DEPFA BANK

Annual Report 2012

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Economic review

The following is a commentary on the global and sector specific economic environments in which the DEPFA Group has operated during 2012.

Whilst an improvement on 2011, the economic and political environment in 2012 continued to be dominated by the Euro area crisis and a number of factors weighed on sentiment throughout the year. These included; concerns over Spain and its banking sector and to a lesser extent that of Cyprus and Slovenia; fears of a Greek exit (continuing political instability following the May general election and ongoing problems meeting the terms of its second bailout); fears of an economic hard landing in China; increased concerns over the fiscal cliff faced by the US in the fourth quarter and ongoing Middle East geopolitical risks. Despite these factors, policy makers eventually responded to prevent the escalation of most of these and thus helped to reduce tail risks through the year. The most important of these measures was arguably the announcement of the European Central Bank's ("ECB") bond purchase programme, the Outright Monetary Transactions programme ("OMT") in September which has served as the notable inflection point for the current Euro area crisis.

Global economic activity in 2012 ebbed and flowed as a result of the above developments. Overall, it is estimated that global growth fell from 3.9% in 2011 to 3.2% in 2012. Weakness was most stark in the Euro area as consolidation efforts continued to undermine the economic environment. The EMU is estimated to have contracted by 0.5% following a 1.4% expansion in 2011. Peripheral Europe continued to contract most sharply with notable contributions coming from Italy (–2.2%) and Spain (–1.4%). Whilst similar weakness was seen in the UK (–0.03%), some non-European major economies posted more solid growth, including the US (2.2% following 1.8% in 2011) and Japan (2.0% following –0.6% in 2011), whilst growth rates notably dipped in both Latin America (3.0% following 4.5%) and developing Asia (6.6% following 8.0%). In general, greater weakness was seen in the second half of the year due to the lagged effect of both the global fiscal contraction and the general investor uncertainty.

Policy developments

Over the course of the year there was an emerging acceptance amongst policy makers that growth was a key component in the potential success of the fiscal adjustment process and hence there was a greater emphasis on pro-growth policy and a general extension of the time frame for achieving fiscal targets. Nevertheless, fiscal consolidation continued, especially in the Euro area. This was reinforced by ongoing support from various lenders of last resort (the International Monetary Fund ("IMF"), the Eurogroup and the various Central Banks). At the end of February, the ECB allotted almost €530 billion to around 800 banks in its second Long Term Refinancing Operation ("LTRO") which was judged as successful in alleviating funding pressures for both banks and sovereigns. This was followed up by a reduction in the main refinancing rate from 1.00% to 0.75% in July and, most importantly, its new OMT programme which provides unlimited capacity for the purchase of government bonds and hence represents a de facto lender of last resort (within the terms of an associated memorandum of understanding). At a European level, other developments included the expansion of the European Financial Stability Facility ("EFSF")/European Stability Mechanism ("ESM") firewall; financial support offered to Spain to help recapitalise its banking sector; the announcement that ESM funds could eventually be used to directly recapitalise banks and a general move towards closer fiscal integration. In addition, the Greek debt restructuring exercise and Private Sector Involvement ("PSI") went relatively smoothly in March and further relief was offered by international lenders in December (lower interest rates, maturity extensions, debt buybacks) following fiscal commitments from the Greek government. This was a clear signal that the Eurogroup were committed to keeping Greece within the single currency area and Greek government bonds benefited accordingly.

Meanwhile, all other major central banks maintained rates at their historically low level throughout the year with the US Federal Reserve committing to near-zero interest rates as long as the unemployment rate remains above 6.5%. As a sign that emerging markets were also feeling the impact of the decline in global demand, many of their central banks commenced monetary easing campaigns. Quantitative easing programmes were also expanded by the major central banks with the US Federal Reserve, the Bank of England and the Bank of Japan all announcing an increase in their security purchase ceilings. Most of the fourth quarter focus revolved around the prospects for the US fiscal cliff, whereby both major parties sought agreement to prevent an automatic fiscal withdrawal of more than 4% of GDP in 2013. After much wrangling, a last minute agreement was formed to avoid the "fiscal cliff" although the issues of the debt ceiling and long-term spending cuts still need to be resolved in 2013.

Financial market developments

Although there were bouts of financial market volatility during 2012, the year was generally less volatile than 2011. This is seen clearly from the Chicago Board Options Exchange Market Volatility Index ("VIX"), which averaged the year at 18.0 (peak of 26.7) compared to 2011 where the index averaged 24.4 (peak of 48.0). Although capital flows to peripheral Europe and emerging markets were slower in the first half of the year, stronger investor appetite in the second half of the year led to a significant increase in such flows. Additional quantitative easing, global growth concerns and acute phases of the Euro crisis prompted a sharp demand for safe haven assets during the summer and drove core government yields to all-time lows with many countries experiencing negative yields at the short end. Despite some recovery, yields remained low for the remainder of the year with real yields deeply negative. Although the Euro was weaker on average versus the dollar in 2012 than 2011 ($1.286 in 2012 versus $1.3922 in 2011) it ranged for most of the year between $1.27 and $1.33 and finished the year around 2% stronger than it started. The Japanese Yen was the worst performing G-10 currency (down 14.9% against the Euro). The price of oil was down on the year given the global slowdown whilst gold was up for the twelfth year in a row.

Sovereign credit continued to be the main driver of spreads during the year. The general trend was lower spreads as investors became less concerned with tail risks over the course of the year. The main exception was the second quarter where fears of a Greek exit and heightened concerns over Spain led to a reduction in risk appetite. Not surprisingly, the strongest spread compression came in the third quarter following the ECB's OMT announcement. That significantly eased financial conditions in peripheral Europe and precipitated a broader-based loosening of monetary conditions across the Euro area. The most notable spread compression was in Portugal and Ireland where 5 year Credit Default Swap ("CDS") spreads contracted by 644bps and 506bps respectively over the course of the year. The ITRAXX Western European Sovereign Index reached its lowest level since April 2010, contracting by 245bps to reach 111bps at year end. Equity markets also posted a strong year. The Standard & Poor's index was up 13.4% whilst the DAX was up 29.1%. The best performance in Europe was Greece (33.4%), albeit from a low base, whilst a notable underperformer was Spain (–4.7%).

Banking sector

The banking sector generally improved its fundamentals in 2012 by continuing to deleverage, reduce costs and boost equity. Despite the glut of banking sector funding needs in the first half of 2012, liquidity conditions for banks improved over the year, helped mainly by the ECB's second LTRO where it allotted a total of €530 billion to around 800 banks (€490 billion was drawn down by 523 banks in December 2011). Liquidity conditions were also boosted by the ECB's full allotment policy for refinancing operations, including a new three-month facility as well as the extension of collateral eligibility. Three-month Euribor fell consistently over the year, starting at 1.34% and finishing the year at 0.19% (0.57% average versus 1.39% in 2011). The absence of major financial stress was also seen in the Euribor to Overnight Index Swap ("OIS") spread, which having started the year close to 100bps, fell below 12bps by year end (its lowest level in nearly five and a half years).

Despite these super easy liquidity conditions, lending conditions remain tight amid the ongoing deleveraging process, especially in Europe. Credit standards tightened for loans to enterprises over the year whilst remaining fairly stable for consumer loans. Bank credit risk also fell through the year. Having started the year at just under 280bps, the Markit ITRAXX Europe Senior Financial Index finished the year at 141bps, with the second quarter being the only quarter of widening spreads. Meanwhile the rating agencies maintained a negative outlook for most countries' banking sectors during 2012 and downgraded a number of major global banks citing significant exposure to the volatility and risk of outsized losses inherent to capital market activities. Senior bank debt continued to receive significant support from the European authorities with no losses being imposed on any investors holding senior unsecured debt in any Euro area bank, irrespective of its solvency position. However, the authorities announced in early June that such implicit support cannot be counted on in future as they provided some details of a bank resolution regime that will come into effect from 2018. In this way, they are attempting to break the negative feedback loop that currently exists between sovereigns and their respective banking sectors.

Public sector

The public sector remained firmly at the forefront of economic and market developments in 2012. Most countries continued to make significant headway in rolling back fiscal deficits. This is especially the case in the Euro area periphery, where the fiscal shock was larger, whilst the adjustment has been less noteworthy in other countries where market pressure was less evident. In the Euro area, the deficit is estimated at 3.3% of GDP in 2012 (4.1% in 2011). Although some other major economies have seen deficits narrow, the level remains significantly higher than the Euro area. For example, the deficit in 2012 is estimated at 8.3% of GDP for the US, 6.4% for the UK and 10.1% for Japan. In particular, the fourth quarter fiscal cliff debate in the US has brought the sustainability of the US public finance position sharply into focus. Despite the improvement in the deficits, efforts at controlling debt stocks are taking longer to yield results. The debt ratio in the Euro area is estimated at 93.6% (88% in 2011), compared with 106.6% in the US, 89.5% in the UK and 235% in Japan.

Public debt rollover requirements were still very high in 2012 and exposed countries to the vagaries of financial markets. However, because of the ample liquidity provided by central banks in support of economic activity, markets have in most cases taken large increases in public debt in their stride. Moreover, although solvency concerns remained elevated for a subset of Euro area countries, they could still finance themselves either through official support or the promise thereof. In this regard, the European Union and its institutions have shown that, whilst policy decisions are slow, it is willing and able to act in a significant manner in order to prevent the crisis from reaching a critical and irreversible phase. For sub-sovereign entities adversely affected by the economic weakness and lower transfers, the presumption of central government support has been affirmed and we continue to see many instances of sovereign funding/liquidity support when needed, most notably in Spain. However, given the inability of the sovereigns to provide unconditional support to all public sector entities, public sector reform continued apace, forcing more public sector entities to re-structure and/or privatise. Ratings for public sector entities continued their downward trend in 2012, with sovereign downgrades being the biggest driver. A number of ratings outlooks did stabilise however, especially in core Europe, which may indicate that the worst may be behind us. Given that the pace of consolidation is slower for some non-European sovereigns, further downward pressure is likely for some core global economies. For example, the US and UK are on negative outlook by all rating agencies.

Directors and other information

Board of Directors

Ms. M. Better [1] Chairman (German)
Dr. J. Bourke [1]
Mr. C. Dunne (resigned 31 January 2012)
Ms. F. Flannery
Mr. T. Glynn (American) (Chief Executive Officer – CEO)
Mr. D. Grehan [1]
Mr. W. Groth [1] (German)
Mr. A. Kearns [1]
Mr. N. Reynolds
Mr. A. von Uslar-Gleichen [1] (German)
Dr. H. Walter [1] (German)

[1] Non-Executive

Audit Committee

Dr. J. Bourke (Chairman)
Mr. A. Kearns
Dr. H. Walter

Board Risk Committee

Ms. M. Better
Dr. J. Bourke
Ms. F. Flannery
Mr. T. Glynn
Mr. D. Grehan
Mr. N. Reynolds
Dr. H. Walter (Chairman)

Secretary & Registered Office

Ms. E. Tiernan
Ms. K. Tempany (appointed 23 July 2012, resigned 4 March 2013)
1 Commons Street
Dublin 1, Ireland

Solicitors

Arthur Cox
Earlsfort Centre
Earlsfort Terrace
Dublin 2, Ireland

Auditors

KPMG
Chartered Accountants
Statutory Audit Firm
1 Harbourmaster Place
IFSC, Dublin 1, Ireland

Registered Number
348819

Directors' report

The directors of DEPFA BANK plc (“the Bank”, “the Company” or “DEPFA”) present their report and the audited consolidated financial statements for the year ended 31 December 2012.

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

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

There was no change in the ownership of the Bank during 2012.

Principal activities The Bank and its subsidiary undertakings (“the DEPFA Group”), operating in Ireland and in other parts of the world, provide a comprehensive range of banking, financial and related services, subject to the conditions imposed by the European Commission’s approval, on 18 July 2011, of the state aid in relation to the stabilisation measures granted to the HRE Group by the Federal Republic of Germany.

Dividends No dividends were paid in 2012 in respect of the year ended 31 December 2011 (2010: € nil). The directors do not propose a dividend in respect of the year ended 31 December 2012.

Directors The names of the directors in office at the date of signing of the audited financial statements for the year ended 31 December 2012 are set out on page 6.

Mr. C. Dunne retired from the Board of Directors of DEPFA BANK plc at the end of his contract on 31 January 2012. Mr. N. Reynolds assumed the board responsibilities of Mr. C. Dunne in addition to his existing board responsibilities.

Directors’ and Secretary’s interest in the share capital The interests of the directors and Company Secretary, in office at 31 December 2012 and of their spouses and minor children in the shares of the Bank or HRE Group undertakings were € nil (31 December 2011: € nil).

No directors held any options on HRE Holding shares at 31 December 2012 (31 December 2011: € nil).

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

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

Subsidiary undertakings Details of subsidiary undertakings are shown in note 51 of the notes to the financial statements.

Branches outside the state The DEPFA Group continues to operate branches within the meaning of Regulation 25 of the European Communities (Accounts) Regulations, 1993, in France, Italy, Japan, United Kingdom and the United States of America.

Takeover bids regulations There is only one class of shares and all of the shares are owned by Hypo Real Estate Holding AG. There are no restrictions on the transfer or voting rights of these shares. For further details please refer to note 34 to the financial statements.

Auditors The auditors, KPMG, Chartered Accountants, Statutory Audit Firm, have indicated their willingness to continue in office in accordance with section 160(2) of the Companies Acts, 1963 to 2012.

Major events

In recent years the DEPFA Group, as part of the HRE Group, has been involved in a process of stabilisation and strategic restructuring. The finalisation of the state aid proceedings between the European Commission and the Federal Republic of Germany in 2011 allows for the DEPFA Group's reprivatisation in the medium-term. The process of strategic restructuring which will enable the functional desegregation of the DEPFA Group from the HRE Group has continued in 2012. These issues are discussed in further detail below.

Proceedings at the European commission

On 18 July 2011, the European Commission approved the state aid in relation to the stabilisation measures granted to the HRE Group by the Federal Republic of Germany. The HRE Group thus obtained the legal and planning certainty necessary for its proper regulation.

The decision of the European Commission related to all elements of aid granted to the HRE Group since the autumn of 2008, i.e. capitalisations, guarantee lines and the transfer of certain non strategic positions to the deconsolidated environment FMS Wertmanagement and required the HRE Group to take appropriate compensation measures.

The consequence of the decision of the European Commission in 2011 is that the companies within the DEPFA Group will not conduct any new business until they are reprivatised. This is not applicable for measures carried out as part of bank, risk and refinancing management which is necessary for regulatory purposes and which has the aim of maintaining value and also within the framework of managing the DEPFA ACS BANK and Hypo Pfandbrief Bank International S.A. cover pools.

The DEPFA Group may be sold in the medium-term and its complete reprivatisation is a medium-term objective. Measures initiated in 2011 to sever the links between the companies of the DEPFA Group and the other companies of the HRE Group are continuing and substantial progress has been achieved in 2012.

Transfer of non strategic positions to FMS Wertmanagement

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

Within the framework of the transfer of certain non strategic positions from the HRE Group to FMS Wertmanagement, the FMSA reserved the right to stipulate a payment condition of up to €1.59 billion in order to avoid distortion of competition.

The European Commission imposed a payment condition in relation to the state aid, namely the complete fulfilment of the payment of the €1.59 billion payment condition to avoid distortions of competition in connection with the utilisation of the deconsolidated environment. In consequence, this payment condition resulted in a subsequent purchase price adjustment in the companies of the DEPFA Group which had transferred certain non strategic positions to FMS Wertmanagement.

In August 2011, the FMSA issued a decree determining that the full amount had to be borne by the DEPFA Group.

A first instalment of €800 million became due and payable in September 2011 and a second instalment of €167 million became due and payable in November 2011. A final instalment of €623 million became due and payable in March 2012. All instalments were paid on their due dates.

The purchase price adjustment did not affect the income statement.

The European Commission also imposed, subject to certain conditions, a requirement to pay further annual fees from the time at which the payment condition is completely settled up to the time of reprivatisation.

The precise terms and conditions of such fees are, at the time of this report, in the course of being negotiated. However, provision has been made in the financial statements for the expected amounts payable.

As with the purchase price adjustment, these fees do not affect the income statement.

On 25 January 2012, in co-ordination with its governing bodies and with the agreement of the FMSA, FMS Wertmanagement reached a fundamental decision with regard to the target model for the servicing of positions transferred from the HRE Group. FMS Wertmanagement plans to set up an independent servicing company for its portfolio management.

Project measures

Following the completion of the state aid proceedings, the HRE Group now focuses on creating the conditions necessary to enable the reprivatisation of the Deutsche Pfandbriefbank Group ("the pbb Group") and the DEPFA Group. A project was started in 2011 with the aim of separating the processes and operations of the pbb Group and the DEPFA Group and also separating the services which are provided by the two subgroups as servicers or subservicers for FMS Wertmanagement. This project has continued in 2012.

Consent solicitation for redemption of preferred securities

On 20 November 2012, DEPFA BANK plc announced a consent solicitation to seek the consent of holders of the preferred securities of three Tier 1 issuing vehicles, namely DEPFA Funding II LP, DEPFA Funding III LP and DEPFA Funding IV LP, to amend the terms and conditions of the securities to allow for a redemption of the securities. This was a voluntary market-based approach which reflects the distressed nature of the securities and which was aimed to allow for the redemption of the securities, thereby optimising and simplifying the capital structure of the DEPFA Group whilst ensuring proper burden sharing as required by the European Commission.

At noteholder meetings on 20 December 2012 the majority of holders of the securities issued by DEPFA Funding II LP and DEPFA Funding IV LP did not vote in favour of the consent solicitation. Accordingly, under the terms of the consent solicitation, the terms and conditions of all three series of securities were not amended and the securities were not redeemed.

Ratings

The DEPFA Group senior unsecured ratings and covered bond ratings are shown in the table below:

Senior unsecured ratings and covered bonds ratings of banks in the DEPFA Group[1]	**31 December 2012**			**31 December 2011**		
Banks in the DEPFA Group[2]	**Fitch Ratings**	**Moody's**	**Standard & Poor's**	**Fitch Ratings**	**Moody's**	**Standard & Poor's**
Long-term rating	BBB+	Baa3	BBB	BBB+	Baa3	BBB
Outlook	Negative	Stable	Stable	Negative	Stable	Stable
Short-term rating	F2	P–3	A–2	F2	P–3	A–2
Asset Covered Securities	A[3,4]	A3	BBB[5]	AAA[6]	Aa3	AA[6]
Lettres de Gage[2]	—	—	AA[6,7]	—	—	AA–[5]

[1] Ratings from mandated rating agencies
[2] DEPFA BANK plc, DEPFA ACS BANK, HYPO Public Finance Bank and Hypo Pfandbrief Bank International S.A. (Hypo Pfandbrief Bank International S.A. and its Lettres de Gage are rated exclusively by Standard & Poor's)
[3] Negative outlook
[4] Affirmed in January 2013
[5] Stable outlook
[6] Rating Watch Negative / Credit Watch Negative
[7] Downgraded to A- and placed on Credit Watch Developing in January 2013

The rating agencies may alter or withdraw their ratings at any time. For the evaluation and usage of ratings, please refer to the rating agencies' pertinent criteria and explanations and the relevant terms of use which are to be considered. Ratings should not substitute individual analysis. Ratings do not constitute any recommendation to purchase, hold or sell securities issued by the DEPFA Group.

The development of ratings is currently heavily driven by exogenous factors such as the ongoing sovereign debt crisis or changes to rating methodologies and parameters applied by the ratings agencies.

Despite a tendentially more critical view towards the banking sector, the senior unsecured ratings assigned by the mandated rating agencies, Fitch Ratings, Moody's and Standard and Poor's, remained unchanged for the banks in the DEPFA Group during 2012. However, all three agencies took negative rating actions on the asset covered securities issued by DEPFA ACS BANK. The CreditWatch Negative assigned by Standard & Poor's to the Lettres de Gage issued by Hypo Pfandbrief Bank International S.A., following the implementation of a new covered bond rating methodology during 2012, had not been resolved by year end 2012.

Review of performance

In the course of the financial year 2012, the DEPFA Group, as part of the HRE Group, attained further milestones on the way towards meeting its own objectives and the requirements of the European Commission. The success of this process along with once-off effects in 2012 are reflected in the financial results. Pre-tax income for 2012 was €68 million compared to €124 million in the previous year. The pre-tax income was affected significantly by positive once-off effects. For instance, there was a positive effect attributable to profits from the buyback of DEPFA ACS BANK asset covered securities that were redeemed before maturity at prevailing market levels on a reverse enquiry basis. This amounted to €61 million in 2012 compared to €143 million for 2011. Also, there was a negative effect attributable to losses from the disposal of financial assets shown under "Financial investments", which amounted to €–11 million in 2012 (2011: €–53 million).

The development in results in 2012 compared with the previous year is detailed in the following table:

Consolidated income statement

€ m	2012	2011
Net interest income	86	196
Net fee and commission expense	–19	–19
Net trading income	41	19
Net expense from financial investments	–11	–53
Net income from hedge relationships	5	4
Other operating income	89	105
Other operating expense	–57	–24
Total operating revenues	**134**	**228**
Provision for/reversals of losses on loans and advances	–32	31
Recovery of losses on loans and advances under financial guarantees	69	-
General administrative expenses	–117	–134
Other income/expenses	14	–1
Pre-tax income	**68**	**124**
Taxes on income	–9	–5
Net income	**59**	**119**

Net interest income declined by 56% to €86 million (2011: €196 million). This decline is primarily attributable to the reduction in profits on buyback of DEPFA ACS BANK asset covered securities that were redeemed before maturity at prevailing market levels on a reverse enquiry basis of €61 million in 2012 (2011: €143 million). Net interest income was also burdened in 2012 due to additional expenses from re-hedging callable liabilities where the related hedging derivative had been called. There was also a reduction in the average holdings of interest bearing assets compared with the previous year.

