructure Finance operating segment is also much higher, and is attributable to a major financing arrangement in the Public Sector segment which is currently being restructured with a positive outlook for recovery (€ 59 million EL) and also a major financing arrangement in the Infrastructure Finance segment (€ 85 million EL). The increase is partially offset by a successful restructuring (€ –90 million EL).

The increase in the Capital Markets & Asset Management segment is attributable to a derivative which is connected to the above-mentioned financing arrangement in the Infrastructure Finance segment.

In the Corporate Center, the creation of individual allowances more than compensated for the increase in the expected loss as a result of rating downgrades.

The expected loss for a period of one year is a key management parameter for the portfolio. It is calculated for the entire exposure, with the exception of trading book positions and non-performing loans for which an individual allowance has already been recognised. The ratio is broken down as follows over the operating segments as well as the Corporate Center:

Distribution of the expected loss

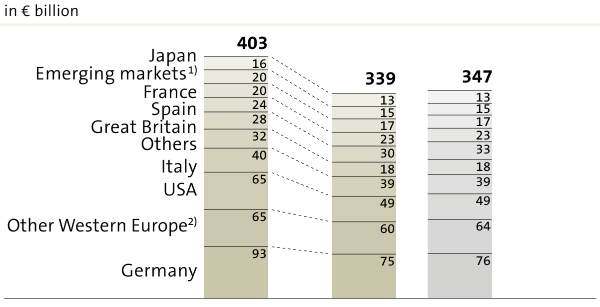
in € million	31.12.2009	31.12.2008
Public Sector & Infrastructure Finance	177	66
Commercial Real Estate	834	365
Capital Markets & Asset Management	36	4
Corporate Center[1]	32	49
Total	**1,079**	**484**

[1] The expected loss in the Corporate Center does not include the synthetic CDOs nor the cash CDOs which have already been impaired

Country risk The relative breakdown of country risk over the individual countries has declined compared with December 2008 by 1.0 percentage points in Germany, by 1.7 percentage points in the USA and by 2.6 percentage points in the "Other" category. Western Europe still accounts for most of the portfolio (more than 72 %).

Total portfolio: exposure/EaD according to regions

in € billion



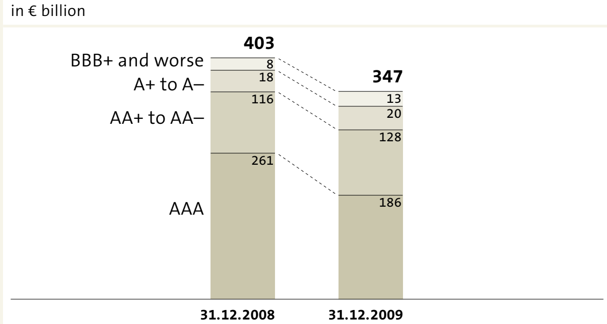
[1] Emerging markets in accordance with the IMF definition
[2] Including: Czech Republic € 1.4 billion as of December 2008 and € 1.2 billion as of December 2009
[3] EaD

Depending on the results of the internal rating process, maximum limits in certain rating ranges are defined for each individual country or groups of countries; these limit the operations of the Group. All country ratings and country limits are reviewed at least once every year by Risk Management & Control. Since the end of October 2008 and until further notice, the current refocusing and restructuring of the Bank have meant that the Group-wide country limits have been reduced to the level of the outstanding receivables at that time, and thus limit new business.

The structure of the country exposure according to internal rating has deteriorated compared with 31 December 2008. Countries with a rating of AA– and higher account for 90 % of the overall portfolio (31 December 2008: 93 %). On the other hand, the percentage of countries with a rating of A+ to A– has increased to 6 % (31 December 2008: 5 %). The country exposure with a rating of BBB+ and worse amounts to 4 % (31 December 2008: 2 %).

Total portfolio: EaD according to ratings internal country

in € billion



Public Sector & Infrastructure Finance: € 248 billion exposure; € 255 billion EaD **Portfolio development and structure** The exposure in the Public Sector & Infrastructure Finance segment (PS & IF) amounted to € 248 billion EaD as of 31 December 2009, and is thus considerably lower than the corresponding previous year figure of € 294 billion.

The € 46 billion decline in the exposure is mainly attributable to the following

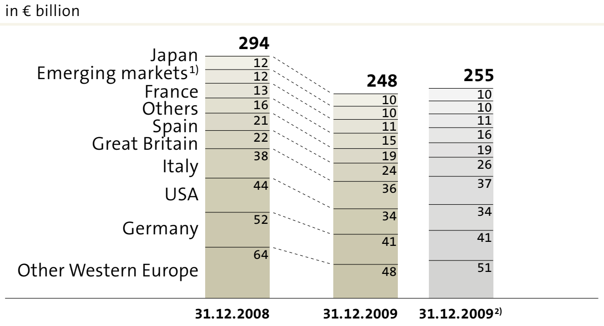
- € 13 billion decline in the counterparty risk reported for repo and repo-related transactions due to the narrowing credit spreads as well as lower levels of collateral to be provided
- € 7 billion reduction in US liquidity facilities
- € 5 billion reduction in swap transactions
- € 16 billion sales of securities in line with overall strategy as well as maturities which were not replaced
- € 0.7 billion net exchange rate effects

The portfolio is regionally diversified in more than 70 countries. Most of the exposure is in Western Europe (unchanged at 72 %), followed by the USA (13 %; December 2008: 15 %). The emerging markets (as per the IMF definition) still accounted for 4 %, whereby Poland and Hungary are the main countries in this respect (with € 3.8 billion and € 2.3 billion, respectively).

The "Others" heading includes Canada (€ 6.9 billion), followed by Australia (€ 1.6 billion) and South Korea (€ 1.7 billion). Major countries under "Other Western Europe" are Austria (€ 10 billion), Greece (€ 9.4 billion) as well as Ireland (€ 7 billion). The exposure in Ireland has declined appreciably as a result of the decline in the repo transactions with the Irish Central Bank in the first half of 2009 (€ 17 billion; at the end of 2008: currently € 4 billion).

PS & IF: exposure/EaD according to regions

in € billion

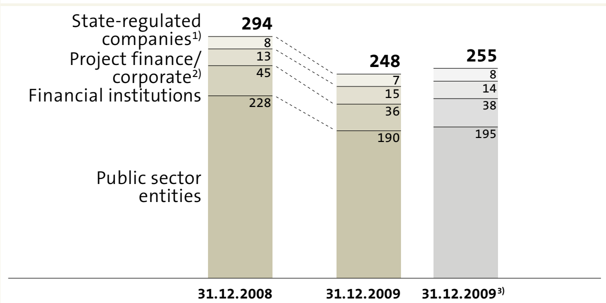


[1)] Emerging markets in accordance with the IMF definition
[2)] EaD

The counterparty structure in the Public Sector & Infrastructure Finance portfolio has not changed significantly compared with December 2008, and is dominated by public sector borrowers (77 %; December 2008: 76 %). This segment comprises companies in the public sector/ public sector enterprises with 32 % (33 %), central states with 26 % (25 %) and municipalities unchanged with 19 %. The category "Public sector borrowers" comprises structured products which are detailed in the following in this chapter.

PS & IF: exposure/EaD according to counterparty structure

in € billion



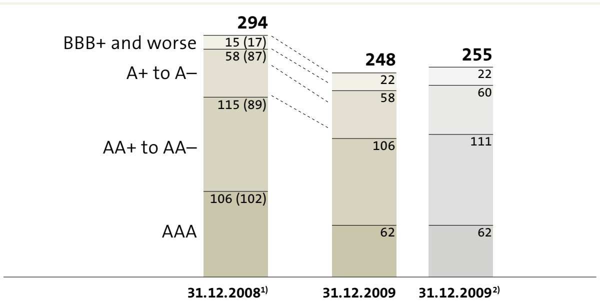
[1)] Including financial institutions with a statebackground or state guarantee
[2)] E.g. water utilities, power supply utilities, etc.
[3)] Exposure at default

The still unchanged high percentage of borrowers from the public sector, of which 97 % are classified as "investment grade", is reflected in the rating. The non-investment grade exposure is attributable to infrastructure finance as well as public sector loans in emerging markets.

In general, 45 % of the emerging markets (as per the IMF definition) have an internal rating of at least A (21 % fewer than at the end of 2008 disregarding the rating upgrade by monoliners, whereas the non-investment grade content has increased from 10 % to 14 %. This decline in quality is mainly due to structural factors, because the entire A-rated exposure of the Czech Republic (€ 0.6 billion) has been excluded from this basket since December 2008, as the IMF no longer considers the country to be an emerging market.

PS & IF: exposure/EaD according to internal ratings

in € billion



[1] Including the rating upgrade by monoliners (excluding this factor)
[2] EaD

Risk parameters The considerable increase in the expected loss for the portfolio of the Public Sector & Infrastructure Finance operating segment is mostly attributable to a major financing arrangement in the Public Sector segment (€ +85 million EL), in which the borrower had been experiencing payment difficulty. This financing arrangement is currently being restructured, with a positive outlook for recovery, so that there was no reason for an individual allowance to be created. In addition, a further exposure in Infrastructure Finance has also been downgraded (€ +59 million EL); although this will be serviced in the medium term, it is foreseeable that a default is very likely in the course of the next few years.

PS & IF: EaD/expected loss[1] by internal classes

		31.12.2009		31.12.2008		
EL class	Basis points	EaD cumulative in %	Expected loss in € million	EaD cumulative in %	Expected loss in € million	Change Expected loss in %
EL class 1	0 to < 1	88.3	4.25	90.4	5.39	−21
EL class 2	1 to < 2	93.5	1.94	94.3	1.61	21
EL class 3	2 to < 3	94.2	0.42	95.5	0.80	−47
EL class 4	3 to < 5	95.0	0.80	96.2	0.72	11
EL class 5	5 to < 10	96.4	2.36	97.1	1.70	39
EL class 6	10 to < 20	97.7	4.50	99.2	8.25	−45
EL class 7	20 to < 35	98.3	4.12	99.2	0.54	> 100
EL class 8	35 to < 55	98.7	5.00	99.4	2.10	138
EL class 9	55 to < 90	99.1	5.54	99.7	4.92	13
EL class 10	90 to < 160	99.4	6.29	99.7	0.28	> 100
EL class 11	160 to < 250	99.5	8.32	99.8	6.37	31
EL class 12	250 to < 400	99.6	5.79	99.9	12.19	−53
EL class 13	400 to < 650	99.6	0.42	99.9	—	—
EL class 14	650 to < 1,100	99.7	3.36	100.0	1.66	102
EL class 15	1,100 to < 1,800	99.7	5.11	100.0	4.81	6
EL class 16	1,800 to < 3,500	99.8	52.93	100.0	—	—
EL class 17	3,500 to < 6,000	100.0	6.53	100.0	14.21	−54
EL class 18	6,000 to < 10,000	100.0	59.36	100.0	0.52	> 100
Total			**177.05**		**66.07**	168

[1] The expected loss is calculated for all positions of the bank book, excluding loans for which an allowance has already been created

Key risk issues **Credit-insured exposure through monoliners**
The credit-insured exposure accounts for 4 % (€ 11 billion) of the portfolio of the PS & IF operating segment (December 2008: € 14.4 billion). This is attributable to a market presence which has so far been strong, particularly on the market for US treasuries. The main counterparties of the insured securities are still public sector borrowers (53 %, such as US municipalities; 47 %); 15 % are state-regulated companies and 33 % are project financing arrangements. The average internal rating of the insured borrowers is A2. The risk assessment focuses exclusively on the rating of creditworthiness of the insured security or issuer.

State-supported and partially guaranteed structured products
In accordance with the recommendations of the Financial Stability Board (FSB, formerly FSF) as well as the Senior Supervisory Group (SSG) for "Leading Practice for Selected Exposures", HRE discloses further information regarding the following sub-portfolios:

1. Structured, partially guaranteed products, mainly in the PS & IF operating segment and, to a minor extent, in the CM & AM operating segment (shown in the following overview for reasons of clarity)
2. Structured products in the banking book as well as consolidated special-purpose vehicles of the Corporate Center (chapter "Corporate Center")
3. Special-purpose vehicles inside and outside the group of consolidated companies (chapter "Special-purpose vehicles of HRE")

State- and bank-guaranteed; state-backed structured products in the PS & IF and CM & AM operating segments[1)]

in € billion	31.12.2009 Nominal value	31.12.2009 Internal fair value	31.12.2008 Nominal value	31.12.2008 Internal fair value
Fully guaranteed structured products				
CDO (securitised, state-guaranteed European (mostly Spain) financing for small enterprises)	4.8	4.4	5.4	5.3
CDO (securitised mortgage loans guaranteed by the Netherlands) (CM & AM)	2.4	2.3	2.5	2.4
State-backed structured products				
ABS (reverse mortgage; guarantee provided by US Federal Home Administration)	0.3	0.1	0.3	0.3
ABS (housing finance: securitised subsidised mortgage loans)	0.8	0.7	1.9	1.9
ABS (stranded costs: securitised mortgage loans of buildings in the public interest; interest payment and repayment of principal by charges imposed by the public sector)	1.6	1.6	1.3	1.4
Structured products with state-backed underlyings (including CM & AM)				
FFELB student loans (securitised student loans,of which at least 97 % with a US state guarantee)	15.6	13.9	16.7	13.5
Bank-guaranteed structured products				
CDO – TRS with Swiss bank	0.6	0.6	0.6	0.6
CDO – TRS almost exclusively with US investment banks	5.4	5.4	6.9	6.9

1) Excluding securities which are additionally insured by monoliners

Increased levels of risk can occur in relation to structured securities without an explicit guarantee (nominal € 2.4 billion with state backing). However, because the securitised loans finance investments "in the public interest", it can be assumed that state support will be provided in the event of payment difficulties.

FFELB student loans Of the € 1.1 billion reduction in the nominal portfolio of FFELB student loans compared with December 2008, € 470 million is attributable to sales in the fourth quarter of 2009. In addition to the reported figures above an amount of nominal € 0.4 billion with a fair value of € 0.4 billion (December 2008 nominal and fair value € 0.5 billion) is monoline-insured student loan exposure.

US liquidity facilities The entire exposure to US liquidity facilities of the business segment PS & IF has declined from € 10.8 billion at the end of 2008 to € 3.9 billion as of 31 December 2009 (including the facilities which have not yet been drawn down) as a result of the expiry of commitments and refinancing of the underlying receivables by the issuers.

There are still undrawn facilities with a nominal amount of € 2.2 billion, which have risen again compared with the end of 2008 by around € 0.2 billion as a result of the successful marketing of securities which have already been served. The average weighted rating of the securities of the drawn and undrawn US liquidity facilities is AA2 (December 2008: AA3).

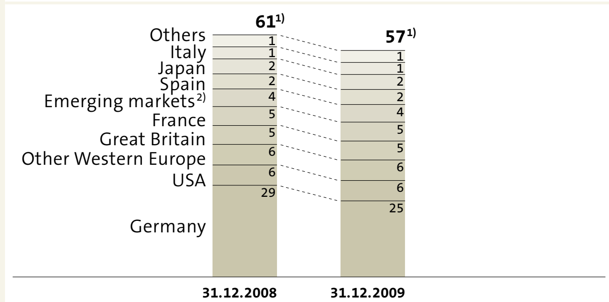
Commercial Real Estate: exposure at default: € 58 billion Portfolio development and structure Compared with 31 December 2008, the EaD (exposure at default) of the Commercial Real Estate portfolio declined gradually by a total of € 4 billion during financial 2009. The customer derivatives included in this figure amounted to € 1.6 billion as of 31 December 2009, compared with € 1.2 billion EaD at the end of 2008.

The commitments amount to € 56 billion, and are thus 12 % lower than the corresponding previous year figure (€ 64 billion). Receivables amount to € 55 billion (previous year: € 58 billion); the credit lines which have not yet been paid out amounted to around € 1 billion, and have declined appreciably compared with the end of 2008 (around € 6 billion).

The regional structure of the Commercial Real Estate portfolio is virtually unchanged compared with the end of 2008, and is spread over 35 countries with the main emphasis in Germany (44 %) and the other Western European countries (33 %); the USA accounts for 10 %.

Commercial Real Estate: EaD according to regions

in € billion

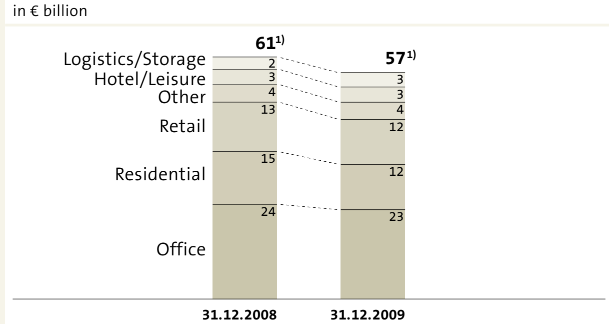


1) Breakdown excluding CRE derivatives approx. € 1.6 billion (December 2008: € 1.2 billion)
2) Emerging markets in accordance with the IMF definition

The distribution of the portfolio according to property types also remained mainly stable compared with the end of 2008. Residential properties (mainly portfolio transactions) account for approx. 21 % (December 2008: 25 %) of the overall portfolio. Commercial properties consist primarily of office buildings and retail properties.

Commercial Real Estate: EaD according to type of property

in € billion

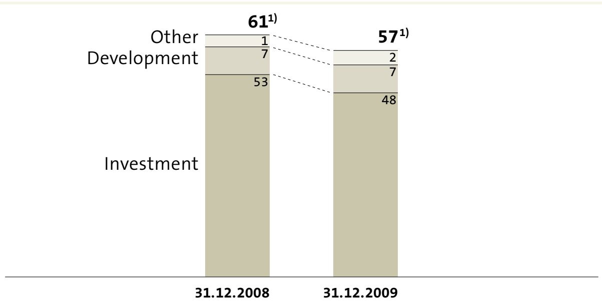


1) Breakdown excluding CRE derivatives of approx. € 1.6 billion (December 2008: € 1.2 billion)

The portfolio is still dominated by investment financing (84 %; December 2008: 87 %); higher risk construction financing still accounts for 12 % of EaD. Investment financing comprises the financing of real estate for which the cash flow is generated by means of rental.

Commercial Real Estate: EaD by loan type

in € billion



[1)] Breakdown excluding CRE derivatives approx. € 1.6 billion (December 2008: € 1.2 billion)

Risk parameters The expected loss (EL) for the Commercial Real Estate portfolio amounted to € 834 million as of 31 December 2009 using the parameters defined by Basel II. It has accordingly deteriorated appreciably compared with 31 December 2008 (€ 365 million). This reflects the negative development on the real estate markets described above, leading to the increase in the watchlist and non-performing exposures and thus the higher expected loss which are described subsequently. With regard to the breakdown of the portfolio according to EL classes, this increase is reflected particularly in classes 12 to 18.

CRE: EaD/expected loss[1)] by internal classes

EL class	Basis points	31.12.2009 EaD cumulative in %	31.12.2009 Expected loss in € million	31.12.2008 EaD cumulative in %	31.12.2008 Expected loss in € million	Change Expected loss in %
EL class 1	0 to < 1	13.9	0.24	19.0	0.30	−21
EL class 2	1 to < 2	18.6	0.38	23.0	0.32	19
EL class 3	2 to < 3	21.9	0.46	28.0	0.74	−38
EL class 4	3 to < 5	24.6	0.68	33.0	1.41	−52
EL class 5	5 to < 10	33.3	3.86	44.0	5.01	−23
EL class 6	10 to < 20	45.2	9.40	59.0	13.09	−28
EL class 7	20 to < 35	56.4	18.12	72.0	21.42	−15
EL class 8	35 to < 55	65.2	22.84	80.0	23.99	−5
EL class 9	55 to < 90	73.4	31.99	86.0	22.81	40
EL class 10	90 to < 160	80.3	45.38	90.0	34.73	31
EL class 11	160 to < 250	82.4	24.21	93.0	32.34	−25
EL class 12	250 to < 400	83.3	14.93	93.0	10.76	39
EL class 13	400 to < 650	84.5	27.99	94.0	6.39	> 100
EL class 14	650 to < 1,100	86.0	52.81	94.0	12.90	> 100
EL class 15	1,100 to < 1,800	86.6	38.96	95.0	8.55	> 100
EL class 16	1,800 to < 3,500	88.8	86.48	96.0	97.63	−11
EL class 17	3,500 to < 6,000	95.2	193.62	98.0	63.97	203
EL class 18	6,000 to < 10,000	100.0	261.89	100.0	9.11	> 100
Total			**834.24**		**365.45**	128

[1)] The expected loss is calculated for all positions of the bank book, excluding loans for which an individual allowance has already been created.

Key risk aspects The negative market developments in the year under review particularly affected the real estate markets in Great Britain (which has been showing initial signs of consolidation since the third quarter of 2009), in Spain and also in the USA. These so-called hot spot markets are analysed regularly and in a particularly thorough manner; the sub-portfolios are subject to intense monitoring and are being further reduced. Because these negative trends had been anticipated at an early stage, the corresponding financing portfolios had been significantly reduced since the end of 2006: Great Britain by 45 % to € 5.2 billion commitments as of the reporting date (€ 5.2 billion EaD), Spain by 36 % to € 1.8 billion commitments (€ 1.9 billion EaD) and financing for so-called condominiums in the USA by 57 % to € 1.2 billion (€ 1.0 billion EaD). Despite these efforts, the remaining portfolios in the above-mentioned countries still feature significant risk concentrations in certain areas. Accordingly, major parts have been classified as high-risk, and have been placed on the watchlist or have already been classified as non-performing loans (Great Britain 31 %, Spain 53 %, USA 58 %). Corresponding impairments have already been recognised in relation to numerous exposures (please refer to the chapter "Watchlist loans and non-performing loans"). Nevertheless, in view of the fact that the very restricted liquidity of the secondary market for credit risks no longer exists, the long-term loan agreements mean that risk management options are limited to loans for which the conditions have to be adjusted, new business and, to a limited extent, credit lines which have not yet been drawn.

On the German commercial real estate markets, area sales and yields are still under pressure due to the continuing risk aversion of investors, particularly in the case of properties in less than prime locations. Since the third quarter of 2009, there have been increasing signs of recovery for quality real estate in excellent locations and with tenants with a high credit rating.

Development financing is a further key risk aspect particularly in times of falling real estate demand. The business volume in this segment amounted to € 6.7 billion EaD as of the reporting date, and was operated mainly in the USA (mainly with the above-mentioned condominiums) and in Germany (in this case primarily with commercial real estate). There has not been any reduction compared with December 2008 because already committed lines have been gradually drawn down in the course of project progress. Virtually all projects are now in the final phase of completion. The development portfolios also contain an above-average volume of exposures which are classified as high risk and which in certain cases have already been impaired.

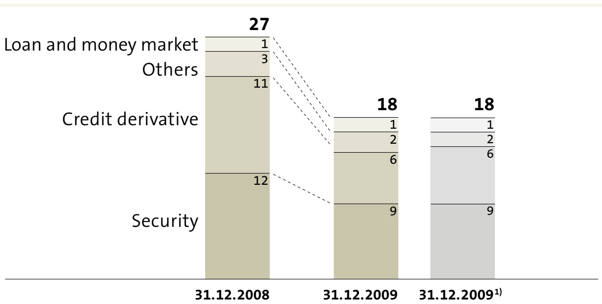
In relation to the type of financed properties, hotels in particular (commitments of € 2.8 billion as of 31 December 2009) have been affected by the economic crisis. Particularly in the USA, there has been a considerable decline in the number of overnight stays in connection with business travel and also holiday travel. The resultant collapse in the cash flows of the financing arrangements together with the decline in the value of the financed real estate has meant that numerous hotel loans have been classified as critical or impaired.

Capital Markets & Asset Management: € 18 billion exposure, € 18 billion EaD **Portfolio development and structure** In line with the Group's overall strategy of completely discontinuing trading activities with the exception of hedging transactions, the portfolio was considerably reduced particularly with regard to the derivative positions. The decline of the exposure compared with 31 December 2008 (€ 27 billion) amounts to € 9 billion.

The portfolio mainly comprises securities 49 % (previous year: 41 %) and credit derivatives 37 % (previous year: 41 %). The credit derivatives (almost exclusively CDS: 96 %) were mostly taken out in order to hedge the credit risk of the trading book. The counterparties for the credit derivatives are sovereigns (38 %) and financial institutions and companies (21 % in each case).

CM & AM: exposure/EaD according to product types

in € billion



[1] EaD

75 % (December 2008: 56 %) of the counterparties in the Capital Markets & Asset Management operating segment are rated either AAA or AA; a very high percentage (97 %) has an investment grade rating (slightly lower than the corresponding figure for 31 December 2008).

Apart from corporates (€ 4.0 billion; 31 December 2008: € 7.2 billion) and financial institutions (€ 2.7 billion; 31 December 2008: € 3.6 billion), most counterparties are classified under the public sector (€ 9.4 billion; 31 December 2008: € 13.3 billion).

That part which is secured via monoliners, the indirect exposure, amounts to € 0.4 billion; the direct exposure with regard to monoliners is € 0.9 billion, in total € 1.3 billion (31 December 2008: € 1.6 billion). The direct exposure consists of derivatives which are part of the position in the trading book described in the following.

Key risk aspects A significant component of the trading position of the Group are four arbitrage positions from the years 2005–2007. An open risk position has been established in CMBS (Commercial Mortgage-Backed Security) or CMBX (CMBS index), and a potential initial loss of almost 30 % was hedged at the same time. This hedging has been provided by way of two Junior Super Senior credit default swaps (JSS) with the monoliners Syncora and Radian – and also by way of a collateralised junior CDS. The overall structure is such that the hedge relates to lower-rated tranches as the risk which has been purchased; this means that there is an additional cushion in the event of a default because the hedge would have to be serviced before the bank itself would have to pay any claims.

As a result of the widening of spreads for CMBX and CMBS, an overall construction which previously had enjoyed virtually delta-neutral backing became an open risk position in relation to the CMBX index. As a result of this development, HRE reduced its CMBX holdings in the years 2008 and 2009 by way of countertrades from the former figure of more than € 4.3 billion to the current figure of € 2.2 billion.

Structured securities from the Halcyon and Pegasus transactions		**31.12.2009**				**31.12.2008**
in € billion	Nominal value	Internal fair value	Book value	Nominal value	Internal fair value	Book value
Long						
Banking book CMBS	1.54	1.24	1.49	1.54	0.95	1.57
Trading book CMBX	2.19	−0.22	−0.22	3.35	−0.57	−0.57
CDS (CMBS)	0.22	−0.02	−0.01	0.24	−0.03	−0.03
Short						
Trading book CSO swaps	0.32	0.27	0.25	0.32	0.30	0.03
JSS swaps	1.29	0.51	0.43	1.34	0.58	0.58

As of 31 December 2009, the long position of HRE was € 4 billion (December 2008: € 5.1 billion)

- € 2.19 billion CMBX, € 0.22 billion CDS in relation to CMBS in the trading book
- € 1.54 billion CMBS bonds in the non-trading book (December 2008: € 1.54 billion) for which the amortised costs of purchase (book value) are € 1.49 billion

The nominal amount of the hedge amounted to € 1.61 billion as of 31 December 2009 (December 2008: € 1.66 billion):

- € 0.32 million Collateralised Synthetic Obligation (CSO) swaps (December 2008: € 0.32 billion)
- € 1.29 billion Junior Super Senior (JSS) CDS (December 2008: € 1.34 billion).

Risk management of the four arbitrage positions focuses on market and credit risks.

The main factors of the market risks are as follows:

- The different rating quality of long positions and hedges may result in unexpected changes when markets are stressed. Spreads of the lower-rated index respond more slowly than the spreads of the better-rated index.
- The valuation of the long position is not directly influenced by the underlyings, whereas the valuation of the hedging instruments (CDO) with the monoliners depends on the developments of the underlyings.

The factors for credit risks are mainly the possibility of differences in the development of the ratings of the two monoliners Syncora and Radian which operate as insurance providers.

The factors have changed in 2009 compared with the end of 2008:

- The downgrading of the rating of monoliners meant that impairments had to be recognised in 2008, in order to reflect the risk of full payment not being made in the event of the default of the insured security. The planned restructuring and further downgrading of the creditworthiness of Syncora, one of the two counterparties of the derivative position, resulted in an increased impairment within the first half year of 2009; however, this was reduced considerably in the third quarter as a result of the restructuring of Synchora. A deterioration in the credit quality of the second counterparty (Radian) was taken into consideration at the end of 2009.
- At present, these adjustments in relation to monoliners are regularly updated. If new and reliable information exists in this respect, it is taken into consideration immediately in the daily valuation.
- Unlike the hedging instruments (CDOs) the long position is not sensitive to the default correlation of the underlyings. Following a sharp increase in the correlation in the first half of 2009, which led to a deterioration in results, the correlation in the second half of the year fell back to the level seen at the beginning of the year.

- At the end of the third quarter of 2009, some model parameters were changed in order to improve the valuation method for the CDOs. The resultant change in the valuation was completely offset by a model reserve which is completely written down on a straight-line basis over the expected remaining term.

Corporate Center: € 15 billion exposure, € 16 billion EaD The Corporate Center comprises non-strategic positions with a total of € 15 billion exposure (December 2008: € 20 billion). The portfolio is broken down as follows:

- € 10.6 billion (December 2008: € 12.1 billion) positions which were taken out by the former DEPFA as part of positioning in interest rate risk. The main positions are borrowers note loans of German federal states as well as medium term notes (MTN) of financial institutions and public sector counterparties with an average rating of AA.
- € 2.0 billion (December 2008: € 2.7 billion) exposure mainly macro-hedged asset/liability management portfolio which can be traced back to the time ahead of the DEPFA/Aareal split.
- € 2.2 billion (December 2008: € 4.9 billion) exposure of structured products in the banking book and in consolidated special-purpose vehicles (please also refer to the following chapter "Portfolio development and structure of the structured products").
- € 0.5 billion (December 2008: € 0.4 billion) real estate portfolio which is fully secured with bank guarantees and which can be traced back to the time before the DEPFA/Aareal split.

Portfolio development and structure of the structured products The holdings of structured securities, which HRE breaks down into real-estate-linked investments such as Commercial Mortgage-Backed Securities (CMBS), Residential Mortgage-Backed Securities (RMBS) and credit-linked investments, e.g. Collateralised Debt Obligations (CDO) (in the narrower sense of the term) and Collateralised Loan Obligations (CLO), have declined considerably compared with the end of 2008, by a nominal amount of € 2.0 billion to the current figure of € 4.2 billion, mainly as a result of sales of € 1.3 billion in the fourth quarter of 2009.

The current intrinsic fair value of these securities which evidence credit risks amounted to € 2.17 billion as of 31 December 2009 (€ 1.67 billion MBS, € 0.40 billion CDO and € 0.10 billion other ABS). The decline compared with December 2008 is 31 % or € 1.02 billion.

Structured securities

in € billion		31.12.2009 Nominal value	31.12.2009 Internal fair value	31.12.2009 Amortised cost of purchase	31.12.2008 Nominal value	31.12.2008 Internal fair value	31.12.2008 Amortised cost of purchase
Real-estate-linked investments							
CMBS	Total	**2.15**	**1.13**	**1.82**	**2.51**	**1.55**	**2.01**
	Europe	1.65	0.78	1.42	1.76	1.07	1.41
	USA	0.50	0.35	0.40	0.75	0.48	0.60
RMBS	Europe	**0.71**	**0.54**	**0.63**	**0.78**	**0.55**	**0.70**
Credit-linked investments							
CDO	Total	**1.17**	**0.40**	**0.39**	**2.76**	**0.96**	**1.01**
	Europe	0.60	0.39	0.38	1.25	0.71	0.77
	USA	0.57	0.01	0.01	1.51	0.25	0.24
ABS (others)	Total	**0.14**	**0.10**	**0.14**	**0.15**	**0.13**	**0.15**

The intrinsic fair value of the CMBS and RMBS securities is measured on the basis of a recognised discounted cash flow model in accordance with the regulations of IAS 39. By way of contrast with the standard Finite-Pool and Copula models used for measuring more simple CDO structures based on liquid reference assets, a separate valuation model is used for complex structures or illiquid underlying securities. Accordingly, the intrinsic fair value of the US CDOs and EU CDOs is measured using a separate CDO model with a bottom-up distribution of expected losses which have been developed in conjunction with a well-known management consultant. Essentially, the valuation of this portfolio reflects the development of the underlying securities, which consist primarily of ABS, MBS or CDO tranches.

The following overview shows the influence of the structured securities on the income statement, with due consideration being given to the change in the model reserve for the valuation model detailed above.

Influence of the structured securities on the income statement

in € million	2009	2008
Q1	−33	−178
Q2	−27	−145
Q3	−57	−308
Q4	114	−1,139
Total	**−3**	**−1,770**

The total amount of the impairments of € −3 million for the whole of 2009 is thus considerably lower than the corresponding previous year level.

Real-estate-linked investments in the Corporate Center As of 31 December 2009, the portfolio of US and European RMBS and CMBS holdings had a total nominal value of € 2.9 billion (December 2008: € 3.3 billion). The decline is almost exclusively attributable to currency changes and repayments.