Net fee and commission expense amounted to €–19 million and was consistent with the corresponding previous year (2011: €–19 million). Fees paid to FMS Wertmanagement for guarantees received on assets not yet transferred and still recognised on the statement of financial position amounted to €–17 million (2011: €–18 million). A revision in the payment schedule of fees payable to the Federal Republic of Germany resulted in an expense of €–2 million in 2012 (2011: €–1 million).

Net trading income of €41 million has increased compared to the previous year (2011: €19 million). Of this, €–25 million (2011: €27 million) is due to market value movements in cross currency basis swaps. Stand-alone derivatives which do not satisfy the criteria of IAS 39 for hedge accounting accounted for €15 million (2011: €–8 million). Trading income includes €51 million (2011: € nil) relating to a change in accounting estimate whereby the DEPFA Group refined its derivative valuation models in 2012 relating to counterparty risk parameters. This effect includes a measure of both the credit risk of the counterparty and the DEPFA Group's own credit risk.

Net expense from financial investments amounted to €–11 million in 2012 (2011: €–53 million). The expense is solely the result of the disposal of financial assets. This was compensated by gains generated by the redemption of liabilities shown under net interest income.

Net income from hedge relationships amounted to €5 million (2011: €4 million). This represents hedge ineffectiveness within the range of 80% to 125% permitted in accordance with IAS 39 and is mainly due to fluctuations in cross currency basis spreads.

Other operating income amounted to €89 million (2011: €105 million), which mainly consisted of income of €81 million from charges to Deutsche Pfandbriefbank AG ("pbb") in relation to asset servicing provided by the DEPFA Group on the positions transferred to FMS Wertmanagement (2011: €93 million). Lower service income corresponded to the lower general administrative expenses. The asset servicing is expected to be completely discontinued by the end of September 2013. Also included are charges to the HRE Group for various supporting activities of €5 million (2011: €7 million) and other income of €3 million (2011: €5 million).

Other operating expense amounted to €–57 million (2011: €–24 million), which included provisions relating to IT costs associated with separating the DEPFA Group's infrastructure and operating processes from that of the HRE Group of €–10 million (2011: €–17 million) and other expenses, which were €–6 million (2011: €–7 million). Also included in 2012 are additional provisions of €–41 million (2011: € nil) in relation to current and expected litigation.

Provisions for/reversals of losses on loans and advances amounted to €–32 million (2011: €31 million). The 2012 figure includes specific loan loss provisions of €–69 million (2011: net write backs €14 million) which relate to exposures which are recoverable under financial guarantee contracts with FMS Wertmanagement There is also a decrease in portfolio-based allowances of €37 million (2011: €17 million). In accordance with IAS 39, portfolio-based allowances are created only for loans and receivables for which there have not yet been any indications of an individual impairment.

Recovery of losses on loans and advances under financial guarantees amounted to €69 million (2011: € nil) and relates to the specific loan losses on exposures guaranteed by FMS Wertmanagement, as referred to above.

General administrative expenses declined to €–117 million in 2012 (2011: €–134 million). Personnel expenses decreased to €–48 million compared to €–53 million in the previous year. The decrease was partially due to the lower average headcount (372 people) compared with the previous year (405 people). Other general administrative expenses amounted to €–69 million and was significantly lower than the corresponding previous year of €–81 million. This was due to lower group insurance costs, lower consultancy fees and lower IT fees incurred in 2012, these costs amounted to €–47 million in 2012 (2011: €–55 million) . The ratio between general administrative expenses and total operating revenues amounted to 87% in the year under review compared to 59% in the prior year.

Other income/expenses amounted to €14 million (2011: €–1 million) and is due to the net movement in provisions created for the strategic refocusing and restructuring of the DEPFA Group.

Pre-tax income amounted to €68 million in 2012 (2011: €124 million).

Taxes on income amounted to €–9 million (2011: €–5 million).

Net income amounted to €59 million in 2012 (2011: €119 million).

Segmental review

The internal reporting structure of the DEPFA Group was reorganised on 1 January 2012 into the following reportable primary business segments, which reflect the basis on which the DEPFA Group is managed by the Board of Directors (being the chief operating decision maker) during 2012:
- DEPFA ACS BANK
- Hypo Pfandbrief Bank International S.A.
- DEPFA BANK plc and other

The business segment DEPFA ACS BANK includes the assets and liabilities in the DEPFA ACS BANK cover pool as well as other ancillary business in that entity.

The business segment Hypo Pfandbrief Bank International S.A. includes the assets and liabilities in the Hypo Pfandbrief Bank International S.A. cover pool as well as other ancillary business in that entity.

DEPFA BANK plc and other includes all other business in the DEPFA Group including asset servicing provided by the DEPFA Group on the positions transferred to FMS Wertmanagement.

DEPFA ACS BANK

Income statement € m	**2012**	**2011**
Net interest income	121	192
Net fee and commission expense	–12	–14
Net trading income/expense	8	–8
Net expense from financial investments	–12	–88
Net expense from hedge relationships	–14	–12
Other operating income	3	–
Other operating expense	–3	–7
Total operating revenues	**91**	**63**
Provision for losses on loans and advances	–3	–1
General administrative expenses	–17	–16
Other expenses/income	–	–
Pre-tax income	**71**	**46**
Taxes on income	–9	–3
Net income	**62**	**43**

Net interest income decreased by 37% to €121 million compared with €192 million in 2011. This decrease was mainly due to a reduction in the contribution to operating revenues from the buyback of the DEPFA ACS BANK's asset covered securities that were redeemed before maturity at prevailing market levels on a reverse enquiry basis. Revenues from buybacks amounted to €61 million in 2012 (2011: €143 million). Net interest income in 2012 also benefitted from short-term basis mismatches, which were closed in the second half of the year.

Net fee and commission expense totalled €–12 million in 2012 (2011: €–14 million), mostly as a result of fees paid to DEPFA BANK plc and Hypo Public Finance Bank for guarantees received on certain assets.

Net trading income/expense totalled €8 million in 2012 (2011: €–8 million), with €3 million (2011: €–8 million) relating to marking to market derivatives that do not qualify for hedge accounting. Trading income includes €5 million (2011: € nil) relating to a change in accounting estimate whereby the DEPFA Group refined its derivative valuation models in 2012 relating to counterparty risk parameters. This effect includes a measure of both the credit risk of the counterparty and the DEPFA Group's own credit risk.

Net expense from financial investments amounted to €–12 million (2011: €–88 million). This result was due to the disposal of financial assets shown under "financial investments". This was compensated by gains generated by the redemption of liabilities shown under net interest income.

Net expense from hedge relationships amounted to €–14 million (2011: €–12 million), relating to hedge ineffectiveness on fair value hedges within the range of 80% to 125% permitted in accordance with IAS 39 and is mainly due to fluctuations in cross currency basis spreads.

Other operating income amounted to €3 million (2011: € nil), which was mainly comprised of foreign currency translation effects.

Other operating expense amounted to €–3 million (2011: €–7 million), which was mainly comprised of provisions relating to IT costs associated with separating the DEPFA Group's infrastructure and operating processes from that of the HRE Group of €–3 million (2011: € nil). In 2011, other operating expense was mainly comprised of foreign currency translation effects.

Provisions for losses on loans and advances amounted to €–3 million (2011: €–1 million), and consisted of an addition to portfolio-based allowances.

General administrative expenses amounted to €–17 million (2011: €–16 million). Administration costs of €–15 million in 2012 (2011: €–14 million) mainly comprised of recharges from other DEPFA Group entities for services provided.

Pre-tax income amounted to €71 million in 2012 (2011: €46 million).

Taxes on income amounted to €–9 million in 2012 (2011: €–3 million).

Net income amounted to €62 million in 2012 (2011: €43 million).

Hypo Pfandbrief Bank International S.A.

Income statement		
€m	2012	2011
Net interest income	8	10
Net fee and commission expense	–	–
Net trading income	20	1
Net income from financial investments	–	–
Net expense from hedge relationships	–1	–3
Other operating income	–	–
Other operating expense	–	–
Total operating revenues	**27**	**8**
Provision for losses on loans and advances	–	–
General administrative expenses	–6	–5
Other expenses/income	–	–
Pre-tax income	**21**	**3**
Taxes on income	–7	3
Net income	**14**	**6**

Net interest income decreased by 20% to €8 million compared with €10 million in 2011.

Net trading income totalled €20 million in 2012 (2011: €1 million). In 2012 €5 million (2011: €1 million) related to a once-off effect from a termination option on a derivative. Trading income also includes €15 million (2011: € nil) relating to a change in accounting estimate whereby the DEPFA Group refined its derivative valuation models in 2012 relating to counterparty risk parameters. This effect includes a measure of both the credit risk of the counterparty and the DEPFA Group's own credit risk.

Net expense from hedge relationships amounted to €–1 million (2011: €–3 million), relating to hedge ineffectiveness on fair value hedges within the range of 80% to 125% permitted in accordance with IAS 39.

General administrative expenses increased slightly to €–6 million in 2012 (2011: €–5 million).

Pre-tax income amounted to €21 million in 2012 (2011: €3 million).

Taxes on income amounted to €–7 million in 2012 (2011: €3 million).

Net income amounted to €14 million in 2012 (2011: €6 million).

DEPFA BANK plc and other

Income statement		
€ m	2012	2011
Net interest expense	–43	–6
Net fee and commission expense	–7	–5
Net trading expense/income	13	26
Net income from financial investments	1	35
Net income from hedge relationships	20	19
Other operating income	86	105
Other operating expense	–54	–17
Total operating revenues	**16**	**157**
Provision for/reversals of losses on loans and advances	–29	32
Recovery of losses on loans and advances under financial guarantees	69	–
General administrative expenses	–94	–113
Other income/expenses	14	–1
Pre-tax loss/income	**–24**	**75**
Taxes on income	7	–5
Net loss/income	**–17**	**70**

Net interest expense increased to €–43 million (2011: €–6 million). The decline is primarily due to the DEPFA Group rehedging costs of callable liabilities where the hedging derivatives were called.

Net fee and commission expense amounted to €–7 million, a slight decrease with the corresponding amount the previous year (2011: €–5 million). Fees paid to FMS Wertmanagement for guarantees received on assets not yet transferred and still recognised on the statement of financial position amounted to €–17 million (2011: €–18 million). Fee income received from DEPFA ACS BANK for guarantees provided on certain assets amounted to €12 million (2011: €14 million). A revision in the payment schedule of fees payable to the Federal Republic of Germany resulted in an expense of €–2 million in 2012 (2011: €–1 million).

Net trading expense/income of €13 million has decreased compared to the previous year (2011: €26 million). Of this, €–25 million (2011: €27 million) is due to market value movements in cross currency basis swaps. Stand-alone derivatives which do not satisfy the criteria of IAS 39 for hedge accounting accounted for €7 million (2011: €–1 million). Trading income also includes €31 million (2011: € nil) relating to a change in accounting estimate whereby the DEPFA Group refined its derivative valuation models in 2012 relating to counterparty risk parameters. This effect includes a measure of both the credit risk of the counterparty and the DEPFA Group's own credit risk.

Net income from financial investments amounted to €1 million in 2012 (2011: €35 million). The income is solely the result of the disposal of financial assets.

Net income from hedge relationships amounted to €20 million (2011: €19 million). This represents hedge ineffectiveness within the range of 80% to 125% permitted in accordance with IAS 39 and is mainly due to fluctuations in cross currency basis spreads.

Other operating income amounted to €86 million (2011: €105 million), which mainly consisted of income of €81 million from charges to pbb in relation to asset servicing provided by the DEPFA Group on the positions transferred to FMS Wertmanagement (2011: €93 million). Lower service income corresponded to the lower general administrative expenses. The asset servicing is expected to be completely discontinued by the end of September 2013. Also included are charges to the HRE Group for various supporting activities of €4 million (2011: €7 million) and other income of €1 million (2011: €5 million).

Other operating expense amounted to €–54 million (2011: €–17 million), which included provisions relating to IT costs associated with separating the DEPFA Group's infrastructure and operating processes from that of the HRE Group of €–10 million (2011: €–17 million) and other expenses, which were €–3 million (2011: €–7 million). Also included in 2012 are provisions of €–41 million (2011: € nil) in relation to current and expected litigation.

Provisions for/reversals of losses on loans and advances amounted to €–29 million (2011: €32 million). The 2012 figure includes specific loan loss provisions of €–69 million (2011: net write backs €14 million) which relate to exposures which are recoverable under financial guarantee contracts with FMS Wertmanagement. There is also a decrease in portfolio-based allowances of €40 million (2011: €18 million). In accordance with IAS 39, portfolio-based allowances are created only for loans and receivables for which there have not yet been any indications of an individual impairment.

Recovery of losses on loans and advances under financial guarantees amounted to €69 million (2011: € nil) and relates to the specific loan losses on exposures guaranteed by FMS Wertmanagement, as referred to above.

General administrative expenses declined to €–94 million in 2012 (2011: €–113 million). Personnel expenses decreased to €–45 million compared to €–50 million in the previous year. Other general administrative expenses amounted to €–49 million and was significantly lower than the corresponding previous year of €–63 million. This was due to lower consultancy and IT fees incurred in 2012. This development reflects the successful conclusion of IT projects in previous years and in 2012. The ratio between general administrative expenses and operating revenues amounted to greater than 100% in the year under review compared to 73% in the prior year.

Other income/expenses amounted to €14 million (2011: €–1 million) and is due to the net movement in provisions created for the strategic refocusing and restructuring of the DEPFA Group.

Pre-tax loss/income amounted to €–24 million in 2012, compared to pre-tax income of €75 million in the previous year.

Taxes on income amounted to €7 million (2011: €–5 million). The tax expense was incurred in countries in which the DEPFA Group generated positive pre-tax income related to this segment.

Net loss/income amounted to €–17 million in 2012 (2011: €70 million).

Development in assets

Total assets of the DEPFA Group amounted to €73 billion at 31 December 2012 and were €57 billion lower than the corresponding figure at the end of the previous year (31 December 2011: €130 billion).

The decline is primarily due to a reduction in the FMS Wertmanagement related counter effects of €52 billion.

These counter effects arose in the case of some assets, as it was not possible for beneficial ownership to be transferred to FMS Wertmanagement, which meant that the criteria for derecognition were not satisfied. Furthermore, in the case of most derivatives, back-to-back transactions were used to transfer the market price risks of the derivative to FMS Wertmanagement by way of taking out a derivative with identical conditions, whereas the counterparty risks were retained by the DEPFA Group. This meant that it was not possible for the original position to be derecognised. Instead, the back-to-back transactions resulted in an increase in total assets and total liabilities.

FMS Wertmanagement provided collateral for the new derivatives which were taken out between FMS Wertmanagement and the DEPFA Group (back-to-back transactions) which, in turn, was used to finance the collateral requirements of the original derivatives.

Furthermore, because FMS Wertmanagement does not have a banking status, the DEPFA Group has previously facilitated certain refinancing functions for FMS Wertmanagement, for instance with the ECB or in bilateral repo transactions. The refinancing funds were passed on to FMS Wertmanagement. The DEPFA Group received a claim against FMS Wertmanagement which increased the total assets and total liabilities.

The counter effects concerning the transfer of positions to FMS Wertmanagement on the DEPFA Group's and the Company's statement of financial position at 31 December 2012 and at 31 December 2011 are set out in note 5 of the notes to the financial statements.

FMS Wertmanagement refinanced its operations on a stand-alone basis during 2012. Overall, the volume of refinancing passed on to FMS Wertmanagement declined from €33 billion at the end of the previous year to € nil as of 31 December 2012, resulting in a decline in loans and advances to customers. The back-to-back derivatives were to a certain extent replaced by direct business relations between FMS Wertmanagement and the external customers (novation of derivatives). Overall, the volume of back-to-back derivatives amounted to €4.2 billion as at 31 December 2012, compared with €12.2 billion as of 31 December 2011. The decline is reflected in trading assets. The lower derivative volumes with FMS Wertmanagement have meant that there has also been a decline in the requirement for collateral, which has resulted in a further decline in total assets and total liabilities.

In addition to the decline in counter effects, the total assets also declined by a net €5 billion, including approximately €4 billion of asset sales and maturities. The DEPFA Group does not currently operate any new business in line with the conditions imposed by the European Commission state aid approval.

Developments in liabilities and equity

The total DEPFA Group liabilities amounted to €71 billion as of 31 December 2012, compared with €127 billion as of 31 December 2011. As was the case on the asset side of the statement of financial position, the decline is also mainly attributable to the same reduction in counter effects with FMS Wertmanagement.

All covered bonds, senior unsecured and subordinated debt instruments issued by the DEPFA Group remained on the statement of financial position following the transfer of positions to FMS Wertmanagement.

Liabilities evidenced by certificates decreased by €4.8 billion from €39.5 billion as of 31 December 2011 to €34.7 billion as of 31 December 2012. This reduction mainly reflected the run off in outstanding debt, of €4 billion, as well as the buyback of certain asset covered securities in DEPFA ACS BANK of €0.3 billion, at prevailing market levels on a reverse enquiry basis.

Equity amounted to €2.1 billion as of 31 December 2012 (31 December 2011: €2.7 billion). Compliance with the payment condition imposed by the FMSA increased the retained earnings deficit by €623 million, representing the payment of the final instalment of the purchase price adjustment which was paid on 14 March 2012. Provision for the DEPFA Group's obligations in relation to the annual state aid compensation fee also increased the deficit by €59 million.

Certain hybrid capital instruments remain classified as equity in 2012 and 2011, as the DEPFA Group has no contractual obligation to make interest payments.

On 6 March 2012 DEPFA BANK plc determined that the perpetual preferred securities issuing vehicle, DEPFA Funding IV LP, would not make payments on its €500,000,000 Preferred Securities (XS0291655727) on the next distribution payment date scheduled for 21 March 2012.

Similarly, on 24 May 2012 DEPFA BANK plc determined that DEPFA Funding III LP would not make payments on its €300,000,000 Preferred Securities (DE000A0E5U85) on the next distribution payment date scheduled for 8 June 2012.

Finally, on 15 October 2012 DEPFA BANK plc determined that DEPFA Funding II LP would not make payments on its €400,000 Preferred Securities (XS0178243332) on the next distribution payment date scheduled for 30 October 2012.

Development in earnings, assets, liabilities and equity of the DEPFA Group

The DEPFA Group has closed the year 2012 with pre-tax income of €68 million. However, the extent of the 2012 net income has benefited from once-off effects such as the profits from the redemption of asset covered securities on a reverse enquiry basis, net of losses from sales of financial investments and loans and receivables and a change in estimate in relation to the valuation of derivatives. The DEPFA Group cannot expect in future to benefit from once-off effects to the same extent. The DEPFA Group's future position may also be adversely affected by higher additions to provisions for losses on loans and advances which may have to be incurred, or there may be other adverse factors such as serious turmoil in financial markets or the defaults of sovereign states.

Due to a requirement in line with the principle of burden sharing required by the European Commission, from the time at which the payment condition of €1.59 billion is completely settled up to the time of reprivatisation, the DEPFA Group will, subject to certain conditions, have to pay further annual fees to the Federal Republic of Germany. The payment condition was completely settled on 14 March 2012. The precise terms and conditions of such fees are, at the time of this report, in the course of being negotiated, and provision has been made in the financial statements for the future expected amounts payable, which have been accounted for directly in equity. However, future developments could result in the requirement for additional provisions.

Total assets in 2012 declined appreciably, mainly due to the diminishing counter effects of the transfer of certain non strategic positions to FMS Wertmanagement. The extent of counter effects will continue to decline in future. For instance, changes of borrowers are carried out for some instruments (novations). Even excluding the FMS Wertmanagement counter effects, it is expected that total assets will continue to decline in 2013 due to the fact that the DEPFA Group is not currently undertaking any new business. However, the development in total assets is not fully subject to the control of the DEPFA Group. Market-related factors such as changes in foreign currency exchange rates and interest rates can also have an impact on total assets.

Opportunities, risks and uncertainties

The developments in earnings, assets, liabilities and equity which have occurred since the transfer of certain non strategic positions to FMS Wertmanagement are in line with the existing strategy of the DEPFA Group. Following the conclusion of the European Commission approval process in 2011, the DEPFA Group is now focused on continuing the process of optimising the value of its core portfolios with the aim of reprivatisation in the medium-term.

At present, a project is continuing to separate the pbb Group and the DEPFA Group. As a result of the separation, it will be easier to distinguish the two sub-groups which improves the chances of a successful reprivatisation.

On a reverse enquiry basis, the DEPFA Group has redeemed certain liabilities before maturity in 2011 and 2012 which has realised significant profits. Such income may also be generated in the future depending on investor behaviour and market conditions.