The internally calculated fair value amounted to € 1.7 billion as of 31 December 2009 (December 2008: € 2.1 billion). The rating structure of the remaining investments has deteriorated considerably, particularly in the case of the EU CMBS, compared with December 2008, namely from 65 % AAA to now only 23 % AAA, 32 % AA and 24 % A (based on fair values). This reflects the deteriorating quality of the security values.

External rating structure of the real-estate-linked investments on the basis of the internal fair values			**31.12.2009**			**31.12.2008**
in € billion	EU CMBS	US CMBS	RMBS	EU CMBS	US CMBS	RMBS
AAA	0.18	0.25	0.28	0.69	0.42	0.32
AA	0.25	0.01	0.12	0.20	—	0.12
A	0.18	0.02	0.07	0.10	0.01	0.09
BBB	0.10	0.04	0.05	0.06	0.04	0.01
BB and worse	0.07	0.03	0.02	0.02	0.01	0.01
Total	**0.78**	**0.35**	**0.54**	**1.07**	**0.48**	**0.55**

Credit-linked investments in the Corporate Center All credit-linked investments are described as "CDO" in the following text.

Of € 2.91 billion nominal value CDOs as of 31 December 2008, positions with a nominal value of € 1.3 billion were sold with a slight book profit in the course of the fourth quarter of 2009. Further parts of the portfolio are also for sale if the right opportunity arises.

The internal fair value of the credit-linked investments was € 0.50 billion as of 31 December 2009 (December 2008: € 1.09 billion), including the ABS other. Sales accounted for € 0.22 billion of this figure as of 30 September 2009. The remaining change is attributable to repayments of principal and currency changes.

The rating structure of the fair values of the investments shows the almost complete sale of US CDOs across all ratings. In the case of the EU CDOs, the portion of non-investment grade has increased from 4 % to 30 % partly due to the sales but also due to deteriorating credit quality of the underlyings.

External rating structure of the credit-linked investments on the basis of the internal fair values			**31.12.2009**			**31.12.2008**
in € billion	US CDO	EU CDO	Other ABS	US CDO	EU CDO	Other ABS
AAA	—	0.13	—	0.08	0.47	
AA	0.004	0.12	0.10	0.01	0.16	
A	0.001	—	—	0.10	0.01	
BBB	0.01	0.03	0.003	0.01	0.04	
BB and worse	—	0.11	0.001	0.05	0.03	
Total	**0.01**	**0.39**	**0.10**	**0.25**	**0.71**	**0.13**[1]

[1] Rating structure not available

The current market value of the "ABS other" category amounted to € 0.10 billion at the end of 2009. 90 % of this position consists of a securitised tranche of an asset financing trust (securitisation of leasing receivables with the asset as collateral). This investment is additionally backed by a guarantee issued by a Canadian province.

Special-purpose vehicles in HRE

Special-purpose vehicles are generally used for largely ring-fencing assets from operating companies in a manner in which they are protected from insolvency and also to enable these assets, which are frequently used as collateral, to be disposed of more readily if necessary. Within the framework of its business activities, HRE mainly uses special-purpose vehicles for reducing risk.

Special-purpose vehicles which have been established or sponsored by HRE or with which contractual relations exist may have to be consolidated. In line with the IFRS, special-purpose vehicles are consolidated if they are substantially controlled by HRE although they are not controlled in the formal legal sense of the term (IAS 27 in conjunction with SIC 12). This is the case particularly if most opportunities and risks of the special-purpose vehicle are attributable to HRE. The question as to whether consolidation in accordance with IFRS is applicable is considered when the special-purpose vehicle is established and also when there is a change in the financial circumstances of the special-purpose vehicle, or when there are any changes in the business relations between the Group and the special-purpose vehicle.

Refinancing of the Group Special-purpose vehicles in this context are used for supporting the refinancing of the Group and thus for reducing the liquidity risk. A variety of forms is used. In addition to traditional refinancing vehicles which collect funds on the capital market and extend them to HRE in the form of loans, special-purpose vehicles can also be used for securitising certain assets in such a way that they can be used in security lending operations.

Outplacement of credit risks The outplacement of own credit risks is also a very important purpose for the use of special-purpose vehicles. Most of these outplacement arrangements were carried out in or before 2007, so that these are only recognised in accordance with Basel I and in general are not recognised in accordance with the Solvency Ordinance (SolvV) or Basel II. HRE generally transfers the risks synthetically to the special-purpose vehicle which in turn transmits them to third parties. The risk is normally transmitted in two stages. For the so-called first loss (primary risks – junior tranche with highest risk of loss) and the subordinate risks, second losses in the broader sense of the term, the special-purpose vehicle issues credit-linked notes (CLN), whereas finance guarantees or credit default swaps (CDS) are acquired from third parties for the remaining subordinated risks (senior tranches). The proceeds generated by the CLN are invested in prime securities, which in turn are used as collateral for HRE. The special-purpose vehicles are consolidated if only a very small percentage of the CLNs of the special-purpose vehicles are placed on the market.

Capital-backed investments In the past, investments were made in capital-backed securitisations in order to optimise the regulatory capital requirements. The special-purpose vehicles issued capital-backed bonds which in turn were acquired completely by HRE. In the case of capital-backed bonds, repayment of the invested nominal amount is guaranteed at maturity. These companies are fully consolidated.

Other use of special-purpose vehicles Special-purpose vehicles are also used for covering trade-relevant risks by way of onward placing on the capital markets. They are generally not consolidated.

In addition, HRE had set up a special-purpose vehicle (Morrigan TRR Funding LLC, Wilmington) in order to provide other capital market players with refinancing possibilities within the framework of secured lending. HRE acted merely as an intermediary, which meant that the Company did not have to be consolidated in accordance with IFRS. The Morrigan structure was wound up in the financial year 2009.

Special-purpose vehicles within the framework of investments in ABS structures As a result of previous investments of HRE in ABS structures, it is necessary for the corresponding special purpose vehicle to be consolidated at some selected investments. These are mainly investments in first loss tranches which have been completely written off, so that they do not pose any risk to HRE in this respect. There is also an investment in a special-purpose vehicle based on a pool of AAA-rated US Commercial Mortgage-Backed Securities (CMBS; please refer to the chapter "Capital Markets & Asset Management").

Assets of consolidated special-purpose vehicles The following table summarises the special-purpose vehicles which have been included in the annual financial statements of HRE as of 31 December 2009 or as of 31 December 2008 in accordance with IFRS. The assets underlying the consolidation are all classified as loans and receivables (LaR).

Consolidated special-purpose entities by categories

Nominal value in € billion	31.12.2009	31.12.2008
Refinancing of the Group	6.18	8.17
Outplacement of credit risks	0.54	0.61
Capital-backed investments	0.63	1.47
Investments in ABS structures	0.95	3.04
Total	**8.30**	**13.29**

The consolidation of the special-purpose vehicles has resulted in particular in a balance sheet extension of € 2.6 billion (31 December 2008: € 3.0 billion) from securitisation special-purpose vehicles within the framework of investments in ABS structures in which HRE holds first loss tranches which have already been fully written down. From the point of view of risk, this means that the volume exposed to risk has declined by € 2.2 billion (31 December 2008: € 2.5 billion).

The following overview sets out the nominal volume of transactions with non-consolidated special-purpose vehicles. The Morrigan structure was wound up in the financial year 2009. The other transactions are mainly cash-collateralised liquidity facilities.

Transactions with non-condolidated special-purpose vehicles

Nominal value in € billion	31.12.2009	31.12.2008
Morrigan	—	1.01
Others	0.11	0.12
Total	**0.11**	**1.13**

Watchlist and non-performing loans: € 14.6 billion (Exposure/EaD)

Early warning system The early warning system of HRE guarantees that loans and borrowers which might be affected by a deterioration in rating or the value of collateral are identified promptly and closely monitored or transferred to the watchlist.

In 2009, the existing early warning criteria as well as impairment criteria were gradually further developed. In particular, they were specified in further detail and segment-specific criteria were defined.

Non-performing loans are classified under the categories "restructuring loans" and "workout". The distinction criteria between "workout" and "restructuring loans" were revised in the third quarter of 2009.

- "Restructuring loans" comprise cases for which an individual allowance has been recognised (but not any enforcement) as well as cases which have defaulted in accordance with Basel II (e.g. payment in arrears > 90 days).
- "Workout loans" now include only loans which are subject to foreclosure and for which an impairment has to be recognised. Only in the Commercial Real Estate segment has this resulted in a considerable shift in the classification of non-performing loans which are now classified as restructuring loans, whereas they had previously been classified as workout loans. In addition, the watchlist now includes loans for which payments are now past due by 60 days instead of the previous figure of 30 days. This has not resulted in any change in the previously reported figures.

Particularly in the event of payment problems and payment arrears of more than 90 days, such cases are forwarded to non-performing loan processing. Non-performing loan processing is also responsible for carrying out an impairment test in line with the relevant accounting regulations of the Group. The calculation method for financial instruments in the category of receivables was standardised throughout the Group in 2009.

The following overview comprises portfolios which are recorded in the Public Sector & Infrastructure Finance (PS & IF) segment and the Commercial Real Estate (CRE) segment. Outside these two operating segments, HRE Group mainly has non-performing structured securities in the Corporate Center segment; these are reported in the chapter "Structured securities in the Corporate Center".

Development of watchlist and non-performing loans

	31.12.2009			31.12.2008				
in € million	PS & IF	CRE	**Total**	PS & IF	CRE	CRE (new def.)	**Total** (new def.)	Change
Workout loans	77	918	995	259	3,723	495	754	241
Restructuring loans	1,327	8,024	9,351	502	495	3,723	4,225	5,126
Non-performing loans	**1,404**	**8,942**	**10,346**	**761**	**4,218**	**4,218**	**4,979**	5,367
Watchlist loans	772	3,449	4,221	453	785	785	1,238	2,983
Total	**2,176**	**12,390**	**14,566**	**1,214**	**5,003**	**5,003**	**6,217**	8,349

The situation on the real estate markets continued to be difficult during the whole of financial 2009, and resulted in a considerable increase in the volume of non-performing loans and provisions for losses on loans and advances. Rents and property values of commercial real estate are still under considerable pressure and will continue to decline further in some markets. At the same time, there will also be further increase in the vacancy rates. This development continues to have a significant impact on our security position, and will probably also be reflected in further declines in value and income in 2010. We continue to see a deterioration in market conditions particularly in the USA, Spain, Eastern Europe and also to some extent in Germany.

The strong increase in non-performing and watchlist loans in financial 2009 in the Commercial Real Estate segment, namely by € 7.4 billion to € 12.4 billion, reflects these market developments. The strongest growth has been achieved in the USA (€ 2.8 billion; of which € 1.2 billion in the third quarter alone), Germany (€ 1.7 billion) and Great Britain (€ 0.8 billion).

The increase in the Public Sector & Infrastructure Finance segment is mainly attributable to the exposures in the Transportation & Asset Finance category. The cash flows of the financed properties, such as toll roads and aircraft, tend to be less affected by a deterioration in the macroeconomic climate.

Impairments and provisions

Individual allowances and portfolio-based allowances All assets which are not allocated to the trading book are regularly tested to determine whether they are impaired. In a first step it is analysed whether there is an objective indication for an impairment. After that the extent of impairment is calculated as the difference of the current book value and the present value of all expected future cash flows. Objective indications of an impairment are described in detail in the “notes” of the consolidated financial statement.

The specific criteria which trigger the creation of an impairment, the so-called “impairment triggers”, were revised and fine-tuned in 2009.

The following factors in particular are taken into consideration for determining the extent of the impairment, taking account of the group-wide credit exposure:

- The amount and timing of the expected interest rate payment and redemption payment
- The recoverable amount of the security and the probability of successful recovery
- The probable amount of costs for collecting outstanding amounts
- If available, the market price of the asset.

Portfolio-based allowances are calculated using risk parameters which are compliant with Basel II, such as probability of default (PD) and loss-given default (LGD). The resultant expected loss in relation to a time horizon of one year is scaled using an IFRS-compliant conversion factor to the period which on average is required for identifying the impairment event.

The impairments of all credit risks are approved in the Risk Provisioning Committee in which the CROs of all subsidiary institutions are represented.

If differences are identified between long-term average values for the parameters PD and LGD on the one hand and the current figures on the other as a result of the market environment in some portfolios of the operating segments, these are taken into consideration accordingly.

Risk provisioning An overview of the development in provisions for losses on loans and advances and provisions is set out in the notes.

The increase in the individual impairments reported in the notes, mainly from € 1.6 billion as of 31 December 2008 to € 3.1 billion as of 31 December 2009, reflects the still difficult situation on the real estate markets as well as the considerable slow-down in the global economy.

The portfolio-based allowances amounted to € 818 million as of 31 December 2009 (31 December 2008: € 629 million) excluding the model reserve for CDOs. Of the figure stated for the increase, around € 100 million were attributable to the recalibration of the PD and LGD methods in the third quarter of 2009; these are used as the basis for calculating the portfolio-based allowances. In addition, a considerable increase in the non-performing loans for which an impairment has not yet been recognised has also resulted in a considerable increase in the portfolio-based allowances. With regards to the assumed timeframe between the evidence and identification of an impairment the parameters have been adapted to the new improved credit process. Other amendments take into account that compared to the previous year the current economic cycle increasingly impacts the historical loss ratios. The amended parameters reduced the portfolio-based allowances by € 323 million.

Cover provided for non-performing loans Cover was provided for 34.8 % of the non-performing loans in the Commercial Real Estate (CRE) segment as of 31 December 2009. The corresponding ratio, calculated using the method which was revised in the second quarter (previously, the impairments under IFRS were related to the sum of the capital receivable, interest arrears and costs and credit lines which were not drawn down; the parameter has now been changed over to EaD) was 34.5 % as of December 2008 (on the basis of the old valuation method: 33.5 %).

Impairments provide cover of 20.0% for the non-performing loans in the Public Sector & Infrastructure Finance segment. The corresponding comparable figure as of 31 December 2008 was 35.8 %. The decline is attributable to the considerable increase in non-performing loans for which in the past it was only necessary for a comparatively low impairment to be recognised.

As detailed in the Corporate Center part of the report, 26.7 % cover is provided for the structured products in the bank book and the consolidated SPVs in relation to the total nominal value.

The provisions for contingent liabilities and other obligations mainly comprise provisions for guarantee risks, letters of credit and irrevocable loan commitments in lending business. At € 19 million as of 31 December 2009, they were € 8 million higher compared with the figure of € 11 million as of 31 December 2008. This increase is attributable mainly to the PS & IF segment.

Market Risk

Definition

Market risk is defined as the risk of a loss of value resulting from the fluctuation of the market prices of financial instruments. Transactions of HRE are mainly exposed to the following risk types:

- Credit-spread risk
- General interest rate risk
- Foreign currency risk

Market risk strategy

HRE follows the following fundamental principles in relation to market risks:

- Transactions should cover customer requirement; own transactions must be limited to a minimum and must be covered.
- Transactions may be conducted only in financial instruments which are measured independently via a model or for which market prices are observable; they must have successfully passed through the new product process.
- All trading and banking book positions are subject to daily income statement and risk monitoring by Risk Management & Control.

Organisation of market risk management

In line with the requirements of MaRisk, the trading and banking book positions are monitored by Risk Management & Control which is separate from trading in the structure organisation right through to the level of management. This is applicable for the individual subsidiaries as well as for the HRE Group as a whole.

Market risk reports

Risk Management & Control prepares extensive market risk reports at Group level every day for various recipients:

- The daily market risk report is addressed to the member of the Management Board responsible for risk and the member of the Management Board responsible for Treasury and Public Finance. It shows market risk value at risks (VaR), limit utilisations and economic performance figures at the Group level and also at various levels of detail.
- Daily sensitivity reports comprise analyses for the main risk factors at various levels of detail. They are made available to the member of the Management Board responsible for risk and the member of the Management Board responsible for Treasury/Public Finance.

Measurement and limiting of market risk

Measurement and operational limitation of risk Risk Management & Control uses a variance-covariance approach to calculate the market risk VaR at the overall and subportfolio level on a daily basis. All trading and bank book positions are taken into consideration for this purpose.

- The correlations and volatilities which are used are based on historical time series of the previous 250 trading days, which are included in the calculation on an equally weighted basis.
- For the daily operational risk management, the VaR relates to a holding period of ten days and a one-sided 99 % confidence interval.
- When the individual market risk components, such as the interest-, FX- and credit-spread-VaR, are aggregated to form a total VaR, which constitutes the basis for the limits, it is assumed that the market risk categories are not correlated. This assumption is regularly and explicitly checked and validated for significant portfolios of the Group.
- The VaR is calculated on a consolidated basis at the Group level and also for the individual subsidiary banks, operating segments, departments, portfolios and trading desks.

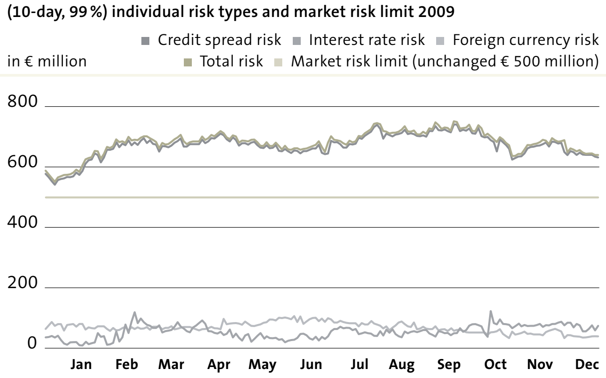
The market risk VaR (ten-day holding period; 99 % confidence level) amounted to € 638.2 million as of 31 December 2009 (31 December 2008: € 592.4 million); it is still considerably higher than the limit of € 500 million applicable in the year 2009. The limit was exceeded throughout the entire year.

At HRE, the limits are determined in the course of the risk-bearing capacity analysis (ICAAP). Despite the fact that HRE has now been partially recapitalised, the existing risk cover funds are still not sufficient.

The increase in VaR despite the reduction of positions in the first three quarters of 2009 is due to an increase in the historical credit spread volatilities used for calculating the VaR. The historical credit spread volatilities have declined further since the fourth quarter of 2009.

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

Market risk VaR
(10-day, 99 %) individual risk types and market risk limit 2009



The utilisation of the market risk VaR limits is also monitored for the individual subsidiary banks as well as for individual segments.

The VaR assessment is complemented by further instruments such as sensitivity analyses as well as stress and backtesting.

Sensitivity analyses Sensitivity analyses quantify the impact of a change in individual market parameters on the value of the positions of HRE. For instance, the credit spread sensitivity provides an indication of the change in economic present value which results from an isolated change of one basis point in the credit spreads which are relevant for measurement purposes.

Backtesting The quality of the riskmeasuring methods which are used is constantly monitored and optimised where appropriate by way of the daily comparison of VaR values and actual changes in present values which subsequently occur. For the quantitative assessment of the risk model, the Group has used the traffic signal system of the Basel Capital Accord of 1996. In this process, the statistical (negative) outliers determined as part of the backtesting process are counted within a period of 250 trading days. Overall, four outliers were observed for the trading books during the past 12 months; these were mainly attributable to the market movements of the credit spreads. The risk model of HRE is thus within an acceptable range.

Stress testing Whereas the VaR measurement simulates the market risk under "normal" market conditions, and is not to be understood as a standard for a potential loss in a market climate which is particularly disadvantageous for the position of the Bank, stress scenarios show the market risk under extreme conditions. At HRE, uniform hypothetical stress scenarios throughout the Group are calculated on a monthly basis for all key risk drivers (credit spreads, interest rates, foreign currency rates) including all trading and banking books. Historical stress scenarios are also simulated. For example, a parallel shift of 200 BP in the interest rate curve would result in a change of approx. € 262.9 million in the market value for all trading and banking books of the Group. The corresponding figure for the end of 2008 was € 318.9 million. The Management Board and the corresponding committees are regularly informed of the results of the scenario analyses.

Measurement and limiting of risk capital For calculating the economic capital (risk capital), which is taken into consideration for the risk-bearing capacity analysis, the VaR is scaled to a period of one year and also to a higher confidence level (from 99 % to 99.95 %).

The economic capital for market risks over a one-year horizon was € 690 million as of 31 December 2009, excluding diversification effects (December 2008: € 1,146 million). It has to be borne in mind that a credit portfolio model is used for calculating the credit spread risks of the AfS positions in the economic capital; these are shown as credit risks.

Control, management and monitoring of market risk

The Group uses a three-pillar approach for managing and monitoring the market risk:

- Management of the positions in Treasury/Public Finance
- Risk measurement and monitoring compliance with limits by Risk Management & Control
- Escalation processes across all decision-making committees right through to the Management Board.

The market risk is monitored by a combination of value-at-risk (VaR) limits for all trading book and banking book positions; the sensitivities as well as the economic capital are also monitored by Risk Management & Control.

Hedging and reducing market risk

The market risks of the trading books are to be further reduced as part of the process of restructuring the Group. The main focus is on the remaining credit-spread-sensitive positions of the arbitrage portfolio. The speed with which it will be possible to reduce these market risks very much depends on the further development of the capital markets.

Outlook

With the planned establishment of a deconsolidated environment, which is described in greater detail in the chapter on "Major events", considerable volumes of risk-relevant positions will be spun off in order to reduce assets and certain risk positions in a value-preserving manner. For HRE, this will result in a lower VaR in future.

After the recapitalisation process has been completed, the limits for economic capital are to be redefined, based on the new business model of HRE and the related reduction in risk propensity.

Because there is a delay before historical volatilities respond to the volatilities which are observable on the market, the fact that market volatilities have already fallen means that the historical volatilities used for measuring the credit spread VaR are likely to fall further in the first half of 2010. In conjunction with the intended further reduction in high-risk positions and the above-mentioned establishment of a deconsolidated environment, this will probably result in a much lower market risk VaR in the year 2010.

Development of the relevant market risk types

General interest rate risk The total general interest rate risk of HRE, which comprises all trading and banking books and thus the entire asset/liability management (excluding shareholders' equity books) amounted to approx. € 40.4 million as of 31 December 2009 (compared with € 66.2 million as of 31 December 2008). On average, the interest rate risk of approx. € 68.3 million for 2009 (max. € 105.9 million; min. € 35.2 million) was still at a low level (average VaR for 2008 € 23.3 million; max. € 80.1 million; min. € 8.1 million). Non-linear interest risks are insignificant. Most of the interest rate risk is included in the banking book positions.

Compared with the end of 2008, the interest rate risk of the trading books declined from € 9.4 million to € 6.0 million as of 31 December 2009.

Credit spread risk The credit spread risk reflects the potential change in the present value of positions as a result of changes in the corresponding credit spreads. Risk-measuring systems for determining credit spread risks exist for all relevant positions of HRE in the trading book as well as in the banking book. Most of the credit spread risk is attributable to assets eligible as cover for Pfandbriefe, Lettres de Gage and asset-covered securities (ACS). The limit is applicable only to the credit spread risks of the trading books and the AfS and FVtPL holdings, and is not applicable for the LaR positions. However, sensitivities are calculated for all holdings, i.e. also for LaR positions, and limited for Deutsche Pfandbriefbank AG. Overall, it is part of Group strategy to further reduce the credit spread sensitivity of the trading books.

As a result of successful measures designed to reduce risk (mainly the reduction of CMBX positions with a nominal value of US$ 1.5 billion), the credit spread VaR of the trading books has declined from € 154.9 million at the end of last year to € 115.6 million.

Due to the business model of the Group, the security holdings in the cover funds account for by far the majority of HRE's positions which are sensitive to credit spread changes. Accordingly, the credit spread sensitivity of the overall portfolio (including the security holdings classified as LaR) amounted to € 192.9 million at the end of December 2009 compared with a simultaneous increase of one basis point in all credit spreads; of this figure, only € 0.7 million was attributable to the trading books (corresponding figures at the end of 2008: € 194.6 million, trading books € 2.7 million).

Foreign currency risk and other market risks The foreign currency risk which is calculated as a present value and which covers all trading and banking books and thus the entire asset/liability management, amounted to € 68.5 million as of 31 December 2009; the corresponding figure at the end of 2008 was € 103.4 million. The general strategy of the Group is to hedge foreign currency risks as far as possible. The decline in the foreign currency risk is due to the successful implementation of this strategy. The risk is hedged with the foreign currency position shown in the balance sheet.

The Group is not exposed to equity price, commodity and inflation risks, or any such risks are essentially hedged. Financial derivatives are used mainly for hedging purposes.

Liquidity Risk

Definition

Liquidity risk is defined as the risk of not being able to meet the extent and deadlines of existing or future payment obligations in full or on time. This would for instance be the case if – as indeed has happened at HRE – there were no longer sufficient external refinancing sources. Because the continued existence of HRE as a going concern very much depends on the guarantees provided by SoFFin, the liquidity risk is currently one of the most significant risks.

Liquidity risk strategy

The liquidity risk strategy is a key component of the Group's risk strategy, and is broken down into various modules. This ensures that the refinancing of HRE is monitored and controlled by means of a limit system. The limits are defined as part of the annual business planning process.

Organisation of liquidity risk management

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

Liquidity risk report

HRE introduced an improved consolidated reporting and planning process in October 2008, and further developed this process in 2009. The liquidity management reports are prepared daily on a Group-wide basis and reported to the entire Management Board as well as to the Bundesbank, BaFin and SoFFin. The reports contain the daily liquidity situation as well as projections on the basis of contractual cash flows and assumptions made in relation to future events which will influence the probable liquidity development.

Measuring and limiting liquidity risk

A system for measuring and limiting short-term and medium-term variances within the cash flows has been installed in order to manage the liquidity risks. In addition to contractual cash flows optional cash flows are also considered. The latter are backtested on a regular basis.

The liquidity position which consists of contractual and optional cash flows is measured by considering different scenarios. This results on a daily basis in different liquidity positions reflecting:
- Constant market and funding environment (base case)
- Liquidity squeeze (risk stress scenario) similar to the situation HRE was confronted with at year end 2008

For the different liquidity positions a limit for short-term liquidity risk has been defined.

The limit system consists of three key aspects:
- Headroom limit for the liquidity reserve of the HRE Group
- Limit for the liquidity stress profile of HRE Group
- Limit system for the subsidiaries Deutsche Pfandbriefbank AG and DEPFA Bank plc

Within the limit system for the next month for the risk stress scenario a buffer of at least € 4.5 billion has been set for the next five trading days and a positive result for the rest of the month. For the base scenario there is a trigger of € 13 billion for a one-month period.

In 2010 it is planned to limit the medium- and short-term liquidity risk.

In addition to reporting, HRE uses additional regular stress tests and scenario analyses for quality assurance of the measurement results and for investigating the effect of additional stress events on the liquidity position.

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

The scenarios are reported to the Management Board and external bodies, e.g. the Bundesbank and SoFFin and are jointly analysed.

Liquidity risk monitoring and management

Monitoring of the liquidity risks is assured by the daily reporting of the liquidity situation of HRE and a defined escalation process. In 2009 a liquidity contingency plan has been approved in this context, which sets the frame for the management of liquidity squeezes.

Liquidity risk management is based on various interconnected components which in turn are based on a “liquidity risk tolerance” defined by the Management Board. This ensures that the individual companies of HRE have adequate liquidity reserves.

Hedging and reduction of liquidity risk

A risk tolerance system is used to limit the liquidity risk. Risk tolerance is integrated in the liquidity management process by means of triggers (limit system) in order to ensure a survival period in stress conditions.

The limits applicable for risk tolerance are regularly determined and adjusted.

Development of the risk position

The development in the liquidity situation in the fourth quarter has shown a slightly positive trend. This was due primarily to the provision of shareholder’s equity by SoFFin (€ 3 billion).

At the same time, an increasing problem was the more stringent requirements imposed by the rating agencies with regard to the surplus cover in the cover funds.

The external liquidity support was restructured as of 23 December 2009 and as of 31 December 2009 respectively. The liquidity aid/commitments provided via BLUE (recently € 43 billion) were replaced by securities of the same amount which were backed with SoFFin guarantees. Of this figure, € 23 billion is refinanced via a syndicate of banks, and € 20 billion is refinanced via the capital market/central banks.

As of 31 December 2009 guarantees from SoFFin of € 95 billion existed. Thereof (after deduction of haircuts) approx. € 14 billion of liquidity facilities remained undrawn.

Despite the fact that the Group has returned to the public financing markets, it will continue to be extremely reliant on external support measures. The liquidity needs of the Group will furthermore be dependant on market fluctuations, especially fluctuations of interest-, currency- and credit spreads. The current support measures are extensively described in the chapter "Major events" in this management report. The support measures are due to expire on 30 June 2010 and on 22 December 2010. Even if Deutsche Pfandbriefbank AG continues to be able to establish itself on the capital markets and even if the capital markets continue to recover in the course of 2010, HRE will still be reliant on the support measures being extended.

As a result of the support measures described in the above-mentioned chapter, the liquidity ratio in accordance with the liquidity ordinance amounted to 2.12 at Deutsche Pfandbriefbank AG as of 31 December 2009; it was thus higher than the statutory minimum of 1.0.

The liquidity requirements of the Irish regulator for DEPFA Bank plc were also satisfied. Accordingly, the liquidity ratio for the range of 0 to 8 days was 1.25 (the minimum figure required by the regulator in this respect is 1.0), and the ratio for the range between 8 days and one month was 1.16 (the minimum required by the regulator in this respect is 0.9).

Breakdown of remaining terms on the HRE Group balance sheet according to IFRS

	31.12.2009		31.12.2008	
in € billion	Assets	Liabilities	Assets	Liabilities
up to 3 months	27	118	30	166
3 months to 1 year	18	69	19	37
1 to 5 years	79	56	87	83
> 5 years	208	67	246	80
Other assets[1)]/liabilities[2)]	28	50	38	54
Total	**360**	**360**	**420**	**420**

1) Trading assets, deferred tax assets, impairments, other assets
2) Shareholders' equity, liabilities held for trading, provisions, deferred tax liabilities, other liabilities

For refinancing, covered and uncovered issues are available as the main financing instruments to HRE. Pfandbriefe and other covered bonds are a key component of the refinancing sources. As a result of their high quality and stable maturity profile, the existing covered bonds have been affected to a comparatively minor extent by market turmoil. This is applicable particularly for the German Pfandbriefe; this is the instrument which Deutsche Pfandbriefbank AG will use for refinancing new business and the residual portfolio after the spin-off. The positive market environment was supported in the fourth quarter of 2009 by the covered bond purchase programme of the ECB. In the third and fourth quarters of 2009, Deutsche Pfandbriefbank AG was able to place two Jumbo Pfandbriefe of € 1 billion and 1.5 billion respectively on the market. These so-called benchmark transactions were complemented by private placings. The strategy of restructuring the business model of Deutsche Pfandbriefbank AG on the basis of new business eligible for cover funds takes account of this development. However, the premiums which Deutsche Pfandbriefbank AG has to pay compared with other issuers are relatively high. If this situation does not return to normal over a period of time, this might have an impact on the profitability of new business.

Deutsche Pfandbriefbank AG and DEPFA Bank plc were also able to re-establish themselves on the market in the field of secured repo transactions, and were thus able to refinance the security portfolio subject to normal market conditions.

The field of unsecured refinancing was also able to contribute to the Group's refinancing via money market transactions and longer-dated issues. However, the volumes are not able to significantly reduce the extent of external liquidity support.

Covered refinancing via ECB

in € billion (as of 31 December 2009)	External liquidity support (SoFFin guarantees)	Own securities
Up to 1 month	37.5	7.8
Up to 3 months	13.6	5.3
Up to 6 months	1.6	0.9
Up to 12 months	23.0	19.9
Total	**75.7**	**33.9**

It was also possible for refinancing of around € 30.6 billion to be obtained on the repo market by means of the Bank's own securities. The terms are around three months.

Outlook

The extent of the liquidity requirement for up to the end of 2010 depends on numerous factors. Most short-term refinancing instruments dating back to the time before the crisis have expired and have been replaced by the liquidity support of SoFFin and the banking syndicate. Scenarios have to be defined for numerous volatile factors in order to present the expected future development:

- The future development of the discounts for repo refinancing on the market and with the central banks
- Possible additional collateral demands as a result of changing market parameters (such as interest rates and foreign currency rates)
- The development in collateral demands for hedges
- Changed requirements of the rating agencies regarding the necessary surplus cover in the cover funds

For assuring the liquidity requirement, unrestricted access to the central banks is necessary. A change in policy of open market operations could have a large impact on liquidity situation and results. So is the continuation of the facilities, currently running at € 95.0 billion, provided by SoFFin and by a financial syndicate essential for the refinancing of the Group in 2010 and in subsequent years. HRE will continue to be reliant on external liquidity support being provided.

Operational Risk

Operational risks are still associated with most aspects of HRE's business, and comprise numerous widely differing risks; particularly in times of internal and/or external problems, which have been affecting the entire financial sector and in particular HRE in the year under review, these will have to be monitored particularly intensively.

Definition

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

Strategy for operational risks

The overriding aims of HRE are the early recognition, recording, valuation as well as monitoring, prevention and limiting of operational risks as well as an early and meaningful report to management. HRE is attempting to minimise the losses attributable to operational risks. The provision of adequate information is the basis for decisions regarding the limitation of risk.

Organisation of operational risk management

In the field of Risk Management & Control, the Operational Risk & MaRisk department is responsible for uniform Group-wide processes, instruments and methods for recording, valuing, monitoring and reporting operational risks in HRE. The primary focus is on the early recognition, reduction and management of risks.

Risk reports, monitoring and management of operational risks

Operational risks are monitored by means of a network of controls, procedures, reports and responsibilities. Within the Group, each individual unit takes on responsibility for its own operational risks, and provides appropriate resources and processes for limiting such risks.

HRE uses the following Group-wide processes and method for management, measurement, monitoring and reporting of operational risks:

- Regular evaluation of risk-relevant parameters (key risk indications, KRI), which are suitable for early recognition of control problems and unfavourable developments
- Performance of risk self-assessments for evaluating the possible impact of potential risk sources in processes, as well as the existing controls for limiting the risk
- Collecting loss data from operational risks for identifying process, control and system weaknesses in order to enable countermeasures for reducing risk to be taken at an early stage
- Coordination of the new product process of the HRE Group for measuring and monitoring risks which may be associated with new products or business activities
- Focused analysis of predefined main risk areas in conjunction with the specialist units for providing appropriate measures for backing risk

The collected information is used in order to determine the operational risk profile of the Group and the measures to be derived from this profile.

The Operational Risk & MaRisk department evaluates the data which are collected; it recommends measures and works together with the specialist units to identify possibilities of preventing and managing operational risks. The head of the specialist unit is responsible for monitoring and managing operational risks.

In order to support the specialist units specifically in critical processes or procedures, Operational Risk & MaRisk carries out individual analyses on behalf of the Management Board, and prepares a catalogue of special measures.

Further, this unit is responsible for the coordination to guarantee compliance with the minimum requirements applicable for risk management (MaRisk) in HRE.

Risk reports

Regular reports are prepared for the Chief Risk Officer (CRO) and the Risk Committee. The quarterly report for the Management Board, which details the operational claims and losses, is used for assessing and evaluating the operational risk profile of the Group. In addition, a quarterly key risk indicator report indicates potential risk sources to the Management Board. The results of the regular risk self-assessments in the specialist units are also reported to the Management Board after the assessment process has been completed. After the completion of a special risk analysis which has been ordered, the relevant member of the Management Board receives a final report.

Risk measurement

In order to determine the minimum capital requirement in accordance with Basel II or in accordance with the EU Capital Adequacy Guideline (CRD), the Group uses the standard approach. The standard approach is also used for allocating the economic capital.

The capital backing for operational risks in line with the standard approach under Basel II is € 104 million as of 31 December 2009 (€ 212 million as of 31 December 2008).

Major operational risks of HRE

The main operational risks are essentially attributable to the ongoing process of restructuring the Group.

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

There is also a significant reliance on know-how for implementing restructuring processes on the one hand and for operating daily business on the other. The loss of know-how represents an increased level of risk in the current situation of the Group. The significant changes which have now been implemented in the Group also require experienced personnel in order to establish and assure a stable control process.

HRE suffered losses of € 8.3 million in total from operational risks in the course of the financial year 2009. The losses were mainly attributable to the incorrect posting of two derivative positions which resulted in an aggregate loss of € 7.9 million.

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

HRE is involved in numerous court proceedings and out-of-court proceedings, resulting in legal risks for the Group particularly in conjunction with the proceedings which are described in the notes to the consolidated financial statement.

Results of Risk-bearing Capacity Analysis

Economic capital according to risk types excluding diversification effects in € million	31.12.2009	31.12.2008	Change in %
Credit risk (default and migration risk as well as credit spread risk in Available for sale)	7,925	5,905	34
Market risk (credit spread risk in the trading book and Fair Value through P&L)	455	454	—
Market risk (interest and currency risk)	236	692	−66
Operational risk	370	438	−16
Business risk	333	388	−14
Risk of the Bank's own real estate holdings	80	76	5
Risk of investment holdings	2	40[1]	−95
Total before diversification effect	**9,401**	**7,993**	18
Total after diversification effect	**8,806**	**7,248**	21
Risk cover funds	5,651	3,530	60
Surplus cover/shortfall	**−3,155**	**−3,718**	−15

[1] The figure of € 99 million reported in Q4 2008 included companies which are consolidated

Excluding the diversification effects between the individual risk types, the economic capital of HRE is approx. € 9.4 billion (December 2008: € 8.0 billion). If these effects are taken into consideration, the economic capital falls to around € 8.8 billion (December 2008: € 7.2 billion). The increase in economic capital is mainly a consequence of the increased credit risk, which is essentially attributable to a deterioration in the rating of the commercial real estate portfolio as well as modelling of much wider credit spread scenarios in Public Sector business. It has not been possible to compensate for this increase by reducing the exposure, particularly in the non-strategic part of Public Sector business, in Infrastructure Finance and in CM & AM. On the other hand, economic capital for market risks has declined appreciably as a result of much lower interest rate and foreign currency positions.

The capital increase totalling € 6 billion which was received in two tranches in 2009 was partially compensated for by reduced subordinate funds, the impact of the net loss for 2009 and the deferred tax expenses as well as increased annual budgets for risk provisioning and negative commission income. This means that the risk cover funds have only increased by € 2.1 billion compared with the previous year.

According to the ICAAP model which is a regulatory requirement and which determines the economic risk-bearing capacity of the Company, there is an economic capital shortfall of around € 3.2 billion for a one-year observation period as of 31 December 2009. In addition, a risk reserve is necessary and usual in order to support future growth which is necessary in the long term and also to guarantee necessary capitalisation for stress test situations as well as unquantifiable risk types. In line with our established guideline concerning this subject, we are assuming a risk reserve of 20 % in relation to the risk capital.

Method used for the individual risk types

The economic capital of each risk type is calculated using a quantitative approach, and is aggregated to the overall bank risk, with due consideration being given to specific correlations. In line with the common market standard, the risk types are scaled to a period of one year and a risk level derived from the target rating (in this case: 99.95 %).

The calculation and allocation of economic capital are subject to various assumptions and expectations. The methods used in the credit portfolio model have been further developed in the period under review in order to ensure that the calculation of economic capital is kept consistent with the current business strategy, ownership structure and the changed funding profile. This adjustment is an initial implementation stage in the direction of the above-mentioned revision of the model. Further details are set out in the section concerning the credit portfolio model in the chapter "Credit Risk".

The definition and method of calculating the economic capital for the risk types credit risk, market risk and operational risk have been detailed in the relevant previous chapters.

Business risk The economic capital is individually scaled on the basis of the scaling of the operational costs for each operating segment. The operating costs are used as an approximation for the fixed costs which would have to be covered in the event of a collapse in earnings. Similar to the situation applicable for operational risk, implied costs from the cost-income ratio of 35 % are used as the calculation basis. The most conservative value from various externally calculated comparable operating segments are used for the scaling factors.

Business risk comprises several underlying risk categories, which mainly consist of strategic risk and the risk of fluctuations in costs/income, and thus to a certain extent also comprises liquidity risk.

Equity participation holdings and the Bank's own real estate holdings Together, these account for approx. 1 % of the economic capital of the Group. Both risk types are derived via the volatility of the MSCI real estate index for a 15-year history. The Bank's own real estate holdings are roughly unchanged compared with the previous year level. The equity participation portfolio has declined to almost zero as a result of sales in 2009.

Liquidity risk In the current situation of the Group, the approach of using specific capital as a cushion in times of substantial liquidity crises is not unproblematical. Sources of capital such as shareholders' equity and subordinate capital may become illiquid as a result of systematic or specific factors. Capital is not able to replace the function of credit lines or high-quality assets. The distinction between capital and liquidity in times of a liquidity crisis shows that liquidity risks have to be managed; however, liquidity risks do not have to be managed by way of providing economic capital. The purpose of calculating the economic capital is to ensure that providers of debt will be repaid their claim with a certain probability in the event of a default.

However, liquidity risks are recognised by way of additional meaningful stress tests which were introduced at HRE in 2009.

Stress tests

Models are based on assumptions and the data which have been entered. Stress tests in relation to the economic capital are used in order to obtain a better understanding of the sensitivity of results in relation to these factors. HRE carries out stress tests as an instrument for appropriate regulatory and economic capital management for eleven categories, each in relation to an isolated risk type:

- Downgrading of the main counterparty
- Stress tests of the real estate credit portfolio
- Stress tests of the creditworthiness of all counterparties
- Operational risk
- Business risk
- Equity participation risks
- Risks of the Bank's own real estate portfolio
- Stress tests of refinancing and liquidity
- Interest rate changes
- Foreign currency changes
- Widening of credit spreads

In addition, stress test scenarios covering all risk types were introduced on the basis of historical results in the third quarter of 2009 as a result of the financial market crisis. The investigation covers both scenarios which actually occurred during the recent financial crisis or which appear to be realistic.

The two scenarios which have been considered are as follows:

First stress scenario

- CRE exposure downgraded by two notches, CRE LGDs increase, depending on the region, by an average of 6.7 %
- The non-CRE exposure is downgraded by one to two notches, non-CRE LGDs unchanged
- Credit spreads increase to the extent where the current portfolio would suffer the maximum 1-year loss based on historical spread changes of the past ten years.
- USD, GBP and JPY rise by 15 % against the euro, other currencies unchanged
- Interest rates increase to the extent where the current portfolio would suffer the maximum 1-year loss based on the historical interest changes of the past ten years.
- Volatilities increase by a factor of 1.55
- 50 % loss in relation to all equity participations, the real estate portfolio and the unguaranteed part of the CDO portfolio of the Group

This scenario would have resulted in a € 1,112 million increase in economic capital at the end of the year.

Second extreme stress scenario

- CRE exposure downgraded by three notches, CRE LGDs increase, depending on the region, by an average of 9.1 %
- The non-CRE exposure is downgraded by one to three notches, non-CRE LGDs are unchanged
- Credit spreads rise for each rating class by the maximum spread increase during one year on the basis of the observed previous ten years. Thus in each rating category the historical maximum loss is considered.
- All currencies rise against the euro by 30 %
- Interest rates change according to the maximum of historical change within one year on the basis of the previous ten years.
- Credit spread volatilities increase by the maximum of historically observed factor of 3.94; interest rate- and FX-volatilities increase by a factor of 2.35.
- 100 % loss in relation to all equity participations, the real estate portfolio and the unguaranteed part of the CDO portfolio of the Group

This scenario would have resulted in a € 3,180 million increase in economic capital at the end of the year.

Outlook

The situation on the financial markets continued to stabilise in the second half of 2009. However, the negative impact of the recession triggered by the financial market crisis on real estate markets will continue to be noticeable. The quality of data which has now been considerably improved as well as the progress made with the risk measurement and management instruments are helping the Group to identify these risks on a timely basis and also to manage these risks. The risk-bearing capacity of the Group will probably be restored in 2010 as a result of the plan to spin off assets into a deconsolidated environment and also as a result of possible further capital measures – approval of the required bodies, the EU commission and the FMSA assumed.

Macro-economic Conditions

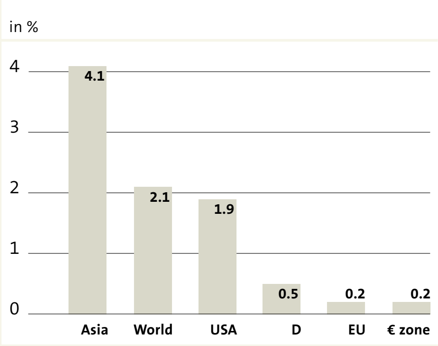
In general, a moderate economic recovery is expected for the year 2010; this means that the economy will probably return to positive growth rates. However, this positive expectation has to be viewed in perspective in two respects: firstly, and particularly for Europe, growth in 2010 will again be considerably lower than the rates seen before the crisis. Secondly, many countries will fail significantly to return to the levels of economic output seen before the crisis.

However, the ranges of expectations for 2010 are still relatively wide at present. Whereas the internationally comparable forecasts used in the following diagram are predicting growth of only 0.5 % for Germany, the current forecasts of other institutions for 2010 are currently running at around 1.5 %, and in certain cases slightly higher than this level. This forecast uncertainty is also a reflection of different scenarios relating to how the economy will react to the extensive range of state measures designed to support the economy. Nevertheless, most forecasts are predicting a considerable recovery for the USA and Asia, whereas the Euro zone will probably achieve only very moderate growth.

The fact that the risk situation for the financial sector still cannot be clearly assessed poses a certain risk for the upswing. It is true that many banks in the USA have now returned the state aid which was originally granted; however, the balance sheets still include particularly high-risk positions such as credit risks and high-risk securities. In addition, a wave of bankruptcies which is still threatened might result in impairments particularly in some economies of Eastern Europe which have been particularly severely affected by the crisis. In this context, banks have become much more cautious with regard to extending new loans. However, if banks also adopt an excessively cautious lending policy with regard to healthy companies, this might also act as a brake on the upswing.

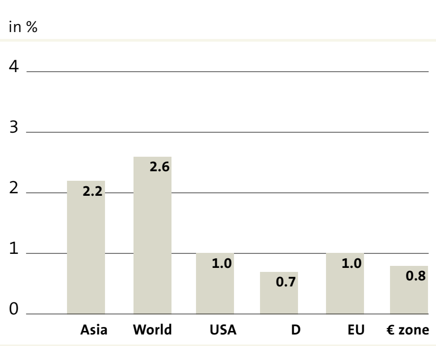
The rates of inflation will continue to be very moderate for the year 2010. Whereas in the USA prices will probably rise by 1 %, inflation in the Euro zone as a whole, and also in Germany, will probably be somewhat lower than this level. This is due to the fact that production capacities are still very much underutilised. In such an economic climate, price increases are not expected, even if some commentators are pointing to potential inflationary pressure as a result of the generous monetary policy of the year 2009. However, with regard to these fears, it has to be borne in mind that the liquidity in the banking system has increased dramatically as a result of quantitative easing; However, there has not been a dramatic increase in the money supply in the private sector outside the banking system which is crucial for inflationary pressure. It appears to be probable that the quantitative easing measures will be reversed in the near future, whereas there are still no specific indications of a hike in leading interest rates.

Real GDP, forecast 2010



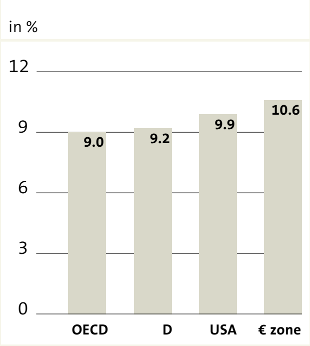
Source: EIU, obtained from Datastream on 15.12.2009

Consumer price inflation, forecast 2010



Source: EIU, obtained from Datastream on 15.12.2009

Unemployment rates, forecast 2010



Source: OECD, Economic Outlook No. 86, 11/2009

The current crisis has also resulted in problems in Public Sector Finance in countries in the Euro zone, some of which are providing cause for concern. The limits of what is possible with fiscal policy have certainly been reached in 2009, if not exceeded in certain cases, particularly in Greece, Portugal, Ireland and Spain, so that no further impetus is likely from this quarter for the year 2010. The risk premium which the financial markets are now demanding in these countries is imposing an additional restriction on the amount of scope available for fiscal policy.

Because of the relatively mild increase in real economic activity, the unemployment rate is expected to increase appreciably in all major economies in 2010. Particularly for the European economies, the unemployment rate typically follows the development in the real economy with a delay of around one year. Specifically in Germany, a wave of redundancies is likely when the short-term working in manufacturing comes to an end. The OECD is predicting that the unemployment rate in Germany will rise by around 1.5 percentage points to 9.2 %, whereas a minor increase to 9.9 % is forecast in the USA.

Sector-specific Conditions

Overall situation of the banking sector

The banking sector is again having to face major challenges in the year 2010. This is due to the still fragile state of the real estate markets, the only moderately expanding economy, the increasing number of insolvencies and rising unemployment as well as the considerable volatility of capital markets. A further factor is the critical national debt of countries such as Greece, Portugal, Ireland, Italy and Spain. It is also likely that banks will again have to recognise further impairments in the year 2010, and will also have to push forward with transferring assets at risk to restructuring units. More stringent accounting rules as well as special taxes are also likely to have an impact on returns on equity at the banks in the year 2010. The financial sector will also have to face new requirements resulting from regulatory changes which are set to come into force in 2010.

New regulatory requirements and changes in the bank regulatory climate

The year 2009 has already seen the introduction of far-reaching innovations with the aim of further harmonising international bank regulation. As part of this process, work has started on revising the Bank and Capital Adequacy Directive. This directive is expected to be implemented in the individual EU states by October 2010, and is expected to come into force by the end of the year.

The main changes are as follows:

- Extension of the obligation to create borrower units for calculating large loans
- Interbank receivables charged in full against large loan limits
- Greater transparency for the individual debtors in the reference asset for investment shares, securitisation positions and other structured products
- Stricter rules for recognising hybrid capital instruments as shareholders' equity
- Tightening the requirements for securitisations

In addition, in response to the financial crisis, various institutions have drawn up numerous proposals for improving bank regulation. However, these proposals have not yet been definitively discussed. Experts expect that these proposals will have considerable implications for the banking sector. As recently as December 2009, the Basel Committee on Banking Supervision published a draft for revising the Basel II framework. The following are examples of major issues in this respect:

- Strengthening the quality, consistency and transparency of core capital
- Increasing the capital requirements for risks of derivatives, repos and financing activities for securitisations
- Establishment of an anti-cyclical capital cushion
- Introduction and limiting of a so-called modified accounting equity ratio
- Tightening of the disclosure requirements
- Strengthening of liquidity backing
- New rule governing the compensation of bank employees

Real estate finance

In the year 2010, the high vacancy rates and rent defaults, falling rents and lower property values as a result of the still difficult economic situation will continue to pose a strain on the credit portfolios of the banks and make it much more difficult for existing loans to be prolonged.

A sustained recovery of the real estate market would solve the problem. In Great Britain, growth of 3.2 % for prime commercial real estate has been reported since the summer. However, any further increase in property prices would be sustainable only in that region and also only if employment figures rise and rents increase.

The market is therefore looking for further solutions. In addition to government aid and deconsolidated environments, the banks are sounding out alternative exit strategies. These range from joint ventures right through to the setting-up of funds and real estate funds which are intended to kick-start the market again.

It is expected that more investors will gradually return to the markets and that investment volumes will gradually rise. Increasing competition might result in lower margins and a gradual increase in LTVs. The prospects for 2010 are indicating that the market will gradually return to normal, whereby there will only be a complete recovery when investors and lenders consider properties in sub-prime locations again.

Public finance

As is the case on other markets, the forecast for 2010 very much depends on the extent of economic recovery. Such a recovery will have an impact on the behaviour of some players on the market, and in particular commercial banks with a broad base. When the capital markets are in a better state, the available liquidity and capital can be shifted to other areas which are more profitable but which are exposed to greater risk, and the attention for the Public Finance sector could decline. On the other hand, many banks in Europe are still restructuring their balance sheets, and the losses which in certain cases run into several billions might continue to have an impact on the business strategies to the benefit of lower risk credit markets. However, the high levels of state debt in countries such as Greece, Portugal, Iceland, Ireland and Spain will probably have a negative impact on the public sector finance market and might also have a negative effect on the risk premiums of the other members of monetary union.

In the year 2010, demand for public sector finance in Europe will increase. Although, according to the EU Commission, the economies of the 16 euro countries will probably expand in the years 2010 and 2011, the low level of growth in conjunction with rising unemployment will not be sufficient to compensate for budget deficits. In 2010, budget deficits throughout Europe will rise up to 6.9 % of gross domestic product. European governments will also continue to support economic recovery for mechanical reasons (rising costs and declining income as a result of the crisis) and also for political reasons.

Accordingly, we expect that our core markets will see continuing demand for medium-term and long-term public sector finance, state-guaranteed public-private partnerships and ECA transactions with public guarantees in our European core markets.

Infrastructure finance

As a result of the moderate economic recovery for the year 2010, there is not yet likely to be a major improvement in the situation for infrastructure finance. The continuing recession means that further defaults are likely. Unless a considerable economic recovery takes place, there is not likely to be any improvement in the valuation of financed assets or the cash flows of infrastructure measures. However, lenders will continue to adopt a risk-averse attitude and, with regard to new business, they will demand a significant injection of equity or public sector involvement.

Refinancing markets

The refinancing markets have stabilised further in recent months. The future development depends on the overall market and individual factors in the individual markets. Certain markets will, selectively probably continue to produce in a stable manner – particularly if the state support programs have an effect. The more stable markets will probably also include the Pfandbrief market, not least as a result of the purchasing programme of the ECB. It is very difficult to predict whether the risk premiums in the market for uncovered bank issues will be able to stabilise further or even be reduced. Moreover, it is not likely that there will be a very rapid increase in the volumes on the money market. Overall, it is possible that there might be further volatilities on individual sub-markets or the overall market.

Company-specific Conditions

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

The existence of companies in HRE continued to be threatened in the whole business year 2009.

HRE continues to assume unchanged that it is a going concern and will continue in operation under the following described conditions (external factors/internal factors). Based on present information, the Management Board considers it currently as predominantly probable that these conditions are in existence or will occur.

External factors

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

Internal factors

- HRE further succeeds in regaining the confidence of customers and successfully writes new business subject to adequate volumes and adequate margins.
- There are no significant delays or obstructions of the implementation of the restructuring of HRE that aims to improve efficiency, profitability and streamlining of business processes.
- Work-out or restructuring of non-performing loans throughout HRE can be implemented as currently scheduled.
- HRE has been given the possibility of reducing assets in a value-preserving manner and of transferring balance sheet items by way of establishing a deconsolidated environment.
- HRE is able to hire and keep staff in key positions despite specific restrictions for example on compensation.

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

As the first step towards recapitalising HRE, the German Finanzmarktstabilisierungsfonds took up 20 million HRE Holding shares on 28 March 2009 for a legal minimum price of € 3.00 per share, with shareholders' subscription rights excluded. As the second step of recapitalisation of HRE, the shareholders adopted a resolution regarding a capital increase of around € 2.96 billion in return for a cash contribution at the Extraordinary General Meeting held on 2 June 2009. The round 986.5 million shares were issued at the nominal value and legal minimum price of € 3.00 specified in the articles of incorporation. Only the German Finanzmarktstabilisierungsfonds was permitted to take up the new shares out of the capital increase, and the statutory shareholders' subscription rights were excluded. After the registration of the capital increase on 8 June 2009, SoFFin holds 90% of the Company's share capital. On 5 October 2009, a resolution for transferring the shares of the minority shareholders to SoFFin was adopted at an Extraordinary General Meeting. The Amtsgericht (local court) Munich entered the transfer resolution on the commercial register on 13 October 2009, so that SoFFin became the only shareholder of HRE Holding. As a third step in the recapitalisation process, HRE received a further capital contribution of a total of € 3.0 billion from SoFFin in November 2009. This tranche consists of a silent participation of € 1.0 billion to Deutsche Pfandbriefbank AG, a contribution of € 1.3 billion to the reserve of Deutsche Pfandbriefbank AG and a contribution of € 0.7 billion to the reserve of HRE Holding.

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

Risks threatening the existence

The future existence of HRE Holding as a going concern is dependent on the assumption that sufficient equity will be provided to HRE Holding and its significant subsidiaries to fulfil regulatory capital requirements as well as to avoid a situation of sustained over-indebtedness. External liquidity support is necessary to avert insolvency due to illiquidity of the significant subsidiaries of HRE Holding or HRE Holding itself. These liquidity supports must be available until HRE Holding and its significant subsidiaries are capable if raising sufficient liquidity on the money and capital market by themselves, and until the agreed restructuring arrangements are implemented and the equity capital increase is performed as scheduled.

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

- the German Finanzmarktstabilisierungsfonds provides sufficient support in the form of equity capital
- the German Finanzmarktstabilisierungsfonds and the Deutsche Bundesbank maintain their liquidity support and, if necessary, provide further liquidity assistance
- refinancing with sustainable conditions on the money and capital market occurs
- the restructuring arrangements will be implemented as scheduled
- the appropriate authorities do not take regulatory actions
- no legal reservations (especially EU legal actions) will be successfully enforced

Development in earnings HRE has reported a negative pre-tax profit for the business year 2009. HRE expects that earnings will continue to be negatively affected in future to a significant extent, resulting in an ongoing loss-making situation. HRE is not assuming that it will be able to return to profitability before the year 2012. The extent of the expected loss-making situation will in particular be influenced by the occurrence or non-occurrence of the following risks, or the extent to which the following risks might materialise.

- The restructuring of the liquidity support measures made available by a syndicate from the German financial sector and the Deutsche Bundesbank with the involvement of the German Federal Government will lower the refinancing costs of the Group. Nevertheless, the refinancing rates for the new and existing SoFFin funds are higher than the refinancing rates before the liquidity support was drawn down in September 2008. This means that net interest income and net commission income will continue to be very much affected.
- Net interest income in 2009 was boosted by high income in the money market field and drawn US customer liquidity facilities. A similarly positive market interest rate situation is not expected to occur in the year 2010 and because most of the facilities have now been repaid, a similarly high net interest income from these factors is not expected to be seen in the course of the next few years.
- The extent that the existing portfolio will decline as a result of streamlining and disposals as well as the possible transfer of assets and liabilities to a deconsolidated

environment, with a resultant negative impact on net interest income. In addition, the negative market values which might result in the case of disposals would depress net interest income or net income from financial investments.

- Apart from the funding through the financial market HRE also uses funding possibilities made available by the central banks. It cannot be assumed that these funding possibilities will change. It cannot be forecasted if and to which costs alternative funding possibilities will be available in time. If alternative funding is necessary, higher costs would probably arise and would therefore be disadvantageous for the profitability of the Group.
- Further widening of credit spreads and a deterioration of the securities pool may result in additional costs arising from the remaining collateralised debt obligations which have to be recognised in the income statement under net income from financial investments and net trading income. In addition, default risks and other deteriorations of market conditions may result in lower fair values of trading assets, which would have to be recognised immediately in the income statement. It may also be necessary to recognise impairments on holdings which have been reclassified from "Held-for-trading" and "Available for sale" into "Loans and receivables" in accordance with IAS 39.
- The situation on the US and some European real estate markets will continue to be tense. The situation of some public sector and infrastructure customers has also deteriorated. As a result of this and also in view of the fact that the overall macro-economic situation is deteriorated, provisions for losses on loans and advances will probably be at an increased level in 2010 and 2011.
- If contracting parties get into financial difficulties as a consequence of the crises on capital and financial markets or even have to announce insolvency, impairments on securities and loans could be unavoidable.
- The restructuring of HRE and the harmonisation of the IT infrastructure and processes will result in further costs which will mainly have an impact on general administrative expenses and which might at least partially compensate for the savings achieved from the process of streamlining the workforce.
- The planned establishment of a deconsolidated environment with a subsequent transfer of assets will result in additional consultancy service costs and other administrative expenses.
- Litigation which is currently pending and which might become pending in future might have a considerably negative impact on the results of HRE or might even threaten the existence of HRE as a going concern. This litigation relates mainly to lawsuits of former shareholders on the grounds of alleged inaccurate capital market information, lawsuits in conjunction with the ad hoc releases of 15 January 2008 and the liquidity situation of DEPFA Bank plc, lawsuits of former shareholders against the capital increase adopted in the Extraordinary General Meeting on 2 June 2009, lawsuits of former shareholders against the squeeze-out adopted in the Extraordinary General Meeting on 5 October 2009, lawsuits of former members of the Management Board with regard to payment, lawsuits of employees with regard to payment of variable compensation for the years 2008 and 2009 and lawsuits of some local authorities for damages.
- As a result of the rating downgrades, several ISDA master agreements as well as Guaranteed Investment Contracts have been terminated or could be terminated in the future; this has resulted in additional costs due to premature contract termination and may also result in costs to repurchase hedges. Further rating downgrades would result in further terminations of ISDA master agreements. The bank might also incur additional costs as a result of the limited choice of counterparties due to their current long-term ratings.
- The support measures received by HRE are being reviewed by the EU Commission in state aid proceedings. The eventual decision of the EU Commission might have a negative impact on the development in earnings of HRE and may possibly endanger the going concern of HRE.
- HRE is exposed to operational risks as a result of its restructuring, such as the reliance on key positions, technology risks due to the large number of entry systems, increased staff fluctuation levels and risks in connection with change management activities. These risks might result in major losses.

Development in assets The development in assets of HRE is particularly influenced through the occurrence or non-occurrence of the following risks, or the extent to which the following risks might materialise:

- If the credit spreads of states e.g. Greece, Portugal, Ireland, Italy and Spain and other banks widen further respectively widen again, the values of the securities issued by them will decline. HRE has reclassified most of the available-for-sale securities into the measurement category "Loans and receivables" in accordance with the Amendments to IAS 39 "Reclassification of Financial Assets" which was published in October 2008. However, for the remainder of the available-for-sale securities, widening of credit spreads would have a further negative impact on the AfS reserve.

- The portfolio will probably decline as a result of streamlining or disposals, and the possible transfer of assets and liabilities to a deconsolidated environment; this is in line with the process of focusing on functioning Group areas of activity.
- The difficult situation and the subsequent action taken to stabilise HRE have resulted in debates on the political scene, in the media and in the public. Overall, the image of HRE has suffered. Despite the fact that success has already been achieved as a result of the Bank re-entering markets, it is possible that there may be negative consequences for future business and customer relations.

Development in the financial position The development in the financial position of HRE is particularly influenced through the occurrence or non-occurrence of the following risks that may occur, or the extent to which the following risks might materialise:

- The support measures received are being reviewed by the EU Commission in the ongoing state aid proceedings. In its final decision, the European Commission will very probably impose some major covenants on HRE, including a major reduction in the balance sheet total and the commitment of a time line for reprivatising Deutsche Pfandbriefbank AG. However, if the European Commission concludes that the state aid is not consistent, or is not completely consistent, with the EC Treaty, it is possible that it might oblige Germany to suspend or restructure this aid by a certain deadline, or it may order the aid to be repaid. This might result in insolvency for some or all companies of HRE, and might thus endanger the continued operation of HRE as a going concern.
- The refinancing of HRE in the course of the next few years will continue to be reliant on the support measures provided by SoFFin. The repayment of the support measures will depend on various factors, including the access of HRE to the refinancing markets and its rating.
- HRE has issued irrevocable loan commitments and liquidity facilities. Drawings may result in additional outflows of liquidity. In addition, further rating downgrades would result in further terminations due to ISDA framework agreements and this may lead to outflows of liquidity.
- The capital backing of HRE and its subsidiaries has improved as a result of the support provided by SoFFin. In the years 2010 and 2011, IFRS equity and the regulatory core capital may decline again as a result of the factors detailed above. In addition, a revision of the regulatory regulations could lead to stricter demands in respect to the capital backing. Based on the assumed support measures by German Finanzmarktstabilisierungsfonds, it is expected that the going concern of HRE will not be put into question.

The new business model may be an opportunity for HRE. In the field of commercial real estate financing, many competitors will probably go out of the market or will be seriously weakened. The granting of loans is becoming more restrictive in general. In consequence, margins on the real estate financing market may rise. Globalisation of financial flows and investors of large-volume projects will appreciate a specialist commercial real estate financier such as HRE as a result of its special market and product knowledge, whose expertise is recognised on the market and who has succeeded in signing new business in 2009. Numerous competitors in the field of public sector finance are also affected by the financial market crisis. The experience of HRE in the Pfandbrief business may be an advantage. In this context, HRE will continue to search for market opportunities in 2010 and 2011 and conclude new business with attractive margins. In line with overall strategy, the focus will be on Pfandbrief-eligible follow-up funding and newly acquired business in the real estate and public sector segments.

On 21 January 2010, and following liaison with SoFFin, HRE Holding submitted an application to the German Financial Market Stabilisation Authority (FMSA) for establishing a deconsolidated environment aimed at reducing assets in a value preserving manner. There is no legal right to the establishment of the deconsolidated environment. Instead, the FMSA has the discretionary authority to establish it. For HRE, a deconsolidated environment may be an opportunity because non-strategic positions will be removed from the balance sheet and because core business can be freed up more quickly.

The results for 2010 and 2011 will probably be considerably affected by further impairments in relation to receivables and securities and the costs of the liquidity support measures. In addition, the expenses arising in the course of the establishment of a deconsolidated environment with a subsequent transfer of assets will depress general administrative expenses and net income. HRE is not assuming that it will be able to return to profitability before the year 2012.