However, it is also possible that the developments in earnings, assets, liabilities and equity may be adversely affected by certain factors. The extent of which is influenced particularly by the occurrence or non-occurrence of the following risks, or the extent to which such risks might materialise:

- Some European countries in 2012 were only able to obtain funds with the support of international aid programmes. If the debt crisis of some countries deteriorates any further, a partial or complete claims waiver might become necessary for creditors, or sovereign debtors may become insolvent in an orderly or disorderly manner. In these cases, the DEPFA Group, in its capacity as a provider of public sector finance, may also have to recognise considerable impairments on loans and advances and on financial investments. These impairments may increase if the negative effect of the crises on certain countries spreads to other countries which are currently considered to be solvent.
- The situation in the refinancing markets has improved in the year under review. Nevertheless the refinancing markets are still problematic. The debt crisis facing some European countries may, for instance, result in a loss of confidence in the issuing markets or the unsecured and secured interbank markets. This could negatively impact on the liquidity situation of the DEPFA Group despite the existing liquidity reserves.
- The rating agencies continue to adapt their methodologies and models in order to assess, amongst other factors, the changing macro-economic environment and the potential impact of the European sovereign debt crisis. These measures, alongside the specific ratings drivers for the DEPFA Group entities and its covered bonds, could lead to rating changes. The ongoing reduction in linkages between the DEPFA Group and FMS Wertmanagement, or any changes to the ownership structure of the DEPFA Group could also lead to rating changes. Downgrades to Bank and/or covered bond ratings could have a negative impact, particularly on the Banks' re-financing capacity and on access to suitable hedge counterparties and hence on their financial position and profitability.

- While the actual liquidity situation for the DEPFA Group remains stable and the DEPFA Group continues to expect that it will meet all contractual and regulatory obligations going forward, the extent of liquidity requirements in the future is dependent on:
  - The future development of the discounts for repo refinancing in the market and with the central banks.
  - Collateral requirements as a result of changing market parameters (including interest rates, foreign currency exchange rates and basis for calculation).
  - Changing requirements of the rating agencies regarding the necessary surplus in the cover pools.
- Litigation which is currently pending and litigation which may occur in future might have a considerably negative impact on the results of the HRE Group and the DEPFA Group.
- The HRE Group and its subsidiaries, including the DEPFA Group, have initiated projects for optimising processes and IT infrastructure. Some of these have already been successfully completed, whereas others are still ongoing. Despite the projects, the DEPFA Group is exposed to operational risks, such as its reliance on key positions and a higher level of staff fluctuation. These risks may result in material losses. The risks may also become relevant for the service obligations assumed by the HRE Group and the DEPFA Group for the ongoing operation of FMS Wertmanagement.
- The ongoing development of national and international regulatory requirements may have an impact on the structure of assets and liabilities and may thus also affect the development in earnings. For instance, the modified obligations regarding more stringent liquidity requirements, presented by the Basel Committee on Banking Supervision (Basel III), may have a negative impact on profitability, or profitability may be reduced by stricter capital requirements. In addition, there may also be an impact on existing regulatory and economic parameters, requiring for example, a change in capital backing.
- The possibility of introducing a tax on financial market transactions continues to be discussed in most of the countries in the European Union. The aim is to introduce a tax on purchase and sales of transferable securities or options and other financial instruments. Such a tax may have a negative impact on the profitability of the DEPFA Group.

Strategy

Organisational and legal structure of the HRE Group

In the year under review, the structure of the HRE Group continued to comprise Hypo Real Estate Holding AG, the senior HRE Holding entity and the operating bank subsidiaries of pbb and DEPFA BANK plc.

Company strategy of the HRE Group

On 18 July 2011, the European Commission approved the state aid in relation to the stabilisation measures granted to the HRE Group by the Federal Republic of Germany. With its positive decision, the European Commission recognised the viability of the business model of pbb as a specialist bank for real estate finance and public sector finance.

The strategic core bank of the HRE Group, pbb, operates Pfandbrief-eligible new business in the fields of commercial real estate finance and public sector finance, with a regional focus on Europe.

Company strategy of the DEPFA Group

The DEPFA Group's strategy and business model is to a large extent influenced by the conditions and commitments agreed between the European Commission and the Federal Republic of Germany during the state aid approval process. In this context, the companies of the DEPFA Group will not carry out any new business operations until they are reprivatised, except in relation to the following:

- restructuring of existing loans to preserve value, provided such loans are subject to problem loan monitoring,
- transactions required as part of the liquidity management of the DEPFA Group or of FMS Wertmanagement, e.g. central bank transactions,
- the management of the cover pool assets of Hypo Pfandbrief Bank International S.A. and DEPFA ACS BANK,
- extensions to existing loans required to avoid losses, to the extent that these extensions hold out far better prospects for final liquidation,
- derivative transactions required for managing interest rate, currency and credit risks of the existing portfolio, e.g. asset swaps, to the extent that they lead to a reduction of the total market risk exposure of the DEPFA Group,
- transactions that had already been fully included in the consolidated financial statements of DEPFA BANK plc and/or whose economic chances and risks had, for the greater part, already rested with the DEPFA Group,
- any and all transactions required to meet regulatory or other legal requirements, including the acquisition, holding and sale of securities permitted for managing the cover pool assets of the DEPFA Group or for managing liquidity at the DEPFA Group,
- any and all transactions concluded by DEPFA BANK plc and its subsidiaries for refinancing purposes, including new issues and redemption of debt instruments.

Furthermore, the DEPFA Group, or the companies therein and/or the credit portfolios are intended to be reprivatised or sold in the medium-term. In this regard, measures designed to separate the DEPFA Group from the other companies of the HRE Group are continuing.

Deutsche Pfandbriefbank AG has provided a contractual undertaking to provide certain defined services to FMS Wertmanagement in relation to the transferred portfolios. The companies of the DEPFA Group act as sub-service provider of certain of these services. Both Deutsche Pfandbriefbank AG and the DEPFA Group will completely discontinue this servicing activity by 30 September 2013 after which time the servicing will be handled by FMS Wertmanagement itself or a servicing company established by FMS Wertmanagement.

The Board of Directors of DEPFA BANK plc have not identified any major items of uncertainty which relate to events or conditions which cast considerable doubts on the going concern assumption in the preparation of the consolidated financial statements of the DEPFA Group.

Major business activities

The management concept of the HRE Group focuses on achieving long-term growth in the value of the HRE Group. The aim is to create a situation in which the subgroups, the pbb Group and the DEPFA Group, can be successfully reprivatised. A major objective in this respect is to achieve a balanced ratio between risk and return, in order to ensure that the risks which are taken on are consistent with external and internal risk bearing capacity guidelines.

Different strategies are used for the pbb Group and for the DEPFA Group in order to achieve this objective. Whereas pbb is the strategic core bank of the HRE Group, in which new business is generated, the holdings of the DEPFA Group continue to be reduced in a manner designed to maintain value.

The DEPFA Group is acting as sub-service provider for pbb, which has entered into various service level agreements with FMS Wertmanagement. Under these agreements, pbb provides the servicing for positions that have been transferred to FMS Wertmanagement. The different servicing tasks are clearly outlined in specific servicing agreements. The majority of the departments in the DEPFA Group are affected by the servicing agreements. Both pbb and the DEPFA Group will completely discontinue this servicing by the end of September 2013.

Besides the servicing of positions transferred to FMS Wertmanagement, there remain substantial portfolios in the DEPFA Group of mostly long-term budget finance assets (in the form of bonds, schuldschein and loans). The strategic focus for these portfolios is the conservation and maximisation of value through a mix of strategies. Certain parts of the portfolio are to be run-down along the original amortisation profile, while a certain part is managed through opportunistic sales, extensions and restructurings, where these activities are considered value enhancing. As the range of credit formats, structures and embedded instruments is still extensive, a team of highly professional asset managers, traders and derivative specialists is dedicated to the management of the remaining portfolio.

Overall, management and measurement in the HRE Group is based on a consistent and integrated system of parameters which provides support to members of management in their leadership of the HRE Group. The system of parameters includes analysis of profitability, growth, risk and capital. Regular actual-budget comparisons with corresponding analyses provide management with the reasons for any variances affecting the key parameters. In addition to strategic planning for the overall HRE Group, medium-term extrapolations of the profitability parameters and stress scenario calculations also provide management with a comprehensive overview of the future business development of the HRE Group.

Cost discipline and efficiency are monitored throughout the HRE Group.

The main risk parameters used for risk management are economic capital, regulatory capital and the cumulative liquidity position and are described in the risk management section of this report.

Management is performed at the level of the HRE Group and at the level of the main companies, including the entities within the DEPFA Group. The HRE Group is also responsible for management at the level of the three HRE Group business segments Public Sector Finance, Real Estate Finance and Value Portfolio. The entire DEPFA Group is included in the Value Portfolio.

Events after 31 December 2012

On 6 March 2013 DEPFA BANK plc determined that the perpetual securities issuing vehicle DEPFA Funding IV LP, would not make payments on its €500,000,000 Preferred Securities (XS0291655727) on the next distribution payment date, scheduled for 21 March 2013.

Apart from the above, there have been no other notable events after 31 December 2012.

Risk management

This section provides information about the:
(1) Organisation and Principles of Risk and Capital Management,
(2) Ongoing Developments in Risk Management,
(3) Major Risk Types:
  (a) Credit Risk;
  (b) Market Risk;
  (c) Liquidity Risk;
  (d) Operational Risk and
(4) Internal Capital Adequacy Assessment Process (“ICAAP”).

(1) Organisation and principles of risk and capital management

Organisation and committees[a)]

As part of the HRE Group, the DEPFA Group coordinates its Risk Management and Strategy closely with the HRE Group and its related Committees. This Risk Report describes the Risk Management system within the DEPFA Group, which is fully integrated into the HRE Group system.

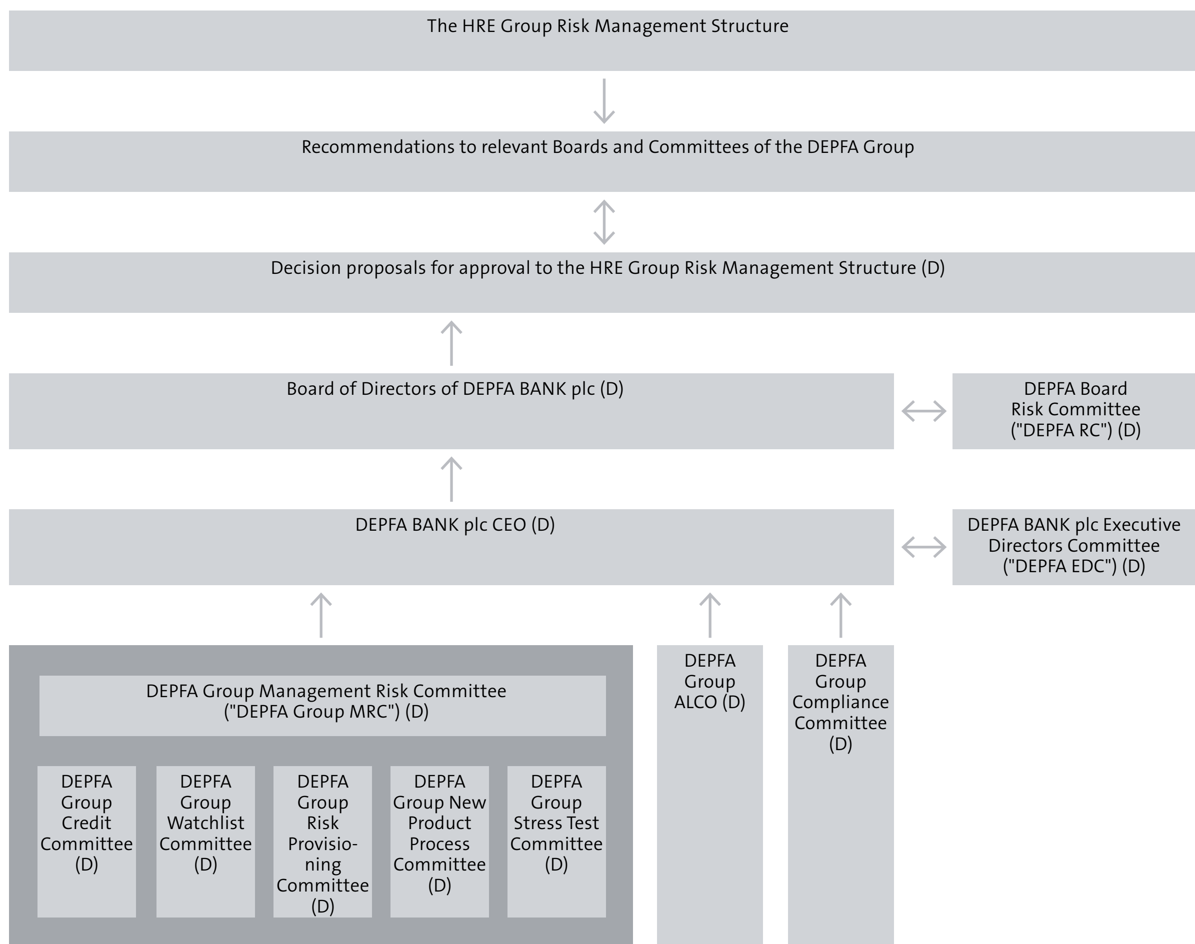
All the HRE Group tasks are performed in accordance with Section 25 a KWG, which requires uniform risk identification, measurement, risk limiting and risk management. Operational implementation is the responsibility of the respective subsidiary. The DEPFA Group relies on its own suite of Risk Management Committees for the effective management, control and implementation of a robust risk management framework.

The Board of Directors of DEPFA BANK plc bears overall responsibility for the DEPFA Group’s risk management system and is responsible for taking decisions in relation to all strategies and key issues of risk management and risk organisation.

The risk management system of the DEPFA Group, which is integrated into the risk management system of the HRE Group, is a system which covers all business activities of the DEPFA Group and comprises the systematic identification, analysis, valuation, management, documentation and communication of all major risks and related monitoring on the basis of the defined risk strategy of the DEPFA Group which is revised annually.

At the HRE Group level, the HRE Group Management Board informs the HRE Group Supervisory Board regularly with regard to the HRE Group-wide business and risk strategies and the risk profile of the HRE Group and the DEPFA Group, as well as the specific business and risk strategies of the DEPFA Group.

[a)] Forms an integral part of the audited financial statements


Risk management of the HRE Group (as applicable for the DEPFA Group)
as of 31 December 2012
(D) Decision making body
Arrows: Recommendation/Proposal/Information
The HRE Group Risk Management Structure
Recommendations to relevant Boards and Committees of the DEPFA Group
Decision proposals for approval to the HRE Group Risk Management Structure (D)
Board of Directors of DEPFA BANK plc (D)
DEPFA Board Risk Committee ("DEPFA RC") (D)
DEPFA BANK plc CEO (D)
DEPFA BANK plc Executive Directors Committee ("DEPFA EDC") (D)
DEPFA Group Management Risk Committee ("DEPFA Group MRC") (D)
DEPFA Group Credit Committee (D)
DEPFA Group Watchlist Committee (D)
DEPFA Group Risk Provisio-ning Committee (D)
DEPFA Group New Product Process Committee (D)
DEPFA Group Stress Test Committee (D)
DEPFA Group ALCO (D)
DEPFA Group Compliance Committee (D)

The DEPFA Board Risk Committee (“DEPFA RC”), which was established in December 2011 has met on a quarterly basis during 2012. The principle purpose of the DEPFA RC is to review, on behalf of the Board of Directors of DEPFA BANK plc (“the Board”), management’s recommendations on risk, in particular:

- Consider and recommend to the Board the DEPFA Group’s risk appetite.
- Consider and recommend to the Board the DEPFA Group’s risk strategy.
- Review on behalf of the Board the DEPFA Group’s risk profile.
- Monitor the effectiveness of the DEPFA Group’s risk management organisation relative to the risk profile of the DEPFA Group.
- Advise the Board on the effectiveness of policies with respect to maintaining, on an ongoing basis, amounts, types and distribution of both internal capital and own funds adequate to cover the risks of the institution.

The HRE Group operates a Group-wide risk management and risk controlling system which represents a pre-condition for the application of the waiver according to Section 2 a KWG. The DEPFA Group Management Risk Committee (“DEPFA Group MRC”) was established by the Chief Executive Officer of DEPFA BANK plc (“DEPFA BANK plc CEO”). The DEPFA Group MRC is concerned with the development and decision of standards of risk management and control as well as the monitoring of portfolio developments.

The DEPFA Group MRC consists of the Chief Risk Officer (“DEPFA Group CRO”) and the Chief Financial Officer (“DEPFA Group CFO”) of the DEPFA Group as well as the DEPFA Head of Risk Management and Control, the DEPFA Head of Liquidity Risk and the DEPFA Head of Country Risk. The DEPFA Group MRC monitors the development of risk-bearing capacity, economic capital, risk cover funds, the credit portfolio and the compliance with limits. In general, the committee meets on a monthly basis and adopts guidelines/policies, methods for risk measurement and the related parameters, as well as methods of monitoring all risk types. The DEPFA Group MRC supports the DEPFA RC on topics arising from the risk functions as well as specific topics that the Board may request.

Further committees are established on a DEPFA Group-level (Credit Committee, Watchlist Committee, Risk Provisioning Committee, New Product Process Committee and the Stress Test Committee). These committees work closely with those of the HRE Group.

The DEPFA Asset and Liability Committee (“DEPFA Group ALCO”) is chaired by the DEPFA Group CRO and comprises the DEPFA BANK plc CEO, the DEPFA Group CFO as well as the Heads of Treasury, Liquidity Risk, Market Risk and Risk Management & Control. It meets at least once every six weeks. Its tasks comprise liquidity management, balance sheet structure management, as well as market risk management and management of the regulatory capital ratios. This committee is also responsible for preparing decision-making documents for liquidity and refinancing strategies which, following discussions in the DEPFA Group MRC, are provided to the DEPFA BANK plc Executive Directors Committee (“DEPFA EDC”), which will ultimately decide on the implementation.

The DEPFA Group Credit Committee comprises the DEPFA Group CRO, Senior Credit Executives and the Head of Country Risk. The front office representatives have a voting right as part of front office responsibility. In general, the committee meets at least once every week and is responsible for competence-based credit decisions for annual reviews, prolongations and material changes in the credit relationship. The DEPFA Group Credit Committee ensures that the credit decisions are consistent with the prevailing business and risk strategy.

The DEPFA Group Watchlist Committee for each business segment meets every month. All exposures identified by the early warning system are discussed and, if appropriate, individual measures are decided by these bodies; these measures must be subsequently implemented by the relevant departments. Where necessary, the committees take decisions regarding any necessary steps for restructuring and workout on the basis of an exposure strategy. All necessary credit decisions are taken by the key personnel in line with the allocation of credit powers or in the DEPFA Group Credit Committee. If there are any indications of an objective impairment, the extent of the impairment is first determined and the result is presented in the DEPFA Group Risk Provisioning Committee.

The DEPFA Group Risk Provisioning Committee takes decisions within the framework of a pre-defined set of allocated powers and provides recommendations regarding the creation and reversal of provisions for losses on loans and advances as well as any necessary rescue acquisitions. The recommendations made by the committee are decided on by the DEPFA EDC and the DEPFA RC must be informed of any new provision over €5 million.

The DEPFA Group New Product Process Committee ensures that all products can be managed and measured by the DEPFA Group's management information systems and are reviewed primarily on an annual basis. As the DEPFA Group is no longer writing new asset business, a new product would only currently arise in the event of re-hedging or management of liquidity or regulatory risks.

The DEPFA Group Stress Test Committee is responsible for the method, performance and monitoring of the stress tests at the level of the DEPFA Group.

Risk strategy and policies

The Risk Strategy is aligned to the Business Strategy. The DEPFA Group's business model is to a large extent influenced by the conditions and commitments agreed between the European Commission and the Federal Republic of Germany during the state aid approval process and this is reflected in its Risk and Business strategies. These commitments are valid until the reprivatisation of the DEPFA Group. The DEPFA Group must be reprivatised as a whole or in part by the end of 2014. According to the EU decision, the DEPFA Group is not allowed to conclude new business transactions other than those necessary for regulatory requirements or for reducing risk or transactions required as part of the liquidity management of the DEPFA Group or FMS Wertmanagement. The DEPFA Group is considered part of the HRE Group's non strategic business within the segment Value Portfolio. The DEPFA Group must discontinue its business areas of Infrastructure Finance and Capital Markets/Asset Management. In addition, the DEPFA Group is active as a sub-service provider for FMS Wertmanagement.

Risk steering in the DEPFA Group is based on three-fold steering focusing on the following risk measures:
- Economic capital
- Regulatory capital
- Cumulative total liquidity position

The risk strategy of the DEPFA Group describes the general approach for the mitigation and limitation of risk for the identified risk types. Furthermore, in the DEPFA Group risk strategy limits are presented at the DEPFA Group level.

Risk reporting

Risk reporting reflects the structure of the operating segments. The senior management of the DEPFA Group receive regular risk reports which include an extensive overview as well as detailed information concerning the risk situation for each risk type and company, as well as other management relevant information. In addition, special reports are prepared on an ad-hoc basis or at the request of the Board; such special reports consider specific and acute risk issues, for instance in relation to critical markets, products, counterparties and tailored stress tests.

Risk quantification and risk management

The credit risk, market risk, business risk and operational risk in particular are quantified and backed with risk cover funds as part of the risk-bearing capacity analysis. The liquidity risk is quantified on the basis of the liquidity position. The individual calculation methods are described in detail in sections (3)(c) “Liquidity risk” and (4) “ICAAP”.