Consolidated Financial Statements

Income/expenses				Change	
in € million	Note · page	2009	2008	in € million	in %
Operating revenues		419	−585	1,004	> 100.0
Net interest income and similar income	31 · 135	1,396	1,633	−237	−14.5
Interest income and similar income		12,108	16,828	−4,720	−28.0
Interest expenses and similar expenses		10,712	15,195	−4,483	−29.5
Net commission income	32 · 135	−642	32	−674	< −100.0
Commission income		137	200	−63	−31.5
Commission expenses		779	168	611	> 100.0
Net trading income	33 · 135, 35 · 136	−154	−1,009	855	84.7
Net income from financial investments	34 · 135, 35 · 136	−1	−1,409	1,408	99.9
Net income from hedge relationships	36 · 136	−117	86	−203	< −100.0
Balance of other operating income/expenses	37 · 136	−63	82	−145	< −100.0
Provisions for losses on loans and advances	38 · 136	2,091	1,656	435	26.3
General administrative expenses	39 · 137	541	605	−64	−10.6
Impairments on goodwill and DEPFA's intangible assets	40 · 137	—	2,482	−2,482	−100.0
Balance of other income/expenses	41 · 137	−8	−47	39	83.0
Pre-tax profit/loss		**−2,221**	**−5,375**	3,154	58.7
Taxes on income	42 · 137	15	86	−71	−82.6
Net income/loss		**−2,236**	**−5,461**	3,225	59.1

Statement of comprehensive income

in € million	2009 before tax	2009 tax	2009 net of tax	2008 before tax	2008 tax	2008 net of tax
Net income/loss	−2,221	15	−2,236	−5,375	86	−5,461
AfS reserve	993	145	848	−3,189	−420	−2,769
Cash flow hedge reserve	605	165	440	881	372	509
Exchange differences	8	—	8	−15	—	−15
Total	**−615**	**325**	**−940**	**−7,698**	**38**	**−7,736**
attributable to:						
Equity holders consolidated profit/loss from the parent company)	−615	325	−940	−7,698	38	−7,736

Disclosure of components of comprehensive income

in € million	2009	2008
Net income/loss	−2,236	−5,461
AfS reserve	848	−2,769
Gains/losses arising during the year	843	−2,974
Reclassification adjustments for gains/losses included in profit or loss	5	205
Cash flow hedge reserve	440	509
Gains/losses arising during the year	440	796
Reclassification adjustments for gains/losses included in profit or loss	—	−287
Exchange differences	8	−15
Total	**−940**	**−7,736**

Assets

in € million	Note · page	31.12.2009	31.12.2008	Change in € million	Change in %	31.12.2007
Cash reserve	7 · 126, 44 · 140	1,824	1,713	111	6.5	10,654
Trading assets	8 · 126, 45 · 140	10,749	17,287	−6,538	−37.8	20,552
Loans and advances to other banks	9 · 126, 46 · 140	37,521	49,409	−11,888	−24.1	51,975
Loans and advances to customers	9 · 126, 47 · 140	198,344	222,048	−23,704	−10.7	213,173
Allowances for losses on loans and advances	10 · 126, 49 · 141	−3,898	−2,277	−1,621	−71.2	−905
Financial investments	11 · 127, 50 · 142	94,808	108,740	−13,932	−12.8	88,851
Property, plant and equipment	12 · 127, 51 · 145	15	32	−17	−53.1	68
Intangible assets	13 · 127, 52 · 146	44	40	4	10.0	2,555
Other assets	14 · 128, 53 · 147	15,399	17,396	−1,997	−11.5	9,870
Income tax assets	23 · 129, 54 · 147	4,870	5,266	−396	−7.5	3,381
Current tax assets		146	132	14	10.6	114
Deferred tax assets		4,724	5,134	−410	−8.0	3,267
Total assets		**359,676**	**419,654**	−59,978	−14.3	**400,174**

Equity and liabilities

in € million	Note · page	31.12.2009	31.12.2008	Change in € million	Change in %	31.12.2007
Liabilities to other banks	15 · 128, 58 · 149	137,349	146,878	−9,529	−6.5	111,241
Liabilities to customers	15 · 128, 59 · 149	13,259	15,936	−2,677	−16.8	27,106
Liabilities evidenced by certificates	60 · 149	156,376	197,978	−41,602	−21.0	218,080
Trading liabilities	16 · 128, 61 · 149	11,391	17,236	−5,845	−33.9	14,835
Provisions	17 · 128, 62 · 149	249	352	−103	−29.3	144
Other liabilities	18 · 128, 63 · 153	29,250	33,835	−4,585	−13.6	14,722
Income tax liabilities	23 · 129, 64 · 153	3,976	4,163	−187	−4.5	2,357
Current tax liabilities		113	161	−48	−29.8	116
Deferred tax liabilities		3,863	4,002	−139	−3.5	2,241
Subordinated capital	19 · 129, 65 · 153	3,217	4,784	−1,567	−32.8	5,615
Liabilities		**355,067**	**421,162**	−66,095	−15.7	**394,100**
Subscribed capital	66 · 155	3,649	633	3,016	> 100.0	602
Hybrid capital instruments[1]	19 · 129, 65 · 154, 66 · 155	1,043	—	1,043	> 100.0	—
Silent participation[2]	20 · 129, 66 · 155	999	—	999	> 100.0	—
Additional paid-in capital		8,351	6,352	1,999	31.5	5,926
Retained earnings	66 · 155	−4,368	1,085	−5,453	< −100.0	943
Revaluation reserve		−2,829	−4,117	1,288	31.3	−1,857
AfS reserve	6 · 122	−2,267	−3,115	848	27.2	−346
Cash flow hedge reserve	6 · 122	−562	−1,002	440	43.9	−1,511
Consolidated loss / profit 1.1.–31.12.		−2,236	−5,461	3,225	59.1	457
Profit carried forward from prior year		—	—	—	—	3
Equity		**4,609**	**−1,508**	6,117	> 100.0	**6,074**
Total equity and liabilities		**359,676**	**419,654**	−59,978	−14.3	**400,174**

[1] Hybrid capital instruments of the subsidiary DEPFA Bank plc which had to be reclassified according to IAS 32 under equity instead of under subordinated capital (non-controlling interest)
[2] Silent participation of SoFFin to the subsidiary Deutsche Pfandbriefbank AG (non-controlling interest)

Equity

in € million	Subscribed capital	Hybrid capital instruments[1]	Silent participation[2]	Additional paid-in capital	Retained earnings[3]	Revaluation reserve: AfS reserve	Revaluation reserve: Cash flow hedge reserve	Consolidated profit/loss	Profit carried forward from prior year	**Equity**
Equity at 1.1.2008	**602**	**—**	**—**	**5,926**	**943**	**−346**	**−1,511**	**457**	**3**	**6,074**
Capital increase	30	—	—	420	—	—	—	—	—	450
Treasury shares	1	—	—	6	—	—	—	—	—	7
Distribution	—	—	—	—	—	—	—	−101	—	−101
Total comprehensive income for the year	—	—	—	—	−15	−2,769	509	−5,461	—	−7,736
Transfer to retained earnings	—	—	—	—	157	—	—	−356	−3	−202
Equity at 31.12.2008	**633**	**—**	**—**	**6,352**	**1,085**	**−3,115**	**−1,002**	**−5,461**	**—**	**−1,508**
Equity at 1.1.2009	**633**	**—**	**—**	**6,352**	**1,085**	**−3,115**	**−1,002**	**−5,461**	**—**	**−1,508**
Capital increase	3,020	—	—	2,000	—	—	—	—	—	5,020
Transaction costs of capital measures	−4	—	−1	−3	—	—	—	—	—	−8
Treasury shares	—	—	—	2	—	—	—	—	—	2
Distribution	—	—	—	—	—	—	—	—	—	—
Total comprehensive income for the year	—	—	—	—	8	848	440	−2,236	—	−940
Transfer to retained earnings	—	—	—	—	−5,461	—	—	5,461	—	—
Reclassification of hybrid capital instruments	—	1,043	—	—	—	—	—	—	—	1,043
Proceeds from silent participation	—	—	1,000	—	—	—	—	—	—	1,000
Equity at 31.12.2009	**3,649**	**1,043**	**999**	**8,351**	**−4,368**	**−2,267**	**−562**	**−2,236**	**—**	**4,609**

[1] Hybrid capital instruments of the subsidiary DEPFA Bank plc which had to be reclassified according to IAS 32 under equity instead of under subordinated capital (non-controlling interest)
[2] Silent participation of SoFFin to the subsidiary Deutsche Pfandbriefbank AG (non-controlling interest)
[3] Including unappropriated net income

Cash Flow Statement

in € million	2009	2008
Net income/loss	**−2,236**	**−5,461**
Write-downs, provisions for losses on, and write-ups of, loans and advances and additions to provisions for losses on guarantees and indemnities	2,032	1,659
Write-downs and depreciation less write-ups on long-term assets	−679	1,542
Change in other non-cash positions	951	3,297
thereof: Impairments on goodwill and DEPFA's intangible assets	—	2,482
Result from the sale of investments, property, plant and equipment	−19	−89
Other adjustments	−1,381	−1,547
Subtotal	**−1,332**	**−599**
Change in assets and liabilities from operating activities after correction for non-cash components		
Increase in assets/decrease in liabilities (–)		
Decrease in assets/increase in liabilities (+)		
Trading portfolio	1,425	5,656
Loans and advances to other banks	10,609	2,658
Loans and advances to customers	20,043	−7,640
Other assets from operating activities	154	105
Liabilities to other banks	−8,209	33,992
Liabilities to customers	−2,496	−11,208
Liabilities evidenced by certificates	−39,962	−21,873
Other liabilities from operating activities	−307	1,051
Interest income received	13,424	11,864
Dividend income received	—	8
Interest expense paid	−12,282	−12,564
Taxes on income paid	−52	−10
Cash flow from operating activities	**−18,985**	**1,440**
Proceeds from the sale of non-current assets	15,285	16,889
Payments for the acquisition of non-current assets	−2,083	−26,275
Proceeds from the sale of investments	29	2
Payments for the acquisition of investments	—	−129
Cash flow from investing activities	**13,231**	**−9,513**
Proceeds from capital increases	6,012	—
Dividends paid	—	−101
Subordinated capital, net	−372	−766
Cash flow from financing activities	**5,640**	**−867**
Cash and cash equivalents at the end of the previous period	**1,713**	**10,654**
+/– Cash flow from operating activities	−18,985	1,440
+/– Cash flow from investing activities	13,231	−9,513
+/– Cash flow from financing activities	5,640	−867
+/– Effects of exchange rate changes and non-cash valuation changes	225	−1
Cash and cash equivalents at the end of the period	**1,824**	**1,713**

1 General information

Hypo Real Estate Group (HRE) is in the process of realigning its business as a specialist for real estate and public finance. The Group will also concentrate its activities in regional terms, and will in future focus on Germany and Europe. Depending on the particular area of activity, it will also be active in other international markets. The focus will always be on the eligibility of business for Pfandbrief funding. The holding company of the HRE is the **Hypo Real Estate Holding Aktiengesellschaft (HRE Holding)**, which is incorporated in the commercial register of the Amtsgericht (local court) Munich (HRB 149393) with Munich as registered office.

Accounting Policies

2 Principles

HRE Holding has prepared its financial statements for the period ended 31 December 2009 in line with EC ordinance No. 1606/2002 of the European Parliament and Council of 19 July 2002 in accordance with International Financial Reporting Standards (IFRS). These financial statements are based on the IFRS rules, which have been adopted in European Law by the EU commission as part of the endorsement process; it is also based on the regulations of commercial law which are applicable in accordance with section 315a (1) HGB (German Commercial Code). With the exception of specific regulations relating to fair value hedge accounting for a portfolio hedge of interest risks in IAS39 all mandatory IFRS rules have been completely endorsed by the EU. HRE does not apply this type of hedge accounting. Therefore, the financial statements are accordingly consistent with the entire IFRS and also with the IFRS as applicable in the EU.

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

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

The Management Board of HRE Holding has prepared the consolidated financial statements on 12 March 2010 under the going concern assumption. In preparing the consolidated financial statements, the Management Board is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the HRE Holding and their significant subsidiaries ability to continue as a going concern. The future existence of the HRE Holding as a going concern is dependent on the assumption that sufficient equity will be provided to the HRE Holding and its significant subsidiaries to fulfil regulatory capital requirements as well as to avoid a situation of sustained over-indebtedness. External liquidity support is necessary to avert insolvency due to illiquidity of the significant subsidiaries of HRE Holding or the HRE Holding itself. These liquidity supports must be available until the HRE Holding and its significant subsidiaries are capable to raise sufficient liquidity on the money and capital market by themselves, and until the agreed restructuring arrangements are implemented and the equity capital increase is performed as scheduled.

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

- the German Finanzmarktstabilisierungsfonds provides sufficient support in form of equity capital
- the German Finanzmarktstabilisierungsfonds and the Deutsche Bundesbank maintain their liquidity support and, if necessary, provide further liquidity assistance
- refinancing with sustainable conditions on the money and capital market occurs
- the restructuring arrangements will be implemented as scheduled
- the appropriate authorities do not take regulatory actions, and
- no legal reservations (especially EU legal actions) will be successfully enforced

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

As a first step in the direction of recapitalising HRE, the German Finanzmarktstabilisierungsfonds has acquired 20 million HRE Holding shares on 28 March 2009 for a legal minimum price of € 3.00 per share, whereby shareholders' subscription rights were excluded. As the second step of recapitalisation of HRE, the shareholders adopted a resolution regarding a capital increase of around € 2.96 billion in return for a cash contribution at the Extraordinary General Meeting held on 2 June 2009. The round 986.5 million shares were issued at the nominal value and legal minimum price of € 3.00 specified in the articles of incorporation. Only the German Finanzmarktstabilisierungsfonds was permitted to take up the new shares out of the capital increase, and the statutory shareholders' subscription rights were excluded. After the registration of the capital increase on 8 June 2009, the German Finanzmarktstabilisierungsfonds hold round 90 % of the Company's share capital. On 5 October 2009, a resolution for transferring the shares of the minority shareholders to SoFFin was adopted at an Extraordinary General Meeting. The Amtsgericht (local court) Munich entered the transfer resolution into the commercial register on 13 October 2009, so that SoFFin became the only shareholder of HRE Holding. On 4 November 2009 as a third step in the recapitalisation process, the Steering Committee of the German Finanzmarktstabilisierungsfonds decided to extend the support provided to HRE. As a third step in the recapitalisation process, HRE received a further capital contribution of a total of € 3.0 billion from the SoFFin in November 2009. This tranche consists of a silent participation of € 1.0 billion to Deutsche Pfandbriefbank AG, a contribution of € 1.3 billion to the reserve of Deutsche Pfandbriefbank AG and a contribution of € 0.7 billion to the reserve of HRE Holding.

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

IFRS and interpretations applied for the first time as well as changes of standards and interpretations In the financial year 2009 the following new or revised standards and interpretations were applied initially:

- IFRS 1 and IAS 27 (Cost of an Investment in a Subsidiary, Jointly-controlled Entity or Associate)
- IFRS 2 (Share-based Payment: Vesting Conditions and Cancellations)
- IFRS 7 (Financial Instruments: Disclosures – Improving Disclosures about Financial Instruments)
- IFRS 8 (Operating Segments)
- IAS 1 (Presentation of Financial Statements: A revised Presentation, revised 2007)
- IAS 23 (Borrowing Costs, revised 2007)
- IAS 32 and IAS 1 (Puttable Financial Instruments and Obligations Arising on Liquidation)
- IFRIC 9 and IAS 39 (Embedded Derivatives, amendment 2009)
- IFRIC 13 (Customer Loyalty Programmes)
- IFRIC 15 (Agreements for the Construction of Real Estate)
- IFRIC 16 (Hedges of a Net Investment in a Foreign Operation)
- IFRIC 18 (Transfer of Assets from Customers)

Only the new or revised standards IAS 1 (Presentation of Financial Statements: A revised Presentation, revised 2007), IAS 24 (Related Party Disclosures), IFRS 7 (Financial Instruments: Disclosures – Improving Disclosures about Financial Instruments) and IFRS 8 (Operating Segments) had a material effect on the disclosure of HRE. The new or revised standards had no effect on recognition and measurement.

As per the revision of IAS 1 the income and expense components of the period are disclosed in two statements, the income statement and a reconciliation from the net income or net loss to the comprehensive income including a disclosure of the components of other comprehensive income (statement of comprehensive income). The balance sheet is disclosed voluntarily with two comparative periods. Apart from the transactions with owners in their capacity as owners the statement of changes in equity contains the comprehensive income in one position.

In March 2009, the IASB issued amendments to IFRS 7 that require enhanced disclosures about fair value measurements and liquidity risk. As a result of this change, all assets and liabilities of HRE which are measured at fair value have to be grouped within the fair value hierarchy. The three-level hierarchy is based on the observability of the parameters which are used for fair value measurement. In addition, an analysis of the remaining contractual maturities for derivative and non-derivative financial liabilities has to be disclosed for the presentation of the liquidity risk. The amended IFRS 7 has resulted in more extensive disclosures in the notes, but does not have any impact on the recognition and measurement of financial instruments.

The standard IFRS 8 supersedes the former standard IAS 14. IFRS 8 deals with the disclosure of operating segments of a company. Currently, the Management Board manages three segments which fulfil the requirements of IFRS 8 for operating segments. Therefore, there were no changes from the revised segment definition of IFRS 8 relating to the segment report of HRE. In addition, the standard contains some additional disclosures, for example the reporting about products and services.

In addition, most of the amendments to IFRS which were implemented by the IASB as part of the Annual Improvements Project 2008 were applicable for the first time in the financial year 2009. These amendments did not have a material impact on the presentation of the financial statements and on the net assets, financial position and results of HRE.

Published IFRS and interpretations that are not yet mandatory and which were not subject to early adoption The following material amended standards and the interpretation which are endorsed by the EU have not been applied earlier by HRE:

- IFRS 3 (Business Combinations, revised 2008)
- IAS 27 (Consolidated and Separate Financial Statements)
- IAS 32 (Financial Instruments: Presentation: Classification of Rights Issues)
- IAS 39 (Financial Instruments: Recognition and Measurement: Eligible Hedged Items)
- IFRIC 17 (Distributions of Non-Cash Assets to Owners)

IFRS 3 (revised) reconsiders the application of acquisition accounting for business combinations. Major changes relate to the measurement of non-controlling interests, the accounting for business combinations achieved in stages as well as the treatment of contingent consideration and acquisition-related costs. The standard is initially applicable prospectively in the annual period beginning on 1 January 2010. The impact for HRE is dependent on future business combinations.

Major changes of IAS 27 relate to the accounting for transactions which do not result in a change of control as well as to those leading to a loss of control. The standard is initially applicable prospectively in the annual period beginning on 1 January 2010. The impact for HRE is dependent on future transactions.

The amendment to IAS 32 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 applies for annual periods beginning on or after 1 February 2010. As HRE has not issued any such rights, at the moment, the amendment will not have an impact on HRE.

The amendment of IAS 39 clarifies how the existing principles underlying hedge accounting should be applied. Addressed are the designation of a one-sided risk in a hedged item and the designation of inflation as a hedged risk. The amendment applies prospectively in the annual period beginning on 1 January 2010. No material impacts on the hedge relationships of HRE are expected.

The interpretation IFRIC 17 provides guidance on the appropriate accounting treatment when an entity distributes assets other than cash as dividends to its shareholders. IFRIC 17 is initially applicable in the annual period beginning on 1 January 2010. Any impact for HRE will depend on future transactions and profit distributions.

Published IFRS and interpretations that are not yet endorsed by the EU In the business year 2009, HRE has not applied the following new or amended standards and interpretations. These standards and interpretations are not yet endorsed by the EU:

- IAS 24 (Related Party Disclosures)
- IFRS 2 (Share-based Payment: Group Cash-settled Share-based Payment Transactions)
- IFRS 9 (Financial Instruments)
- IFRIC 14 (Prepayments of a Minimum Funding Requirement)
- IFRIC 19 (Extinguishing Financial Liabilities with Equity Instruments)

Compared with the predecessor version, the revised IAS 24 has remedied the previous inconsistencies regarding the definitions of a related entity and a related person. In addition, it will only be necessary to disclose information about significant transactions with entities which are controlled or significantly influenced by the same government. The revised IAS 24 is applicable for the first time in annual periods beginning on or after 1 January 2011. Especially the new disclosure rules regarding government-related entities will impact HRE.

The amendment to IFRS 2 clarifies the accounting for group cash-settled share-based payment transactions. The amended IFRS 2 is initially applicable in annual periods beginning on 1 January 2010. As HRE currently does not have any share-based payment arrangements, the amendment will not have an impact.

The IASB revises the current accounting requirements for financial instruments. The new standard IFRS 9 (Financial Instruments) shall be effective for annual periods beginning on or after 1 January 2013. In November 2009 the IASB published the first phase of the new IFRS 9 which focus on the classification and measurement of financial assets. Rules regarding the classification and measurement of financial liabilities are scheduled to be published in the first half of 2010. The second and third phase of the new standard will cover the subjects "Impairments of financial instruments" and "Hedge accounting". However, it will only be possible to make a definitive assessment of the impact of the new standard when all parts of IFRS 9 have been published.

The IASB issued an amendment to the interpretation IFRIC 14 regarding the recognition of pension plans. The amendment permits entities, under certain circumstances, to recognise prepayments as an asset. IFRIC 14 amended is applicable for the first time in annual periods beginning on or after 1 January 2011. The amendment is not expected to have any impact on HRE.

The interpretation IFRIC 19 clarifies the accounting when an entity issues equity instruments to extinguish all or part of a financial liability. IFRIC 19 is applicable for the first time for annual periods beginning on or after 1 July 2010. Any impact for HRE will depend on future transactions.

In addition, various standards and interpretations were amended by the IASB as part of the Annual Improvements Project 2009. Most of the amendments are effective for the annual period beginning on 1 January 2010. It is not expected that the amendments will have a material impact on the presentation of the financial statements and on the net assets, financial position and results of HRE.

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

Consolidated financial review The consolidated financial review meets the requirements of section 315 (1) and (2) HGB (German Commercial Code) and DRS 15. It comprises a report on the business and conditions, a report on the net assets, financial position and results of operations, a report of significant events after 31 December 2009, and a forecast report as well as a risk report. The risk report contains information which, under IFRS 7, is required to be disclosed (especially in the chapters Credit Risk, Market Risk and Liquidity Risk). Events after the balance sheet date are described in the report of events after 31 December 2009 and the major events.

3 Consistency

HRE applies accounting policies consistently in accordance with the framework of IFRS as well as IAS 1 and IAS 8. In principal, in financial year 2009 no accounting policies for recognition, measurement and disclosure were changed.

4 Uniform consolidated accounting

The individual financial statements of the consolidated domestic and foreign companies are incorporated in the IFRS consolidated financial statements of HRE Holding, using uniform accounting and valuation principles.

5 Consolidation

HRE Holding and subsidiaries (including special-purpose entities)	fully consolidated		not fully consolidated (due to immateriality/ not to be consolidated according to SIC-12)		
	Total	thereof: special purpose entities	Total	thereof: special purpose entities	**Total**
1.1.2009	**74**	**45**	**45**	**20**	**119**
Additions	3	3	2	—	5
Disposals	11	9	10	7	21
Merger	1	—	3	—	4
31.12.2009	**65**	**39**	**34**	**13**	**99**

Associated companies and other investments	Associated companies	Other investments	**Total**
1.1.2009	**13**	**11**	**24**
Additions	—	3	3
Disposals	—	7	7
31.12.2009	**13**	**7**	**20**

These financial statements set out a list of shareholdings in the chapter "Holdings". In this list, the subsidiaries are structured on the basis of whether or not they are consolidated. Other shareholdings are also listed. All fully consolidated companies have prepared their financial statements basically for the period ended 31 December 2009.

The balance sheet effects of the contractual relations between the Group companies and the subsidiaries which are not consolidated are set out in the consolidated financial statements. The pooled results of the subsidiaries, which have not been consolidated in view of their minor significance, totalling € 0 million. Net losses are almost completely included in the Group financial statement by depreciation on investments, provisions and profits transferred. The pooled total assets of the non-consolidated subsidiaries account for 0.01 % of the Group total assets. The shares in the non-consolidated companies are shown as AfS financial investments.

The following newly established or existing subsidiaries have been initially included in the group of consolidated companies since control has been obtained:

PSION Synthetic CDO I plc, Dublin, was initially consolidated in the first quarter 2009 as the majority of the notes issued by the special-purpose entity was acquired. The initial consolidation had no material impact on the income statement. Total assets and total liabilities increased by US$ 25 million as financial investments and liabilities evidenced by certificates rose.

The special-purpose entity Sirrah Funding IV Ltd., Dublin, was set up in the first quarter 2009. Sirrah Funding IV Ltd. purchased assets from HRE and securitised them for funding purposes. HRE holds all tranches issued (€ 892 million) by the special-purpose entity. The initial consolidation thus resulted in an asset swap in the balance sheet and had no material impact on the income statement.

Liffey Camelback LLC, Wilmington, was initially consolidated on 15 June 2009. This subsidiary of Hypo Real Estate Capital Corp., New York, took over a salvage acquisition in Arizona, USA. The book value of salvage acquisition amounted to € 9 million as of the initial consolidation date and as of 31 December 2009. The initial consolidation has not resulted in any significant impact on the income statement or balance sheet of the Group.

The subsidiaries DEPFA Erste GmbH, Frankfurt am Main, Högni Portfolio GmbH, Munich, and PBI-Beteiligungs-GmbH (in liquidation), Munich, were not consolidated due to considerations of materiality; in the fourth quarter 2008, they were merged with their parent company Deutsche Pfandbriefbank AG, Munich. This has not resulted in any significant impact on the income statement or balance sheet of the Group.

DEPFA First Albany Securities LLC was deconsolidated after the sale of the company to the New-York-based investment bank Jefferies & Company Inc. on 27 March 2009. A gain of less than € 1 million resulted from the deconsolidation of the company. The pre-tax profit of the company until the date of deconsolidation amounted to € 1 million. Total assets of DEPFA First Albany Securities amounted to € 56 million at date of deconsolidation, thereof € 24 million trading assets, € 27 million loans and advances to other banks, and € 5 million other assets on the asset side as well as € 14 million liabilities to other banks, € 1 million trading liabilities, € 11 million other liabilities and € 30 million equity on the liability side.

The India Debt Opportunities Fund Ltd., Ebene/Mauritius, was deconsolidated after the sale of more than 90 % of the shares to UTI Asset Management Company Ltd., Mumbai. Before the share sale, the assets of the Fund were transferred to the parent company DEPFA Bank plc, Dublin. The deconsolidation has not resulted in any significant impact on the income statement or balance sheet of the Group.

The merger of DEPFA Deutsche Pfandbriefbank AG into Hypo Real Estate Bank AG was registered on 10 and 29 June 2009 in the commercial registers Frankfurt and Munich. The new entity trades under the name of Deutsche Pfandbriefbank AG, and has its registered office in Munich. The group internal transaction had no impact on the income statement or the balance sheet of HRE. In addition, Hypo Real Estate Systems GmbH was sold for an adequate purchase price from HRE Holding to Deutsche Pfandbriefbank AG. This Group internal transaction also had no impact on the net assets, financial position and results of operations of HRE.

DEPFA Holdings B.V. in liquidation, Amsterdam, was liquidated and deconsolidated on 28 December 2009. The assets of the company were transferred to subsidiaries of the Group in the previous year. Hence, the deconsolidation has not resulted in a significant effect on the income statement or balance sheet.

The following special-purpose entities were deconsolidated in the year 2009:
- House of Europe II Funding plc, Dublin
- House of Europe III Funding plc, Dublin
- Kiel I Ltd., St. Helier, Jersey
- Kiel II Ltd., St. Helier, Jersey
- Kiel VI Ltd., St. Helier, Jersey
- Kiel VII Ltd., St. Helier, Jersey
- Kiel VIII Ltd., St. Helier, Jersey
- Kiel IX Ltd., St. Helier, Jersey

The securitisation vehicles House of Europe II Funding plc, Dublin, and House of Europe III Funding plc, Dublin, were deconsolidated in 2009 after the tranches held were sold. The deconsolidation of both vehicles resulted in a reduction of the Group's balance sheet sum of € 1.6 billion.

The special-purpose entities Kiel I Ltd., Kiel II Ltd., Kiel VI Ltd., Kiel VII Ltd., Kiel VIII Ltd. and Kiel IX Ltd., St. Helier, were unwound in the fourth quarter 2009. All assets of the entities were transferred to Deutsche Pfandbriefbank AG in exchange for the tranches issued. The asset swap in the balance sheet had no material impact on the income statement.

Consolidation principles At the acquisition date the costs of a business combination are allocated by recognising the acquiree's identifiable assets, liabilities and contingent liabilities that satisfy the recognition criteria according to IFRS 3.37 at their fair values at that date. Any difference between the cost of the business combination and the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities so recognised are accounted as goodwill or as an excess if acquirer's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities in accordance with IFRS 3.51-57. If the interest in net fair value of the identifiable assets, liabilities and contingent liabilities exceeds the costs of business combination the acquirer shall reassess the identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination and recognise immediately in profit or loss any excess remaining after reassessment.

Business relations within the group of consolidated companies are netted with respect to each other. Intercompany results attributable to internal transactions are eliminated.

6 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 HRE recognises a financial asset or a financial liability on its balance sheet when, and only when, a group company becomes party to the contractual provisions of the financial instrument.

In principle, the purchases or sales of financial instruments are accounted for at trade date. Premiums and discounts appear in the position net interest income and similar income for the accounting period in question. In accordance with the primary derecognition concept of IAS 39, a financial asset has to be derecognised when all risks and rewards have mainly been transferred. If the main risks and rewards associated with ownership of the transferred financial asset are neither transferred nor retained, and if the power of disposal continues to be exercised over the transferred asset, the company has to recognise the asset to the extent of the supposed continuing involvement. There are no transactions within HRE which result in partial derecognition due to a continuing involvement.

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

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

For subsequent measurement according to IAS 39, all financial instruments have to be classified according to this standard, to be recognised in the balance sheet and to be measured according to its categorisation:

Held-for-trading A financial asset or a financial liability is held for trading if it is:
- acquired or incurred principally for the purpose of selling or repurchasing it in the near term

- part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking or
- a derivative (except for a derivative that is a designated and effective hedging instrument).

Held-for-trading financial instruments are measured at fair value. Changes in fair value are recognised in profit or loss. Held-for-trading financial instruments are 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.

Designated at fair value through profit or loss (dFVTPL) If certain conditions are satisfied, financial assets or liabilities can be classified at their fair value through profit or loss when they are initially stated. A designation can be made if the use of the valuation category means that a recognition and valuation inconsistency is either avoided or considerably reduced, and management and performance measurement of a portfolio of financial instruments are based on the fair values or if the instrument contains a separable embedded derivative. HRE classifies financial assets under the dFVTPL category only for the first two cases. As of 31 December 2009, only fixed-income securities and loans and advances are held in the category dFVTPL. Financial liabilities are not allocated to this category. The portfolio of fixed-income securities and loans and advances is managed on fair value basis. In addition, open interest risk positions of the portfolio are to a large extent closed by hedging derivatives. Because changes in the value of derivatives under IAS 39 in principle have to be recognised in profit or loss, the designation of fixed income securities and loans and advances under the category dFVTPL will avoid inconsistency in terms of valuation. As a result of the designation of fixed income securities and loans and advances, the opposite movements relating to the hedged risk in the income statement cancel each other to a large extent. The accounting treatment is accordingly consistent with risk management and the investment strategy.

dFVTPL financial instruments are measured at fair value. Changes in fair value are recognised in profit or loss. The amount of change, during the period and since initial recognition, in the fair value of the loan and advance that is attributable to changes in the credit risk of the financial asset is disclosed in the notes. The amount is determined as the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risks. Hence, the amount resulting from credit risk is the difference between the total change of fair value and the change attributable to market risks. Because financial liabilities are not designated in the category dFVTPL, HRE does not have any effect resulting from the instruments being valued with the own current credit risk. The fixed income securities under the category dFVTPL are stated under the item of financial instruments, the loans and advances under loans and advances to customers. Interest income from the securities and loans and advances is shown under the position net interest income and similar income. The changes in value to be recognised in profit or loss (net gains and net losses from fair value option) are stated under the line net income from hedge relationships in the same way as the changes in value of the corresponding derivatives.

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.

In the past, HRE has used the HtM category. As a result of the changed intention of HRE of not necessarily holding the financial investments to maturity the entire portfolio of HtM investments was reclassified as of 1 July 2007 in accordance with IAS 39.51 into the category AfS. In financial years 2009 and 2008, no financial assets were classified as HtM.

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

Loans and receivables are recognised in the positions loans and advances to banks, loans and advances to customers and financial investments, and are measured at amortised cost. Interest income from loans and receivables are shown in net interest income and similar 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 banks are shown under the position net interest income and similar income. Such net gains and net losses from financial investments are shown in net income from financial investments. Reductions in value due to credit standing factors are shown under provisions for losses on loans and advances respectively in net income from financial investments for financial investments.

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. HRE only categorises securities as AfS but not loans and advances.

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

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

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

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

Derivatives are measured at fair value. Changes in fair value are recognised in the income statement if the derivatives are not recognised in cash flow hedge accounting. The valuation results from stand-alone derivatives are shown in net trading income and from hedging derivatives in net income from hedge relationships. The interest from trading derivatives is shown under net trading income. In the balance sheet stand-alone derivatives are disclosed under trading assets and trading liabilities and hedging derivatives under other assets and other liabilities.

Outside the held-for-trading and dFVTPL category, embedded derivative financial instruments to be separated within a structured product are separated from the host contract and recognised as separate derivative financial instruments. The host contract is then accounted for in accordance with the categorisation made. The change in value arising from the separated derivatives that are recognised and measured at fair value is recognised in the income statement.

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

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

Impairment According to IAS 39.58 a financial asset must be tested for impairment. At each balance sheet date HRE assesses on a case-by-case basis whether there is objective evidence for impairment. The criteria used to determine if there is such objective evidence included:

- significant financial difficulties of the borrower
- overdue contractual payments of either principal or interest or other breaches of contract
- becoming probable that the borrower will enter bankruptcy or other financial reorganisation
- renegotiations due to economic problems
- when available, the market price of the asset
- for AfS equity instruments a significant and/or prolonged decline in the fair value.

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

HRE 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:

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

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

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

With respect to the period between the occurrence and the identification of an impairment the accounting estimates were adjusted due to the improved credit processes. Further adjustments compared to the prior year were done to reflect the economic cycle as this is reflected in the historic loss rates. Due to the changed parameters the portfolio-based provisions decreased by € 323 million.

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

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

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

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

HRE 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 mainly the regression analysis is used. The dollar offset method is applied for quantifying the ineffectiveness. If the hedge relationship is terminated for reasons other than the derecognition of the hedged item, the difference between the carrying amount of the hedged item at that point and the value at which it would have been carried, had the hedge never existed (the unamortised fair value adjustment), is amortised 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.

Cash flow hedge According to IAS 39, a cash flow hedge hedges the risk inherent with fluctuating payment streams which is attributable to a certain risk associated with the stated asset, the stated liability (for instance some or all future interest payments of a variable-interest debt), the risk associated with a future transaction (expected to occur with a high degree of probability) and might have an effect on profit or loss for the period.

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

HRE uses the cash flow hedge model for hedging interest risks on a portfolio basis. For that no planned transactions were recognised.

Under cash flow hedge accounting, hedging instruments are stated with their fair value. The valuation result has to be broken down into an effective and an ineffective part of the hedge relationship.

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

A hedging relationship is deemed to be effective if, at the beginning and throughout the entire duration of the transactions, changes in the payment streams of the underlying transactions are balanced almost completely (range of 80 % to 125 %) by changes in the payment streams of the hedging instruments. For the purpose of establishing whether a specific part of the hedging instrument is effective, the future variable interest payments from the receivables and liabilities to be hedged are compared quarterly for the financial statements with the variable interest payments from the interest derivatives in detailed maturity bands. The dollar offset method or statistical methods are used to measure efficiency.

In those periods in which the payment streams of the hedged underlying transactions have an impact on profit or loss for the period, the cash flow hedge reserve is released in the income statement. If a cash flow hedge for a forecast transaction is deemed to be no longer effective, or if the hedge relationship is terminated, the cumulative gain or loss on the hedging derivative previously reported in equity remains there until the committed or forecast transaction occurs or is no longer expected to occur, at which point it is transferred to the income statement.

Hedge of a net investment in a foreign operation A net investment hedge is a hedge of the foreign currency exposure on a net investment in a foreign operation. Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. The HRE does not hedge a net investment in a foreign operation in the financial year 2009 and as of 31 December 2008.

7 Cash reserve

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

8 Trading assets

Trading assets comprise held-for-trading securities as well as positive market values of trading derivatives and of stand-alone derivatives of the bank book. In addition, borrowers' note loans and registered bonds as well as public sector bonds, to the extent they are used for trading purposes, are stated under other trading assets.

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

9 Loans and advances

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

10 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 effective interest rate. Market rate changes do not have any effect in this respect. The increase in the present value of an adjusted receivable (so-called unwinding) which occurs over a period of time is shown as interest income.

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

Allowances for losses on loans and advances are broken down into allowances relating to loans and advances and provisions for contingent liabilities and other commitments like irrevocable loan commitments. An allowance relating to loans and advances is shown as a negative item on the assets side of the balance sheet, whereas a provision for contingent liabilities and other commitments is shown on the liabilities side of the balance sheet. 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 and similar income.

11 Financial investments

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

12 Property, plant and equipment

Property, plant and equipment are normally shown at cost of purchase or cost of production. The carrying amounts, if the assets are subject to wear and tear, are diminished by depreciation in accordance with the expected useful life of the assets. In addition, property, plant and equipment are tested at least annually for impairment. If the value of property, plant and equipment has additionally been diminished, non-scheduled depreciation is taken to the income statement. If the reasons for the non-scheduled depreciation are no longer applicable, an amount is written back to the income statement, not exceeding the extent of the amortised cost of purchase or production. In the case of fittings in rented buildings, the contract duration taking account of extension options is used as the basis of this contract duration if it is shorter than the economic life.

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

Cost of purchase or cost of production, which is subsequently incurred, is capitalised if an additional economic benefit accrues to the Company. Measures which are designed to maintain the condition of the property, plant and equipment are recognised in the income statement of the financial year in which they arose.

13 Intangible assets

Purchased and internally generated software are the main items disclosed as intangible assets. Goodwill, brand names and customer relationships have not been recognised after their complete impairment in the financial year 2008.

Software is an intangible asset with a finite useful life. Purchased software is stated at amortised cost of purchase. HRE capitalises internally generated software if it is probable that future economic benefits will flow to the Group and the expenses can be measured reliably. Expenses eligible for capitalisation include external directly attributable costs for materials and services as well as personnel expenses for employees directly associated with an internally generated software project. Software is written down in a straight-line basis over an expected useful life of three to five years. In addition, intangible assets with a finite useful life have to be tested for impairment at least annually and whenever there is an indication that the intangible asset may be impaired.

14 Other assets

Other assets mainly contain positive fair values from derivative financial instruments (hedging derivatives and derivatives hedging dFVTPL financial instruments), salvage acquisitions and the capitalised excess cover of qualified insurance for pension provisions. Salvage acquisitions are measured as inventories according to IAS 2 at the lower of cost of purchase and net realisable value.

15 Liabilities

Liabilities other than underlying transactions of an effective fair value hedge and which are not classified as dFVTPL are stated at amortised cost. Discounts and premiums are recognised on a prorata basis. Interest-free liabilities are stated with their cash value. The HRE 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 net interest income and similar income.

16 Trading liabilities

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

17 Provisions

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

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

The actuarial profits and losses are dealt with using the so-called corridor method: a consideration in the income statement only has to be taken to the income statement in subsequent years if the total profits or losses which have accumulated as of the reference date for the financial statements exceed 10 % of the maximum figure calculated as the cash value of the earned pension entitlements and the assets of any external benefit facility. The effect to be treated in income statement is divided by the expected average remaining working lives of the employees participating in that plan.

The interest rate used for discounting defined benefit obligations is based on the long-term interest rate applicable for first-class fixed-income corporate bonds on the reference date for the financial statements.

HRE obtained insurance against parts of the risks arising from defined-benefit pension commitments as of 1 January 2005 by taking reinsurance classified as a "qualifying insurance policy" under IAS 19. This reinsurance is pledged to the plan beneficiaries and constitutes plan assets under IAS 19. The pension obligations have to be netted with the plan assets by taking into account the ceiling according to IAS 19.58.

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

18 Other liabilities

Besides negative fair values from derivative financial instruments (hedging derivatives and derivatives hedging dFVTPL financial instruments), accrued liabilities are one of the items stated under other liabilities. 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 flexitime 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.

19 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 HRE encompasses subordinated liabilities, participating certificates outstanding and hybrid capital instruments. For some instruments of subordinated capital the holders participate in any net loss or balance sheet loss. In addition, the interest entitlement can be ceased or reduced under specific conditions. For other instruments the interest ceases only in case of a net loss which can be caught up depending on the structuring.

Pursuant to IAS 32 the subordinated capital instruments issued by companies of HRE 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.

By applying the effective interest method an expected reduction of the interest entitlement and/or an expected loss participation of the subordinated capital led to a devaluation of the subordinated capital in the years 2008 and 2009. The devaluation is disclosed as an interest income in the income statement. In the following years the present value of the adjusted allowances resulting over a period of time (unwinding) will result in an expense.

20 Silent participation

The SoFFin provided the Deutsche Pfandbriefbank AG with a silent participation of € 1.0 billion in 2009. The silent participation has an indefinite life. The silent partner SoFFin shares any balance sheet deficit suffered by Deutsche Pfandbriefbank AG up to the full amount of the silent participation. The silent participation is classified as an equity instrument on initial recognition in accordance with the substance of the contractual arrangement and the definitions in IAS 32. The silent participation is measured initially at cost, with such cost being equivalent to the fair value of the consideration received.

21 Share-based compensation

As of 31 December 2009 no company of HRE have provided a commitment for share-based compensation. All shares of HRE Holding due under the award scheme and which were vested to employees of the Group in the second quarter 2009 were transferred to SoFFin because of the squeeze-out at the latest.

22 Currency translation

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

Income and expenditures attributable to currency translation at the individual companies in the Group are normally shown in the income statement under “Balance of other operating income/expenses”.

In these consolidated financial statements, balance sheet items of the subsidiaries, if they do not prepare financial statements in Euros, are translated using the closing rates at reference date for the financial statements. For translating the expenses and income of these subsidiaries, the average rates are used. Differences resulting from the translation of the financial statements of the subsidiaries are treated without any impact on the income statement and are shown in movements in shareholders’ equity. The group of consolidated companies does not include any companies from high-inflation countries.

23 Taxes on income

Taxes on income are accounted for and valued in accordance with IAS 12. Apart from the exceptions defined in the standard, deferred taxes are calculated for all temporary differences for the values under IFRS and the tax values as well as for the differences resulting from uniform Group valuation within the Group and differences from the consolidation (balance sheet method). Deferred tax assets arising from non-utilised losses carried forward, interest assets carried forward and tax credits are calculated if necessary according to IAS 12.34 et seq.

Deferred taxes are calculated using the national tax rates which are expected at the time when the differences are balanced, as the concept of deferred taxes is based on the presentation of future tax assets or tax liabilities (liability method). Changes of tax rates have been taken into account. The pay-out of the corporate income tax claim which was capitalised on 31 December 2006 has begun since 1 January 2008 over a period of ten years independently of a dividend payment. The interest-free claim had to be shown with the present value. A rate of 3.7 % p.a. has been used for discounting purposes. Changes of the capitalised corporate income tax claims due to tax assessment notes for previous periods in the year 2009 were recognised accordingly in the income statement.

24 Non-current assets held for sale

In accordance with IFRS 5, non-current assets or disposal groups held for sale have to be shown on the balance sheet date at the lower of carrying amount and fair value less costs to sell. The assets have to be shown separately in the balance sheet. As of 31 December 2009 and of 31 December 2008, HRE did not own material non-current assets held for sale.

25 Future-related assumptions and estimation uncertainties

When the financial statements are being prepared, HRE 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.

Going concern The consolidated financial statements of HRE Holding is based on the assumption of going concern. The conditions of going concern are described in the forecast report.

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

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

Impairment on financial investments In 2009 and 2008 no reliable market prices existed for the assessment of the majority of structured products and for other securities. These were measured on the basis of valuation models with observable market data. For this, the expected cash flows were discounted with the swaps curves allocated per kind of product, rating category and currency. The methods and assumptions concerning the assessments of the extent and timing of the payment streams are regularly checked in order to minimise the differences between estimated and actual defaults.

Fair values of original and derivative financial 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.

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

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

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

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

With regard to the capitalisation of losses carried forward and other tax credits, the extent as well as the availability of such tax benefits are subject to estimation. Major losses carried forward are subject to national German tax law, and their availability also depends on the restrictions set out in section 8 (4) and 8c KStG as well as section 10a GewStG. Deferred tax assets arising from losses carried forward are stated as far as it is likely that taxable income will be available to offset the non-utilised tax losses carried forward.

The extent of future payments of the corporate income tax claim has been calculated using the present-value method and an interest rate of 3.7 % p.a.

26 Notes to segment reporting by business segment

HRE is refocusing its business. On the one hand, the strategic, sustainable business areas will be elaborated, meaning that the strategic activities will be comprised at the core bank Deutsche Pfandbriefbank AG. On the other hand, non-strategic portfolios will be reduced, whereas the income statement should not be depressed as far as possible. Parallel to the approved refocusing of HRE, the existing segment structure is currently revised elementarily. Until the corporate steering will be reorganised completely, HRE still divides its business activities into the three operating segments Commercial Real Estate, Public Sector & Infrastructure Finance and Capital Markets & Asset Management. In addition, the Corporate Center is disclosed.

The business segment **Commercial Real Estate (CRE)** combines mainly the international and German businesses of the strategic, commercial real estate financing including customer derivatives from Deutsche Pfandbriefbank AG.

The business segment **Public Sector & Infrastructure Finance (PS & IF)** pools mainly the Public Sector business. In addition, the segment contains the infrastructure- and Asset-Based-Finance portfolios.

The business segment **Capital Markets & Asset Management (CM & AM)** pools the Capital Markets and the Asset Management business of the Group. The platform Capital Markets reflects the majority of trading assets and trading liabilities as well as income from securitisations and business with specific customer derivatives. The platform Asset Management consists amongst others of the positioning in guaranteed investments contracts (GIC) business.

The column **Corporate Center** includes the contributions to earnings of some non-strategic portfolios like CDOs and MBS. In addition, it includes the contributions to earnings of the HRE Holding centres and the expenses for essential corporate functions.

The segment reporting of HRE is based on the internal controlling instruments and the management information system which is prepared in accordance with IFRS. Income and expenses are allocated to appropriate cost centres, whereby portfolio structures are used as the basis for allocating income. General administrative expenses are allocated to the appropriate cost centres in the segment. The segments generated only Group external income, and did not generate any income with other segments of HRE or the Corporate Center. Accordingly, there are no issues of consolidation between the segments or with the Corporate Center. The management information is based on the accounting and valuation methods of the consolidated financial statements prepared in accordance with IFRS. Accordingly, reconciliation with the accounting and valuation methods used in the consolidated financial statements is not necessary.

The cost-income ratio is the ratio of general administrative expenses and operating revenues, consisting of net interest income and similar income, net commission income, net trading income, net income from financial investments, the result of hedging relationships and the balance of other operating income/expenses.

27 Income statement, broken down by business segment

Income/expenses

in € million		CRE	PS & IF	CM & AM	Corporate Center	HRE
Operating revenues	2009	587	148	31	−347	419
	2008	876	609	−506	−1,564	−585
Net interest income and similar income	2009	632	683	65	16	1,396
	2008	756	730	73	74	1,633
Net commission income	2009	97	−477	−73	−189	−642
	2008	95	−39	5	−29	32
Net trading income	2009	−151	34	—	−37	−154
	2008	−45	−124	−518	−322	−1,009
Net income from financial investments	2009	3	−7	33	−30	−1
	2008	58	13	−61	−1,419	−1,409
Net income from hedge relationships	2009	—	−86	6	−37	−117
	2008	—	26	−5	65	86
Balance of other operating income/expenses	2009	6	1	—	−70	−63
	2008	12	3	—	67	82
Provisions for losses on loans and advances	2009	1,866	203	—	22	2,091
	2008	1,066	420	—	170	1,656
General administrative expenses	2009	177	89	26	249	541
	2008	155	75	32	343	605
Impairments on goodwill and DEPFA's intangible assets	2009	—	—	—	—	—
	2008	—	—	—	2,482	2,482
Balance of other income/expenses	2009	−1	3	—	−10	−8
	2008	−5	−8	—	−34	−47
Pre-tax profit	2009	**−1,457**	**−141**	**5**	**−628**	**−2,221**
	2008	**−350**	**106**	**−538**	**−4,593**	**−5,375**

Key ratio

in %		CRE	PS & IF	CM & AM	HRE
Cost-income ratio	2009	30.2	60.1	83.9	> 100.0
	2008	17.7	12.3	> 100.0	> 100.0

28 Total assets, broken down by business segment

Total assets, broken down by business segment

in € million		CRE	PS & IF	CM & AM	Corporate Center	HRE
Total assets	31.12.2009	54,608	270,044	16,878	18,146	359,676
	31.12.2008	58,703	295,240	32,934	32,777	419,654

29 Key regulatory capital ratios (based on German Commercial Code [HGB]), broken down by business segment

The risk-weighted assets and the market risk positions were as follows:

Risk-weighted assets[1)]

in € billion		CRE	PS & IF	CM & AM	Corporate Center	**HRE**
Risk-weighted assets	31.12.2009	27.1	37.5	7.8	8.6	81.0
	31.12.2008	26.9	41.1	10.7	16.6	95.3

1) Including risk-weighted credit risk positions as well as the capital requirements for market risk positions and operational risks scaled with the factor 12.5; according to Basel II advanced IRB approach for authorised portfolios, otherwise Basel II standardised approach; before prepared annual financial statements and before result distribution

Market risk positions

in € million		CRE	PS & IF	CM & AM	Corporate Center	**HRE**
Currency risks	31.12.2009	36	—	1	—	37
	31.12.2008	63	—	1	—	64
Interest rate risks	31.12.2009	—	—	198	—	198
	31.12.2008	—	—	282	—	282
Total	31.12.2009	**36**	—	**199**	—	**235**
	31.12.2008	**63**	**—**	**283**	**—**	**346**

30 Breakdown of operating revenues

Operating revenues by products

Operating revenues by products

in € million	**2009**	**2008**
Commercial Real Estate financings	587	876
Public Sector financings	137	463
Infrastructure financings	11	146
Other products	−316	−2,070
Total	**419**	**−585**

Operating revenues by regions HRE as of 31 December 2009 differentiates between the regions Germany, rest of Europe and America/Asia. The column Corporate Center includes consolidation transactions as well as the contributions to earnings of the non-strategic portfolios. In addition, it includes the contributions to earnings of the Corporate Center. Allocation of values to regions is based on the location of the registered offices of the Group companies or their branches.

Operating revenues by regions

in € million		Germany	Rest of Europe	America/Asia	Corporate Center	**HRE**
Operating revenues	2009	540	−277	240	−84	419
	2008	−935	111	422	−183	−585

Operating revenues by customers HRE has not generated 10 % or more of its operating revenues with a single external customer.

Notes to the Income Statement

31 Net interest income and similar income

Net interest income and similar income, broken down by categories of income/expenses in € million	2009	2008
Interest income and similar income	**12,108**	**16,828**
Lending and money-market business	8,861	12,876
Fixed-income securities and government-inscribed debt	3,247	3,927
Equity securities and other variable-yield securities	—	2
Participating interests	—	6
Subordinated capital	—	16
Other	—	1
Interest expenses and similar expenses	**10,712**	**15,195**
Deposits	3,641	6,605
Liabilities evidenced by certificates	6,294	8,496
Subordinated capital	36	—
Current result from swap transactions (balance of interest income and interest expenses)	741	94
Total	**1,396**	**1,633**

Total interest income for financial assets that are not at fair value through profit or loss, amount to € 12.1 billion (2008: € 16.7 billion). Total interest expenses for financial liabilities that are not at fair value through profit or loss amount to € 10.0 billion (2008: € 15.1 billion).

Net interest income and similar income includes income of € 103 million (2008: € 37 million) due to the increase in the present value of the adjusted allowances resulting over a period of time and an expense of € –24 million (2008: € 0 million) due to the increase in the present value of the adjusted liabilities over a period of time.

32 Net commission income

Net commission income in € million	2009	2008
Securities and custodial services	–6	–9
Lending operations and other service operations	–636	41
thereof: Expenses of the liquidity support	–741	–92
Total	**–642**	**32**

Net commission income is attributable exclusively to financial assets and financial liabilities which are not designated at fair value through profit or loss. The decline in net commission income results mainly due to the expenses through the liquidity support. Commission income from trust and other fiduciary activities amount to € 0 million as was the case last year, with commission expenses at € 0 million (2008: € 0 million).

33 Net trading income

Net trading income in € million	2009	2008
From interest rate instruments and related derivatives	–188	–97
From credit risk instruments and related derivatives	26	–907
From foreign exchange trading interest	8	–5
Total	**–154**	**–1,009**

Net trading income includes interest and dividend income totalling € 9 million (2008: € 143 million) and refinancing costs totalling € 64 million (2008: € 158 million) resulting from the balance of trading assets and trading liabilities.

34 Net income from financial investments

Net income from financial investments in € million	2009	2008
Income from financial investments	247	205
Expenses from financial investments	248	1,614
Total	**–1**	**–1,409**

Net income from financial investments consists of income from the sale of securities of the measurement categories AfS and LaR together with changes in the value of such instruments that are to be recognised in the income statement. HtM investments were not held in 2009 and 2008. Based on valuation categories, net income from financial investments is broken down as follows:

Net income from financial investments by IAS 39 categories in € million	2009	2008
Held-to-maturity financial investments	—	—
Available-for-sale financial investments	27	–350
Loans-and-receivables financial investments	5	–1,099
Negative difference from business combination	—	23
Result from investment properties	–33	17
Total	**–1**	**–1,409**

35 Combined valuation result from the CDO portfolio and similar products

Valuation result affecting income in € million	2009	2008
Synthetic CDOs	−58	−395
US-American	−9	−251
European	−49	−144
Cash CDOs	−57	−846
US-American	−9	−703
European	−60	−213
Model reserve	12	70
MBS	131	−528
Total	**16**	**−1,769**

The portfolio of collateralised debt obligations (CDOs) and similar structured products is reclassified from the measurement category AfS to LaR according to the amendment of IAS 39 and IFRS 7 published by the IASB on 13 October 2008. The European cash CDOs also contain credit linked notes (CLNs) and credit swap options (CSOs). Furthermore, it is a matter of importance for accounting whether CDOs are classified as cash structures or as synthetic structures.

Synthetic CDOs constitute embedded derivatives which have to be separated in accordance with IAS 39 – as clarified from the Institut der Wirtschaftsprüfer (IDW) in its position paper dated 10 December 2007– and any changes in value have to be recognised in the income statement. Cash CDOs of the category loans and receivables are measured at amortised cost. If there is objective evidence for impairment the cash CDOs will be written off. The valuation is based on internal present-value models. A model reserve of € 8 million (after the reversal of € 12 million in 2009; 2008: € 70 million) exists for uncertainty with regard to the assumptions and estimates which have been made on the valuation of collateralised debt obligations (31 December 2008: € 20 million).

36 Net income from hedge relationships

Net income from hedge relationships in € million	2009	2008
Result from fair value hedge accounting	−110	163
Result from hedged items	−3,424	11,387
Result from hedging instruments	3,314	−11,224
Result from dFVTPL investments and related derivatives	−6	−76
Result from dFVTPL investments	−492	404
Result from derivatives related to dFVTPL investments	486	−480
Ineffectiveness from cash flow hedge accounting affecting income	−1	−1
Total	**−117**	**86**

The item net income from hedge relationships reflected two effects. On the one hand expenses resulted from hedge inefficiencies within the range of 80 % to 125 % which is admissible under IAS 39. These expenses are mainly a reverse effect from the corresponding income in the fourth quarter 2008. On the other hand a negative valuation result was attributable to assets designated at Fair Value through Profit or Loss (dFVTPL) and related derivatives.

37 Balance of other operating income/expenses

Balance of other operating income/expenses in € million	2009	2008
Other operating income	14	120
Other operating expenses	77	38
Balance of other operating income/expenses	**−63**	**82**

Rental income attributable to buildings in current assets (salvage acquisitions) of € 4 million (2008: € 4 million) is the biggest individual amount in other operating income. The main component in other operating expenses stems from currency translation effects totalling € 56 million (2008: € 96 million income). Depreciation and other expenses attributable to buildings in current assets (salvage acquisitions) amounted to € 12 million (2008: € 16 million). In addition the balance of other operating income/expenses does not contain any individual amounts of major significance.

38 Provisions for losses on loans and advances

Provisions for losses on loans and advances in € million	2009	2008
Provisions for losses on loans and advances	2,090	1,655
Additions	2,326	1,709
Releases	−236	−54
Provisions for contingent liabilities and other commitments	3	4
Additions	4	6
Releases	−1	−2
Recoveries from write-offs of loans and advances	−2	−3
Total	**2,091**	**1,656**

The development of individual allowances on loans and advances as well as portfolio-based allowances is shown in the note allowances for losses on loans and advances.

39 General administrative expenses

General administrative expenses in € million	2009	2008
Personnel expenses	213	260
Wages and salaries	167	205
Social security costs	27	30
Pension expenses and related employee benefit costs	19	25
Other general administrative expenses	300	296
Depreciation/amortisation	28	49
On software and other intangible assets excluding goodwill	16	30
On property, plant and equipment	12	19
Total	**541**	**605**

Cost-income ratio in %	2009	2008
Cost-income ratio	> 100.0	> 100.0

40 Impairments on goodwill and DEPFA's intangible assets

Impairments on goodwill and DEPFA's intangible assets in € million	2009	2008
Goodwill	—	2,223
Software acquired	—	14
Customer relationships	—	165
Brand names	—	80
Total	**—**	**2,482**

As the future benefit which was originally used as the basis of valuing the goodwill and other intangible assets accordingly no longer existed HRE impaired the recognised goodwill, brand names and customer relationships completely and software partly non-scheduled in the financial year 2008.

41 Balance of other income/expenses

Balance of other income/expenses in € million	2009	2008
Other income	27	186
thereof: Releases of restructuring provisions	27	6
Effects from DEPFA acquisition	—	180
Other expenses	35	233
thereof: Other taxes	—	2
Additions to restructuring provisions	35	229
Balance of other income/expenses	**−8**	**−47**

In the previous year the balance of other income/expenses included an effect from the acquisition of DEPFA Bank plc. These effects were attributable to the mandatory convertible bond issued in August 2007 to finance the acquisition of DEPFA Bank plc. The mandatory convertible bond contained an embedded compound derivative based on shares of HRE Holding, which, in accordance with IAS 39, should be separated from the host contract and measured at fair value as derivative. The change in the fair value has to be recognised in the income statement. On 20 August 2008 the mandatory convertible bond was converted into ordinary shares of HRE Holding. The final valuation of the derivative has resulted in pre-deferred tax income of € 180 million.

42 Taxes on income

Breakdown in € million	2009	2008
Current taxes	53	62
Deferred taxes	−38	24
thereof: Deferred taxes on capitalised losses carried forward	3	84
Effects from DEPFA acquisition	—	46
Total	**15**	**86**

In 2008 non-recurrent effects amounted to € 64 million expenses as a result of the revaluation of deferred taxes according to the relocation of the place of business to Unterschleißheim together with € 46 million expenses resulting from the DEPFA acquisition. The current taxes contain tax expense for prior years of € 17 million (2008: € 19 million tax income).

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

Reconciliation

in € million	2009	2008
Net income/loss before taxes	−2,221	−5,375
Applicable (legal) tax rate in %	15.83	15.83
Expected (computed) tax expense	−352	−851
Tax effects		
arising from foreign income	10	18
arising from tax rate differences	−21	60
arising from losses	−10	−2
arising from tax-free income	−28	365
arising from deductible and non-deductible items	99	9
arising from valuation adjustments and the non-application of deferred taxes	291	507
arising from the write-down (2008: write-up) of deferred taxes	4	−6
arising from prior years and other aperiodical effects	28	−15
arising from other differences	−6	1
Accounted taxes on income	**15**	**86**
Group tax ratio in %	**−0.7**	**−1.6**

The tax rate applicable for the financial year is 15.83 % and is comprised of the current valid German corporate tax rate of 15 % together with the payable solidarity surcharge of 5.5 %.

The effects attributable to foreign income comprise tax rate differences arising from foreign fiscal jurisdictions. These arose as foreign income has been taxed at different rates.

The effects from tax rate differences include the trade tax burden (current and deferred in accordance with IFRS) which exists in Germany additionally to German corporation tax and solidarity surcharge.

The offsetting performed with respect to existing losses carried forward for which no deferred taxes had been capitalised previously is shown under the item “Effects arising from losses”.

The item “Effects arising from tax-free income” comprises effects from tax-free income from participating interests, dividends and capital gains or losses both domestically and internationally. Regulations for the determination of taxable income were applied as valid for the particular jurisdiction. Significant effects from the impairments of holdings/goodwill in the previous year are also included in this position.

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

The item “Effects arising from valuation adjustments and the non-application of deferred taxes” comprises major effects from not recognised deferred tax assets at loss carryforwards. We recognised no impairments on deferred tax assets which have been recorded last year on the basis of existing losses carried forward. Effects from periodical losses are shown under the item “Effects from losses”.

The item “Effects from previous years and other aperiodical effects” includes both current taxes for years which have been incurred as a result of tax audits or a reassessment of the tax liability, as well as aperiodical effects and deferred taxes for prior years.

The Group tax ratio is the quotient of the stated income taxes (current and deferred taxes) and pre-tax profit. In the year 2009 it has been mainly influenced by the non-application of deferred tax assets on losses carried forward.

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

Deferred tax liabilities/assets in € million	2009	2008
Loans and advances to other banks/customers (including loan loss allowances)	22	54
Financial investments	478	389
Intangible assets/ property, plant and equipment	2	1
Other assets/liabilities	2,682	2,918
Liabilities to other banks/to customers	585	522
Others	94	118
Deferred tax liabilities	**3,863**	**4,002**
Loans and advances to other banks/customers (including provisions for losses on loans and advances)	689	645
Financial investments	432	602
Provisions	32	53
Other assets/liabilities	2,940	3,442
Liabilities evidenced by certificates	297	25
Losses carried forward	168	170
Others	166	197
Deferred tax assets	**4,724**	**5,134**

For the domestic companies, the deferred taxes are calculated using the pending uniform rate of corporation tax of 15 % plus the 5.5 % solidarity surcharge payable on this and the locally applicable collection rate for municipal trade tax (the current basic rate is 3.5 %). As a result of the relocation the cumulative tax rate for the calculation of deferred taxes for HRE Holding is 27.03 %.

On the reporting date, there are non-utilised losses carried forward totalling € 5,043 million (2008: € 3,645 million). Deferred tax assets have been stated as € 625 million (2008: € 632 million) because the criteria for recognition in accordance with IAS 12.34 et seq. were satisfied. The losses carried forward can be utilised for an unlimited period of time. Additionally temporary differences of € 505 million (2008: € 61 million) were not recognised with deferred tax assets.

A figure of € 437 million (2008: € 582 million) for deferred and actual taxes has been netted with the AfS reserve and € 206 million (2008: € 371 million) has been netted with the cash flow hedge reserve. The remaining equity was netted with € 48 million (2008: € 73 million).

43 Net gains/net losses

The income statement contains the following income-statement-related net gains/net losses according to IFRS 7.20 (a):

Net gains/net losses in € million	2009	2008
Loans and receivables	−2,069	−2,674
Held to maturity	—	—
Available for sale	27	−350
Held for trading[1]	−154	−829
Designated at Fair Value through P&L	−6	−76
Financial liabilities at amortised cost	149	355

[1] 2008 including the income in the amount of € 180 million from the embedded derivative comprised in the mandatory convertible bond shown in balance of other income/expenses

Notes to the Balance Sheet (Assets)

44 Cash reserve

Cash reserve in € million	31.12.2009	31.12.2008
Cash in hand	—	—
Balances with central banks	1,824	1,713
Total	**1,824**	**1,713**

Cash in hand amounts to less than € 1 million as was the case last year.

45 Trading assets

Trading assets in € million	31.12.2009	31.12.2008
Debt securities and other fixed-income securities	956	1,669
Money market securities	—	—
Bonds and notes	956	1,669
Issued by public-sector borrowers	218	506
Issued by other borrowers	738	1,163
thereof: Listed	883	1,416
Unlisted	73	253
Positive fair values from derivative financial instruments	1,734	3,044
Equity-related transactions	—	—
Interest-based and foreign-currency-based transactions	572	888
Others	1,162	2,156
Other trading assets	44	56
Stand-alone derivatives (bank book)	8,015	12,518
Total	**10,749**	**17,287**

46 Loans and advances to other banks

Loans and advances to other banks, broken down by type of business in € million	31.12.2009	31.12.2008
Loans and advances	37,185	45,055
Public sector loans	23,730	30,866
Real estate loans	42	94
Other loans and advances	13,413	14,095
Investments	336	4,354
Total	**37,521**	**49,409**

Loans and advances to other banks, broken down by maturities in € million	31.12.2009	31.12.2008
Repayable on demand	11,239	5,947
With agreed maturities	26,282	43,462
Up to 3 months	4,283	11,936
From 3 months to 1 year	2,078	2,289
From 1 year to 5 years	8,527	11,905
From 5 years and over	11,394	17,332
Total	**37,521**	**49,409**

47 Loans and advances to customers

Loans and advances to customers, broken down by type of business in € million	31.12.2009	31.12.2008
Loans and advances	198,209	220,965
Public sector loans	131,461	150,629
Real estate loans	54,302	58,455
Other loans and advances	12,446	11,881
Investments	135	1,083
Total	**198,344**	**222,048**

Loans and advances to customers, broken down by maturities in € million	31.12.2009	31.12.2008
Unspecified terms	23	32
With agreed maturities	198,321	222,016
Up to 3 months	8,592	7,910
From 3 months to 1 year	12,860	12,088
From 1 year to 5 years	55,606	58,962
From 5 years and over	121,263	143,056
Total	**198,344**	**222,048**

The loans and advances to customers contain a portfolio of loans that have been designated as at fair value through profit or loss (dFVTPL) to reduce the measurement inconsistency with the offsetting derivative, which is an economic hedge of the position. The dFVTPL loans and advances amount to € 333 million (31 December 2008: € 395 million). The dFVTPL loans and advances were acquired in the course of the takeover of DEPFA Bank plc.