Further risk types considered as material, such as strategic, regulatory, model, pension, participation and property risks which are considered to be immaterial, are not measured quantitatively. They are managed and limited by means of regular detailed reports and clear specifications, e.g. the regulations concerning compliance and corporate governance.

Overall, portfolio optimisation and risk management is maintained through:
1. Monitoring the risk-bearing capacity on the basis of comparing economic capital and the available financial resources of the DEPFA Group.
2. Monitoring the risk-weighted assets (“RWA”) at the portfolio level to ensure maintenance of capital ratios.
3. Operational risk management via:
   - The use of Basel-II-compliant risk parameters in lending business. The Basel-II-compliant management approach shows the average expected loss at the borrower level and is therefore a major component in early recognition and profitability monitoring. The parameters are reviewed and recalibrated annually.
   - A limit system for counterparty and issuer risks on the basis of uniform risk measuring methods.
   - Intense monitoring and management of individual counterparties.
   - Monitoring the risk of losses by way of appropriate impairment triggers in accordance with IAS 39.

(2) Ongoing developments in risk management

During 2012 the DEPFA Group implemented a new, more granular borrower classification breakdown. The benefits of the new classification include;

- A clearer distinction of strong guarantee dependencies and hence, a more comprehensive risk classification.
- A new structured finance classification, which provides a better view on risk changes within the securitisations market.
- The risk of international organisations are now grouped within the Supranational cluster.

(3) Major risk types

The DEPFA Group distinguishes the following major risk types for its business activities:
(a) Credit risk
(b) Market risk
(c) Liquidity risk and
(d) Operational risk

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

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

- Strategic risks
- Reputational risks
- Regulatory risks and
- Model risks

(a) Credit risk

Definition[a]

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 trades, attributable to the default of the counterparty. The following sub-categories are distinguished in this respect:

- Settlement risk 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.

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.

Organisation of credit risk management[a]

DEPFA ensures the full separation of both the Front and Back Office functions through reporting lines up to the Board member responsible.

Credit risk strategy and principles[a]

According to the European Commission, the DEPFA Group cannot carry out any new business operations until reprivatised. This is not applicable for measures designed to maintain value, for the efficient management of cover funds as well as business necessary as a result of regulatory requirements or other legal reasons, particularly within the framework of risk and refinancing management.

In the DEPFA Group portfolio, emphasis is placed on the reduction of existing assets in a manner which poses minimum strain on capital and which is designed to maintain value.

[a] Forms an integral part of the audited financial statements

Credit risk reporting[a]

- The DEPFA Group risk report contains the development of exposures as relevant credit risk management indicators such as the development of the expected loss, as well as the unexpected loss via Value at Risk ("VaR"). The report produced quarterly shows the credit risk within the DEPFA Group, as well as within each legal entity within the DEPFA Group, with emphasis on the overall bank risk and the risk-bearing capacity. It reports limit utilisations and violations of existing limits and also identifies risk concentrations. Key indicators which are relevant for management purposes, such as the development of the exposure at default ("EaD"), the expected loss ("EL") and the credit VaR are integrated in this report and are discussed in detail at the DEPFA RC.
- In the quarterly credit risk report of the DEPFA Group, details concerning the portfolio and risk parameters are extensively reported; they are provided to the DEPFA RC for discussion. Major parameters which are relevant for management purposes, such as the development of the EaD, the EL and the credit VaR, are integrated in these quarterly reports.
- Decisions on limit maintenance, adjustments of conditions, concentration levels, reviews of internal ratings and probabilities of default ("PD") and loss given defaults ("LGD") and other major parameters are presented to the DEPFA Group Credit Committee for discussion and approval.
- In the daily business of the DEPFA Group, additional reporting supports operational management with regard to the management and timely recognition of risks at the sub-portfolio level.
- Developments, which may result in a major deterioration in the risk position of an individual exposure of the DEPFA Group are reported to a wider group by way of "credit issue notes".

Credit risk quantification via economic capital and risk weighted assets according to Basel II

Credit portfolio model: Unexpected loss forms the basis for determining the economic credit risk capital. The DEPFA Group uses a credit portfolio model which is described in greater detail in section (4) ICAAP.

Stress tests: Stress tests help to anticipate effects of potential scenarios on the credit portfolio by feeding stressed parameters to the credit portfolio model. The stress tests for economic capital in credit risk are described in greater detail in section (4) ICAAP.

Basel II: The preparations for the IRBA-HRE Group approval according to Basel II have been completed. The result of the regulatory audit for the introduction of the Advanced IRBA at the HRE Group has been postponed to 2013. It is expected that the DEPFA Group, on a standalone group basis, will remain under the standardised approach for Irish Regulatory reporting purposes.

[a] Forms an integral part of the audited financial statements

Credit risk management ("CRM")[a]

Credit risk is mainly determined by credit exposure, default probabilities and collateral values. Credit risk in the DEPFA Group is identified, measured and monitored at different individual levels:

- Individual borrower, counterparty or issuer level
- Product level
- Country level
- Overall portfolio level

The DEPFA Group uses the EaD, PD and LGD models. In addition, a credit portfolio model is in place to measure the Credit VaR.

The risk appetite (limit) for credit risk is derived in a top-down approach. This is the ceiling for limits on an operating level, which are derived in a bottom-up approach. Emphasis is placed on the reduction of existing assets and maintaining value.

The primary targets of credit risk management are:

- to maintain a low probability that certain potential default events will occur in the future
- to ensure a low severity of losses (e.g. taking guarantees and additional collateral, where possible)
- the transfer of risk to external third parties (via syndication, securitisation, portfolio sales, credit derivatives and as insurance)

The credit competence guideline also defines the decision-making powers of the individual credit risk managers for prolongations in existing business in the DEPFA Group, depending on the counterparty group and expected loss class.

Credit risk management and monitoring[a]

Credit risk is an intrinsic component of the business model. The objective is to manage credit risk actively. The general principle of risk management is to ensure the preservation of value within single transactions and on an overall portfolio basis. Early detection of risk issues support measures for risk limitation as well as for monitoring and reporting of credit risk.

The following measures, among others, are used within the risk management process:

- Detailed analysis of the borrower/counterparty and the transaction, as well as sponsors if applicable, including a detailed audit of the profit and cost sources of the borrower/counterparty
- Definition of the minimum requirements (limits) for the key risk factors (e.g. loan-to-value ratio, term, ticket-size)
- Definition of processes for making credit decisions, including clear and comprehensive assignment of competencies
- Standardised credit documentation using standard forms
- Standardised defined parameters for managing engagements which have been classified under intensified management

[a] Forms an integral part of the audited financial statements

- Credit issue notes as an instrument for internal ad-hoc reporting in the DEPFA Group to key personnel for material risk-related changes

Monitoring and reporting of the credit risk takes place at regular intervals at the borrower/borrower unit and the portfolio levels. The annual review is concentrated on a future-oriented analysis which allows for a stress of existing circumstances when current or expected market conditions are considered. It serves to analyse business development, profitability, confirmation of adherence to legal covenants (for public corporations), credit rating and recoverability of the financed assets. This also includes a detailed risk analysis and early reporting and escalation to the key personnel if required. Furthermore, measures required to protect the DEPFA Group’s risk position are defined. The analysis includes written documentation of the planned and existing engagements on the basis of borrower units.

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

- The CRM teams carry out the risk analysis for all existing business of the DEPFA Group. PD and LGD rating tools, which are developed by the Ratings Analytics team and annually validated and calibrated, are used by the CRM teams for valuation purposes and for preparing the credit decision for the review process.
- The DEPFA Group legal department, with external lawyers/lawyer’s offices where appropriate, are responsible for the contract and collateral documentation review.
- Defined early warning indicators are regularly analysed by 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 DEPFA Group Watchlist Committee.
- CRM analyses the impairment triggers (please also refer to the section concerning the Watchlist and non-performing loans) and the necessary impairment calculations are carried out for the DEPFA Group and submitted to the DEPFA Group Risk Provisioning Committee for consideration. CRM draw up a restructuring plan or a workout plan for critical and impaired exposures of the DEPFA Group. 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 DEPFA Group Watchlist Committee, whose members include the DEPFA Group CRO.
- Critical exposures (Watchlist) as well as restructuring and workout cases (non-performing loans) of the DEPFA Group are reported monthly in the DEPFA Group risk report and in the DEPFA Group MRC and also, upon request, in special analyses to the DEPFA RC.

Hedging and minimising risk by collateral

At the DEPFA Group, assets and also other financial securities and guarantees are 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 CRM.

Credit portfolio

EaD figures used throughout this report are based on the HRE Group methodology which is IRBA based.

The Basel II term EaD represents an estimate of the exposure amount for each transaction the Bank will lose as a result of a counterparty default. It is calculated to include the principal outstanding, plus future interest accruals for one year as well as any committed undrawn position which the counterparty could utilise. All of these loss estimates should seek to fully capture the risks of an underlying exposure. In the case of derivatives, the EaD is defined as the sum of the current market value and the regulatory add-on, which constitutes a buffer in the event of future potential increases of the market value.

The EaD of the credit portfolio of the DEPFA Group from a risk perspective amounted to €41.5 billion as of 31 December 2012, which is a €14.3 billion reduction as of 31 December 2011 (€55.8 billion). The total reduction can be attributable to the following:
- Reduction of exposure to Central Bank of Ireland (52% of total reduction)
- Reduction in OTC and Netting exposures (12% of total reduction)
- Bond sales and amortisations (12% of total reduction)
- Maturities and foreign exchange effects (24% of total reduction)

The DEPFA Group continued to upgrade trades to FMS Wertmanagement during 2012. This process allows for the legal transfer of the trade to FMS Wertmanagement while the trade initially remained with the DEPFA Group via back-to-back transactions which removed the economic risk from the DEPFA Group.

During 2012, FMS Wertmanagement ceased to access funding via the Central Bank of Ireland, hence, the reduction of approximately €7 billion in exposure between the DEPFA Group and the Central Bank of Ireland.

The following analysis represents the remaining portfolio in the DEPFA Group from a risk perspective (“Core Portfolio”) and excludes the transactions where the economic risk has been transferred to FMS Wertmanagement. However it includes transactions where the counterparty risk remains with the DEPFA Group. It excludes counterparty credit risk with FMS Wertmanagement insofar as it does not relate to assets held in the DEPFA ACS BANK cover pool or hedging of economic risk remaining in the DEPFA Group.

The total portfolio analysed is reconciled to the total assets as disclosed in the statement of financial position as follows:

Total portfolio € bn	31 December 2012	31 December 2011
EaD of Core Portfolio	41.5	55.8
FMS Wertmanagement non derivative counter-effects replaced in EaD with residual counterparty risk	7.4	36.2
EaD netting impacts (derivatives, repos and collateral)	21.1	35.2
Difference between IFRS and EaD measurement basis	2.8	2.3
Non financial instrument balances not included in EaD	0.5	0.4
IFRS Balance Sheet	73.3	129.9

Risk parameters

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 a single loan loss provision ("SLLP") has been assigned.

The EL, which is calculated from the annual PD, the LGD and the EaD, amounted to €5.8 million as of 31 December 2012 using the parameters specified by Basel II (31 December 2011: €6.9 million). The reduction in 2012 is due to a decrease in exposure to the Central Bank of Ireland, combined with bond sales and maturities.

Economic credit risk capital

The unexpected loss of the credit portfolio is calculated using a Monte-Carlo based credit portfolio model for a period of one year and a confidence level of 99.95%. Within the framework of risk-bearing capacity analysis of the DEPFA Group, the credit risk economic capital amounts to €1,152 million as of 31 December 2012 (31 December 2011: €758 million) excluding diversification effects to other risk types. The increase in capital is driven mainly by the economic capital required for credit risk due to downgrades of Italy and Spain in 2012. Details of the calculation are set out in section (4) ICAAP.

Country risk[a)]

Allocations to regions in the table below are based on the geographic location of the respective risk. Germany, the UK and the US account for 46% (EaD €19.2 billion) of the DEPFA Group's total exposure at the end of December 2012 (2011: 40%, €22 billion).

DEPFA Group portfolio: Break-down according to region[1)]

EaD in € bn	31 December 2012	31 December 2011
Austria	1.4	1.5
Belgium	1.8	2.0
Emerging Markets[2)]	0.7	0.8
France	2.1	3.0
Germany	10.3	11.9
Ireland	2.3	9.7
Italy	1.9	2.6
Japan	0.8	1.1
Netherlands	1.4	1.4
Other Europe	2.7	2.9
Other Rest of World	2.7	3.5
Scandinavia	1.0	1.2
Spain	3.5	3.9
UK	1.1	1.1
US	7.8	9.2
Total	**41.5**	**55.8**

1) Forms an integral part of the audited financial statements
2) As per IMF definition

All country limits comply with a set of maximum country limits derived and calibrated with a VaR style credit portfolio model. In addition, an independent risk assessment is performed by a team of economists within the DEPFA Group who provide expert judgement in relation to the associated risks of doing business within a particular framework.

The maximum country limits ensure that the additional capital requirement caused by full limit utilisation does not exceed the headroom as defined by the capital planning process.

Exposures to both Spain and Italy continue to represent an important component of the core balance sheet of the DEPFA Group. Throughout 2012 both countries have experienced ratings downgrades, and intensive monitoring has, in some cases, been necessary to monitor individual transactions. However, due to the public sector nature of all exposures within these countries, none of the portfolio is in arrears and all counterparties continue to perform within expectations.

a) Forms an integral part of the audited financial statements

Rating structure[a)]

Changes in the internal rating classes between 2011 and 2012 are a reflection of the external economic environment to which the DEPFA Group is exposed. External rating agencies' view on the macro economic environment led to a high number of downgrades. As the DEPFA Group uses its own internal rating models and based on the current global environment, a similar downgrading effect occurred internally. The internal downgrades had an impact on a large number of obligors within the DEPFA Group, most notably Sovereign and Sub-Sovereign exposure. However, this does not account solely for all changes. During 2012, DEPFA realigned its PD mapping scale to a more appropriate granular scale, which reflects the differences between public sector and other, and creates a greater differentiation within each rating band (e.g: AA, A, BBB). As a result of this, the 31 December 2011 rating class amounts have been restated for comparative purposes.

DEPFA Group portfolio: Break-down according to internal ratings

Internal DEPFA Letter rating mapped to Standard & Poor's classes EaD in € bn	31 December 2012	31 December 2011
AAA	8.5	11.6
AA+	4.5	6.8
AA	1.4	5.2
AA–	11.5	8.0
A+	3.7	9.1
A	1.7	2.4
A–	1.1	2.1
BBB+	3.4	9.7
BBB	4.3	0.4
BBB–	0.9	0.2
Sub Investment Grade	0.5	0.3
Total	**41.5**	**55.8**

[a)] Forms an integral part of the audited financial statements

Borrower classification[a)]

DEPFA Group portfolio: Borrower classification EaD in € bn	31 December 2012	31 December 2011
Corporation	0.3	1.2
Financial Institutions	4.7	6.5
Infrastructure Finance	–	0.2
PSE (Direct)	8.5	9.0
PSE (Indirect)	1.4	1.2
Regional Government (Direct)	6.7	6.9
Regional Government (Indirect)	4.3	3.2
Sovereign (Direct)	5.7	16.3
Sovereign (Indirect)	3.4	4.0
Structured Finance	4.8	4.8
Supranational	1.7	2.5
Total	**41.5**	**55.8**

As stated under section (2) Ongoing developments in Risk Management, during 2012 the DEPFA Group implemented a new, more granular borrower classification breakdown. The 2011 comparatives figures have been realigned in accordance with this classification for comparative purposes.

Structured products[a)]

In accordance with the recommendations of the Financial Stability Board ("FSB", former "FSF") as well as the Senior Supervisory Group ("SSG") for "Leading Practice for Selected Exposures", further information regarding the following sub portfolios is disclosed:

- Structured and partially guaranteed products;
- Other structured products; and
- Special purpose entities inside and outside the group of consolidated companies.

[a)] Forms an integral part of the audited financial statements

The table below refers to nominals of guaranteed securities.

Overview of state-backed and partially guaranteed securities	31 December 2012		31 December 2011		2012 nominal percentage change versus 2011
Product Category	Nominal value	Fair value	Nominal value	Fair value	
State-guaranteed structured securities €1.1 billion					
CDOs/ABS guaranteed by European states (mainly Spain), Spanish municipalities, and the Federal State of Lower Austria and also by the US Federal Home Administration	1.1	1.0	1.2	1.1	–8%
State backed structured securities €1.6 billion					
ABS for financing the state-backed US Social Housing Program	0.5	0.6	0.6	0.7	–17%
ABS for financing privately constructed buildings and facilities in the public interest for which interest payments and redemption payments are covered by public sector charges, and other government related ABS	1.1	1.2	1.0	1.1	10%
Securities which securitise state guaranteed (97%) US student loans €3.6 billion					
Securities which securitised student loans (FFELP[1] student loans), of which at least 97% are guaranteed by the US State	3.6	3.4	4.2	3.8	–14%
Total	**6.3**	**6.2**	**7.0**	**6.7**	**–10%**

[1] Federal Family Educational Loan Program

2012 performance was stable: Student loan ABS ("SLABS") transactions held within DEPFA Group are backed by pools of loans that carry U.S. Department of Education ("DoE") default insurance under the Federal Family Education Loan Program ("FFELP"); they are often referred to as FFELP-backed SLABS. Over 2012, the FFELP-backed SLABS portfolio experienced a large number of rating downgrades. The downgrades were primarily driven by Standard & Poor's rating downgrade of U.S. sovereign debt and secondarily by Standard & Poor's updated counterparty criteria (for the Euro-denominated transactions in the portfolio). Despite the rating downgrades, performance remained stable.

Basis risk in most of the FFELP-backed SLABS transactions within the DEPFA Group portfolio was lowered, following the Consolidated Appropriations Act of 2012, which allowed issuers to permanently change the Special Allowance Payment ("SAP") interest rate index on the loans they own from three-month CP to one-month Libor.

2013 outlook is stable: Considering the concentration level of ABS student loan transactions within the DEPFA Group, it is important to consider the outlook, which is considered stable. The outlook for FFELP-backed SLABS sector in general is driven by (1) the U.S. unemployment rate and (2) the strength of the U.S. Government.

U.S. unemployment rate Historically, default rates, deferment and forbearance levels on FFELP loan pools have been positively correlated to the U.S. unemployment rate. Moody's currently forecasts that the average U.S. unemployment rate will drop to 7.7% for 2013 (from the average 8.9% witnessed in 2011 and 8.1% in 2012) and slide further down to 7.0% in 2014. This is credit positive for FFELP-backed SLABS as it should drive down default rates, along with deferment and forbearance levels.

An additional benefit to the FFELP-backed SLABS transactions held within DEPFA Group is that the majority of the transactions are pre-2007 securitisations, which means that they contain a higher proportion of borrowers who graduated into a stronger job market and have already established their professional careers (unlike the recent college graduates who are entering into a still weak job market with high unemployment rates).

Strength of the U.S. Government: According to Moody's, FFELP-backed SLABS transactions derive between 10% and 30% of all cashflow from the DoE, an arm of the U.S. Government. Since the U.S. Government supports these transactions with defaulted-loan reimbursement and guaranteeing a minimum yield on the loans, the credit quality of these securitisations will weaken if the fiscal position of the U.S. Government weakens.

It is currently projected that the U.S. economy will slowly continue to recover in 2013 and that GDP will grow by approximately 2.5%. And while it is not yet known if Congress will be successful in cutting federal debt in 2013, the projected decrease in unemployment levels should alleviate some of the financial burden imposed on the U.S. Government by unemployment claims and student loan default reimbursement.

Special purpose entities[a]

Special purpose entities ("SPE") are generally used for isolating assets of operating companies so that they are not affected by insolvency and also, if necessary, to enable these assets, which are frequently used as collateral, to be disposed of more easily. The DEPFA Group uses special purpose entities for various purposes as part of its business operations, whereby the emphasis is clearly placed on risk reduction.

The following table summarises the special purpose entities included in the consolidated financial statements of the DEPFA Group in accordance with International Financial Reporting Standards ("IFRSs") as of 31 December 2012 and 31 December 2011. The assets used as the basis of consolidation are mainly classified as loans and receivables ("LaR").

Consolidated special purpose entities by categories

Nominal value in € m	31 December 2012	31 December 2011
Refinancing of the DEPFA Group	31	32
Total	**31**	**32**

[a] Forms an integral part of the audited financial statements

The following overview sets out the nominal volume of transactions with non-consolidated special purpose entities. The other transactions mainly consist of cash-collateralised liquidity facilities.

Transactions with non-consolidated special purpose entities

Nominal value in € m	31 December 2012	31 December 2011
Other	395	402
Total	**395**	**402**

Watchlist and non-performing loans[a]

Early warning system The early warning system of the DEPFA Group guarantees that risks are identified as early as possible and are steered effectively.

The Watchlist serves as the early identification mechanism for loans/borrowers/sponsors that are currently not developing as planned (in particular before a contractual event of default occurs). This enables the DEPFA Group to start to take the necessary measures as early as possible to steer the risk and maximise value.

Restructuring loans are generally loans extended to counterparties which satisfy at least one criterion under Basel II (e.g. a major liability of the debtor is more than 90 days overdue as a result of arrears due to the banking group, a moratorium on interest payments, costs and fees, waiver of receivables or interest, the debtor has applied for insolvency) and for which no individual impairment has yet been recognised.