In 2009, the loans and advances designated as at fair value through profit or loss had fair value move of € 9 million attributable to a change in the credit risk of the asset (2008: € –55 million) and cumulatively since initial recognition of € –50 million (31 December 2008: € –59 million). This was offset by a fair value move on the credit derivative of € –22 million (2008: € 42 million) and cumulatively since initial recognition of € 24 million (31 December 2008: € 46 million).

The book value of the above loans reflects the maximum exposure to credit risk on these assets. This credit exposure is reduced by € 329 million (2008: € 391 million) by the related credit derivative.

48 Volume of lending

Volume of lending in € million	31.12.2009	31.12.2008
Loans and advances to other banks	37,185	45,055
Loans and advances to customers	198,209	220,965
Contingent liabilities	785	1,309
Total	**236,179**	**267,329**

49 Allowances for losses on loans and advances

Development in € million	Individual allowances on loans and advances	Portfolio-based allowances	Total
Balance at 1.1.2008	**672**	**233**	**905**
Changes affecting income	1,117	431	1,548
Gross additions	1,208	501	1,709
Releases	−54	—	−54
Increase of the present value due to passage of time (unwinding)	−37	—	−37
Release model reserve	—	−70	−70
Changes not affecting income	−161	−15	−176
Use of existing loan-loss allowances	−203	−15	−218
Effects of currency translations and other changes not affecting income	42	—	42
Balance at 31.12.2008	**1,628**	**649**	**2,277**
Balance at 1.1.2009	**1,628**	**649**	**2,277**
Changes affecting income	1,793	182	1,975
Gross additions	2,037	289	2,326
Releases	−141	−95	−236
Increase of the present value due to passage of time (unwinding)	−103	—	−103
Release model reserve	—	−12	−12
Changes not affecting income	−349	−5	−354
Use of existing loan-loss allowances	−406	−4	−410
Effects of currency translations and other changes not affecting income	57	−1	56
Balance at 31.12.2009	**3,072**	**826**	**3,898**

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

Breakdown in € million	31.12.2009	31.12.2008
Individual allowances for losses on loans and advances to other banks	30	84
Individual allowances for losses on loans and advances to customers	3,042	1,544
Portfolio-based allowances	826	649
Total	**3,898**	**2,277**

Loan loss ratio in € million	31.12.2009	31.12.2008
Loan losses	411	221
Use of existing loan-loss allowances	410	218
Use of allowances for losses on guarantees and indemnities	3	6
Recoveries from written-off loans and advances	−2	−3
Total volume of lending	236,179	267,329
Loan loss ratio[1] in %	**0.17**	**0.08**

[1] Loan losses/total volume of lending

Ratio of allowances to total lendings in € million	31.12.2009	31.12.2008
Total allowances	3,917	2,288
Allowances for losses on loans and advances	3,898	2,277
Allowances for contingent liabilities and other commitments	19	11
Total volume of lending	236,179	267,329
Provision rate[1] in %	**1.66**	**0.86**

[1] Total allowances/total volume of lending

50 Financial investments

Breakdown in € million	31.12.2009	31.12.2008
AfS financial investments	13,423	14,470
Shares in non-consolidated subsidiaries	2	53
Participating interests	7	8
Debt securities and other fixed-income securities	13,410	14,406
Equity securities and other variable-yield securities	4	3
dFVTPL financial investments	3,229	4,476
Debt securities and other fixed-income securities	3,229	4,476
LaR financial investments	78,156	89,794
Debt securities and other fixed-income securities	78,156	89,794
Total	**94,808**	**108,740**

The carrying amounts of the LaR financial investments were reduced by portfolio-based allowances amounting to € 33 million (31 December 2008: € 24 million).

Financial investments, broken down by maturities in € million	31.12.2009	31.12.2008
Unspecified terms	13	64
With agreed maturities	94,795	108,676
Up to 3 months	1,164	2,209
From 3 months to 1 year	3,356	4,751
From 1 year to 5 years	15,132	16,207
From 5 years and over	75,143	85,509
Total	**94,808**	**108,740**

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

On 30 September 2008, HRE reclassified retrospectively as of 1 July 2008 trading assets out of the category held-for-trading amounting to € 3.5 billion and financial investments out of the category available-for-sale of € 76.1 billion. In addition, trading assets of € 0.7 billion were reclassified prospectively into financial investments of the category loans and receivables on 1 October 2008.

At the date of reclassification the effective interest rate for the trading assets was between 1.3 % and 21.9 %. For AfS assets the interest rate was between 0.25 % and 34.4 %.

Since the date of reclassification, financial assets with a (reclassified) carrying amount of around € 9.0 billion became due. Thereof € 7.8 billion are reclassified AfS financial investments and € 1.2 billion are reclassified trading assets.

In 2009 securities with a reclassified carrying amount of € 2.6 billion were sold due to the decided reduction of portfolios. Thereby a net loss of € –108 million was realised.

Interest income for reclassified trading instruments is now shown under net income from financial investments; before reclassification interest income was shown in net trading income. In 2009, net income from financial investments 2009 contains € 137 million (2008: € 95 million) of interest income for reclassified trading instruments. 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.

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

Reclassifications 2009	into: Financial investment loans and receivables (LaR)			Effect in reporting period if no assets would have been reclassified (2009)	
		31.12.2009			
	Date	Carrying amount in € billion	Fair value in € billion	Income statement in € million	AfS reserve (after taxes) in € million
out of: Trading assets held for trading (HfT)	1.7.2008	2.4	2.0	415	
	1.10.2008	0.5	0.5	−1	
out of: Financial investments available for sale (AfS)	1.7.2008	72.5	68.5	−35	2,718
Total		**75.4**	**71.0**		

Reclassifications 2008	into: Financial investment loans and receivables (LaR)			Effect if no assets would have been reclassified (date of reclassification until 31.12.2008)	
		31.12.2008			
	Date	Carrying amount in € billion	Fair value in € billion	Income statement in € million	AfS reserve (after taxes) in € million
out of: Trading assets held for trading (HfT)	1.7.2008	3.5	2.7	−755	
	1.10.2008	0.7	0.7	19	
out of: Financial investments available for sale (AfS)	1.7.2008	81.0	72.8	24	−7,070
Total		**85.2**	**76.2**		

Securities listed on the stock exchange

in € million		Debt securities and other fixed-income securities	Equity securities and other variable-yield securities	**Total**
Listed	31.12.2009	81,569	1	**81,570**
	31.12.2008	93,871	2	**93,873**
Unlisted	31.12.2009	13,226	3	**13,229**
	31.12.2008	14,805	1	**14,806**

Development of financial investments			2009			2008
in € million	Participating interests	Companies valued using the equity method	Investment properties	Participating interests	Companies valued using the equity method	Investment properties
Acquisition costs						
Balance at 1.1.	**90**	**—**	**—**	**104**	**91**	**27**
Changes in the group of consolidated companies	—	—	—	—	−91	—
Changes from foreign currency translation	—	—	—	−15	—	—
Additions	—	—	—	1	—	—
Reclassifications	—	—	—	—	—	—
Disposals	−74	—	—	—	—	−27
Balance at 31.12.	**16**	**—**	**—**	**90**	**—**	**—**
Changes in valuation not affecting income						
Balance at 1.1.	**—**	**—**	**—**	**33**	**—**	**—**
Changes in the group of consolidated companies	—	—	—	—	—	—
Changes from foreign currency translation	—	—	—	−1	—	—
Changes in value	—	—	—	−32	—	—
Reclassifications	—	—	—	—	—	—
Disposals	—	—	—	—	—	—
Balance at 31.12.	**—**	**—**	**—**	**—**	**—**	**—**
Cumulative change arising from accounting using the equity method	**—**	**—**	**—**		**—**	
Amortisation/depreciation and write-ups						
Balance at 1.1.	**−82**	**—**	**—**	**−5**	**—**	**−1**
Changes in the group of consolidated companies	—	—	—	—	—	—
Changes from foreign currency translation	—	—	—	—	—	—
Impairments	−1	—	—	−77	—	—
Write-ups	—	—	—	—	—	—
Reclassifications	—	—	—	—	—	—
Disposals	74	—	—	—	—	1
Changes in fair value	—	—	—	—	—	—
Balance at 31.12.	**−9**	**—**	**—**	**−82**	**—**	**—**
Carrying amounts						
Balance at 31.12.	**7**	**—**	**—**	**8**	**—**	**—**

HRE cannot determine reliably a fair value for some shares in companies for which there is no market value available and which are not fully consolidated or are not accounted for using the equity method due to considerations of materiality. These companies in the legal form of limited or private are not traded in an active market. Therefore, the investments are stated at amortised cost. The carrying amount of these financial investments amounted to € 552 million as of 31 December 2009 (2008: € 646 million). In financial year 2009, financial investments, for which it is not possible for the fair value to be reliably established, were sold for € 53 million (2008: € 28 million). As in the previous year, this resulted in a profit of less than € 1 million.

After the complete takeover of Quadra Realty Trust, Inc., New York, Hypo Real Estate Group does not have any holding in joint ventures or associated companies valued using equity method.

Breakdown of debt securities and other fixed-income securities in € million	31.12.2009	31.12.2008
Money market papers	461	12
Bonds and debt securities	94,334	108,664
By public issuers	68,716	75,456
By other issuers	25,618	33,208
Total	**94,795**	**108,676**

51 Property, plant and equipment

Breakdown

in € million	31.12.2009	31.12.2008
Land and buildings used for operational purposes and buildings under construction	—	—
Plant and operating equipment	15	32
Total	**15**	**32**

Development of property, plant and equipment

in € million	Land and buildings used for operational purposes and buildings under construction	Plant and operating equipment	2009 Total	2008 Total
Acquisition/production costs				
Balance at 1.1.	**—**	**96**	**96**	**119**
Changes in the group of consolidated companies	—	−1	−1	6
Changes from foreign currency translation	—	−1	−1	—
Additions	—	3	3	14
Disposals	—	−30	−30	−43
Balance at 31.12.	**—**	**67**	**67**	**96**
Amortisation/depreciation and write-ups				
Balance at 1.1.	**—**	**64**	**64**	**51**
Changes in the group of consolidated companies	—	−1	−1	4
Changes from foreign currency translation	—	—	—	—
Scheduled amortisation/depreciation	—	12	12	16
Unscheduled amortisation/depreciation	—	—	—	3
Write-ups	—	—	—	—
Reclassifications	—	—	—	—
Disposals	—	−23	−23	−10
Balance at 31.12.	**—**	**52**	**52**	**64**
Carrying amounts				
Balance at 31.12.	**—**	**15**	**15**	**32**

52 Intangible assets

Breakdown

in € million	31.12.2009	31.12.2008
Software acquired	22	31
Internally generated software	13	1
Other intangible assets	1	1
Advance payments	8	7
Total	**44**	**40**

Development of intangible assets

in € million	Software acquired	Internally generated software	Other intangible assets	Advance payments
Acquisition/production costs				
Balance at 1.1.2009	**128**	**1**	**3**	**7**
Changes in the group of consolidated companies	—	—	—	—
Changes from foreign currency translation	—	—	—	—
Additions	3	7	3	9
Reclassifications	4	6	−2	−8
Disposals	−5	—	—	—
Balance at 31.12.2009	**130**	**14**	**4**	**8**
Amortisation/depreciation and write-ups				
Balance at 1.1.2009	**97**	**—**	**2**	**—**
Changes in the group of consolidated companies	—	—	—	—
Changes from foreign currency translation	—	—	—	—
Scheduled amortisation/depreciation	14	1	1	—
Unscheduled amortisation/depreciation	—	—	—	—
Write-ups	—	—	—	—
Reclassifications	—	—	—	—
Disposals	−3	—	—	—
Balance at 31.12.2009	**108**	**1**	**3**	**—**
Carrying amounts				
Balance at 31.12.2009	**22**	**13**	**1**	**8**

53 Other assets

Other assets in € million	31.12.2009	31.12.2008
Positive fair values from derivative financial instruments	15,079	16,918
Hedging derivatives	14,715	16,362
Micro fair value hedge	6,388	6,884
Cash flow hedge	8,327	9,478
Derivatives hedging dFVTPL financial instruments	364	556
Salvage acquisitions	108	183
Other assets	171	208
Deferred charges and prepaid expenses	41	26
Capitalised excess cover of qualified insurance for pension provisions	—	61
Total	**15,399**	**17,396**

The salvage acquisitions initially recognised in 2009 are described in the note consolidation. The impairments on salvage acquisitions amounted to € 37 million in the financial year 2009 (2008: € 5 million) and the losses from sales to € 5 million (2008: € 0 million).

54 Income tax assets

Income tax assets in € million	31.12.2009	31.12.2008
Current tax assets	146	132
Deferred tax assets	4,724	5,134
Total	**4,870**	**5,266**

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

55 Subordinated assets

The following balance sheet items contain subordinated assets:

Subordinated assets in € million	31.12.2009	31.12.2008
Trading assets	19	15
Loans and advances to other banks	761	824
Loans and advances to customers	727	690
Financial investments	81	83
Total	**1,588**	**1,612**

56 Repurchase agreements

As a pledgor of genuine repurchase agreements, HRE has pledged assets with a book value of € 67 billion (2008: € 86 billion). The securities are not derecognised. The considerations which have been received amount to € 56 billion (2008: € 67 billion) and are recognised under liabilities and thereof mainly come under liabilities to other banks. Assets in repurchase agreements are the only transferable assets the acquirer can sell or repledge in the absence of default according to IAS 39.37 (a).

57 Securitisation

Synthetic securitisation Issuer	Transaction name	Maturity in years	Type of asset securitised	Total volume of lending in € million
Deutsche Pfandbriefbank AG	DUKE 2002	25	Commercial mortgage loans	114
Deutsche Pfandbriefbank AG	GECO 2002	52	Commercial mortgage loans	253
Deutsche Pfandbriefbank AG	Estate Germany 2007-1	56	Private/small commercial mortgage loans	1,019
Deutsche Pfandbriefbank AG	Estate UK-3	15	Commercial mortgage loans	512
Deutsche Pfandbriefbank AG	ESTATE Pan Europe 5	11	Commercial mortgage loans	1,315
DEPFA Bank plc	EPIC I	27	Infrastructure finance loans	384
DEPFA Bank plc	EPIC II	36	Infrastructure finance loans and bonds	689
DEPFA Bank plc	EPIC III	52	Infrastructure finance utility bonds	751
DEPFA Bank plc	PSION	7	Investment grade sovereign and sub-sovereign bonds	661
Total				**5,698**

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

- cash-funded transactions, where HRE is entering into a credit default swap (CDS) (protection buyer) which is collateralised, and
- unfunded transactions, where HRE is entering into a CDS which is not collateralised.

Securitisation programmes usually provide for a small part of the risks being retained in the form of a first-loss piece or interest sub-participation on the part of the pledgor. For the programmes listed above, first-loss pieces amount to € 141 million. Thereof risks are held by interest sub-participations (€ 43 million) and purchase of own junior tranches (€ 65 million).

Due to changed regulatory requirements (Basel II) the reduction of risk-weighted assets is no longer possible for the majority of the above-mentioned securitisation programmes. Overall a reduction of risk-weighted assets according to Basel II of € 220 million was achieved with the transactions.

Notes to the Balance Sheet (Equity and Liabilities)

58 Liabilities to other banks

Liabilities to other banks by maturities in € million	31.12.2009	31.12.2008
Repayable on demand	967	1,843
With agreed maturities	136,382	145,035
Up to 3 months	106,845	116,311
From 3 months to 1 year	24,166	16,047
From 1 year to 5 years	3,578	7,692
From 5 years and over	1,793	4,985
Total	**137,349**	**146,878**

59 Liabilities to customers

Liabilities to customers by maturities in € million	31.12.2009	31.12.2008
Repayable on demand	53	615
With agreed maturities	13,206	15,321
Up to 3 months	269	1,751
From 3 months to 1 year	1,695	1,800
From 1 year to 5 years	3,912	3,463
From 5 years and over	7,330	8,307
Total	**13,259**	**15,936**

60 Liabilities evidenced by certificates

Liabilities evidenced by certificates, broken down by type of business in € million	31.12.2009	31.12.2008
Debt securities in issue	130,824	170,887
Mortgage bonds	11,549	12,469
Public sector bonds	82,497	99,708
Other debt securities	36,731	55,759
Money market securities	47	2,951
Registered notes in issue	25,552	27,091
Mortgage bonds	8,230	9,409
Public sector bonds	16,308	16,673
Other debt securities	1,014	1,009
Total	**156,376**	**197,978**

Liabilities evidenced by certificates, broken down by maturities in € million	31.12.2009	31.12.2008
With agreed maturities		
Up to 3 months	9,565	45,528
From 3 months to 1 year	43,297	18,541
From 1 year to 5 years	47,601	70,258
From 5 years and over	55,913	63,651
Total	**156,376**	**197,978**

61 Trading liabilities

Trading liabilities in € million	31.12.2009	31.12.2008
Negative fair values from derivative financial instruments	1,326	2,575
Interest-based and foreign-currency-based transactions	616	769
Credit-related transactions	710	1,806
Other trading liabilities	1,379	2,969
Stand-alone derivatives (bank book)	8,686	11,692
Total	**11,391**	**17,236**

62 Provisions

Breakdown in € million	31.12.2009	31.12.2008
Provisions for pension and similar obligations	1	64
Restructuring provisions	192	235
Provisions for contingent liabilities and other commitments	19	11
Other provisions	37	42
thereof: Long-term liabilities to employees	4	5
Total	**249**	**352**

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

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

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

The non-German Group entities only have defined contribution plans. For almost all international entities, a defined percentage of fixed salary is paid into externally managed pension funds for employees as a part of defined contribution pension schemes. Expenses in respect of contribution-based plans amounted to € 11 million, compared with € 11 million in the previous year.

Discount rates and valuation parameters in %	**31.12.2009/ 1.1.2010**	**31.12.2008/ 1.1.2009**
Discount rate	5.25	5.80
Expected return from plan assets	4.50	5.00
Rate of increase in pension obligations	2.00	2.25
Rate of increase in future compensation and vested rights	2.50	2.50
Rate of increase over career	0–1.50	0–1.50

As of 1 January 2005, HRE took out reinsurance which is classified as a “qualifying insurance policy” under IAS 19 to protect itself against parts of the risks arising from the defined-benefit pension commitments. The expected return of the plan assets has been calculated by employing the long-term risk-free interest rate in accordance with the investment strategy of the plan assets.

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

Funding status in € million	**31.12.2009**	**31.12.2008**	**31.12.2007**	**31.12.2006**
Present value of pension claims, partly funded	237	232	233	190
Fair value of plan assets	–232	–233	–223	–222
Funding status	**5**	**–1**	**10**	**–32**
Outstanding actuarial profit (+)/loss (–)	–4	4	—	–23
Outstanding past service cost	—	—	–1	–2
Net of balance sheet value[1]	**1**	**3**	**9**	**–57**
thereof: Capitalised excess cover of plan assets	—	–61	–56	–57
Pensions provisions recognised	1	64	65	—

[1] As of 31 December 2008 the defined benefit obligations of DEPFA Bank plc and its subsidiaries taken over on 2 October 2007 were treated separately. Since the merger of DEPFA Deutsche Pfandbriefbank AG with Hypo Real Estate Bank AG to Deutsche Pfandbriefbank AG the defined benefit obligations have been treated as one plan.

The 10 % corridor of the higher amount originating from the present value of the pension claims vested and the fair value of plan assets was not exceeded as of 31 December 2009 and as of 31 December 2008. Movements in pension obligations are shown below:

Development of pension obligations in € million	2009	2008
Balance at 1.1.	**232**	**233**
Changes in the group of consolidated companies	—	2
Pensions claims vested	5	11
Interest expense	13	12
New arised actuarial profit (–)/loss (+)	4	−13
Adjustment of pension claims	−3	—
Payments to beneficiaries	−14	−13
Balance at 31.12.	**237**	**232**

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

Pension expenses are broken down as follows:

Breakdown of pension expenses in € million	2009	2008
Present value of pension claims vested	5	11
Interest expense	13	12
Expected return from plan assets	−11	−12
Past service cost	−3	1
Actuarial losses recognised as expense	—	—
Total	**4**	**12**

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

Development of plan assets in € million	2009	2008
Balance at 1.1.	**233**	**223**
Contributions to plan assets	—	13
Expected return from plan assets	11	11
Outstanding actuarial profit (+)/loss (–)	−5	−7
Payments to beneficiaries	−7	−8
Changes in the group of consolidated companies	—	1
Balance at 31.12.	**232**	**233**

The actual return from the plan assets amounts to € 6 million (2008: € 4 million).

Development of provisions in € million	Restructuring provisions	Provisions for contingent liabilities and other commitments	Other provisions
Balance at 1.1.2009	**235**	**11**	**42**
Changes in the group of consolidated companies	—	—	—
Additions	40	4	8
Reversals	−27	−1	−4
Amounts used	−56	−3	−9
Reclassifications	—	8	—
Balance at 31.12.2009	**192**	**19**	**37**

On 19 December 2008 the Management Board and Supervisory Board of HRE decided upon the strategic realignment and restructuring of the Group. HRE is adjusting its business model to sustainable changed conditions on capital markets and increasing challenges in the real estate business. The objective of the strategic realignment is to reposition HRE as one of the leading specialists for real estate and public-sector finance in Germany and Europe, with a funding strategy focused on Pfandbrief issuance. The structural cost base shall be reduced, and the balance sheet structure and risk profile shall be enhanced. The Group plans to further simplify its corporate structure. The number of employees shall be further reduced. A restructuring provision amounting to € 225 million was created for obligations relating to the strategic realignment and restructuring in the fourth quarter 2008. In the business year 2009 € 52 million were used of this provision. The provision will be completely utilised until the year 2013.

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

The other provisions comprise mainly provisions in connection with town planning agreements of € 9 million (2008: € 9 million) and provisions for long-term liabilities with regard to employees of € 4 million (2008: € 5 million).

Legal and arbitration proceedings Hypo Real Estate Group (HRE) is exposed to potential risks stemming from litigation and other proceedings in which it is currently involved. In particular, risks may arise from the following proceedings:

Claims are being made on the grounds of alleged misconduct regarding information in connection with the CDO impairment requirement and the ad hoc press release dated 15 January 2008 on the one hand and also the liquidity situation of DEPFA Bank plc on the other. As per the balance sheet date in total, 197 lawsuits for a total of around € 883 million against HRE Holding are pending. 85 conciliatory proceedings for a total of around € 20 million have been initiated; these proceedings will probably also become legal proceedings. Further lawsuits for a total of around € 2 million are also threatened – in verbal or written form. This results in a total value in dispute of around € 905 million as per the balance sheet date. After the balance sheet date there were no material changes of the number of proceedings and the total amount. It is alleged that HRE Holding was aware at an earlier date of the impairments in connection with US-CDO which it announced on 15 January 2008. It is also alleged that HRE Holding deliberately provided incorrect information in public with regard to the liquidity of DEPFA Bank plc. Only in one case a verdict of the first instance exists. The verdict granted the plaintiff about 40 % of the original claim. An appeal has been submitted. Some of the plaintiffs have submitted an application for carrying out a collective action (Musterverfahren). For four (as per 26 February 2010) proceedings collective claims (Musteranträge) were registered in the claim register. Some collective claims were refused as illegitimate. The company assumes that a collective action (Musterverfahren) will be initiated in the summer of 2010.

The investigations by the public prosecutor against former executives are still ongoing. It is possible that fines may be imposed on HRE Holding if the investigations by the public prosecutor or investigations by BaFin, which are taking place in parallel, identify any violations of information obligations under capital markets law.

In June 2008, on the basis of an order of the public prosecutor in Milan, the business premises of the Rome branch of DEPFA Bank plc were searched and items were seized. The investigations were targeted at employees of DEPFA Bank plc as well as at employees of three other banks in connection with allegations that the banks had violated their obligation to advise properly and had unlawfully enriched themselves in connection with derivative transactions concluded with the City of Milan. Preliminary hearings started on 25 January 2010 for the court in Milan to determine whether the public prosecutor's request for a criminal trial will succeed. In January 2009, the City of Milan instituted a civil law suit for damages against DEPFA Bank plc (as well as against the other banks which were involved) in connection with these derivative transactions. The court in Milan is to determine the loss of the City of Milan and determine the banks' liability for damages, at least in an amount claimed by the City of Milan of approx. € 239 million. Out of this total amount, amongst the four banks brought before court, an amount of approx. € 59.7 million would be attributable to DEPFA Bank plc. At the end of May 2009, DEPFA Bank plc filed the statement of defence followed by a replication writ from the City of Milan and another statement by DEPFA Bank plc.

On 26 June 2009 DEPFA Bank plc (with DEXIA as co-claimant) filed a claim against the Province of Pisa with the London High Court for a statement by the court that Pisa has to honour its obligations under an interest rate swap documented by an ISDA Master Agreement dated 15 June 2007 and a confirmation dated 4 July 2007 (Pisa had denied payment that was to become due on 28 June 2009). After negotiations with Pisa for a restructuring of the swap, driven by DEXIA, had failed, the writ had formally been served on 30 November 2009 after having been amended to also cover the payments which Pisa had failed to make in June 2009 of € 372,147.23.

DEPFA Bank plc is also a party in litigation proceedings with two Norwegian municipalities and Norwegian legal counsel relating to sums advanced by DEPFA Bank plc under swap agreements. Judgment was received in the English courts on 4 September 2009. The judge held that the swaps were in fact ultra vires loans under Norwegian law; DEPFA Bank plc was entitled to restitution of the outstanding sums advanced (€ 44 million); and Norwegian counsel had been negligent in advising DEPFA Bank plc of the municipalities' capacity to enter into the swap agreements. In a further judgment on 12 February 2010 the judge held that DEPFA Bank plc was entitled to recover the full amount from their Norwegian legal counsel. An appeal of the first judgment was heard on 15 to 18 February 2010 and judgment is outstanding.

Three lawsuits are currently pending in connection with the termination of the employment agreements with members of the former Management Board. Frank Lamby has sued for payment of his salary for January 2009. Georg Funke has sued for his salary for January and February 2009. Georg Funke and Dr. Markus Fell have each instituted a lawsuit in order to establish that the immediate termination of their employment contracts was null and void. Georg Funke has also initiated a lawsuit in order to establish that the revocation of his retirement pension commitment is null and void.

Six actions for annulment have been initiated against the Extraordinary General Meeting of 2 June 2009. In case of a successful lawsuit it cannot be excluded that minority shareholders have a claim for damages against HRE Holding.

Twenty-two minority shareholders have filed law suits against the squeeze-out resolution approved at the Extraordinary General Meeting of Shareholders on 5 October 2009. Taking into account that the provisions relating to recapitalisation and the related modifications to the squeeze-out rules have been newly introduced into German law in the context of measures aiming at the stabilisation of financial markets it is not predictable how the German courts, potentially including the Constitutional Court, will decide on actions already initiated or to be initiated in the future by the minority shareholders against the squeeze-out resolution. In case a lawsuit against the squeeze-out resolution should be successful, SoFFin will be obliged to re-transfer step by step the shares to the minority shareholders against reimbursement of the settlement payment. Furthermore, in case of a successful lawsuit it cannot be excluded that minority shareholders have a claim for damages against HRE Holding.

HRE Holding as the legal successor of DIA GmbH following the merger of DIA GmbH (transferring entity) into HRE Holding (absorbing entity) on 10 March 2004, is the defendant in judicial appraisal proceedings (Spruchverfahren) filed regarding the squeeze-out of minority shareholders of Hypo Real Estate Bank AG, which was entered into the commercial register in Munich on 3 September 2003. A new assessment ordered by the court leads to an increase of the cash compensation of € 4.41 per share.

The decision of the Management Board not to pay any discretionary variable compensation for the year 2008 has since resulted in the institution or threat of labour court proceedings with several employees in Germany. The question as to whether bonus claims of employees exist for the year 2008 (and if so, to what extent), is a question of the basis of the claim, the contract interpretation and the application of the law of the general terms and conditions in each individual case. So far, two first instance judgements have been issued against the Bank with regard to the bonus for the year 2008 (Labour Court Munich) and already did so in one case. The reasons for the judgement have not yet been provided. The Company intends to appeal against this judgement. It is possible that further employees might be able to enforce bonus claims for 2008.

Bonus claims for the year 2009 have also already been enforced by employees, in certain cases by way of court proceedings. The Management Board has also taken the decision that no discretionary variable compensation will be paid for the year 2009. Also with regard to these bonuses, it is possible that further employees might enforce successfully bonus claims for 2009.

63 Other liabilities

Other liabilities

in € million	31.12.2009	31.12.2008
Negative fair values from derivative financial instruments	28,622	33,329
Hedging derivatives	28,500	33,251
Micro fair value hedge	19,425	23,314
Cash flow hedge	9,075	9,937
Derivatives hedging dFVTPL financial instruments	122	78
Other liabilities	522	387
Deferred income	106	119
Total	**29,250**	**33,835**

Other liabilities mainly include liabilities from the offsetting of results and also accruals pursuant to IAS 37. Accrued liabilities in particular include trade accounts liabilities to employees and other accruals in respect of commission, interest, operating expenses, etc.

64 Income tax liabilities

Income tax liabilities

in € million	31.12.2009	31.12.2008
Current tax liabilities	113	161
Deferred tax liabilities	3,863	4,002
Total	**3,976**	**4,163**

Income tax liabilities include both provisions and liabilities from current taxes as well as deferred tax liabilities. A significant proportion of deferred tax liabilities were netted against AfS or cash flow hedge reserve.

65 Subordinated capital

Breakdown

in € million	31.12.2009	31.12.2008
Subordinated liabilities	2,948	2,387
Participating certificates outstanding	13	1,072
Hybrid capital instruments	256	1,325
Total	**3,217**	**4,784**

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-subordinate creditors have been satisfied.

Subordinated capital, broken down by maturities

in € million	31.12.2009	31.12.2008
With agreed maturities		
Up to 3 months	33	227
From 3 months to 1 year	217	384
From 1 year to 5 years	1,363	1,574
From 5 years and over	1,604	2,599
Total	**3,217**	**4,784**

The devaluation of some instruments of subordinated capital led to an income of € 138 million in the year 2009 (2008: € 353 million).

Participating certificates outstanding Issued participatory capital comprises the following issues:

Participating certificates outstanding

Issuer	Year of issue	Type	Nominal amount in € million	Interest rate in %	Maturity
Deutsche Pfandbriefbank AG	1989	Registered participation certificate	10	8.000	2014
Deutsche Pfandbriefbank AG	1998	Bearer participation certificate	38	variable interest rate	2009
Deutsche Pfandbriefbank AG	1999	Bearer participation certificate	70	7.000	2009
Deutsche Pfandbriefbank AG	1999	Registered participation certificate	5	6.000	2009
Deutsche Pfandbriefbank AG	1999	Registered participation certificate	1	6.000	2009
Deutsche Pfandbriefbank AG	2001	Registered participation certificate	21	7.100	2011
Deutsche Pfandbriefbank AG	2001	Registered participation certificate	5	7.130	2011
Deutsche Pfandbriefbank AG	2001	Bearer participation certificate	13	6.750	2010
Deutsche Pfandbriefbank AG	2001	Bearer participation certificate	50	7.000	2011
Deutsche Pfandbriefbank AG	2002	Bearer participation certificate	50	7.000	2012

The interest entitlement is reduced to the extent that a pay-out would result in the respective issuer recording an annual net loss or balance sheet loss for the year. Holders of participating certificates outstanding principally participate in any net loss or balance sheet loss for the year recorded by an issuer through a reduction in their repayment entitlements; this is based on the ratio between the repayment entitlements and the subscribed capital as shown in the balance sheet plus retained earnings and additional paid-in capital, participatory capital as well as profits and losses carried forward.

Balance profits for subsequent years must be increased to bring repayment entitlements back up to their nominal value. The participating certificates outstanding certify subordinated creditor rights; they do not guarantee any share in liquidation proceeds.

Hybrid capital instruments Hybrid capital instruments in particular include issues in the form of preferred securities placed by specifically established special-purpose entities. These instruments differ from conventional supplementary capital in that they are subject to more stringent conditions in terms of maturity. In addition, hybrid capital instruments are not repaid until after supplementary capital (subordinated liabilities and participating certificates outstanding) in the event of bankruptcy. In contrast to traditional components of core capital, the claim to a share of profit, which depends on the existence of profit, takes the form of a fixed or variable interest payment in the case of hybrid capital instruments. Moreover, hybrid capital can be issued both with unlimited maturity and repayable in the long term.

Since the first quarter of 2009, certain hybrid issues of DEPFA Bank plc have had to be recognised as equity instruments in accordance with IAS 32.16. The classification of financial instruments as capital instruments or debt instruments does not depend on the company law regulations. Instead, it depends on whether the company has a contractual obligation to make payments from an issued financial instrument. DEPFA Bank plc has issued subordinate debt in the form of undated bonds via its issuance vehicles DEPFA Funding II LP, DEPFA Funding III LP and DEPFA Funding IV LP. These hybrid capital instruments only have to make interest payments if creditors of equal-ranking receive an interest payment. After the last equal-ranking liability with interest claims was repaid in the first quarter of 2009, the company no longer has a contractual obligation to make interest payments after this time. Accordingly, it was necessary for the carrying amount of these hybrid capital instruments (€ 1,043 million) to be reclassified under equity (instead of under subordinated capital).

As a result of the merger between the former DEPFA Deutsche Pfandbriefbank AG and Hypo Real Estate Bank AG, the instruments of profit participation rights of the former DEPFA Deutsche Pfandbriefbank AG have become subordinated liabilities because the holders of the instruments were granted co-equal rights. These rights encompass modifications in relation to distribution and loss participation. The instruments were reclassified on the basis of these modifications as this reflects better the economic content of the contracts.

66 Equity

On 31 December 2009, the subscribed capital of HRE Holding of € 3,648 million was divided into:

Subscribed capital number (face amount: € 3)	**31.12.2009**	**31.12.2008**
Shares of common bearer stock	1,217,628,600	211,084,520
Shares of registered non-voting preferred stock	—	—
Total	**1,217,628,600**	**211,084,520**

Authorised capital in € million	Available until	Original amount	**Balance at 31.12.2009**
Year authorised 2008	27.5.2010	180	180

Conditional capital 2008/I in € million	Available until[1]	Original amount	**Balance at 31.12.2009**
Year authorised 2008	27.5.2010	60	60

[1] Related to the issue of convertible bonds and/or bonds with warrants, profit-participation rights and/or profit-linked bonds (or combinations of these instruments)

Conditional capital 2008/II in € million	Available until[1]	Original amount	**Balance at 31.12.2009**
Year authorised 2008	27.5.2010	60	60

[1] Related to the issue of convertible bonds and/or bonds with warrants, profit-participation rights and/or profit-linked bonds (or combinations of these instruments)

Retained earnings in € million	**31.12.2009**	**31.12.2008**
Legal reserve	—	—
Other retained earnings	−4,368	1,085
Total	**−4,368**	**1,085**

The number of shares of common bearer stocks increased from 211,084,520 at 31 December 2008 by 1,006,544,080 to 1,217,628,600 at 31 December 2009 because of the capital increases within the year 2009.

Subscribed capital equals the maximum liability of the shareholder for the liabilities of the corporation to its creditors. The hybrid capital instruments of DEPFA Bank plc have to be disclosed as equity according to IAS 32 as they do not contain contractual obligations for redemption or interest. Additional paid-in capital includes premiums from the issue of shares and the contribution of SoFFin to reserves. It is only permissible to designate amounts to retained earnings where these are created from net income in the current or previous financial years. This includes legal reserves to be created from net income and other retained earnings.

In the fourth quarter 2009 SoFFin provided Deutsche Pfandbriefbank AG with a silent participation of € 1.0 billion. The silent participation participates in the cumulative loss calculated in accordance with the regulations of commercial law to the same extent that the silent participation is related to the total carrying amount of all liable capital shares which participate in the cumulative loss. The total loss of the silent partner in relation to the cumulative loss under commercial law is limited to its silent contribution. The cumulative loss which is attributable to the year 2008 is not used for calculating the loss participation. At the end of the year, the silent contribution was reduced by € 397 million to € 603 million in the commercial law financial statements of Deutsche Pfandbriefbank AG. Deutsche Pfandbriefbank AG has a replenishment obligation.

67 Treasury shares and incentive compensation programme

An incentive compensation scheme did not exist anymore on 31 December 2009. All shares due under the award scheme (181,820 shares) were vested to employees of the Group from the holdings of DEPFA Bank plc Deferred Stock Trust, Dublin, in the second quarter 2009 and were transferred to SoFFin by the squeeze-out at the latest. The shares had been awarded on 2 October 2007. The weighted average grant date fair value amounted to € 8 million. The total compensation cost recognised to date in relation to the incentive compensation programme amounts to:

Compensation cost

in € million	Compensation cost recognised
2007	1
2008	6
2009	1
Total	**8**

DEPFA Bank plc Deferred Stock Trust, Dublin, held 196,084 shares of HRE Holding. The Trust took up the tender offer from the Federal Republic of Germany on all remaining shares which were not allocated in the incentive compensation scheme (14,264 shares), and received € 1.39 per share. As of 31 December 2009 HRE Holding or a subordinated affiliated company did not have treasury shares. All shares were held by SoFFin instead.

No treasury shares were traded in the years 2008 and 2009.

68 Foreign-currency assets and liabilities

Foreign-currency assets and liabilities

in € million	31.12.2009	31.12.2008
Foreign-currency assets	122,646	124,486
thereof: US $	59,181	79,091
JP ¥	16,795	17,708
CHF	6,215	7,927
SEK	2,942	2,679
HK $	8	70
GB £	27,871	12,000
Others	9,634	5,011
Foreign-currency liabilities (excluding equity)	121,009	123,795
thereof: US $	59,662	79,104
JP ¥	17,283	17,527
CHF	6,643	7,940
SEK	2,794	2,586
HK $	1	84
GB £	28,480	11,607
Others	6,146	4,947

69 Trust business

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

Trust assets

in € million	31.12.2009	31.12.2008
Loans and advances to other banks	—	7
Loans and advances to customers	25	24
Other assets	—	45
Total	**25**	**76**

Trust liabilities

in € million	31.12.2009	31.12.2008
Deposits from other banks	20	26
Amounts owed to other depositors	5	50
Total	**25**	**76**

Notes to the Cash Flow Statement

70 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. Cash and cash equivalents correspond to the balance sheet item cash reserve, and include cash in hand and credit balances at central banks.

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

Cash flow from investing activities comprises payments for investment and security holdings as well as for property, plant and equipment.

Cash flow from financing activities comprises inflows from capital increases, payments into reserves and silent participations as well as inflows and outflows for subordinated capital.

In 2009, the company DEPFA First Albany Security LLC was sold and no company was purchased. In addition no other non-special-purpose entities were purchased or sold. The effects from the transactions are described in the note consolidation.

Notes to the Financial Instruments

71 Derivative transactions

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

In order to minimise (reduce) both the economic and the regulatory credit risk arising from these instruments, master agreements (bilateral netting agreements) have been concluded. By means of such netting agreements, the positive and negative fair values of the derivatives contracts included under the master agreement can be offset against one another, and the future regulatory risk add-ons for these products can be reduced. Through this netting process, the credit risk is limited to a single net claim on the party to the contract (close-out netting).

For both regulatory reports and the internal measurement and monitoring of the credit commitments, such risk-reducing techniques are utilised only if they are considered to be enforceable under the respective legal system in the event that the business associate becomes insolvent. Legal advice was taken in order to check enforceability.

Similar to the master agreements, HRE concludes collateral agreements with its business associates to collateralise the net claim or liability remaining after netting (obtained or pledged collateral). As a rule, this collateral management reduces credit risk by means of prompt measurement and adjustment exposure to customers.

Volume of derivatives at 31.12.2009	Nominal amount				Fair value	
	Remaining maturities					
in € million	Less than 1 year	1 to 5 years	More than 5 years	Total	Positive	Negative
Interest-based transactions						
OTC products	86,808	211,060	334,329	632,197	22,174	35,675
Forward rate agreements	1,000	—	—	1,000	—	—
Interest rate swaps	81,792	203,497	328,544	613,833	22,036	35,212
Interest rate options	4,016	7,563	5,775	17,354	138	461
Call options	2,036	3,931	4,860	10,827	125	320
Put options	1,980	3,632	915	6,527	13	141
Other interest rate contracts	—	—	10	10	—	2
Exchange-traded products	2,769	—	—	2,769	7	2
Interest futures	2,769	—	—	2,769	7	2
Total	**89,577**	**211,060**	**334,329**	**634,966**	**22,181**	**35,677**
Foreign-currency-based transactions						
OTC products	56,088	3,600	7,235	66,923	1,243	1,740
Spot and forward currency transactions	53,970	136	—	54,106	85	1,095
Interest rate/currency swaps	2,118	3,464	7,235	12,817	1,158	645
Total	**56,088**	**3,600**	**7,235**	**66,923**	**1,243**	**1,740**
Other transactions						
OTC products	2,664	11,011	16,403	30,078	1,404	1,217
Credit derivatives	2,664	11,011	16,403	30,078	1,404	1,217
Total	**2,664**	**11,011**	**16,403**	**30,078**	**1,404**	**1,217**
Total	**148,329**	**225,671**	**357,967**	**731,967**	**24,828**	**38,634**

Use made of derivative transactions at 31.12.2009		Fair value	
in € million	Nominal amount	Positive	Negative
Interest-based transactions			
Fair value hedge accounting	241,653	5,866	18,909
Cash flow hedge accounting	237,212	7,881	8,753
Derivatives hedging dFVTPL financial instruments	3,510	364	122
Stand-alone derivatives	152,591	8,070	7,893
Total	**634,966**	**22,181**	**35,677**
Foreign-currency-based transactions			
Fair value hedge accounting	5,995	522	515
Cash flow hedge accounting	18,500	446	322
Stand-alone derivatives	42,428	275	903
Total	**66,923**	**1,243**	**1,740**
Other transactions			
Fair value hedge accounting	29	—	1
Stand-alone derivatives	30,049	1,404	1,216
Total	**30,078**	**1,404**	**1,217**
Total	**731,967**	**24,828**	**38,634**

Volume of derivatives at 31.12.2008				Nominal amount		Fair value
		Remaining maturities				
in € million	Less than 1 year	1 to 5 years	More than 5 years	Total	Positive	Negative
Interest-based transactions						
OTC products	171,261	228,811	391,432	791,504	26,042	42,927
Forward rate agreements	33	—	—	33	—	—
Interest rate swaps	158,978	218,823	386,761	764,562	25,793	41,559
Interest rate options	10,958	9,988	4,095	25,041	219	1,277
Call options	4,578	3,836	2,388	10,802	219	8
Put options	6,380	6,152	1,707	14,239	—	1,269
Other interest rate contracts	1,292	—	576	1,868	30	91
Exchange-traded products	2,608	140	—	2,748	5	2
Interest futures	2,608	140	—	2,748	5	2
Total	**173,869**	**228,951**	**391,432**	**794,252**	**26,047**	**42,929**
Foreign-currency-based transactions						
OTC products	50,067	5,079	7,834	62,980	3,890	1,880
Spot and forward currency transactions	41,664	92	48	41,804	1,735	222
Interest rate/currency swaps	8,403	4,987	7,786	21,176	2,155	1,658
Total	**50,067**	**5,079**	**7,834**	**62,980**	**3,890**	**1,880**
Other transactions						
OTC products	4,220	16,828	22,207	43,255	2,543	2,787
Credit derivatives	4,220	16,828	22,207	43,255	2,543	2,787
Total	**4,220**	**16,828**	**22,207**	**43,255**	**2,543**	**2,787**
Total	**228,156**	**250,858**	**421,473**	**900,487**	**32,480**	**47,596**

Use made of derivative transactions at 31.12.2008			Fair value
in € million	Nominal amount	Positive	Negative
Interest-based transactions			
Fair value hedge accounting	248,821	6,282	22,590
Cash flow hedge accounting	356,718	8,031	9,293
Derivatives hedging dFVTPL financial instruments	4,879	509	78
Stand-alone derivatives	183,834	11,225	10,968
Total	**794,252**	**26,047**	**42,929**
Foreign-currency-based transactions			
Fair value hedge accounting	7,375	602	724
Cash flow hedge accounting	23,381	1,447	644
Stand-alone derivatives	32,224	1,841	512
Total	**62,980**	**3,890**	**1,880**
Other transactions			
Derivatives hedging dFVTPL financial instruments	395	47	—
Stand-alone derivatives	42,860	2,496	2,787
Total	**43,255**	**2,543**	**2,787**
Total	**900,487**	**32,480**	**47,596**

Counterparties	31.12.2009		31.12.2008	
	Fair value		Fair value	
in € million	Positive	Negative	Positive	Negative
OECD banks	18,530	29,042	24,635	36,244
OECD financial institutions	3,602	8,893	6,297	10,588
Non-OECD central governments (and central banks)	13	4	31	3
Non-OECD banks	13	—	17	—
Non-OECD financial institutions	20	—	365	—
Other companies and private individuals	2,650	695	1,135	761
Total	**24,828**	**38,634**	**32,480**	**47,596**

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

72 Cash flow hedge accounting

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

Cash flow hedge: periods of hedged items when cash flows are expected to occur in € million	31.12.2009	31.12.2008
Up to 1 month	12	67
From 1 month to 3 months	5	154
From 3 months to 1 year	117	431
From 1 year to 2 years	130	317
From 2 years to 5 years	656	833
From 5 years and over	1,838	1,643
Total	**2,758**	**3,445**

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.

73 Undiscounted cash flows of financial liabilities

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

Contractual undiscounted cash flows of the financial liabilities according to IFRS 7.39 in € billion	31.12.2009	31.12.2008
Up to 3 months	127	179
From derivative financial instruments	4	—
From non-derivative financial instruments	123	179
From 3 months to 1 year	93	46
From derivative financial instruments	14	3
From non-derivative financial instruments	79	43
From 1 year to 5 years	98	109
From derivative financial instruments	29	8
From non-derivative financial instruments	69	101
From 5 years and over	139	132
From derivative financial instruments	49	32
From non-derivative financial instruments	90	100

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

74 Assets assigned or pledged as collateral for own liabilities

The following assets were assigned or pledged as collateral:

Own liabilities		
in € million	31.12.2009	31.12.2008
Liabilities to other banks	123,835	139,294
Liabilities to customers	570	—
Liabilities evidenced by certificates	—	30,098
Total	**124,405**	**169,392**

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

Assets pledged		
in € million	31.12.2009	31.12.2008
Trading assets	110	19
Loans and advances to other banks	26,432	14,080
Loans and advances to customers	31,602	80,908
Financial investments	44,423	61,184
Total	**102,567**	**156,191**

Within the framework of the liquidity support from a syndicate from the German finance sector and the Bundesbank with the participation of the German Federal Government as well as from the financial market stabilisation fund, HRE Holding as well as its major subsidiaries have transferred or assigned almost all of their freely available assets with a total nominal value of approx. € 60 billion as collateral to the security trustee of the lenders. In addition HRE Holding pledged the shares in Deutsche Pfandbriefbank AG and DEPFA Bank plc and DEPFA Bank plc pledged shares in its subsidiaries. Within the scope of the restructuring of the liquidity support the collateral portfolio of originally approx. € 60 billion will be widely released until 31 March 2010. The pledging of the shares in Deutsche Pfandbriefbank AG and DEPFA Bank plc as well as the pledging of the shares in subsidiaries of DEPFA Bank plc have not been released.

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

75 Collaterals permitted to resell or repledge

The fair value of collaterals that may be resold or repledged in the absence of default amounted to € 30 million as of 31 December 2009 (2008: € 43 million). Collaterals with a fair value of € 0 million (2008: € 15 million) were sold or repledged in the absence of default. HRE received the collaterals as part of repurchase agreements and is principally obliged to return the collaterals to the grantor. If and only if the collateral redeems in the mean time a cash compensation is possible.

76 Fair values of financial instruments

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

As per the amendment to IFRS 7 “Financial Instruments: Disclosures” issued in March 2009 all financial assets and liabilities of 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 at 31.12.2009

in € million	**Total**	Level 1	Level 2	Level 3
Assets				
Financial assets at fair value through P & L	21,063	871	18,631	1,561
Trading assets	10,749	—	9,546	1,203
Loans and advances to customers	333	—	—	333
dFVTPL financial investments	3,229	871	2,358	—
Hedging derivatives	6,388	—	6,363	25
Derivatives hedging dFVTPL financial investments	364	—	364	—
Financial assets at fair value not affecting P & L	21,741	12,941	8,752	48
AfS financial investments[1]	13,414	12,941	473	—
Cash flow hedge derivatives	8,327	—	8,279	48
Total	**42,804**	**13,812**	**27,383**	**1,609**
Liabilities				
Financial liabilities at fair value through P & L	30,938	—	28,673	2,265
Trading liabilities	11,391	—	9,301	2,090
Hedging derivatives	19,425	—	19,250	175
Derivatives hedging dFVTPL financial instruments	122	—	122	—
Financial liabilities at fair value not affecting P & L	9,075	—	9,057	18
Cash flow hedge derivatives	9,075	—	9,057	18
Total	**40,013**	**—**	**37,730**	**2,283**

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

During the current year, due to changes in market conditions for certain financial instruments, quoted prices in active markets were no longer available for these instruments. However, there was sufficient information available to measure fair values of these instruments based on observable market inputs. Hence, these financial assets with a fair value of € 63 million, were transferred from Level 1 to Level 2 of the fair value hierarchy.

In 2009, information available to measure fair value improved significantly for some instruments such that instead of observable market data now quoted prices in active markets are available. Instruments with a fair value of € 1,898 million were transferred from Level 2 to Level 1 of the fair value hierarchy.

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

Changes in Level 3 financial assets			Financial assets at fair value through P & L	Financial assets at fair value not affecting P & L	
in € million	Trading assets	Loans and advances to customers	Hedging derivatives	Cash flow hedge derivatives	**Total**
Balance at 1.1.2009	**1,511**	**395**	**81**	**34**	**2,021**
Comprehensive income recognised in					
Income statement	–179	–45	–46	—	–270
Equity	—	—	—	14	14
Purchases	488	—	—	—	488
Sales	—	—	—	—	—
Issues	—	—	—	—	—
Settlements	–617	–17	–10	—	–644
Transfers into Level 3	—	—	—	—	—
Transfers out of Level 3	—	—	—	—	—
Balance at 31.12.2009	**1,203**	**333**	**25**	**48**	**1,609**

Changes in Level 3 financial liabilities		Financial liabilities at fair value through P & L	Financial liabilities at fair value not affecting P & L	
in € million	Trading liabilities	Hedging derivatives	Cash flow hedge derivatives	**Total**
Balance at 1.1.2009	**–4,178**	**–106**	**–15**	**–4,299**
Comprehensive income recognised in				
Income statement	364	–68	—	296
Equity	—	—	–3	–3
Purchases	–208	–1	—	–209
Sales	—	—	—	—
Issues	—	—	—	—
Settlements	1,932	—	—	1,932
Transfers into Level 3	—	—	—	—
Transfers out of Level 3	—	—	—	—
Balance at 31.12.2009	**–2,090**	**–175**	**–18**	**–2,283**

In 2009, HRE transferred no financial instruments into or from Level 3.

Of the total gains or losses for the period recognised in income statement € 26 million relates to financial assets and financial liabilities dFVTPL held at the balance sheet date. Fair value gains or losses on financial assets dFVTPL (thereof € –179 million trading assets, € –45 million loans and advances to customers and € –46 million hedging derivatives) are included in "net trading income" (€ –179 million) and "net income from hedge relationships" (€ –91 million). Fair value gains or losses on financial liabilities dFVTPL (thereof € 364 million trading liabilities and € –68 million hedging derivatives) are included in "net trading income" (€ 364 million) and "net income from hedge relationships" (€ –68 million).

All gains or losses recognised directly in equity (€ 11 million) relate to cash flow hedge derivatives held at the balance sheet date and are reported as changes of "cash flow hedge reserve".

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

Sensitivities of Level 3 instruments

in € million	Favourable changes	Unfavourable changes
Assets		
Financial assets fair value through P & L		
Trading assets	126	–150
Loans and advances to customers	23	–19
Hedging derivatives	8	–10
Total	**157**	**–179**
Liabilities		
Financial liabilities at fair value through P & L		
Trading liabilities	8	–23
Hedging derivatives	30	–38
Total	**38**	**–61**

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

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

The methods and valuation techniques used for the purpose of measuring fair value are unchanged compared to the previous reporting period. In the following the valuation methods on the level of product classes are described in detail:

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

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

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

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

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

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

Fair values of financial instruments in € million	31.12.2009 Carrying amounts	31.12.2009 Fair value	31.12.2008 Carrying amounts	31.12.2008 Fair value
Assets	**354,747**	**332,950**	**414,316**	**382,860**
Cash reserve	1,824	1,824	1,713	1,713
Trading assets (HfT)	10,749	10,749	17,287	17,287
Loans and advances to other banks[1]	37,491	36,854	49,325	48,360
Category LaR	37,491	36,854	49,325	48,360
Loans and advances to customers[1]	194,476	178,714	219,855	199,487
Category LaR	194,143	178,381	219,460	199,092
Category dFVTPL	333	333	395	395
Financial investments[2]	94,808	89,410	108,740	98,617
Category AfS	13,423	13,423	14,470	14,470
Category dFVTPL	3,229	3,229	4,476	4,476
Category LaR	78,156	72,758	89,794	79,671
Other assets	15,399	15,399	17,396	17,396
thereof: Hedging derivatives	14,715	14,715	16,362	16,362
Derivatives hedging dFVTPL financial instruments	364	364	556	556
Liabilities	**350,842**	**345,558**	**416,647**	**405,987**
Liabilities to other banks	137,349	137,311	146,878	146,444
Liabilities to customers	13,259	13,149	15,936	14,184
Liabilities evidenced by certificates	156,376	151,500	197,978	190,964
Trading liabilities (HfT)	11,391	11,391	17,236	17,236
Other liabilities	29,250	29,250	33,835	33,835
thereof: Hedging derivatives	28,500	28,500	33,251	33,251
Derivatives hedging dFVTPL financial instruments	122	122	78	78
Subordinated capital	3,217	2,957	4,784	3,324
Other items	**8,870**	**8,469**	**14,498**	**12,787**
Contingent liabilities	785	785	1,309	1,309
Irrevocable loan commitments	5,931	5,530	11,271	9,560
Liquidity facility	2,154	2,154	1,918	1,918

[1] Reduced by allowances for losses on loans and advances
[2] Excluding investment properties and companies valued using the equity method

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

Asset and liabilities according to measurement categories and classes in € million	31.12.2009	31.12.2008
Assets		
Loans-and-receivables (LaR)	309,790	358,579
Held-to-maturity (HtM)	—	—
Available-for-sale (AfS)	13,423	14,470
Held-for-trading (HfT)	10,749	17,287
dFVTPL-assets (dFVTPL)	3,562	4,871
Cash reserve	1,824	1,713
Positive fair values from hedging derivatives	15,079	16,918
Liabilities		
Held-for-trading (HfT)	11,391	17,236
Financial liabilities at amortised cost	310,348	365,847
Negative fair values from hedging derivatives	28,622	33,329

77 Past due but not impaired assets

At 31 December 2009, the following amounts were noted by the Group as being past due. However, no individual impairment provision was made against these assets respectively the collaterals underlying these assets as HRE does not consider that there is any issue regarding their recoverability. Such timing issues in receipts of payments due occur regularly (up to three months) in the normal course of business and do not, by themselves, impair the quality of the asset. The total investment in relation to the past due amounts have also been disclosed to put the size of the amounts in question into context.

LaR assets

LaR assets: past due but not impaired (total investments) in € million	31.12.2009	31.12.2008
Up to 3 months	774	927
From 3 months to 6 months	288	265
From 6 months to 1 year	301	120
From 1 year and over	222	79
Total	**1,585**	**1,391**

Carrying amounts LaR assets in € billion	31.12.2009	31.12.2008
Carrying amount LaR assets that are neither impaired nor past due	308.8	358.0
Carrying amount LaR assets that are past due but not impaired (total investment)	1.6	1.4
Carrying amount of individually assessed impaired LaR assets (net)	2.4	0.8
Balance of portfolio-based allowances	0.9	0.6
Total	**313.7**	**360.8**
thereof: Loans and advances to other banks (including investments)	37.5	49.4
Loans and advances to customers (including investments)	198.0	221.6
Financial investments (gross)	78.2	89.8

The carrying amount of assets that would otherwise be past due or impaired and whose terms have been renegotiated amounts to € 0 million (2008: € 0 million).

The fair value of collaterals for the impaired financial assets amounts to approx. € 2.0 billion (2008: € 1.2 billion). The collaterals mainly consist of land charges.

AfS assets As of 31 December 2009 and as of 31 December 2008 HRE has neither past due and not impaired nor impaired AfS financial investments in the portfolio.

78 Accruing of day one profits

Accruing of day one profits in € million	2009	2008
Beginning balance of day one profits yet to be recognised in P & L	**51**	**42**
Changes in the group of consolidated companies	—	—
New recognised day one profits	4	13
Day one profits accrued to P & L	–3	–4
Final balance of day one profits yet to be recognised in P & L	**52**	**51**

The day one profits to be accrued result from financial assets categorised as held-for-trading.

Other Notes

79 Contingent liabilities and other commitments

Contingent liabilities and other commitments in € million	31.12.2009	31.12.2008
Contingent liabilities	**785**	**1,309**
Guarantees and indemnity agreements	785	1,309
Loan guarantees	39	58
Performance guarantees and indemnities	746	1,251
Other commitments	**8,127**	**13,246**
Irrevocable loan commitments	5,931	11,271
Book credits	636	2,269
Guarantees	64	83
Mortgage and public sector loans	5,231	8,919
Liquidity facilities	2,154	1,918
Other commitments	42	57
Total	**8,912**	**14,555**

HRE Holding has issued the loss indemnity declaration for the deposit protection fund established by the Bundesverband deutscher Banken e.V., Berlin, as prescribed by the applicable articles of association.

HRE is a lessor within the framework of operating lease agreements. Non-terminable operating lease agreements for land and buildings as well as for operating and business equipment existed as of 31 December 2009. The minimum obligations arising from non-terminable leasing arrangements will result in costs of € 23 million in 2010, € 79 million in total in the years 2011 to 2014 and € 118 million in total for 2015 and beyond. In the previous year the non-terminable operating lease agreements were as follows: for financial year 2009: € 21 million, in financial years 2010 to 2013 € 83 million in total and for 2014 and beyond € 130 million in total.

For HRE irrevocable loan commitments and liquidity facilities form the largest part of other commitments. Irrevocable loan commitments comprise all commitments of a creditor which can grant a loan and advance at a later date and which can cause a credit risk. These are mainly credit commitments which are not fully drawn by the customer. Liquidity facilities are committed credit lines.

80 Key regulatory capital ratios (based on German Commercial Code)

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

HRE is obliged to assure a minimum own funds ratio of 8 % according to section 3 SolvV in connection with section 2 (2) and (3) SolvV. In the financial year 2009 the fulfilment of this minimum ratio was not met in the period from 24 April 2009 (date of the approval of the financial statements 2008) to 7 June 2009. The relevant regulators BaFin and Deutsche Bundesbank were informed about that in time as obligatory according to section 7 SolvV. Due to the steps to recapitalise HRE which were already under way the regulators did not impose a sanction for the relevant period of time. The own funds ratio has not fallen below 8 % since the capital increase approved on 2 June 2009 was registered in the commercial register on 8 June 2009.

According to German regulatory standards, the calculation of own funds for the due dates 31 December 2009 and 31 December 2008 had to happen without the respective year end result, due to the fact that at the time of the Solvency Reporting to the Supervisors, the prepared annual financial statement did not exist. This would have been the prerequisite to include the annual result.

For HRE the capital for regulatory purposes (according to German Solvency Regulation [SolvV]) is as follows:

Own funds[1] in € million	31.12.2009[2]	31.12.2009[3]	31.12.2008[2]	31.12.2008[3]
Core capital (Tier I)	7,614	6,260	5,897	2,928
Supplementary capital (Tier II)	1,133	2,213	2,275	2,069
Equity capital	**8,747**	**8,473**	**8,172**	**4,997**
Tier III capital	—	—	—	—
Total	**8,747**	**8,473**	**8,172**	**4,997**

[1] Consolidated pursuant to section 10a German Banking Act (KWG)
[2] Before prepared annual financial statements and before result distribution
[3] Pro forma as per prepared annual financial statements and after result distribution

The risk-weighted assets, the operational risks and market risk positions were as follows:

Risk-weighted assets[1] in € billion	31.12.2009[2]	31.12.2009[3]	31.12.2008[2]	31.12.2008[3]
Risk-weighted assets	81.0	80.2	95.3	87.3

[1] Including risk-weighted credit risk positions as well as the capital requirements for market risk positions and operational risks scaled with the factor 12.5; according to Basel II advanced IRB approach for authorised portfolios, otherwise Basel II standardised approach
[2] Before prepared annual financial statements and before result distribution
[3] Pro forma as per prepared annual financial statements and after result distribution

Operational risks in € million	31.12.2009	31.12.2008
Total	**212**	**237**

Market risk positions in € million	31.12.2009	31.12.2008
Currency risks	37	64
Interest rate risks	198	282
Total	**235**	**346**

The regulatory capital ratios were calculated on the basis of the definition for regulatory capital according to SolvV and risk-weighted assets according to Basel II. The resulting capital ratios as of 31 December 2009 and as of 31 December 2008 were thus as follows:

Key capital ratios in %	31.12.2009[1]	31.12.2009[2]	31.12.2008[1]	31.12.2008[2]
Core capital ratio[3]	9.4	7.8	6.2	3.4
Equity capital ratio[4]	11.2	11.0	9.0	6.0
Own funds ratio (overall indicator)[3]	10.8	10.6	8.6	5.7

[1] Before prepared annual financial statements and before result distribution
[2] Pro forma as per prepared annual financial statements and after result distribution
[3] Including risk-weighted credit risk positions as well as the capital requirements for market risk positions and operational risks scaled with the factor 12.5
[4] Including risk-weighted credit risk positions as well as the capital requirements for operational risks scaled with the factor 12.5

81 Group auditors' fee

Group auditors' fee in € thousand	31.12.2009	31.12.2008
Audits	5,560	5,170
Other affirmation	148	650
Tax consultancy	116	178
Other services	7,358	6,139
Total	**13,182**	**12,137**

82 Relationship with related parties

According to IAS 24 (Related-Party Disclosures), a party is related to an entity if, directly, or indirectly through one or more intermediaries, the party controls or is controlled by the reporting entity, has an interest in the entity that gives it significant influence over the entity or has joint control over the entity as well as associates and joint ventures.

In addition to the subsidiaries included in the consolidated financial statements, HRE Holding also directly or indirectly maintains relations with non-consolidated subsidiaries and other related entities in the course of exercising its normal business operations. Transactions with related parties are carried out on an arm's length basis, until the application of section 7 (d) FMStBG, by considering the specifics of section 311 ff AktG (German Stock Corporation Act).

Related companies Assets to related parties

Assets to related parties in € million	31.12.2009	31.12.2008
Loans and advances to customers	**66**	**66**
of non-consolidated subsidiaries	16	18
of other related companies	50	48

In addition, the portfolio did not include assets to non-consolidated subsidiaries and other related companies.

Liabilities to related parties

Liabilities to related parties in € million	31.12.2009	31.12.2008
Liabilities to customers	**4**	**—**
of non-consolidated subsidiaries	4	—
of other related companies	—	—

In addition, the portfolio did not include liabilities to non-consolidated subsidiaries and other related companies.

As was the case last year no loans and advances nor any liabilities existed with respect to defined contribution plans as of 31 December 2009.

Income and expenses recognised during the period in respect to related parties were not significant.

As a result of HRE Holding being controlled by the SoFFin, a special estate of the German Federal Government according to § 2 section 2 FMStFG, HRE Holding is 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 (so-called government-related entities). Business relations with public sector entities are carried out on an arm's length basis. The support measures of SoFFin are described in detail in the management report.

Related persons

Remuneration paid to persons with key function in the Group (Senior Management)[1]			2009	2008
in € thousand	Remuneration	Severance payments	**Total**	Total
Total	14,963	5,649	**20,612**	20,212

[1] Members of the Management Board of HRE Holding, its subsidiaries as well as managing directors of HRE Systems GmbH and the staff of the second management level of the Group

Pension obligations to persons with key function in the Group (Senior Management)		
in € thousand	**31.12.2009**	**31.12.2008**
Total[1]	96,493	61,090

[1] Thereof € 82,816 thousand (2008: € 41,798 thousand) for pensioners and surviving dependants

The compensation for the members of the Management Board and the members of the Supervisory Board is shown (inclusive tables) in the compensation report.

In 2009, the members of the Supervisory Board of HRE Holding did not receive any compensation for personal services. On the reference date for the financial statements, there were no receivables in respect of members of the Supervisory Board being active at the balance sheet date.

In the year 2009 no shares or share derivatives of HRE Holding were purchased or sold by members of the Supervisory Board and Management Board.

On 31 December 2009, SoFFin held all shares of HRE Holding. Hence, members of the Management Board and Supervisory Board did not hold shares of the company.

Disclosure of remuneration of HRE Holding by group of persons according to section 285 (9) a) and b) German Commercial Code former version The remuneration of the Management Board amount to € 6,245 thousand (2008: € 6,430 thousand) and of the Supervisory Board to € 599 thousand (2008: € 1,178 thousand).

The pension claims according to IFRS for active members of the Management Board amount to € 11,195 thousand as of 31 December 2009. The claims for former members of the Management Board amount to € 17,471 thousand.