If no further default criterion exists 90 days after the debtor has settled the default, the default can be cancelled and it is no longer necessary for the loan to be classified as non-performing.

Workout comprises all loans exposed to acute default risks and for which risk provisioning had to be created (an individual allowance or single loan loss provision).

Development of the watchlist and non-performing loans The portfolio of non-performing loans and Watchlist loans as at the end of the year is set out in the following table:

Watchlist and non-performing loans

€ m	31 December 2012	31 December 2011
Workout loans	2	3
Restructuring loans	293[1)]	90
Total	**295**	**93**

[1)] of which €205 million relates to exposures guaranteed by FMS Wertmanagement (2011: € nil)

[a)] Forms an integral part of the audited financial statements

Impairments and provisions[a)]

Individual 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. Following this, the extent of impairment is calculated as the difference between the current book value and the present value of all expected future cash flows discounted at the original effective interest rate of the asset. The following are major objective indications of an impairment:
- Considerable financial difficulties of the borrower;
- Overdue contractual interest payments or redemption payments or other breaches of contract;
- Increased probability that the borrower will become insolvent or will undergo a restructuring process; and
- Re-negotiations as a result of financial difficulties.

As part of the process of individual processing of significant loans, the extent of the sustainably recoverable amount is determined by discounting the expected cash flows. The interest rate specified at the point at which the loan was extended is normally used for discounting purposes. The impairment is calculated by deducting this amount from the current book value of the asset. In the case of financial assets classified as available-for-sale ("AfS") the impairment is defined with reference to the market price.

In 2012 the impairment triggers continued to be refined and adapted.

The following factors in particular are taken into consideration for determining the actual amount of the impairment:
- The total exposure of the DEPFA Group to the borrower;
- The amount and timing of the expected interest rate payment and redemption payment;
- The recoverable amount of the securities and the probability of successful recovery;
- The probable amount of costs for collecting outstanding amounts; and
- If available, the market price of the asset.

Portfolio-based allowances are calculated using risk parameters which are compliant with Basel II, such as PD and 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.

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.

Impairment process The impairment of all credit risks is approved by the DEPFA Group Risk Provisioning Committee and is communicated to the DEPFA EDC. Such approval is preceded by a multiple stage process which is applicable in all subsidiaries throughout the DEPFA Group. The following instruments have been implemented for identifying, analysing and measuring the credit risk:

[a)] Forms an integral part of the audited financial statements

- Annual review with regular check of the rating (PD, LGD and EL) and the relevant security;
- Where appropriate, covenant monitoring with a check to determine whether the specified covenants are being met;
- System monitoring on the basis of overdue items (interest, redemption payments and costs); and
- Early warning system for placing critical exposures on the Watchlist.

All non-performing loans are dealt with at least as of the statement of financial position date in order to determine whether it is necessary to adjust the provisions for losses on loans and advances.

An overview of the development of allowances for losses on loans and advances can be found in note 20 in the notes to the consolidated financial statements.

Provisions for/reversals of losses on loans and advances amounted to €–32 million (2011: €31 million). The 2012 figure includes specific loan loss provisions of €–69 million (2011: net write backs €14 million) which relate to exposures which are recoverable under financial guarantee contracts with FMS Wertmanagement. There is also a decrease in portfolio-based allowances of €37 million (2011: €17 million). In accordance with IAS 39, portfolio-based allowances are created only for loans and receivables for which there have not yet been any indications of an individual impairment.

Recovery of losses on loans and advances under financial guarantees amounted to €69 million (2011: € nil) and relates to the specific loan losses on exposures guaranteed by FMS Wertmanagement, as referred to above.

Contingent liabilities and other obligations Contingent liabilities and other obligations mainly comprise guarantee risks, letters of credit and irrevocable loan commitments and declined to €120 million in 2012 (2011: €295 million). With regard to the analysis of the impairments, it has to be borne in mind that provisions for losses on loans and advances do not include impairments in relation to exposures reported as derivatives, trading assets or financial investments. Accordingly, defaults of credit institutions are mainly recognised in net trading income or in net expense from financial investments. In the financial year 2012, a cost of € nil (2011: € nil) from default risk of customer derivative positions was recognised in net trading income.

Direct write-ups, impairments and portfolio-based allowances for financial investments – income statement effects

Income statement effects € m	31 December 2012	31 December 2011
Portfolio-based allowances	2	1
Total	**2**	**1**

(b) Market risk

Definition[a)]

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 the DEPFA Group are mainly exposed to the following risk types:
- Credit-spread risk
- General interest rate risk
- Foreign currency risk
- Tenor and foreign exchange basis risk

Organisation of market risk management[a)]

In line with the requirements of Risk Management ("MaRisk"), the trading and banking book positions are monitored by Risk Management & Control which is separate from Treasury in the structure of the organisation right through to responsibility at the Board of Directors level.

Market risk strategy[a)]

The DEPFA Group adheres to the following guiding principles to manage market risk:
1. In compliance with MaRisk, business is allowed only in financial instruments that can be priced independently (availability of pricing methods and market data), which can be broken down into risk drivers (availability of market data history), which have successfully passed the New Product Process and for which of the following aspects have been documented properly:
   - System representation;
   - Pricing methods;
   - Required market and model data; and
   - Risk monitoring methodology.
2. Business is conducted with respect to client needs.
3. Risk monitoring and the economic profit and loss monitoring are performed daily.
4. Risk concentrations regarding market risk are monitored on a daily basis.
5. Credit spread risks are an integral part of the business model (e.g. PSF cover pool positions). Therefore the credit spread risk of positions classified as Loans and Receivables (LaR) are not limited in market risk. The risk resulting from credit spread changes due to rating migrations is considered in the credit risk limit. However, the credit spread risk of positions which are not part of LaR is limited by the market risk limit.
6. Hedging of foreign exchange risk, e.g. no active proprietary FX-risk positioning (HRE Group ALCO provides HRE Group-wide steering for IFRS based FX positions).

[a)] Forms an integral part of the audited financial statements

Market risk reports[a]

Risk Management & Control prepares extensive market risk reports at the DEPFA Group level daily for various recipients:

- The daily market risk report is addressed to the DEPFA Group's senior management. It shows market risk VaR, limit utilisations and economic performance figures at the DEPFA Group level and also at various levels of detail.
- Daily sensitivity reports comprise analyses of the main risk factors at various levels of detail and are made available to Risk Management personnel as well as to the DEPFA Group's senior management.

Measurement and limiting[a]

Daily measurement and limiting of market risk positions: Risk Management & Control uses a variance-covariance approach to calculate the market risk VaR at the overall and sub-portfolio level on a daily basis. All trading and banking 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.

Individual market risk components, such as the interest, foreign exchange and credit spread VaR, are aggregated to form a total VaR.

The VaR is calculated on a consolidated basis at the DEPFA Group level and also at the individual subsidiary banks, operating segments, departments, portfolios and desk levels.

The market risk VaR (10-day holding period; 99% confidence level) for the DEPFA Group amounted to €7 million as of 31 December 2012 (31 December 2011: €13 million).

During the third quarter of 2012, the Board approved a market risk limit reduction for the DEPFA Group from €45 million to €25 million.

[a] Forms an integral part of the audited financial statements

The following table illustrates the market risk VaR of the DEPFA Group as well as the VaR for the individual risk types compared with the market risk limits at year end:

Market risk VaR, VaR for the individual risk types and market risk limits

€ m	31 December 2012	31 December 2011
Total VaR	**7**	**13**
Interest Rate VaR	7	10
Foreign Exchange VaR	1	9
Limit	**25**	**45**
% utilisation	**28%**	**29%**

No VaR limit breach occurred during 2012.

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

Sensitivity analysis Sensitivity analyses quantify the impact of a change in individual market parameters on the value of the positions of the DEPFA Group. 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.

Back testing The quality of the risk measuring 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 DEPFA Group has used the traffic signal system of the Basel Capital Accord. In this process, the statistical (negative) outliers determined as part of the back testing 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 the DEPFA Group is thus within an acceptable range.

Stress testing Stress scenarios show the market risk under extreme conditions compared to the VaR measurement which 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 disadvantageous for the position of the Bank. At the DEPFA Group, uniform hypothetical stress scenarios throughout the DEPFA Group are calculated on a monthly basis for all key risk drivers (credit spreads, interest rates, foreign currency rates) across all books. Historical stress scenarios are also simulated. For example, an upward parallel shift of 200 bps in the interest rate curve would result in a change of approximately €–13.0 million in the market value for all books of the DEPFA Group (2011: €42.8 million).

Economic market risk capital

Economic Market Risk Capital is calculated using a methodology known as history preserving resampling. This involves creating a loss distribution from monthly historic measurements of Market Risk factors and calculating the associated changes in portfolio values. The required Economic Capital figure is the 99.95th percentile of this distribution.

The economic capital for market risk over a one-year horizon was €30 million as of 31 December 2012 (December 2011: €205 million), excluding diversification effects to other risk types. The decrease is mainly driven by the removal of perpetual hybrid capital instruments from the market risk economic capital calculation.

Control, management and monitoring of market risk[a)]

The DEPFA Group uses a three-pillar approach for managing and monitoring the market risk:
- Risk management controls implemented in the front office;
- Risk measurement and monitoring compliance with limits by Risk Management & Control; and
- Escalation processes across all decision-making committees right through to the DEPFA BANK plc Board of Directors level.

The market risk is monitored by a combination of 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. The daily management of the market risk positions is carried out in Treasury/Public Finance.

Development of the relevant market risk types[a)]

General interest rate risk The total general interest rate risk of the DEPFA Group amounted to approximately €7.03 million VaR as of 31 December 2012 (compared with €10.2 million as of 31 December 2011). On average, the interest rate risk of approximately €6.9 million for 2012 (max. €13 million; min. €3.1 million) was still at a lower level than the previous year (average VaR for 2011 €9.9 million; max. €27 million; min. €3.6 million). Non-linear interest risks are insignificant.

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 the DEPFA Group. Most of the credit spread risk is attributable to assets eligible as cover for asset covered securities and Lettres de Gage. The limit is applicable only to the credit spread risks of the trading books, AfS fair value positions and designated as at fair value through profit and loss ("dFVTPL") holdings and is not applicable for the LaR positions. However, sensitivities are calculated for all holdings, i.e. also for LaR positions.

[a)] Forms an integral part of the audited financial statements

Due to the business model of the DEPFA Group, the security holdings in the asset covered securities and Lettres de Gage cover pools account for the majority of the DEPFA Group'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 €–25.7 million at the end of December 2012 with a simultaneous increase of one basis point in all credit spreads; of this figure, only €–0.05 million was attributable to the trading books (corresponding figures at the end of 2011 €–27.7 million, trading books €0.1 million).

Foreign currency risk and other market risks The foreign currency risk which is calculated as a present value amounted to €1.0 million as of 31 December 2012; the corresponding figure as at 31 December 2011 was €9.3 million. The general strategy of the DEPFA Group is to hedge foreign currency risks as far as possible.

The DEPFA Group is not exposed to equity or commodity risks and inflation risks are hedged.

(c) Liquidity risk

Definition[a)]

Liquidity risk is defined as the risk of not being able to meet future payment obligations in full or on time. This would for instance be the case if there were no longer sufficient external refinancing sources.

Organisation of liquidity risk management[a)]

The DEPFA Group MRC identifies, measures, reports and monitors the liquidity risk at the DEPFA Group level. The processes and methods used are regularly reviewed by the DEPFA Group ALCO and are reported to the HRE Group ALCO.

Liquidity risk strategy[a)]

The liquidity risk strategy is a key component of the DEPFA Group's risk strategy. Liquidity risk reports project the liquidity position of the DEPFA Group under a variety of scenarios. The DEPFA Group's liquidity risk is controlled by means of a limit system applied to these reports. The limits are defined as part of the annual business planning process.

[a)] Forms an integral part of the audited financial statements

To produce the liquidity reports, contractual cash flows are combined with estimates for contingent cash flows and the funding capacity of liquid assets. Estimates of non-contractual cash flows reflect the scenario underpinning the report and are subject to regular back testing. Liquidity reports corresponding to three scenarios are produced on a daily basis:

- constant market and funding environment ("Base" scenario);
- a more conservative market and funding environment ("Risk" scenario); and
- a combined idiosyncratic and market wide liquidity shock event ("Stress" scenario – similar to the market conditions post Lehman default.)

Limits are defined for these three scenarios on a DEPFA Group level. For the risk and stress scenarios, limits are defined out to two years. For the base scenario, limits are defined out to ten years.

In addition to these daily calculated scenarios, the DEPFA Group established additional liquidity stress testing, which simulates possible effects of a macro-economic, fiscal and political crisis on the liquidity situation of the DEPFA Group.

Liquidity risk report[a]

The liquidity management reports are prepared daily on a DEPFA Group-wide basis and reported to the DEPFA Group senior management. They are reported to the Central Bank of Ireland as part of its liquidity monitoring process periodically. The reports are consolidated at the HRE Group level and liquidity reporting is also provided to the Bundesbank, Bundesanstalt für Finanzdienstleistungsaufsicht ("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.

Liquidity risk monitoring and management[a]

Monitoring of the liquidity risks is assured by the daily reporting of the liquidity situation of the DEPFA Group and a defined escalation process. A liquidity contingency plan has been approved in this context, which sets out the procedures 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 Board of Directors of DEPFA BANK plc. This ensures that the individual companies of the DEPFA Group have adequate liquidity reserves.

[a] Forms an integral part of the audited financial statements

Hedging and reduction of liquidity risk[a]

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. In addition, the DEPFA Group maintains a "buffer" of highly liquid assets for use in withstanding liquidity shocks and stress events. The necessary size and composition of this buffer is specified by the DEPFA Group ALCO and is monitored daily.

Development of the risk position[a]

The transfer of positions to FMS Wertmanagement was a key milestone for the stabilisation of the DEPFA Group. The transfer of non strategic positions and risk positions was a significant improvement to the DEPFA Group's statement of financial position structure and liquidity position, which resulted in no further requirement for liquidity assistance and a significantly lower dependence on market movements. The DEPFA Group continued to exceed all minimum liquidity ratio requirements from the Central Bank of Ireland during 2012.

The liquidity situation for the DEPFA Group remains stable and the DEPFA Group continues to expect that it will meet all contractual and regulatory obligations going forward. The liquidity requirements for 2013, however, are dependent on:

- the future development of the discounts for repo refinancing on the market and with the central banks;
- collateral requirements as a result of changing market parameters (includes interest rates, foreign currency rates and basis for calculation). The DEPFA Group has a policy which ensures all derivative contracts with major Financial Institutions are covered by a Collateral Support Agreement. Changes in the underlying market parameters could result in posting or receiving additional liquidity under such contracts; and
- changing requirements of the rating agencies regarding the necessary surplus in the cover pools.

[a] Forms an integral part of the audited financial statements

(d) Operational risk

Definition

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

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

Organisation of operational risk management

The DEPFA Group has established a centralised Operational Risk function within the Risk Management & Control division that focuses on the coordination of consistent policy, tools and practices throughout the DEPFA Group for the management, measurement, monitoring and reporting of relevant operational risks.

Strategy for operational risks

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

Risk reports, monitoring and management of operational risks

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

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

- Key risk indicator ("KRI") reporting – provide potential early warning of increased risk associated with non-attainment of control objectives;
- Operational risk self-assessments – based on the identification of threats to business processes, the impact of those threats and the subsequent evaluation of controls in place to mitigate the risk; mitigation plans for high-rated risks are monitored by the Operational Risk department;
- Risk event management – the collection, reporting and analysis of internal risk event data enables the DEPFA Group to identify weak controls, ineffective processes or activities and poor systems; and ensures that the DEPFA Group takes appropriate action to mitigate any exposures;

- New Products – the New Product Process Committee ensures that all products can be managed and measured by the DEPFA Group's management information systems and are reviewed primarily on an annual basis. As the DEPFA Group is no longer writing new asset business, a new product would only arise in the event of re-hedging or management of liquidity or regulatory risks; and
- Targeted risk reviews – in partnership with the business, pre-defined key areas of risk examined in depth and recommendations for risk mitigation are provided.

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

Risk measurement

The economic capital for operational risk amounted to €19 million as of 31 December 2012 (31 December 2011: €11 million).

In order to determine the minimum capital requirement in accordance with Basel II and the EU Capital Requirements Directives ("CRD"), the DEPFA Group uses the standardised approach. The capital requirement of the DEPFA Group for operational risks under this approach is €15.3 million as at 31 December 2012 (€22.7 million as of 31 December 2011).

Major operational risks of the DEPFA Group

The main operational risks are essentially attributable to the ongoing process of restructuring and repositioning the DEPFA Group. This includes the current provision of services to FMS Wertmanagement and the planned deployment of the servicing teams within DEPFA to the FMS Wertmanagement Servicing company scheduled for October 2013.

There is a significant reliance on key staff for execution of the restructuring and performance of regular processes and controls. This is particularly important given the environment of processing systems and manual processes and controls. The loss of know-how represents a significant level of risk in the current situation of the DEPFA Group. While the level of staff turnover within the DEPFA Group reduced during 2012, this risk still remains high.

The oversight of Operational Risk within the DEPFA Group has increased in 2012. Monthly reporting of Operational Risk events and losses to the DEPFA Board highlight significant operational risks which allow the DEPFA Board to focus on key areas of concern.

KRI reporting produced quarterly for DEPFA Group has been extended to include individual location KRI reports specifically for London and New York. KRI data and thresholds have also been reviewed in 2012 by the business segments and agreed and signed off by the DEPFA Board Risk Committee.

Group wide staff training has been rolled out in all DEPFA locations to increase awareness and knowledge of Operational Risk.

(4) Internal capital adequacy assessment process ("ICAAP")

Economic capital and monitoring the risk-bearing capacity

The DEPFA Group has established a risk-bearing capacity analysis which is based on ICAAP. The assessment of internal capital adequacy is based on the concept of economic capital and the comparison to the available financial resources of the DEPFA Group.

Economic capital ("ECap") is the amount of capital required by a bank to cover the risk it is running. It is defined as "the quantity of capital required by a bank in order to cover the largest potential unexpected total loss with a defined probability over a time horizon of one year". The standard used by the DEPFA Group for the quantification of the potential losses, over a one-year horizon, is a statistical confidence level of 99.95% which implies a lower default probability than that associated with companies with good long-term credit ratings from the external rating agencies (A– at Standard & Poor's, A/A2 at Fitch Ratings and Moody's).

The specific methods of calculating the unexpected loss for the individual risk types are described in greater detail in the section "Method used for individual risk types." As is market standard for commercial banks, liquidity risk is not included in the DEPFA Group's economic capital calculations but it is taken into consideration by quantifying the potentially higher funding costs.

In evaluating the capital adequacy of the DEPFA Group, the amount of economic capital is compared with the available financial resources of the DEPFA Group in a one year timeframe. Included in the available financial resources are the customary components such as the shareholders' equity, in accordance with IFRS, subordinated capital and hybrid capital with a holding period of at least one year, as well as the planned net income or loss for the next twelve months. These components are suitable for absorbing potential losses and maintaining a risk buffer. Thus capital adequacy would be achieved provided the level of available financial resources is over and above the economic capital.

The results of the capital adequacy assessment process and of the stress tests are regularly presented to the DEPFA Group MRC and the Board of Directors of DEPFA BANK plc, and when necessary appropriate management measures are defined by the DEPFA Group MRC.

Result of the ICAAP of the DEPFA Group

Economic capital according to risk types and available financial resources € m	31 December 2012	31 December 2011	Change
Credit risk	1,152	758	394
Market risk	30	205	–175
Operational risk	19	11	8
Total before diversification effect	**1,201**	**974**	**227**
Total after diversification effect	**1,182**	**925**	**257**
Available financial resources (AFR)	3,167	3,060	107
Capital buffer	1,985	2,135	–150

The increase in capital is driven mainly by the increased economic capital required for credit risk due to credit downgrades of Italy and Spain in 2012. The decrease in market risk is mainly driven by the removal of perpetual hybrid capital instruments from the market risk economic capital calculation.

Credit risk is the most significant risk type on the basis of the ICAAP and accounts for 96% of the undiversified economic capital.

There is a significant economic capital buffer of approximately €2 billion for a one-year observation period as of 31 December 2012 (31 December 2011: €2.1 billion). In terms of economic capital, the DEPFA Group was adequately capitalised during 2012.

Method used for the individual risk types

The economic capital of each risk type is determined using a quantitative approach and aggregated to form an overall measure of the Bank’s risks, taking account of specific correlations. In line with the common market standard, the risk types are measured for a period of one year and at a confidence level derived from the target rating of the ICAAP (in this case: 99.95%).

The method of calculating the economic capital for the individual risk types for 2012 is explained in the following paragraphs:

Credit risk

For calculating credit risk at the portfolio level, the DEPFA Group uses a credit portfolio model following the asset value approach. In this model correlated rating migrations and borrower defaults are simulated and the resulting changes in the values are calculated. After a large number of simulations a loss distribution may be generated. The credit risk economic capital is defined as the difference between the 99.95th percentile of the simulated loss distribution and the mean of this distribution. Moreover, the loss distribution of the credit portfolio allows the attribution of the potential losses (economic capital) to individual obligors based on the calculation of the expected shortfall associated with individual obligors. The risk-adjusted allocation of the credit risk capital measured in this way to the individual obligors constitutes a major module in the risk-oriented management of the credit portfolio.

Market risk

Market Risk Economic Capital is calculated using a methodology known as history preserving resampling. This involves creating a loss distribution from monthly historic measurements of Market Risk factors and calculating the associated changes in portfolio values. The required Economic Capital figure is the 99.95th percentile of this distribution.

The economic capital for market risk over a one-year horizon was €30 million as of 31 December 2012 (December 2011: €205 million), excluding diversification effects to other risk types.

Operational risk

The calculation of economic capital for operational risk is based on the standard approach (past gross income figures are taken as indicators of Operational Risk) in accordance with Basel II. However for estimation of ICAAP Operational Risk the standardised approach is made more conservative by also taking into account planned Total Operating Revenues figures. The capital requirement specified by the regulator is also scaled to reflect the higher confidence level (from 99.9% to 99.95%).

The economic capital for operational risk amounted to €19 million as of 31 December 2012 (31 December 2011: €11 million).

Business risk

The business risk that has been identified for the DEPFA Group ICAAP is the risk of higher funding costs.

Funding costs may increase for the following two reasons:
- Higher funding requirement
- Increase in the unsecured funding rate

As part of the liquidity risk measurement, the increased funding requirement which would occur in conjunction with certain market events is simulated every month under a stress scenario. For the unsecured funding rate, the historic maximum of credit spreads for a bank with DEPFA's credit rating is used in the calculation of the potential funding cost. We prudently assume that the higher funding rate and the greater funding requirement happen simultaneously.

The calculation of the economic capital for Business Risk reflects the risk arising from higher funding costs. As the DEPFA Group had a secure funding position during 2012 and the stress scenarios result in a positive liquidity buffer over the following 12 months, no capital needs to be allocated for business risk.

Stress tests

Stress tests in relation to the economic capital are used in order to obtain a better understanding of the sensitivity of the results to the changes in the risk parameters underlying the model. The DEPFA Group carries out stress tests as an instrument for appropriate economic capital management for four individual categories, each in relation to an isolated risk type:

- Downgrading of the main counterparties as measured by economic capital attribution
- Stress tests of the creditworthiness of all counterparties
- Operational risk
- Business risk

In addition the DEPFA Group runs several ad-hoc scenarios tailored specifically to its portfolio.

This concludes the risk management section of the Directors' report.

Regulatory capital and capital adequacy ratios

Since 1 January 2008 the regulatory capital and capital adequacy ratios were produced in accordance with the Capital Requirements Directive 2006/48/EC and 2006/49/EC ("CRD") as transposed into Irish law in Statutory Instruments 661 & 660.

The DEPFA Group is regulated by the Central Bank of Ireland, which applies a capital/risk framework for measuring capital adequacy based on the CRD. Under this framework banks are required to maintain a minimum Tier 1 capital of 4% and a Total capital of 8% of risk weighted assets (known as Pillar One requirements). The DEPFA Group uses the Basel II standardised approach to calculate the risk weighted assets.

Under the framework following a Supervisory Review and Evaluation Process ("SREP"), the Central Bank of Ireland has imposed additional requirements on the DEPFA Group resulting in minimum capital requirements higher than those calculated under Pillar One. The additional requirements are only applicable to total own funds and are based on a combination of the Pillar One calculations and certain individual economic risk calculations which are described in the risk management section of the Directors' report, (4) ICAAP. The DEPFA Group's capital was in excess of the Pillar One and SREP requirements during both 2012 and 2011.

There were no breaches by the Bank of the capital ratios during 2012 (2011: no breaches). At 31 December 2012 the Bank's Total capital ratio exceeds the minimum required ratio at 40.95% (2011: 61.72%).

No capital contributions were received by the Bank during 2012 (2011: € nil). During 2010 the Bank received non-refundable capital contributions from HRE Holding totalling €900 million. These non-refundable contributions qualify as Regulatory Tier 1 Capital.

With a Tier 1 capital ratio of 37.60% (2011: 47.77%) and a Total capital ratio of 58.85% (2011: 64.28%) the DEPFA Group exceeds the minimum required ratios at Group level (Tier 1 capital ratio 4%, Total capital ratio 8.5%).

Regulatory capital € m	**31 December 2012**	**31 December 2011**
Tier I capital	1,803	2,745
Tier II supplementary capital	1,018	949
Total regulatory capital	**2,821**	**3,694**

Capital adequacy ratios	**31 December 2012**	**31 December 2011**
Risk weighted assets (€ m)	4,793	5,746
Tier I capital ratio (%)	37.60%	47.77%
Total capital ratio (Tier I + II)	**58.85%**	**64.28%**

The Central Bank of Ireland uses the term Alternative Capital Instruments ("ACI's") to describe non-standard forms of capital that are generally referred to in the market as hybrid capital. The following structures qualify as ACI's under Notice BSD S1/04, "Alternative Capital Instruments: Eligibility as Tier 1 Capital", an amendment to the implementation of EC Own Funds and Solvency Ratio Directives BSD S1/00 of the Central Bank of Ireland.

Under the terms and conditions of the ACI's issued out of DEPFA Funding II LP as listed below, DEPFA BANK plc (as the General Partner) has certain call rights. The Bank will not exercise any call right if such exercise would breach any of the eligibility criteria for Tier 1 Capital set out in Notice BSD S1/04 quoted above.

Based on the latest draft CRD IV/Capital Requirements Regulation ("CRR") (implementing the Basel III proposals for a revised regulatory framework) these instruments will no longer qualify for inclusion in Tier 1 regulatory capital. The draft CRD IV/CRR contains transitional provisions which permit the grandfathering of existing instruments with a phase out of qualifying amounts from the implementation date of the CRD IV/CRR to 31 December 2021.

The below hybrid instruments of the DEPFA Group are recognised as capital instruments in accordance with IAS 32.16. The classification of financial instruments as capital instruments or debt instruments depends on whether the DEPFA Group has a contractual obligation to make payments from an issued financial instrument. The above instruments are subordinated debt issued in the form of undated bonds via the issuance vehicles DEPFA Funding II LP, DEPFA Funding III LP and DEPFA Funding IV LP on which the DEPFA Group has no contractual obligation to make interest payments.

Hybrid capital instruments

€ m		31 December 2012	31 December 2011
DEPFA Funding II LP, perpetual note	6.50%	400	400
DEPFA Funding III LP, perpetual note	7% until 2008, thereafter CMS 10 yr + 0.1%	300	300
DEPFA Funding IV LP, perpetual note	5.029% until 2017, thereafter Euribor + 1.87%	500	500
Total		**1,200**	**1,200**

Central Bank of Ireland Corporate Governance Code (the "Code")

DEPFA BANK plc is regulated by the Central Bank of Ireland and is subject to the requirements of the Central Bank of Ireland's Corporate Governance Code for Credit Institutions and Insurance Undertakings (the "Code"). DEPFA BANK plc is not required to comply with the additional disclosure requirements for major institutions.

The Board

Role

The Board is responsible for effective, prudent and ethical oversight of the Company, setting business strategy and ensuring that risk and compliance are properly managed. There is a comprehensive schedule of matters specifically reserved for decision by the Board which includes, without limitation:

- Approval of corporate governance framework
- Changes to the DEPFA Group capital structure
- Major changes to the DEPFA Group corporate structure
- Changes to management and control structure
- Material capital expenditure
- Changes to the structure, size and composition of the Board
- Selection of the Chairman or Chief Executive Officer
- Terms of reference, membership and chairmanship of Board committees
- Changes or amendments to the terms of the delegated authority of the Chief Executive Officer

The role of the Chairman, which is non-executive, is separate from the role of the Chief Executive. There is a procedure in place to enable the directors to take independent professional advice, at the DEPFA Group's expense. The Company's parent company, for the benefit of all HRE Group entities including the Company, holds insurance cover to protect directors and officers against liability arising from legal actions brought against them in the course of their duties.

Meetings

The Chairman sets the agenda for each Board meeting. The directors are provided in advance with relevant papers to enable them to consider the agenda items and are encouraged to participate fully in the Board's deliberations. Executive management attend Board meetings and make regular presentations. The Board held seven scheduled meetings during 2012 and three additional out-of-course meetings.

Attendance at Board meetings	Board (Regular)		Board (Out-of-course)	
	A	B	A	B
Ms. M. Better[1] Chairman (German)	7	7 (1)	3	3 (3)
Dr. J. Bourke[1]	7	7	3	2 (1)
Mr. C. Dunne (resigned 31 January 2012)	–	–	–	–
Ms. F. Flannery	7	7	3	3 (1)
Mr. T. Glynn (American)	7	7	3	3
Mr. D. Grehan[1]	7	7	3	3 (3)
Mr. W. Groth[1] (German)	7	6	3	3 (3)
Mr. A. Kearns[1]	7	7	3	1
Mr. N. Reynolds	7	7	3	3
Mr. A. von Uslar-Gleichen[1] (German)	7	7 (3)	3	3 (2)
Dr. H. Walter[1] (German)	7	7	3	3 (3)

[1] Non-executive

Column A indicates the number of meetings held during 2012 which the director was eligible to attend.
Column B indicates the number of meetings attended by each director during 2012.
Numbers in parenthesis indicate meetings attended in 2012 by videoconference or teleconference.

Membership

At 31 December 2012 there were seven non-executive directors and three executive directors. The names of the directors appear in the table above. Four of the non-executive directors in office during 2012 are considered to have been independent: Dr. John Bourke, Mr. Duncan Grehan, Mr. Adrian Kearns and Dr. Herbert Walter. Non-executive directors are appointed so as to maintain an appropriate balance on the Board and to ensure a sufficiently wide and relevant mix of backgrounds, skills and experience to provide strong and effective leadership and control of the Company.

Internal control and risk management system with regard to the accounting process

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

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

In the DEPFA Group, the internal control and risk management system with regard to the accounting process is reflected in the structure and procedure organisation. In terms of structure organisation, the internal control and risk management system with regard to the accounting process comprises the Board of Directors, the Audit Committee and the departments which report to the DEPFA Group CFO.

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

The Board of Directors has established an audit committee that operates within specific terms of reference approved by the Board. The internal audit department supports the Board of Directors in its control function by way of independent audits.

The DEPFA Group CFO is responsible for preparing the consolidated financial statements in accordance with IFRSs as adopted by the EU. The companies of the DEPFA Group prepare their financial statements in accordance with the respective local legal requirements. For DEPFA Group accounting purposes, the financial statements are harmonised in relation to uniform accounting policies in accordance with IFRSs. Each company included in the consolidated financial statements reports its statement of financial position, income statement and notes via the consolidation software to a central department in Finance. In Finance, the data of the foreign currency companies is translated into Euro by means of the consolidation software. In addition, this is where the data is checked for plausibility, analysed and consolidated.

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

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

Chairman

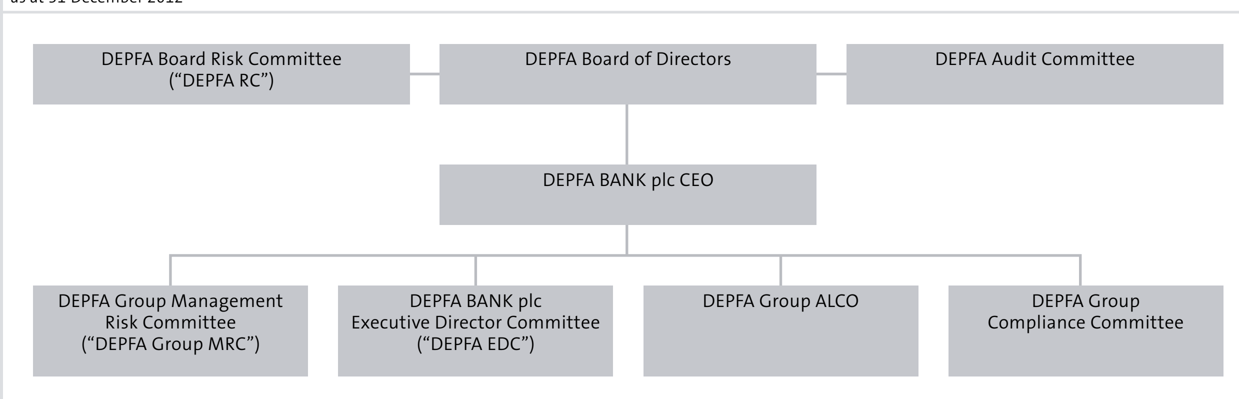
The role of the Chairman is to lead the Board, encourage critical discussions, challenge mindsets and promote effective communication between executive and non-executive directors.

Chief Executive Officer

The Board has delegated responsibility for DEPFA BANK plc's operations, the execution of its strategy and responsibility for its compliance and performance to the Chief Executive Officer ("DEPFA BANK plc CEO"). The DEPFA BANK plc CEO is authorised by the Board to establish management committees to support him in carrying out his functions, including a DEPFA BANK plc Executive Director Committee ("DEPFA EDC"), to which the Board has authorised the Chief Executive Officer to appoint and sub-delegate certain matters.

Standing committees of the Board of Directors and management committees of the Chief Executive Officer

as at 31 December 2012



Company Secretary

The directors have access to the advice and services of the Company Secretary who is responsible for ensuring that Board procedures are followed and that applicable rules and regulations are complied with.

Performance evaluation

The Board evaluated its own performance during the year, under the guidance of the Chairman. Each director completed a questionnaire, the results of which were collated and presented for discussion at a Board meeting. Arising from the evaluation, a number of modifications were made to further strengthen the Board's functioning.

Induction and professional development

There is an induction process for new directors. The induction is designed to familiarise directors with the Company and its operations and comprises the provision of relevant briefing material and a programme of meetings with the heads of divisions and senior management. During 2012, workshops on the topics ICAAP, Compliance, Anti-Money Laundering, Financial Reporting and Risk Management were held for the benefit of the directors.

In addition, some directors attended external seminars run by the Central Bank of Ireland and external training companies relating to Corporate Governance matters, Directors Duties and Effective Risk Management.

Board Committees

The Board is assisted in the discharge of its duties by a number of Board Committees, whose purpose it is to consider, in greater depth than would be practicable at Board meetings, matters for which the Board retains responsibility. The composition of such Committees is reviewed annually by the Board. A description of these Committees, each of which operates under Terms of Reference approved by the Board, is given below. Their membership is listed on page 6.

Audit Committee

The purpose of the Committee is to carry out the following duties:
- Monitor the effectiveness of the internal control systems.
- Oversee the financial reporting process.
- Monitor the effectiveness of the HRE Group internal audit function, as it applies to the DEPFA Group.
- Manage the overall relationship with the external auditor.
- Monitor the effectiveness of the process for monitoring compliance with applicable laws and regulations.
- Monitor the effectiveness of the IT system.

Board Risk Committee

The purpose of the Committee is to carry out the following duties:

- Consider and recommend to the Board the DEPFA Group's Risk Appetite.
- Consider and recommend to the Board the DEPFA Group's Risk Strategy.
- Review on behalf of the Board the DEPFA Group's risk profile.
- Monitor the effectiveness of the DEPFA Group's risk management organisation relative to the risk profile of the DEPFA Group.
- Advise the board on the effectiveness of policies with respect to maintaining, on an ongoing basis, amounts, types and distribution of both internal capital and own funds adequate to cover the risks of the institution.

On behalf of the Board

Tom Glynn	**John Bourke**	**Noel Reynolds**	**Elaine Tiernan**
Director	Director	Director	Company Secretary

14 March 2013

Statement of directors' responsibilities

The directors are responsible for preparing the Directors' report and the DEPFA Group and Parent Company financial statements, in accordance with applicable law and regulations.

Company law requires the directors to prepare Group and Parent Company financial statements for each financial year. Under that law the directors are required to prepare the DEPFA Group financial statements in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the EU and have elected to prepare the Parent Company financial statements in accordance with IFRSs as adopted by the EU as applied in accordance with the Companies Acts 1963 to 2012.

The DEPFA Group and Parent Company financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position and performance of the DEPFA Group and Parent Company. The Companies Acts 1963 to 2012 provide in relation to such financial statements that references in the relevant part of those Acts to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing each of the DEPFA Group and Parent Company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state that the financial statements comply with IFRSs as adopted by the EU and in accordance with the Companies Acts 1963 to 2012; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the DEPFA Group and the Parent Company will continue in business.

Under applicable law, the directors are also responsible for preparing a Directors' report. In addition, in accordance with the Transparency (Directive 2004/109/EC) Regulations 2007 (the Transparency Regulations), the directors are required to include in their report a fair review of the business and a description of the principal risks and uncertainties facing the DEPFA Group and the Parent Company and a responsibility statement relating to these and other matters, included below.

The directors are responsible for keeping proper books of account that disclose with reasonable accuracy at any time the financial position of the DEPFA Group and Parent Company and enable them to ensure that the financial statements comply with the Companies Acts 1963 to 2012 and, as regards the DEPFA Group financial statements, Article 4 of the IAS Regulations. They are also responsible for taking such steps as are reasonably open to them to safeguard the assets of the DEPFA Group and to prevent and detect fraud and other irregularities.

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

On behalf of the Board

Tom Glynn	**John Bourke**	**Noel Reynolds**	**Elaine Tiernan**
Director	Director	Director	Company Secretary

14 March 2013

Responsibility statement, in accordance with the Transparency Regulations

Each of the directors in office, whose names and functions are listed on page 6 confirm that, to the best of each person's knowledge and belief:

- The DEPFA Group financial statements, prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities and financial position of the DEPFA Group at 31 December 2012 and its net income for the year then ended;
- The Parent Company financial statements, prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the Companies Acts 1963 to 2012, give a true and fair view of the assets, liabilities and financial position of the Parent Company at 31 December 2012; and
- The Directors' report includes a fair review of the development and performance of the business and the position of the DEPFA Group and Parent Company, together with a description of the principal risks and uncertainties that they face.

On behalf of the Board

Tom Glynn	**John Bourke**	**Noel Reynolds**	**Elaine Tiernan**
Director	Director	Director	Company Secretary

14 March 2013

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

We have audited the Group and Parent Company financial statements ("financial statements") of DEPFA BANK plc ("the Bank" or "the Company") for the year ended 31 December 2012 which comprise; the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated Statement of Financial Position, the Company Statement of Financial Position, the Consolidated Statement of Changes in Equity, the Company Statement of Changes in Equity, the Consolidated and Company Cash Flow Statements and the related notes. The financial reporting framework that has been applied in their preparation is Irish law and International Financial Reporting Standards ("IFRSs") as adopted by the European Union, and, as regards the Parent Company financial statements, as applied in accordance with the provisions of the Companies Acts 1963 to 2012.

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

Respective responsibilities of directors and auditors

As explained more fully in the Statement of Directors' Responsibilities set out on page 74 the directors are responsible for the preparation of the financial statements giving a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with Irish law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Ethical Standards for Auditors issued by the Auditing Practices Board.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on the financial statements

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Group's affairs as at 31 December 2012 and of its net income for the year then ended;

- the Parent Company statement of financial position gives a true and fair view, in accordance with IFRSs as adopted by the EU as applied in accordance with the provisions of the Companies Acts 1963 to 2012, of the state of the Parent Company's affairs as at 31 December 2012; and
- the financial statements have been properly prepared in accordance with the Companies Acts 1963 to 2012.

Matters on which we are required to report by the Companies Acts 1963 to 2012

We have obtained all the information and explanations which we consider necessary for the purposes of our audit.

The Parent Company statement of financial position is in agreement with the books of account and, in our opinion, proper books of account have been kept by the Company.

In our opinion the information given in the Directors' report is consistent with the financial statements and the description in the Corporate Governance Statement of the main features of the internal control and risk management systems in relation to the process for preparing the Group financial statements is consistent with the Group financial statements.

The net assets of the Company, as stated in the Company statement of financial position are more than half of the amount of its called-up share capital and, in our opinion, on that basis there did not exist at 31 December 2012 a financial situation which under Section 40 (1) of the Companies (Amendment) Act, 1983 would require the convening of an extraordinary general meeting of the Company.

Matters on which we are required to report by exception

We have nothing to report in respect of the provisions in the Companies Acts 1963 to 2012 which require us to report to you if, in our opinion the disclosures of directors' remuneration and transactions specified by law are not made.

Frank Gannon

for and on behalf of
KPMG
Chartered Accountants, Statutory Audit Firm

1 Harbourmaster Place
IFSC
Dublin 1, Ireland

14 March 2013

Financial statements

Consolidated income statement

Consolidated income statement € m	Note	For year ended on 31 December 2012	For year ended on 31 December 2011
Interest and similar income	7	1,507	1,867
Interest expense and similar expenses	7	–1,482	–1,813
Income from buyback of liabilities	7	61	142
Net interest income		**86**	**196**
Fee and commission income	8	1	5
Fee and commission expense	8	–20	–24
Net fee and commission expense		**–19**	**–19**
Net trading income	9	41	19
Net expense from financial investments	10	–11	–53
Net income from hedge relationships	11	5	4
Other operating income	12	89	105
Other operating expense	12	–57	–24
Total operating revenues		**134**	**228**
Provision for/reversals of losses on loans and advances	20	–32	31
Recovery of losses on loans and advances under financial guarantees	20	69	–
Total reversals of losses on loans and advances net of guarantees		**37**	**31**
General administrative expenses	13	–117	–134
Other income/expenses	14	14	–1
Of which: restructuring expenses		12	3
Of which: other		2	–4
Pre-tax income		**68**	**124**
Taxes on income	15	–9	–5
Net income		**59**	**119**
Attributable to:			
Equity holders of the parent		59	119

The notes on pages 87 to 153 are an integral part of these consolidated financial statements.