83 Employees

Average number of employees	2009	2008
Employees (excluding apprentices)	1,562	1,884
Apprentices	6	8
Total	**1,568**	**1,892**

84 Summary of quarterly financial data

Group		2008				2009
		4th quarter	1st quarter	2nd quarter	3rd quarter	4th quarter
Operating performance						
Operating revenues	in € million	−660	−80	348	244	−93
Net interest income and similar income	in € million	676	371	345	333	347
Net commission income	in € million	−72	−108	−99	−97	−338
Net trading income	in € million	−574	−162	135	25	−152
Net income from financial investments	in € million	−881	−30	−14	1	42
Net income from hedge relationships	in € million	120	−110	3	−30	20
Balance of other operating income/expenses	in € million	71	−41	−22	12	−12
Provisions for losses on loans and advances	in € million	1,409	196	881	810	204
General administrative expenses	in € million	181	130	121	142	148
Balance of other income/expenses	in € million	−227	—	−10	−1	3
Pre-tax profit	in € million	−2,477	−406	−664	−709	−442
Net income/loss	in € million	−2,569	−382	−750	−574	−530
Key indicators						
Total volume of lending	in € billion	267.3	258.5	248.7	239.7	236.2
Employees		1,786	1,656	1,582	1,480	1,397

Commercial Real Estate		2008				2009
		4th quarter	1st quarter	2nd quarter	3rd quarter	4th quarter
Operating performance						
Operating revenues	in € million	219	153	173	167	94
Net interest income and similar income	in € million	187	161	162	158	151
Net commission income	in € million	28	17	31	24	25
Net trading income	in € million	−25	−25	−23	−18	−85
Net income from financial investments	in € million	18	—	1	1	1
Net income from hedge relationships	in € million	—	—	—	—	—
Balance of other operating income/expenses	in € million	11	—	2	2	2
Provisions for losses on loans and advances	in € million	839	135	899	616	216
General administrative expenses	in € million	22	40	34	47	56
Balance of other income/expenses	in € million	−5	—	−1	—	—
Pre-tax profit	in € million	−647	−22	−761	−496	−178

Public Sector & Infrastructure Finance		2008				2009
		4th quarter	1st quarter	2nd quarter	3rd quarter	4th quarter
Operating performance						
Operating revenues	in € million	180	96	127	51	−126
Net interest income and similar income	in € million	205	286	212	110	75
Net commission income	in € million	−63	−84	−79	−79	−235
Net trading income	in € million	−10	−21	—	44	11
Net income from financial investments	in € million	5	−1	−2	3	−7
Net income from hedge relationships	in € million	40	−84	−5	−27	30
Balance of other operating income/expenses	in € million	3	—	1	—	—
Provisions for losses on loans and advances	in € million	420	49	−20	180	−6
General administrative expenses	in € million	−15	25	24	22	18
Balance of other income/expenses	in € million	−8	—	—	3	—
Pre-tax profit	in € million	−233	22	123	−148	−138

Capital Markets & Asset Management		2008				2009
		4th quarter	1st quarter	2nd quarter	3rd quarter	4th quarter
Operating performance						
Operating revenues	in € million	−522	−95	102	40	−16
Net interest income and similar income	in € million	17	17	14	17	17
Net commission income	in € million	−12	−11	−15	−13	−34
Net trading income	in € million	−444	−99	122	35	−58
Net income from financial investments	in € million	−82	—	−17	—	50
Net income from hedge relationships	in € million	−1	−2	−2	1	9
Balance of other operating income/expenses	in € million	—	—	—	—	—
Provisions for losses on loans and advances	in € million	—	—	—	—	—
General administrative expenses	in € million	−25	12	5	4	5
Balance of other income/expenses	in € million	—	—	—	—	—
Pre-tax profit	in € million	−497	−107	97	36	−21

Corporate Center		2008				2009
		4th quarter	1st quarter	2nd quarter	3rd quarter	4th quarter
Operating performance						
Operating revenues	in € million	−537	−234	−54	— 14	−45
Net interest income and similar income	in € million	267	−93	−43	48	104
Net commission income	in € million	−25	−30	−36	−29	−94
Net trading income	in € million	−95	−17	36	−36	−20
Net income from financial investments	in € million	−822	−29	4	−3	−2
Net income from hedge relationships	in € million	81	−24	10	−4	−19
Balance of other operating income/expenses	in € million	57	−41	−25	10	−14
Provisions for losses on loans and advances	in € million	150	12	2	14	−6
General administrative expenses	in € million	199	53	58	69	69
Balance of other income/expenses	in € million	−214	—	−9	−4	3
Pre-tax profit	in € million	−1,100	−299	−123	−101	−105

85 Summary of annual financial data

Group						
Income/expenses		**2009**	**2008**	**2007**	**2006**	**2005**
Operating revenues	in € million	419	−585	906	1,082	946
Net interest income and similar income	in € million	1,396	1,633	1,105	804	722
Net commission income	in € million	−642	32	198	145	125
Net trading income	in € million	−154	−1,009	−224	43	26
Net income from financial investments	in € million	−1	−1,409	−169	79	70
Net income from hedge relationships	in € million	−117	86	−5	9	−2
Balance of other operating income/expenses	in € million	−63	82	1	2	5
Provisions for losses on loans and advances	in € million	2,091	1,656	−61	159	151
General administrative expenses	in € million	541	605	435	335	317
Impairments on goodwill and DEPFA's intangible assets	in € million	—	2,482	—	—	—
Balance of other income/expenses	in € million	−8	−47	55	−17	−35
Pre-tax profit	in € million	**−2,221**	**−5,375**	**587**	**571**	**443**
Taxes on income	in € million	15	86	130	29	63
Net income/loss	in € million	**−2,236**	**−5,461**	**457**	**542**	**380**

86 Members of the Supervisory Board and of the Management Board

Supervisory Board of HRE Holding as of 25.1.2010 Name, place of residence and function in the Supervisory Board	Principal activity	Function in the Committees Executive Committee	Audit Committee	Nomination Committee	Risk Management and Liquidity Strategy Committee
Dr. Bernd Thiemann Kronberg Chairman (from 13.8.2009)	Self-employed management consultant	Chairman (from 13.8.2009)	Member (from 13.8.2009)	Chairman (from 13.8.2009)	Member (from 13.8.2009)
Dagmar P. Kollmann Bad Homburg Deputy chairperson (from 13.8.2009)	Chairperson of the Partners Committee of Kollmann GmbH	Member (from 13.8.2009)	Chairman (from 13.8.2009)	Member (from 13.8.2009)	Member (from 13.8.2009)
Dr. Günther Bräunig Frankfurt Member (from 9.7.2009)	Member of the Management Board of KfW	Member (from 13.8.2009)	Member (from 13.8.2009)	Member (from 13.8.2009)	Chairman (from 13.8.2009)
Dr. Alexander Groß Teltow Member (from 13.8.2009)	Head of the Economic Policy department in the Federal Ministry for Industry and Technology				
Dr. Markus Kerber Berlin Member (from 5.12.2009)	Head of the department responsible for Fundamental Issues of Financial Policy and Economics in the Federal Ministry of Finance				
Dr. Hedda von Wedel Andernach Member (from 13.8.2009)	President of the Bundesrechnungshof, retired		Member (from 13.8.2009)		
Dr. Michael Endres Koenigstein Chairman (until 13.8.2009)	Chairman of the Management Board of the charitable Hertie Foundation, Frankfurt/Main	Chairman (until 13.8.2009)	Member (28.3. to 13.8.2009)	Chairman (until 13.8.2009)	Member (28.3. to 13.8.2009)
Dr. h.c. Bernhard Walter Bad Homburg Deputy chairman (until 13.8.2009)	Member of the Supervisory Board and Chairman of the Audit Committee of Daimler AG, Stuttgart	Member (28.3. to 13.8.2009)	Chairman (until 13.8.2009)	Member (28.3. to 13.8.2009)	
Dr. Renate Krümmer Hamburg Deputy chairman (until 31.3.2009)	Managing Director of J. C. Flowers & Co GmbH, Hamburg				
J. Christopher Flowers New York Member (until 27.3.2009)	Chairman and Chief Executive Officer of J.C. Flowers & Co. LLC, New York/USA	Member (until 27.3.2009)		Member (until 27.3.2009)	
Bernd Knobloch Frankfurt Member (until 13.8.2009)	Member of the Management Board of the charitable Hertie Foundation, Frankfurt/Main				Chairman (until 13.8.2009)
Dr. h.c. Edgar Meister Kronberg Member (until 18.5.2009)	Member of the Supervisory Board of Commerzbank AG, Frankfurt/Main		Member (until 18.5.2009)		
Siegmar Mosdorf Potsdam Member (until 13.8.2009)	Partner of CNC AG, Berlin		Member (22.6. to 13.8.2009)		
Richard S. Mully Dublin Member (until 27.3.2009)	Managing Partner Grove International Partners (UK) LLP, London/Great Britain				Member (until 27.3.2009)
Dr. Albert Peters Berlin Member (13.8. to 4.12.2009)	Head of the Tax department in the Federal Ministry of Finance				
Hans-Jörg Vetter Koenigstein Member (until 13.8.2009)	Chairman of the Management Board of Landesbank Baden-Württemberg, Stuttgart	Member (until 13.8.2009)		Member (until 13.8.2009)	
Manfred Zaß Koenigstein Member (until 13.8.2009)	Chairman of the Supervisory Board of Deutsche Euroshop AG, Hamburg				Member (until 13.8.2009)

Management Board of HRE Holding as of 25.1.2010 Name, place of residence	Function in the Management Board
Dr. Axel Wieandt Koenigstein	Chairman
Manuela Better Munich	Member (from 1.2.2009)
Dr. Kai Wilhelm Franzmeyer Bad Homburg	Member
Frank Krings Hofheim	Member
Dr. Bernhard Scholz Regensburg	Member (from 1.1.2010)
Alexander Freiherr von Uslar-Gleichen Gruenwald	Member (from 1.10.2009)
Cyril Dunne Dublin	Member (until 31.1.2009)
Dr. Robert Grassinger Neufarn	Member (until 31.1.2009)
Bettina von Oesterreich Munich	Member (until 31.1.2009)

87 Holdings of HRE Holding

Holdings of HRE Holding as of 31.12.2009 Name and place of business	Interest in % Total Sec 16 (4) Stock Corp. Act	of which held indirectly	Currency	Total asset in thousand	Equity in thousand	Net income/loss in thousand	Alternative financial year
Subsidiaries							
Consolidated subsidiaries							
Banks and financial institutions							
Domestic banks and financial institutions							
Deutsche Pfandbriefbank AG, Munich	100.00	—	€	272,944,403	2,491,097	−1,660,120	—
Foreign banks and financial institutions							
DEPFA ACS Bank puc, Dublin	100.00	100.00	€	83,064,546	585,264	21,625	—
DEPFA Bank plc, Dublin	100.00	—	€	157,745,522	634,367	−320,067	—
DEPFA Bank Europe plc, Dublin	100.00	100.00	€	34,054	26,383	399	—
Hypo Pfandbrief Bank International S.A., Luxembourg	100.00	100.00	€	8,053,396	158,439	3,117	—
Hypo Public Finance Bank puc, Dublin	99.99	99.99	€	1,465,816	526,522	15,838	—
Hypo Public Finance USA Inc., New York	100.00	100.00	US $	1,311,022	15,113	−62,887	—
Hypo Real Estate Capital Hong Kong Corporation Ltd. i.L., Hong Kong	100.00	100.00	HK $	799,330	−54,303	−63,265	—
Hypo Real Estate Capital India Corporation Private Ltd., Mumbai	100.00	100.00	INR	375,857	317,320	9,500	—
Hypo Real Estate Capital Singapore Corporation Private Ltd., Singapore	100.00	100.00	SG $	631,150	2,021	804	—
Other consolidated subsidiaries							
DEPFA Asset Management Romania S.A. i.L., Bucharest	100.00	90.00	€	1,249	1,156	−120	—
DEPFA Bank Representacoes Ltda.i.L., São Paulo	100.00	100.00	€	—	—	—	—
DEPFA Finance N.V., Amsterdam	100.00	100.00	€	1,230,640	3,298	554	—
DEPFA Funding II LP, London	100.00	100.00	€	407,319	4,417	25,929	—
DEPFA Funding III LP, London	100.00	100.00	€	300,311	7,787	25,814	—
DEPFA Funding IV LP, London	100.00	100.00	€	560,576	15,533	20,976	—
DEPFA Hold Six, Dublin	100.00	100.00	US $	—	—	—	—
DEPFA Investment Bank Ltd. i.L., Nicosia	100.00	100.00	€	—	—	—	—
DEPFA Ireland Holding Ltd., Dublin	100.00	100.00	US $	265,049	−5,238	−911	—
Flint Nominees Ltd., London	100.00	100.00	GB £	228,669	50,300	1,024 [4)]	—
Hypo Property Investment (1992) Ltd., London	100.00	100.00	GB £	1	1	—	—

Holdings of HRE Holding as of 31.12.2009 Name and place of business	Interest in % Total Sec 16 (4) Stock Corp. Act	of which held indirectly	Currency	Total asset in thousand	Equity in thousand	Net income/loss in thousand	Alternative financial year
Hypo Property Investment Ltd., London	100.00	100.00	GB £	497	497	136[4]	—
Hypo Property Participation Ltd. i.L., London	100.00	100.00	GB £	240	238	1	—
Hypo Property Services Ltd., London	100.00	100.00	GB £	112	112	1	—
Hypo Real Estate Capital Corp., New York	100.00	100.00	US $	6,019,163	459,079	32,951[4]	—
Hypo Real Estate Capital Japan Corp., Tokyo	100.00	100.00	JP ¥	285,794,682	29,988,776	−124,900	—
Hypo Real Estate Finance B.V. i.L., Amsterdam	100.00	—	€	276	18	—	—
Hypo Real Estate International LLC I, Wilmington	100.00	100.00	€	381,941	59	33	—
Hypo Real Estate International Trust I, Wilmington	100.00	100.00	€	381,741	57	7	—
Hypo Real Estate Investment Banking Ltd. i.L., London	100.00	100.00	GB £	—	—	−96[4]	—
Hypo Real Estate Systems GmbH, Munich	100.00	100.00	€	36,649	2,615	1,792[1]	—
Hypo Real Estate Transactions S.A.S., Paris	100.00	100.00	€	59,940	65	33	—
IMMO Immobilien Management GmbH & Co. KG, Munich	94.00	94.00	€	6,385	−6,319	−4,392	—
Liffey Belmont I LLC i.L., Wilmington	100.00	100.00	US $	1,042	1,021	—	—
Liffey Belmont II LLC i.L., Wilmington	100.00	100.00	US $	1,378	1,350	—	—
Liffey Belmont III LLC i.L., Wilmington	100.00	100.00	US $	1,152	1,129	—	—
Liffey Camelback LLC i.L., Wilmington	100.00	100.00	US $	17,017	1,500	—	—
Liffey NSYC LLC i.L., Wilmington	100.00	100.00	US $	40,181	2,600	—	—
Quadra Realty Trust, Inc. i.L., Maryland	100.00	100.00	US $	—	—	641	—
Ragnarök Vermögensverwaltung AG & Co. KG, Munich	94.00	94.00	€	8,657	−1,447	−1,547[3]	—
The Greater Manchester Property Enterprise Fund Ltd. i.L., London	100.00	100.00	GB £	—	—	−133[4]	—
WH-Erste Grundstücks GmbH & Co. KG, Schoenefeld	93.98	93.98	€	83,387	78,803	−25,484	—
WH-Zweite Grundstücks GmbH & Co. KG, Schoenefeld	93.98	93.98	€	44,764	42,299	−25,574	—
Zamara Investments Ltd. i.L., Gibraltar	100.00	100.00	GB £	89	81	−11,506[4]	—

Holdings of HRE Holding as of 31.12.2009 Name and place of business	Interest in % Total Sec 16 (4) Stock Corp. Act	of which held indirectly	Currency	Total asset in thousand	Equity in thousand	Net income/loss in thousand	Alternative financial year
Non- consolidated subsidiaries							
Other non-consolidated subsidiaries							
DBE Property Holdings Ltd., Dublin	100.00	100.00	€	75	58	2	—
DEPFA Hold Four Ltd. i.L., Dublin	100.00	100.00	€	—	—	—	—
DEPFA Hold One Ltd., Dublin	100.00	100.00	€	—	—	—	—
DEPFA Hold Three Ltd. i.L., Dublin	100.00	100.00	€	—	—	—	—
DEPFA Hold Two Ltd., Dublin	100.00	100.00	€	—	—	—	—
DEPFA Royalty Management Ltd. i.L., Dublin	100.00	100.00	€	—	—	—	—
Frappant Altona GmbH, Munich	88.40	88.40	€	11,883	26	[2]	—
FSHC Guernsey Holdings Ltd., Guernsey	6.03	6.03	GB£	—	—	—	—
FSHC Jersey Holdings Ltd., Jersey	6.03	6.03	GB£	—	—	—	—
FUNDUS Gesellschaft für Grundbesitz und Beteiligungen mbH, Munich	94.00	94.00	€	3,360	904	[1]	—
GfI-Gesellschaft für Immobilienentwicklung und -verwaltung mbH i.L., Stuttgart	100.00	100.00	€	15	11	4	1.1.–31.12.2008
Hypo Dublin Properties Limited, Dublin	100.00	100.00	€	157	62	59	—
Immo Immobilien Management Beteiligungsgesellschaft mbH, Munich	100.00	100.00	€	35	35	−1	—
IMMO Invest Real Estate GmbH, Munich	100.00	100.00	€	3,514	28	[1]	—
IMMO Trading GmbH, Munich	100.00	100.00	€	1,817	525	[1]	—
Meridies Grundbesitz- und Bebauungsgesellschaft mbH, Munich	94.00	94.00	€	724	78	[1]	—
Quadra QRS, LLC i.L., Maryland	100.00	100.00	US$	—	—	—	—
WestHyp Immobilien Holding Aktiv Bau GmbH, Munich	100.00	100.00	€	33	−27	37	1.1.–31.12.2008
WestHyp Immobilien Holding GmbH, Munich	100.00	100.00	€	882	734	105	1.1.–31.12.2008
WH-Erste Grundstücks Verwaltungs GmbH, Schoenefeld	100.00	100.00	€	307	295	18	—
WH-Zweite Grundstücks Verwaltungs GmbH, Schoenefeld	100.00	100.00	€	19	19	—	—

Holdings of HRE Holding as of 31.12.2009

Name and place of business	Interest in % Total Sec 16 (4) Stock Corp. Act	of which held indirectly	Currency	Total asset in thousand	Equity in thousand	Net income/loss in thousand	Alternative financial year
Associated companies							
Associated companies valued using the equity method							
Other companies							
Aerodrom Bureau Verwaltungs GmbH, Berlin	32.00	32.00	€	714	−702	−10	1.1.–31.12.2007
Airport Bureau Verwaltungs GmbH, Berlin	32.00	32.00	€	713	−661	−41	1.1.–31.12.2007
Archplan Projekt Dianastraße GmbH, Munich	33.20	33.20	€	192	−135	−24	1.1.–31.12.2008
Burleigh Court (Barnsley) Management Limited, London	20.00	20.00	GB£	—	—	—	—
Kondor Wessels – WestHyp Immobilien Holding GmbH i.L., Berlin	33.30	33.30	€	740	−562	−55	1.1.–31.12.2008
Logicité S.A.S., Guyancourt	42.50	42.50	€	16,786	37	—	—
Projektentwicklung Schönefeld Verwaltungsgesellschaft mbH, Stuttgart	50.00	50.00	€	29	28	—	1.1. 31.12.2008
Riedemannweg 59–60 GbR, Schoenefeld	32.00	32.00	€	11,315	−4,761	47	1.1.–31.12.2008
SANO Grundstücks-Vermietungsgesellschaft mbH & Co. Objekt Dresden KG, Duesseldorf	33.33	33.33	€	13,614	−4,122	−219	1.1.–31.12.2008
SOMA Grundstücks-Vermietungsgesellschaft mbH & Co. Objekt Darmstadt KG, Duesseldorf	33.33	33.33	€	35,659	−8,492	−705	1.1.–31.12.2008
SP Projektentwicklung Schönefeld GmbH & Co. KG, Stuttgart	50.00	50.00	€	16,734	15,372	−4,538	1.1.–31.12.2008
Vierte Airport Bureau Center KG Airport Bureau Verwaltungs GmbH & Co., Berlin	32.00	32.00	€	10,859	−2,183	335	1.1.–31.12.2008
Wisus Beteiligungs GmbH & Co. Zweite Vermietungs-KG, Munich	33.00	33.00	€	10,970	−3,182	164	1.1.–31.12.2008
Other investments							
Other companies							
ILLIT Grundstücks- und Verwaltungsgesellschaft mbH & Co. KG i.L., Gruenwald	5.00	5.00	€	67,625	−17,227	−2,531	1.1.–31.12.2008
Inula Grundstücks-Verwaltungsgesellschaft mbH & Co. KG, Gruenwald	10.00	10.00	€	95,646	−45,703	1,284	1.1.–31.12.2008
JER Europe Fund III, L.P., London	0.31	0.31	GB£	—	—	—[5]	—
KOROS Grundstücks-Verwaltungs GmbH & Co. KG, Gruenwald	2.50	2.50	€	18,491	−8,818	463	1.1.–31.12.2008
S.W.I.F.T. SCRL, La Hulpe	0.04	0.04	€	1,003,304	524,562	49,460	1.1.–31.12.2008
The India Debt Opportunities Fund Ltd. i.L., Mauritius	> 0	> 0	US$	107	—	10,421	—
WILMA Bouwfonds Bauprojekte GmbH & Co. "An den Teichen" KG, Ratingen	5.00	5.00	€	117	86	32	1.1.–31.12.2007

[1] Profit transfer by shareholders on the basis of profit and loss transfer agreement
[2] Profit transferred by Meridies Grundbesitz- und Bebauungsgesellschaft mbH, Munich, on the basis of profit and loss transfer agreement
[3] General partner liability (Komplementärhaftung) of Deutsche Pfandbriefbank AG
[4] Result including dividend distributions received/paid
[5] Figures for this company were not available at the time of preparation

Exchange rates		
1 € equates to		**31.12.2009**
Australia	AU $	1.6008
Great Britain	GB £	0.8881
Hong Kong	HK $	11.1709
India	INR	67.0400
Japan	JP ¥	133.1600
Romania	RON	4.2363
Singapore	SG $	2.0194
USA	US $	1.4406

Munich, 12 March 2010

Hypo Real Estate Holding Aktiengesellschaft
The Management Board

Dr. Axel Wieandt

Manuela Better

Dr. Kai Wilhelm Franzmeyer

Frank Krings

Dr. Bernhard Scholz

Alexander von Uslar

We have audited the consolidated financial statements prepared by Hypo Real Estate Holding AG, Munich – the balance sheet, the income statement, the statement of comprehensive income, statement of changes in equity, cash flow statement and notes to the consolidated financial statements – together with the group management report for the business year from 1 January to 31 December 2009. The preparation of the consolidated financial statements and the group management report in accordance with IFRSs, as adopted by the EU, and the additional requirements of German commercial law pursuant to § 315a Abs. 1 HGB [Handelsgesetzbuch “German Commercial Code”] are the responsibility of the parent company’s management. Our responsibility is to express an opinion on the consolidated financial statements and on the group management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with § 317 HGB [Handelsgesetzbuch “German Commercial Code”] and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements in accordance with the applicable financial reporting framework and in the group management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the consolidated financial statements and the group management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of those entities included in consolidation, the determination of entities to be included in consolidation, the accounting and consolidation principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements and group management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the consolidated financial statements comply with IFRSs, as adopted by the EU, the additional requirements of German commercial law pursuant to § 315a Abs. 1 HGB and give a true and fair view of the net assets, financial position and results of operations of the Hypo Real Estate Group in accordance with these requirements. The group management report is consistent with the consolidated financial statements and as a whole provides a suitable view of the Group’s position and suitably presents the opportunities and risks of future development.

Without qualifying our opinion we refer to the passages in the group management report concerning “Risks threatening the existence” [“Bestandsgefährdende Risiken”] as well as in the condensed notes under number one. There it is mentioned that the future existence of the Hypo Real Estate Holding AG as a going concern is dependent on the assumption that sufficient equity will be provided to the Hypo Real Estate Holding AG and its significant subsidiaries to fulfil regulatory capital requirements as well as to avoid a situation of sustained over-indebtedness. External liquidity support is necessary to avert insolvency due to illiquidity of the significant subsidiaries of the Hypo Real Estate Holding AG or the Hypo Real Estate Holding AG itself. These liquidity supports must be available until the Hypo Real Estate Holding AG and its significant subsidiaries are capable of raising sufficient liquidity on the money and capital market by themselves, and until the agreed restructuring arrangements are implemented and the equity capital increase is performed as scheduled.

To ensure the future existence of the Hypo Real Estate Holding AG and its significant subsidiaries as a going concern it is thus particularly necessary that

- the German Finanzmarktstabilisierungsfonds provides sufficient support in form of equity capital,
- the German Finanzmarktstabilisierungsfonds and the Deutsche Bundesbank maintain their liquidity support and, if necessary, provide further liquidity assistance,
- refinancing with sustainable conditions on the money and capital market occurs,
- the restructuring arrangements will be implemented as scheduled
- the appropriate authorities do not take regulatory actions, and
- no legal reservations (especially EU legal actions) will be successfully enforced.

Munich, 12 March 2010

KPMG AG
Wirtschaftsprüfungsgesellschaft

Dielehner	Wiechens
Wirtschaftsprüfer	Wirtschaftsprüfer
[German Public Auditor]	[German Public Auditor]

Service Chapter

Glossary

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

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

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

Assets book Risk-carrying positions that are not allocated to the ≫trading book.

Asset finance Asset finance is funding to acquire additional assets to drive a business forward. Virtually any asset can be financed including IT, software, refurbishment, machinery, etc.

Available-for-sale assets Financial assets that are available for the Company to sell and that do not relate to loans, financial instruments held for trading or ≫held-to-maturity financial instruments. Available-for-sale financial instruments include in particular fixed-income securities that cannot or should not be held to maturity and also equity instruments with no final maturity.

Basel II The term Basel II stands for a new capital adequacy framework, which was presented by the Basel Committee on Banking Supervision in summer 2004. The committee meets on a regular basis at the Bank for International Settlements (BIS) and is formed by representatives of the central banks and banking supervisors of the major developed nations. It gives general strategic recommendations on the framework and standards for banking supervision. In comparison to the first capital adequacy framework (Basel I) from 1988, Basel II will define new general conditions for the measurement of risk-weighted assets and the minimum capital requirements for credit institutions.

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

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

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

Bonds Term used in English-speaking countries for fixed-income securities and/or debentures.

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

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

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

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

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

Commercial mortgage-backed security (CMBS) A type of ≫mortgage-backed security (MBS) on commercial real estate.

Commercial paper (CP) Money market instruments in the form of bearer instruments that do not have standardised maturities but can be geared to individual investment requirements and are paid on a discount basis. Their maturities vary between 1 and 270 days. They are issued on the money market by debtors with an irreproachable credit standing, usually first-class industrial corporations; they are issued in high amounts and with high minimum nominal values.

Concentration risk Risk resulting from concentration of the credit risk on a single party (counterparty, issuer, country or borrowing customer) in the portfolio or among a group of parties that over a period of time exhibit a parallel development in terms of probability of default caused, for example, by similar economic dependencies. Synonym: cluster risk.

Corporate governance Corporate governance refers to the legal and factual framework for managing and monitoring companies. The recommendations of the Corporate Governance Code create transparency and are intended to strengthen confidence in a good and responsible management; they are primarily aimed at protecting shareholders.

Cost-income ratio Relationship between general administrative expenses and the total of net interest income and similar income, net commission income, net trading income, net income from investments and balance of other operating income/expenses; a low cost-income ratio indicates high productivity.

Counterparty risk Risk that, as a result of default on the part of a contracting partner, it will no longer be possible to collect an unrealised profit from outstanding interest and currency-related derivative and futures transactions. The counterparty risk is differentiated according to performance risk (from the value date until performance) and exchange/pre-settlement risk (from the date of conclusion until the value date).

Country risk Risk that a business partner in a certain country will be unable to fulfil his contractually agreed obligations due to political or social unrest, nationalisation or expropriation, non-recognition by governments of foreign debts, currency controls or a devaluation of the national currency.

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

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

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

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

Debt service coverage margin Relationship between the net income that can be earned from a property and the debt service applicable to the property in question.

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

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

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

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

Developer Developers develop and execute real estate projects (generally large commercial projects) with the aim of securing a swift sale.

Earnings per share Indicator comparing the net income for the year after taxes with the average number of ordinary shares.

Fair value Amount at which an asset would be exchanged or a debt settled between expert, independent, willing business partners; often identical with the market price.

Fair-value hedge Hedging of a fixed-income balance sheet position (e.g. a receivable or a security) against the market risk by means of a ≫swap; it is valued at market value (≫fair value).

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

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

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

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

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

German Minimum Requirements for the Conduct of Lending Business (MaK) Minimum requirements that must be met by all lending institutes in order to limit risks from lending business, taking into account the respective type and extent of business conducted.

German Minimum Requirements for the Conduct of Trading Operations (MaH) Minimum requirements that must be complied with by all financial institutes in order to secure solvency and must be supplemented/specified in more detail in internal instructions, taking into account the respective type and extent of trading activities. They include requirements with regard to risk control and risk management, the organisation of trading operations and auditing, as well as regulations for specific transaction types. They were issued in October 1995 by the Federal Banking Supervisory Office (BaKred), which is now known as the Federal Financial Supervisory Office (BaFin).

Goodwill Amount that a purchaser of a company pays in excess of the ≫fair value of the individual assets after deducting debts (= intrinsic value), taking into account future expected earnings (= net income value).

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

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

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

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

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

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

Issuer risk Losses of own-portfolio securities due to a deterioration in the credit standing of or default on the part of an issuer.

Lending risk Risk that a business partner will not fulfil his contractual payment obligations. The lending risk includes ≫default, ≫country and settlement risks.

Liquidity facility The obligation to provide liquidity to a contract partner. The purpose of the liquidity facility is to ensure that the payments are forwarded smoothly and on time. It provides a cushion for the risk if any payment problems arise. Regulatory conditions are attached to the drawing of a liquidity facility.

London Interbank Offered Rate – LIBOR Benchmark rate in interbank operations, which is determined daily by the main international banks of the British Banker's Association in London. Banks are able to raise funds or be offered funds from other banks on the basis of the rates.

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

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

Market risk position The market risk position pursuant to Principle I includes foreign currency, commodity and options risks as well trading-book risk positions such as risks relating to interest rates and share prices as well as ≫ credit risks pertaining to the trading book.

Mezzanine finance Term used to describe forms of finance that have characteristics of both debt and equity.

Monoliner A monoline insurer, in the context of financial markets, guarantees the repayment of bonds.

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

On-balance-sheet lender A loan creditor who is able to incur risks on his own balance sheet.

Operational risk The risk of direct or indirect losses resulting from the inappropriateness or failure of human beings, technical systems, internal procedures or external events (definition pursuant to Basel II).
Operational risks are not usually entered into consciously; such risks are not subject to diversification and are difficult to narrow down.
Examples: human error, faulty management processes, criminal actions, fraud, natural disasters (fire, etc.), technical failures, departure of key employees.

Option An option grants the purchaser the right to purchase (= purchase option or call) or sell (= put option or put) a specific quantity of the item underlying the option (e.g. a security or currency) from or to a contracting partner (option writer) at a price determined when the contract is concluded (= strike). The option can be exercised either on a date specified in advance or during a period specified in advance; the purchaser pays an option premium for this right.

Participation certificate Certification of participatory rights issued by companies of all legal forms and admitted to official (stock exchange) trading. Under certain circumstances, participatory certificates may be allocated to liable equity capital.

Rating Risk rating of a debtor (internal) and/or assessment of the credit standing of an issuer and its debt instruments by specialised agencies (external).

Repo transaction Short-term money-trading transaction backed by securities.

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

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

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

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

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

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

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

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

Senior lender Financer of first priority loans.

Solvency The extent to which an insurer or credit institution is provided with own funds. Own funds back the claims of policy holders or creditors. The greater the solvency, the greater is the backing for these claims.

Standard risk costs Average risk costs and/or valuation adjustments due to loan losses that are expected within a given year.

Swap In principle, an exchange of payment flows: an exchange of fixed and variable interest payment flows in the same currency (= interest rate swap) and/or exchange of payment flows in different currencies (= currency swap).

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

Total return swap Swap between the assignee and the guarantor with respect to the income from and changes in valuation of the underlying financial instruments. In addition to the lending risk, the guarantor also assumes the price risk resulting from the underlying financial instrument, in return for a corresponding interest payment.

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

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

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

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

Financial Calendar 2010

26 March 2010	Publication of the results for the year 2009
7 May 2010	Publication of the results for the first quarter of 2010
13 August 2010	Publication of the results for the second quarter of 2010
5 November 2010	Publication of the results for the third quarter of 2010

Addresses

Hypo Real Estate Holding AG
Freisinger Straße 5
85716 Unterschleißheim
Germany
Telephone +49(0)89 2880-0
Fax +49(0)89 2880-12100
info@hyporealestate.com
www.hyporealestate.com

Deutsche Pfandbriefbank AG
Freisinger Straße 5
85716 Unterschleißheim
Germany
Telephone +49(0)89 2880-0
Fax +49(0)89 2880-12100
info@pfandbriefbank.com
www.pfandbriefbank.com

DEPFA Bank plc
1 Commons Street
Dublin 1
Ireland
Telephone +353 1 7922222
Fax +353 1 7922211
info@depfa.com
www.depfa.com

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Future-oriented Statements

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

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KMS TEAM GmbH, Munich

Hypo Real Estate Holding AG
Freisinger Straße 5
85716 Unterschleißheim
Germany
Telephone +49(0)89 2880-0
Fax +49(0)89 2880-28772
www.hyporealestate.com