On behalf of the Board

Tom Glynn
Director

John Bourke
Director

Noel Reynolds
Director

Elaine Tiernan
Company Secretary

14 March 2013

Consolidated statement of comprehensive income			2012			2011
€ m	Before tax	Tax	Net of tax	Before tax	Tax	Net of tax
Net income	68	–9	59	124	–5	119
AfS reserve movement – net	6	–1	5	13	–1	12
Exchange differences	–	–	–	2	–	2
Total	**74**	**–10**	**64**	**139**	**–6**	**133**
attributable to:						
Equity holders of the parent	74	–10	64	139	–6	133

Disclosure of components of comprehensive income		
€ m	2012	2011
Net income	59	119
Other comprehensive income	**5**	**14**
AfS reserve movement – net	5	12
Gains arising during the year	5	12
Reclassification adjustments for gains/losses included in net income or loss	–	–
Cash flow hedge reserve – net	–	–
Losses arising during the year	–	–7
Reclassification adjustments for gains included in the consolidated income statement	–	7
Exchange differences	–	2
Total	**64**	**133**

The notes on pages 87 to 153 are an integral part of these consolidated financial statements.

On behalf of the Board

Tom Glynn
Director

John Bourke
Director

Noel Reynolds
Director

Elaine Tiernan
Company Secretary

14 March 2013

Consolidated statement of financial position

Consolidated statement of financial position € m	Note	31 December 2012	31 December 2011
Assets			
Cash reserve	16	1,564	600
Trading assets	17	13,364	20,517
Loans and advances to other banks	18	10,191	15,991
Loans and advances to customers	19	16,853	55,028
Allowance for losses on loans and advances	20	–102	–70
Losses on loans and advances recoverable under financial guarantees	20	69	–
Financial investments	21	25,334	31,617
Property, plant and equipment	22	1	1
Intangible assets	23	12	17
Other assets	24	5,798	6,028
Income tax assets	25	214	193
Current tax assets		2	1
Deferred tax assets		212	192
Total assets		**73,298**	**129,922**
Liabilities			
Liabilities to other banks	26	6,631	38,057
Liabilities to customers	27	9,085	21,356
Liabilities evidenced by certificates	28	34,654	39,456
Trading liabilities	29	13,317	20,604
Provisions	30	148	112
Other liabilities	31	6,016	6,289
Income tax liabilities	32	244	230
Current tax liabilities		31	44
Deferred tax liabilities		213	186
Subordinated capital	33	1,082	1,079
Total liabilities		**71,177**	**127,183**
Equity			
Equity attributable to equity holders			
Share capital	34	106	106
Share premium	34	1,142	1,142
Capital reserve	35	1,500	1,500
Preferred securities	36	1,136	1,136
Retained earnings	37	–1,723	–1,100
Other reserves	38	–40	–45
AfS		–42	–47
Currency translation		2	2
Total equity		**2,121**	**2,739**
Total equity and liabilities		**73,298**	**129,922**

The notes on pages 87 to 153 are an integral part of these consolidated financial statements.

On behalf of the Board

Tom Glynn
Director

John Bourke
Director

Noel Reynolds
Director

Elaine Tiernan
Company Secretary

14 March 2013

Company statement of financial position

Company statement of financial position € m	Note	31 December 2012	31 December 2011
Assets			
Cash reserve	16	1,331	587
Trading assets	17	20,605	26,559
Loans and advances to other banks	18	11,608	17,351
Loans and advances to customers	19	3,292	40,251
Allowance for losses on loans and advances	20	−97	−67
Losses on loans and advances recoverable under financial guarantees	20	69	–
Financial investments	21	4,688	8,715
Property, plant and equipment	22	1	1
Intangible assets	23	12	17
Other assets	24	341	719
Income tax assets	25	2	2
Current tax assets		1	1
Deferred tax assets		1	1
Total assets		**41,852**	**94,135**
Liabilities			
Liabilities to other banks	26	5,765	40,180
Liabilities to customers	27	8,439	19,021
Liabilities evidenced by certificates	28	2,152	2,626
Trading liabilities	29	20,662	26,489
Provisions	30	146	112
Other liabilities	31	2,241	2,633
Income tax liabilities	32	31	40
Current tax liabilities		30	38
Deferred tax liabilities		1	2
Subordinated capital	33	1,687	1,682
Total liabilities		**41,123**	**92,783**
Equity			
Equity attributable to equity holders			
Share capital	34	106	106
Share premium	34	1,142	1,142
Capital reserve	35	2,403	2,403
Retained earnings	37	−2,932	−2,310
Other reserves	38	10	11
AfS		2	2
Currency translation		8	9
Total equity		**729**	**1,352**
Total equity and liabilities		**41,852**	**94,135**

The notes on pages 87 to 153 are an integral part of these consolidated financial statements.

On behalf of the Board

Tom Glynn
Director

John Bourke
Director

Noel Reynolds
Director

Elaine Tiernan
Company Secretary

14 March 2013

Statement of changes in equity

Consolidated statement of changes in equity – Group

€ m	Share capital	Share premium	Capital reserve	Preferred securities	Retained earnings	Other reserves: Unrealised gains/losses on available-for-sale investments	Other reserves: Accumulated effects of currency translations	**Total equity**
Balance at 1 January 2011	**106**	**1,142**	**1,500**	**1,136**	**–256**	**–59**	**–**	**3,569**
Net income for the year	–	–	–	–	119	–	–	119
Net changes in available-for-sale investments, net of tax	–	–	–	–	–	12	–	12
Net changes in currency translation reserve	–	–	–	–	–	–	2	2
Total recognised comprehensive income	**–**	**–**	**–**	**–**	**119**	**12**	**2**	**133**
FMSA payment condition, net of tax	–	–	–	–	–963	–	–	–963
Balance at 31 December 2011	**106**	**1,142**	**1,500**	**1,136**	**–1,100**	**–47**	**2**	**2,739**
Balance at 1 January 2012	**106**	**1,142**	**1,500**	**1,136**	**–1,100**	**–47**	**2**	**2,739**
Net income for the year	–	–	–	–	59	–	–	59
Net changes in available-for-sale investments, net of tax	–	–	–	–	–	5	–-	5
Net changes in currency translation reserve	–	–	–	–	–	–	–	–
Total recognised comprehensive income	**–**	**–**	**–**	**–**	**59**	**5**	**–**	**64**
FMSA payment condition, net of tax	–	–	–	–	–623	–	–-	–623
Annual state aid compensation	–	–	–	–	–59	–	–	–59
Balance at 31 December 2012	**106**	**1,142**	**1,500**	**1,136**	**–1,723**	**–42**	**2**	**2,121**

The notes on pages 87 to 153 are an integral part of these consolidated financial statements.

Statement of changes in equity – Company

€ m	Share capital	Share premium	Capital reserve	Retained earnings	Other reserves: Unrealised gains/losses on available-for-sale investments	Other reserves: Accumulated effects of currency translations	**Total equity**
Balance at 1 January 2011	**106**	**1,142**	**2,403**	**–1,470**	**6**	**5**	**2,192**
Loss for the year	–	–	–	–31	–	–	–31
Net changes in available-for-sale investments, net of tax	–	–	–	–	–4	–	–4
Net changes in currency translation reserve	–	–	–	–	–	4	4
Total recognised comprehensive loss	**–**	**–**	**–**	**–31**	**–4**	**4**	**–31**
FMSA payment condition, net of tax	–	–	–	–809	–	–	–809
Balance at 31 December 2011	**106**	**1,142**	**2,403**	**–2,310**	**2**	**9**	**1,352**
Balance at 1 January 2012	**106**	**1,142**	**2,403**	**–2,310**	**2**	**9**	**1,352**
Net income for the year	–	–	–	60	–	–	60
Net changes in available-for-sale investments, net of tax	–	–	–	–	–	–	–
Net changes in currency translation reserve	–	–	–	–	–	–1	–1
Total recognised comprehensive income	**–**	**–**	**–**	**60**	**–**	**–1**	**59**
FMSA payment condition, net of tax	–	–	–	–623	–	–	–623
Annual state aid compensation	–	–	–	–59	–	–	–59
Balance at 31 December 2012	**106**	**1,142**	**2,403**	**–2,932**	**2**	**8**	**729**

The notes on pages 87 to 153 are an integral part of these consolidated financial statements.

Consolidated and company cash flow statement	Group		Company	
€ m	2012	2011	2012	2011
Cash flows from operating activities				
Pre-tax income/loss	**68**	**124**	**54**	**–30**
Adjustments for non-cash movements:				
Depreciation and amortisation of tangible and intangible assets	7	5	7	5
Foreign exchange gain	–2	–4	–	–12
Net decrease in accrued interest income	660	1,068	413	844
Net decrease in accrued interest expenditure	–593	–1,032	–429	–795
Provision for/ reversals of losses on loans and advances	32	–30	–39	–31
Recovery of losses on loans and advances under financial guarantee	–69	–	–	–
Loss/(gain) on sale of investment securities and loans	11	53	–2	64
Income from buyback of liabilities	–61	–142	–	–
Other non cash items	143	–114	72	75
Net decrease in loans and advances to other banks	5,716	5,666	5,748	6,898
Net decrease in loans and advances to customers	38,318	2,299	36,905	1,196
Net decrease in other assets	20	288	58	491
Net decrease in liabilities to other banks	–31,407	–1,640	–34,370	–4,318
Net decrease in amounts due to customers	–12,298	–4,683	–10,610	–4,505
Net decrease in liabilities evidenced by certificates	–4,836	–6,365	–431	–1,166
Net decrease in other liabilities	–101	–19	–106	–3
Net (increase)/decrease in trading assets and other receivables	–	–1	–	4
Net (decrease)/increase in derivatives and trading liabilities	–47	–120	118	135
Tax paid	–16	–9	–2	–12
Net cash from operating activities	**–4,455**	**–4,656**	**–2,614**	**–1,160**
Cash flows from investing activities				
Purchase of investment securities	–838	–1,382	–838	–1,618
Sale/maturity of investment securities	6,877	5,366	4,819	1,948
Purchase of property and equipment	–	–1	–	–1
Purchase of intangible assets	–2	–3	–2	–3
Net cash from investing activities	**6,037**	**3,980**	**3,979**	**326**
Cash flows from financing activities				
FMSA payment condition	–623	–967	–623	–809
Net cash from financing activities	**–623**	**–967**	**–623**	**–809**
Net increase/(decrease) in cash and cash equivalents	**959**	**–1,643**	**742**	**–1,643**
Cash and cash equivalents at the beginning of the year (Note 16)	**563**	**2,206**	**563**	**2,206**
Cash and cash equivalents at the end of the year (Note 16)	**1,522**	**563**	**1,305**	**563**
Included in the cash flows for the year are the following amounts:				
Interest income received	2,167	2,935	777	1,673
Interest expense paid	–2,075	–2,845	–760	–1,637

The notes on pages 87 to 153 are an integral part of these consolidated financial statements.

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01 General information

DEPFA BANK plc ("the Bank", "the Company" or "DEPFA") is a provider of financial services to public sector clients worldwide. The Bank and its subsidiary undertakings ("the DEPFA Group"), operating in Ireland and in other parts of the world, provides a comprehensive range of banking, financial and related services subject to the conditions imposed by the European Commission's approval on 18 July 2011 of the state aid in relation to the stabilisation measures granted to the HRE Group by the Federal Republic of Germany. The DEPFA Group is regulated by the Central Bank of Ireland and the German Bundesanstalt für Finanzdienstleistungsaufsicht ("BaFin"). Debt issued by the DEPFA Group is listed on exchanges in Dublin, Frankfurt, London, Luxembourg and Zurich.

On 2 October 2007 the entire ordinary share capital of the Company was acquired by Hypo Real Estate Holding AG (the "HRE Holding") the parent entity of the Hypo Real Estate Group ("the HRE Group").

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

There was no change in the ownership of the Bank during 2012.

Accounting policies

02 Summary of significant accounting policies

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

International Financial Reporting Standards ("IFRSs") The DEPFA Group has prepared its financial statements for the period ended 31 December 2012 in line with EC ordinance No. 1606/2002 of the European Parliament and Council of 19 July 2002 in accordance with IFRSs. These financial statements are based on IFRSs, which have been adopted in European Law by the European Commission as part of the endorsement process. With the exception of specific regulations relating to fair value hedge accounting for a portfolio hedge of interest risks in IAS 39 all mandatory IFRSs have been completely endorsed by the EU. The DEPFA Group does not apply this type of hedge accounting. Therefore, the financial statements are accordingly consistent with the entire IFRSs and also with the IFRSs as applicable in the EU.

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

Consistency These policies have been consistently applied in accordance with the framework of IFRSs as well as IAS 1 and IAS 8.

Basis of preparation The consolidated and Parent Company financial statements have been prepared in accordance with European Union (EU) endorsed IFRSs, IFRIC interpretations as endorsed by the European Union (EU) and also the Companies Acts 1963 to 2012, applicable to companies reporting under IFRSs.

The Company has availed of the exemption in Section 148 (8) of the Companies Acts 1963 to 2012 from presenting to its members its Company income statement and related notes that form part of the Company financial statements.

The consolidated and Parent Company financial statements are prepared on a going concern basis.

Initially adopted standards, interpretations and amendments The following standards, interpretations and amendments were applicable initially in the financial year 2012:

- Amendments to IFRS 7 Financial Instruments: Disclosures – Transfer of Financial Assets

Amendments to IFRS 7 require disclosing in a separate note the relationships between transferred financial assets, which were not derecognised in their entirety, and the associated financial liabilities as well as the nature and the risks of the continuing involvement in derecognised assets. Note 43 relating to Transfers of financial assets and collateral pledged or held was added to these consolidated financial statements of the DEPFA Group.

Endorsed standards, interpretations and amendments, which are not yet mandatorily applicable The following standards, interpretations and amendments are EU endorsed, but are not mandatorily applicable in these consolidated financial statements and were not adopted early:

- Amendments to IFRS 1 – Severe Hyperinflation and Removal of Fixed Dates for First-Time Adopters
- IFRS 10 Consolidated Financial Statements and Amendments to IAS 27 Separate Financial Statements
- IFRS 11 Joint Arrangements and Amendments to IAS 28 Investments in Associates and Joint Ventures
- IFRS 12 Disclosure of Interests in Other Entities
- IFRS 13 Fair Value Measurement
- Amendments to IAS 1 Presentation of Items of Other Comprehensive Income
- Amendments to IAS 12 Income Taxes – Deferred Tax: Recovery of Underlying Assets
- IAS 19 (revised 2011) Employee Benefits
- Amendments to IAS 32 Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities and Amendments to IFRS 7 Financial Instruments: Disclosure – Offsetting Financial Assets and Financial Liabilities

Amendments to IFRS 1 solely concern IFRS first-time adopters. As the DEPFA Group is not a IFRS first-time adopter, there were no impacts on these consolidated financial statements.

IFRS 10 supersedes the requirements of IAS 27 and SIC-12 regarding control and consolidation. IFRS 10 implements the control concept as a consolidation model. According to this, parent-subsidiary relationships will not depend on voting rights, but also on other contractual commitments. IAS 27 was renamed “Separate Financial Statements” and is solely applicable to separate financial statements. SIC-12 was cancelled. The new standards in accordance with the IASB are applicable for financial years beginning on or after 1 January 2013, but were endorsed in European Law with an effective date on 1 January 2014. IFRS 10 will likely result in impacts on the DEPFA Group of consolidated companies, especially in connection with structured entities.

IFRS 11 supersedes IAS 31 and cancels the proportionate consolidation option of joint ventures. In the future, the equity method is applicable according to IAS 28. The new standard in accordance with the IASB, is applicable for financial years beginning on or after 1 January 2013, but were endorsed in European Law with an effective date on 1 January 2014. Impacts on future consolidated financial statements will depend on whether or not joint arrangements and equity investments exist in the DEPFA Group at the time of application. To date, this has not been the case.

In IFRS 12 the IASB consolidated the disclosure requirements concerning subsidiaries, joint arrangements and associates as well non-consolidated structured entities. The new standard in accordance with the IASB, is applicable for financial years beginning on or after 1 January 2013, but was endorsed in European Law with an effective date on 1 January 2014. Arising from the requirements of IFRS 12 the DEPFA Group expects extended disclosures regarding its interests in other entities.

The requirements for all assets and liabilities concerning fair value measurement were consolidated into IFRS 13. Material new requirements of IFRS 13 Fair Value Measurement concern, for example, the definition of fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between independent market participants

(exit price). For measuring financial instruments applying bid prices or asking prices is required, if these prices best represent the fair value of the financial instrument. IFRS 13 expands the disclosure requirements regarding the fair value hierarchy. IFRS 13 is applicable to financial years beginning on or after 1 January 2013. The standard is applicable prospectively. Impacts on consolidated financial statements of the DEPFA Group will be due to the amended methods to measure fair value and the extended disclosures.

According to Amendments to IAS 1 Presentation of Items of Other Comprehensive Income ("OCI"), items included in other comprehensive income have to be grouped depending on whether or not they may be recycled into the income statement – including subtotals for both groups. Amendments to IAS 1 are applicable for periods beginning on or after 1 July 2012. The DEPFA Group will adjust its disclosures accordingly.

Amendments to IAS 12 regulate the nature of the realisation of specific assets in conjunction with deferred tax measurement for investment properties, property, plant and equipment measured at fair value. There were no impacts on these consolidated financial statements because the DEPFA Group does not own any such assets.

Arising from IAS 19 (revised 2011) the corridor approach of recognising actuarial gains or losses is prohibited. Instead, all actuarial gains or loss effects have to be recognised in OCI. Past service costs have to be recognised in the period of the plan changes instead of allocating the expenses over the period until the claims become vested. The interest rate for discounting the defined benefit obligation is also now to be used for the expected return on plan assets. In addition, sensitivity analysis of pension plans and the average duration of the defined benefit obligation have to be disclosed in the notes. Furthermore, the accounting of bonus feature elements in connection with semi-retirement contracts was amended by IAS 19 (revised). IAS 19 is applicable for periods beginning on or after 1 January 2013. The Amendments to IAS 19 will generally have impacts on employee benefits accounting and disclosures of the DEPFA Group. Using the measurement parameters available at the end of 2012, the amendments would result in an equity reducing effect. Disclosure requirements will also increase. However, based on the level of defined benefit obligations in the DEPFA Group, none of the above impacts are expected to be significant.

The IASB revised the requirements regarding the netting of financial assets and financial liabilities and published the revision in the form of Amendments to IAS 32 and Amendments to IFRS 7. To allow the comparison between financial statements under IFRS and under US accounting principles, Amendments to IFRS 7 requires materially expanded note disclosures. As well as a qualitative description comprehensive quantitative disclosures will be required, e.g. the gross amount before netting, the net amount after netting and the fair value of financial instruments which have been received or pledged as collateral. Amendments to IAS 32 and Amendments to IFRS 7 are retrospectively applicable for financial years beginning on or after 1 January 2013 (IFRS 7) respectively 1 January 2014 (IAS 32). The DEPFA Group expects expanded note disclosures.

Published standards, interpretations and amendments, which are not yet endorsed The following published standards, interpretations and amendments were not yet endorsed in European Law:
- IFRS 9 Financial Instruments and Subsequent Amendments (also affected is IFRS 7 Financial Instruments: Disclosures)
- Amendments to IFRS 10, IFRS 11 and IFRS 12: Transition Guidance
- Amendments to IFRS 10, IFRS 12 and IAS 27: Investment Entities
- Improvement to IFRSs (2009-2011)

The IASB is replacing the standard IAS 39 with IFRS 9 in several project phases. For the first project phase Classification and Measurement, the IASB published new policies in 2009 and 2010, which may possibly be further amended. On the other hand, finally adopted standard parts are not yet available for the two other project phases, Impairment Methodology and Hedge Accounting. The Classification and Measurement phase will probably provide the following measurement categories for financial instruments:
- at fair value through profit or loss
- at fair value through other comprehensive income
- at amortised cost

Financial debt instruments on the assets' side of the statement of financial position will be classified depending on the business model of the entity for managing financial assets and the characteristics of the contractual cash flows of the financial asset. Equity instruments and assets designated as at fair value through profit and loss ("dFVTPL") will generally have to be measured at fair value. On the liabilities side of the statement of financial position, all non-derivative liabilities which are not used for trading or which are not designated for measuring at fair value will be measured at amortised cost. In the case of the liabilities dFVTPL, changes in value which are attributable to the change in the entity's own credit risk will be recognised directly in equity. The initial application of the new standard IFRS 9, which is envisaged for financial years beginning on or after 1 January 2015, will have a material impact for the DEPFA Group. In future, it is expected it will be necessary for some assets and liabilities which have previously been measured at amortised cost to be measured at fair value, and vice versa. However, it will only be possible to make a definitive assessment of the entire impacts on the DEPFA Group when all parts of IFRS 9 have been completely published.

Amendments to IFRS 10, IFRS 11 and IFRS 12: Transition Guidance clarify the retrospective application of the concerned standards and have to be initially adopted along with IFRS 10, IFRS 11 and IFRS 12 for financial years beginning on or after 1 January 2014.

Amendments to IFRS 10, IFRS 12 and IAS 27: Investment Entities is not relevant for the DEPFA Group, because according to its business model, the DEPFA Group is not an investment entity. Therefore, it is not expected that future consolidated financial statements of the DEPFA Group will be impacted.

In the course of the process to slightly amend several standards and interpretations, the IASB published the further amendment standard Improvements to IFRS 2009-2011. The amendment standard is applicable for financial year beginning on or after 1 January 2013 and is expected to result in only immaterial effects on future consolidated financial statements of DEPFA Group.

Consolidation

Subsidiaries The subsidiaries comprise all entities (including special purpose entities) over which the DEPFA Group has the power to govern the financial and operating policies. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the DEPFA Group controls an entity. Subsidiaries are fully consolidated from the date on which control is transferred to the DEPFA Group and cease to be consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to

the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the DEPFA Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the net fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary acquired, the difference is recognised directly in the income statement.

Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred. The financial statements and group reporting of all subsidiaries are drawn up to the year ended 31 December and the accounting policies applied in their preparation are consistent with the DEPFA Group accounting policies.

Non-controlling interests comprise minority shareholders' proportionate share in shareholders' equity and net income. The DEPFA Group applies the parent company method of consolidation. Therefore, goodwill can arise on the acquisition of non-controlling interests and the sale of such interests can give rise to a net income or loss in the income statement.

There have been no new entities consolidated since 2007.

Common Control Transactions Common control transactions are business combinations involving businesses or entities under common control. These transactions are accounted for at book value. Consequently, any differences between consideration paid/received and the book value are transferred directly to shareholders equity and no goodwill arises.

In 2002 the DEPFA Group was reorganised, the purpose of which was to de-merge the Property Finance and IT Services activities from the Public Finance business, which resulted in the formation of the current parent company, DEPFA BANK plc. This de-merger was treated as a discontinued operation.

DEPFA BANK plc was created by a share for share exchange with the previous parent company, DEPFA Deutsche Pfandbriefbank AG. This share for share exchange and other transfers of assets and property as part of the reorganisation were treated as a transaction under common control and accounted for at book value.

Under Irish company law, a share premium was created on the above share for share exchange. A merger adjustment arose being the difference between the fair value of the shares issued and the book value of the net assets acquired. The merger adjustment was transferred to retained earnings.

The DEPFA Group availed of the exemption in IFRS 1 to apply IFRS to business combinations, including common control transactions, from 15 March 2002, the date of the DEPFA Group restructuring.

On 31 December 2007 the Company acquired Hypo Public Finance Bank from Hypo Real Estate Holding AG. This was accounted for as a transaction under common control. A merger adjustment arose being the difference between the fair value of the shares acquired and the book value of the net assets acquired. The merger adjustment was transferred to retained earnings.

As discussed in note 5 of the notes to the financial statements, the transfer of non strategic positions to FMS Wertmanagement on 1 October 2010 is accounted for as a transaction under common control.

As part of the transfer of positions to FMS Wertmanagement as described in note 5, the European Commission imposed a payment condition in relation to the state aid, namely the complete fulfilment of the payment of €1.59 billion payment condition to avoid distortions of competition in connection with the utilisation of the deconsolidated environment. In consequence, this payment condition resulted in a subsequent purchase price adjustment in the companies of the DEPFA Group which had transferred positions to FMS Wertmanagement.

The full amount was borne by the DEPFA Group and has been fully settled in 2011 and 2012. This payment has been accounted for through retained earnings as a transaction with a party under the common control of the DEPFA Group's ultimate shareholder.

Furthermore, the European Commission also imposed, subject to certain conditions, a requirement to pay further annual fees from the time at which the payment condition is completely settled up to the time of reprivatisation. The DEPFA Group's obligations in relation to this requirement are estimated and accounted for through retained earnings as a transaction with a party under the common control of the DEPFA Group's ultimate shareholder.

Segment reporting An operating segment is a component of the DEPFA Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the DEPFA Group's other components, whose operating results are reviewed regularly by the Board of Directors (being the chief operating decision maker) to make decisions about resources allocated to each segment and assess its performance and for which discrete financial information is available. For detail on these disclosures please see note 6 "Business segments".

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

Income and expenditures attributable to currency translation at the individual companies in the DEPFA Group are normally shown in the income statement under "Other operating income" or "Other operating expense".

The presentation currency of the DEPFA Group is the Euro, which is the functional currency of the Company and the majority of its subsidiaries. All financial information presented in Euro has been rounded to the nearest million, except when otherwise indicated.

In these consolidated financial statements, statement of financial position items of foreign operations, whose functional currency is not Euro, are translated using the closing rates at reporting date for the financial statements. For translating the expenses and income of these subsidiaries, the average rates are used where this is a reasonable approximation to the actual transacted rates in place throughout the year. 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 "Other reserves". The DEPFA Group of consolidated companies does not include any companies from high-inflation countries.

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

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

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

Fee and commission expense Fees and commissions which are not part of the effective interest rate calculation are generally recognised on an accruals basis when the service has been provided. Loan syndication fees are recognised as income when the syndication has been completed and the DEPFA Group has retained no part of the loan package for itself or retained a part at the same effective interest rate as the other participants.

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

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

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

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

The purchases or sales of financial instruments are accounted for at trade date. Premiums and discounts appear in the position “Net interest income” for the accounting period in question in line with the effective interest rate. In accordance with the derecognition requirements of IAS 39, a financial asset is derecognised when substantially all risks and rewards have been transferred. If the significant risks and rewards associated with ownership of the transferred financial asset are neither transferred nor retained and if the power of disposal continues to be exercised over the transferred asset, the asset must continue to be recognised to the extent of the continuing involvement. There are no transactions within the DEPFA Group which result in partial derecognition arising due to a continuing involvement.

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

Categories pursuant to IAS 39 Initially, when a financial asset or financial liability is recognised, it is measured at its fair value, adjusted for initial direct costs where the item is not subsequently measured at fair value through profit or loss.

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

(a) Designated at fair value through profit or loss (“dFVTPL”) If certain conditions are satisfied, financial assets or liabilities can be classified at their fair value through profit or loss when they are initially recognised. A designation can be made, if the use of the valuation category means that an accounting mismatch is either avoided or considerably reduced, if the management and performance measurement of a portfolio of financial instruments are based on the fair values or if the instrument contains a separable embedded derivative. The DEPFA Group classifies financial assets under the dFVTPL category only for the first two cases.

In the periods covered by these consolidated financial statements, only fixed-income securities were held in the category dFVTPL. Financial liabilities are not allocated to this category. The portfolio of fixed-income securities has been managed on a fair value basis. In addition, open interest risk positions of the portfolio were 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 under the category dFVTPL will avoid an accounting mismatch in terms of reported results.

As a result of the designation of fixed income securities, the opposite movements relating to the hedged risk in the income statement significantly cancel each other. 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. As financial liabilities are not designated in the category dFVTPL, the DEPFA Group does not have any effect resulting from the instruments being valued with the DEPFA Group's own current credit risk.

The fixed income securities under the category dFVTPL are stated under the item of "Financial investments". Interest income from the securities is shown under the position "Net interest income". The changes in value to be recognised in profit or loss (net gains and net losses from fair value option) are stated under the line "Net income from hedge relationships" in the same way as the changes in value of the corresponding derivatives, as a result of the securities being in designated hedge relationships.

As of 31 December 2012, the DEPFA Group no longer has any dFVTPL positions.

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

Held-for-trading financial instruments are measured at fair value. Changes in fair value are recognised in the income statement. 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.

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

Loans and receivables are recognised in the line items "Loans and advances to other banks", "Loans and advances to customers" and "Financial investments" and are measured at amortised cost using the effective interest rate. Interest income from loans and receivables are shown in "Net interest income". Market price related net gains and net losses attributable to prepayment penalties or to selling of loans and advances to customers and of loans and advances to other banks are shown under the position "Net interest income". Such net gains and net losses are shown in "Net expense from financial investments" for financial investments. Impairments are shown under "Provision for/reversals of losses on loans and advances" for loans and advances and in "Net expense from financial investments" for financial investments.

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

No financial assets were classified as HtM in financial years 2012 or 2011.

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

AfS financial assets are measured at fair value. Changes in fair value are recognised through other comprehensive income and then retained in a separate item of equity (AfS reserve) not affecting income until the asset is sold, withdrawn or otherwise disposed, or if an impairment is established for the financial asset in accordance with IAS 39.58 et seq., so that the cumulative

loss previously recorded in other comprehensive income is now reclassified to the income statement. If the objective evidence for the impairment of an AfS debt instrument is no longer present, the impairment must be reversed to the income statement. On the other hand, impairments for an AfS equity instrument which have been recognised in the income statement are not permitted to be reversed through the income statement.

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

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

Financial liabilities are measured at amortised cost. Financial liabilities that are not securitised are recognised in the positions "Liabilities to other banks" 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 are shown under the line item "Interest expense and similar expenses". In addition, the line item "Net interest income" includes net gains and net losses attributable to repurchases or extinguishments of financial liabilities before maturity.

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

Valuation methods Financial instruments which must be measured at fair value are valued on the basis of stock market prices or other market prices, if they exist. If a price is not available from an active market, observable market prices from comparable financial instruments are used. If prices from comparable financial instruments are not available, valuation models are used that are based on observable market parameters. If these parameters are not observable at the markets, the valuation of the financial instruments is based on models with certain non-market-observable parameters. The valuation models used are market standard models. A description of these models and the products involved is given in note 44 "Fair values of financial assets and liabilities".

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

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

Where the DEPFA Group is the holder of financial guarantees, the fee expense is recognised in the income statement on a straight line basis over the life of the guarantee. Recovery of losses on assets which are the subject of guarantees held are recognised at the same time as specific allowances for losses on those assets. In the event of a specific allowance for losses being released, the associated guarantee recoverable would also be released.

Derivative financial instruments and hedge accounting

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

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

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

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

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

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

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

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

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

- The net income or loss arising when the hedging instrument is revalued to its fair value (for a derivative hedging instrument), or the currency component of its carrying amount calculated in accordance with IAS 21 (for non-derivative hedging instruments), is recognised in net income or loss for the period.
- The carrying amount of an underlying non-AfS hedged item is adjusted by the fair value change attributable to the hedged risks and is recognised in net income or loss for the period. If the underlying transaction is an AfS financial asset, the fair value change attributable to hedged risk is re-classified from other comprehensive income to net income or loss.

The DEPFA Group uses fair value hedge accounting for 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". Regression analysis is mainly used to measure effectiveness. The dollar offset method is applied in some cases for quantifying the ineffectiveness. If the hedge relationship is terminated for reasons other than the derecognition of the hedged item, the difference between the carrying amount of the hedged item at that point and the value at which it would have been carried, had the hedge never existed (the unamortised fair value adjustment), is amortised to the income statement over the remaining term of the original hedge. If the hedged item is derecognised, e.g. due to sale or repayment, the unamortised fair value adjustment is recognised immediately in the income statement.

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

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

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in other comprehensive income at that time remains in other comprehensive income and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in other comprehensive income is immediately reclassified to the income statement.

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 identically to cash flow hedges. The DEPFA Group has not had hedges of a net investment in a foreign operation in the financial years 2012 and 2011.

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

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

Impairment of financial assets Where financial assets are not measured at fair value through profit and loss, they must be tested for impairment. At each statement of financial position date the DEPFA Group 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 include:

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

Two types of impairment allowances are established, individual allowances and portfolio-based allowances.

Allowances for loans and advances are disclosed in a separate account, “Allowances for losses on loans and advances” rather than directly reducing the carrying amount of the assets. The expense is shown under “Provision for/reversals of losses on loans and advances” in the income statement.

For impairment of financial investments the impairment charge is shown under “Net expense from financial investments” in the income statement.

Where subsequent measurement of financial assets is based on fair value through profit or loss, any impairments are implied in the fair value.

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

In determining allowances on individually assessed accounts, the following factors are especially considered:
- the DEPFA Group aggregate exposure to the customer;
- the amount and timing of expected interest and redemption payments;
- the realisable value of collateral and likelihood of successful repossession;
- the likely deduction of any costs involved in recovering amounts outstanding; and
- the market price of the asset, if available.

Financial assets carried at amortised cost for which no evidence of impairment has been specifically identified on an individual basis are grouped according to their credit risk for the purpose of calculating portfolio-based allowances.

This impairment covers losses which have been incurred but have not yet been identified on loans subject to individual assessment. The parameters used to determine portfolio-based provisions are updated regularly and adjusted if necessary. The portfolio-based allowances are determined after taking into account:
- historical loss experience in portfolios of similar credit risk characteristics;
- a judgement whether current economic conditions and credit conditions improved or deteriorated compared to the past;
- the estimated period between impairment occurring and being identified; and
- state of the current economic cycle.

Leases The leases entered into by the DEPFA Group are operating leases. The total payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

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

Employee benefits

Pension obligations The DEPFA Group operates two types of pension schemes – defined benefit schemes and defined contribution schemes.

A defined contribution scheme is a pension plan under which the DEPFA Group pays fixed contributions into a separate fund. In these plans, the DEPFA Group has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods. A defined benefit scheme is a pension plan that is not a defined contribution scheme. Typically, defined benefit plans define an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation.

The liability recognised in the statement of financial position in respect of defined benefit pension plans is the present value of the defined benefit obligation at the statement of financial position date, together with adjustments for past service costs. The defined benefit obligation, which is unfunded, is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating to the terms of the related pension liability.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to the income statement as they are identified. Past-service costs are recognised immediately in income, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

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

Income tax Current income tax payable on net income, based on the applicable tax law in each jurisdiction, is recognised as an expense in the period in which net income arise.

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

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

Deferred income tax is provided on temporary differences arising from investments in subsidiaries, except where the timing of the reversal of the temporary difference is controlled by the DEPFA Group and it is probable that the difference will not reverse in the foreseeable future.

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

The tax effects of income tax losses available for carry forward are recognised as an asset when it is probable that future taxable net income will be available against which these losses can be utilised.

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

Discontinued operations A discontinued operation is a component of the DEPFA Group's business which represents a separate major line of business or geographical area of operations and has been disposed of or is held for sale. When an operation is classified as a discontinued operation, the comparative income statement is restated as if the operation had been discontinued from the start of the earliest period presented.

Trading assets Trading assets comprise held-for-trading securities as well as positive market values of trading derivatives and of stand-alone derivatives in the banking 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 at their fair value. In the case of derivative and original financial transactions which are not listed on an exchange, internal price models based on cash value considerations and option price models are used as the basis of calculating the statement of financial position value. Valuation and realised net income and losses attributable to trading assets are stated under net trading income in the income statement.

Loans and advances "Loans and advances to other banks" and "Loans and advances to customers" are disclosed under IAS 39 with their amortised cost of purchase if they are not categorised dFVTPL or AfS or an underlying transaction of a fair value hedge. dFVTPL financial instruments are measured at fair value. Changes in fair value are recognised in net income or loss. As of 31 December 2012 and as of 31 December 2011, the DEPFA Group 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/reversals of losses on loans and advances" in the income statement. Fair value changes attributable to hedged risks on loans and advances in qualifying fair value hedge relationships are shown under "Net income from hedge relationships". All other income and expenses from loans and advances, including net gains and net losses, are shown under the position "Net interest income" in the income statement.

Financial investments dFVTPL, LaR and AfS securities are stated under "Financial investments". dFVTPL and AfS financial assets are stated at their fair value. Changes in the fair value are taken to the income statement in the case of dFVTPL financial assets. Changes in fair value of AfS financial assets are recognised in other comprehensive income not affecting income statement until the asset is sold, disposed of, or if an impairment is established for the financial asset in accordance with IAS 39.58 et seq., in which case the cumulative net income or loss previously recorded in OCI is then taken to the income statement. Portfolio-based allowances are not created for AfS financial assets. AfS financial assets which are hedged effectively against market price risks are recognised within the framework of fair value hedge accounting whereby fair value changes attributable to hedged risks are reclassified from other comprehensive income to the income statement under "Net income from hedge relationships". LaR financial investments are measured at amortised cost. Individual allowances on LaR financial investments are directly deducted from the carrying amount of the assets. In the financial years 2012 and 2011, the DEPFA Group did not have any HtM financial assets.

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

Allowances for losses on 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 flows. The latter is calculated on the basis of the original financial effective interest rate in the case of fixed income instruments and on the basis of the interest rate at impairment date in the case of variable income instruments. Market rate changes do not have any effect in this respect. The increase in the present value of an adjusted receivable (so-called unwinding) which occurs over a period of time is shown as interest income.

Portfolio-based allowances Under IAS 39.64, loans for which there is no objective indication for the need of an allowance on an individual basis are grouped together to form risk-inherent portfolios. Portfolio-based allowances are set aside for these portfolios; these allowances are calculated based 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, provisions for contingent liabilities and other commitments such as irrevocable loan commitments. An allowance relating to loans and advances is shown as a negative item on the assets side of the statement of financial position, whereas a provision for contingent liabilities and other commitments is shown on the liability side of the statement of financial position. In the income statement, all effects are shown in “Provisions for/reversals of 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”.

Property, plant and equipment Property, plant and equipment are normally shown initially at cost of purchase or cost of production. The carrying amounts, if the assets are depreciable, are diminished by depreciation in accordance with the expected useful life of the assets. In addition, property, plant and equipment is tested at least annually for impairment. If the value of property, plant and equipment has additionally been diminished, an impairment is taken to the income statement. If the reasons for the impairment 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 the depreciation period if it is shorter than the economic life.

Useful economic life in years	
Furniture, fixtures and office equipment	5
IT equipment	3–5
Other plant and operating equipment	5

Cost of purchase or cost of production, which is subsequently incurred, is capitalised if an additional economic benefit accrues to the DEPFA Group. 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 arise.

Intangible assets

Computer software Software is an intangible asset with a finite useful life. Purchased software is stated at amortised cost of purchase. The DEPFA Group capitalises internally generated software if it is probable that future economic benefits will flow to the DEPFA 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 on 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.

Other assets Other assets mainly contain positive fair values from derivative financial instruments (hedging derivatives and derivatives hedging dFVTPL financial instruments).

Liabilities Liabilities other than underlying transactions of an effective fair value hedge and which are not classified as dFVTPL are stated at amortised cost. The DEPFA Group has not designated any liabilities under the category dFVTPL. Fair value changes attributable to hedged risks on liabilities in qualifying fair value hedge relationships are shown under “Net income from hedge relationships”. All other income and expenses from liabilities including net gains and net losses resulting from redemption of liabilities are shown under the position “Net interest income” in the income statement.

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

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

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

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

Subordinated capital In the event of bankruptcy or liquidation, subordinated capital may only be repaid after all non-subordinated creditors have been satisfied. Subordinated capital of the DEPFA Group encompasses subordinated liabilities, participating certificates outstanding and hybrid capital instruments.

Pursuant to IAS 32, the subordinated capital instruments issued by the DEPFA Group 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.

Non-current assets held for sale In accordance with IFRS 5, non-current assets or disposal groups held for sale must be shown on the statement of financial position date at the lower of carrying amount and fair value less costs to sell. The assets must be shown separately in the statement of financial position. As of 31 December 2012 and 31 December 2011, the DEPFA Group had no non-current assets held for sale.

Share capital

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

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

(c) Own shares Where the Company or other members of the consolidated Group purchases the Company's equity share capital, the consideration paid is deducted from total equity as own shares until they are cancelled. Where such shares are subsequently sold or reissued, any consideration received is included in equity.

03 Risk management

The risk management disclosures are contained as indicated in the "Risk management" section of the Directors' report.

04 Critical accounting estimates and judgements

Fair value of financial and derivative instruments The fair value of financial instruments that are not listed on active markets is calculated using valuation models. In the cases in which valuation models are used, a check is performed regularly to assess whether the valuation models provide a comparable standard for current market prices. For practical considerations, the valuation models can only take account of quantifiable factors (e.g. cash flows and discount rates) that also require estimates. Changes in assumptions relating to these factors might have an impact on the fair values of the financial instruments. In 2012 the DEPFA Group has implemented a refinement to the valuation models in relation to counterparty risk parameters. A further description of the resulting change in estimate is contained in note 9 to the financial statements.

Taxation The taxation charge includes amounts due to fiscal authorities in the various territories in which the DEPFA Group operates and includes estimates, based on a judgement of the application of law and practice in certain cases to determine the quantification of any liabilities arising. In arriving at such estimates, management assesses the relative merits and risks of tax treatments assumed, taking into account statutory, judicial and regulatory guidance and, where appropriate, external advice.

In relation to the recognition of deferred tax assets and liabilities, estimates are required on the extent to which temporary differences are expected to be reversed.

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

Securitisations and special purpose entities The DEPFA Group has sponsored the formation of special purpose entities ("SPEs") primarily for the purpose of allowing clients to hold investments, for securitisation transactions and for buying or selling credit protection. The DEPFA Group does not consolidate SPEs that it does not control. As it can sometimes be difficult to determine whether the DEPFA Group controls the SPE, it makes judgements about its exposure to the risks and rewards, as well as its ability to make operational decisions for the SPE in question.

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

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

Provisions In accordance with IAS 37.14, the creation and adjustment of provisions for obligations, including those relating to litigation risks, requires the DEPFA Group to use judgement to determine whether it has a present obligation, to estimate the probability that an obligation will result in an outflow of resources and also to estimate the amount that will be required to settle the obligation. The development of such obligations in subsequent years may result in revisions to estimates being required which could result in different amounts being settled. A further description of the DEPFA Group's provisions and the related uncertainties are contained in note 30 to the financial statements.

Annual state aid compensation The DEPFA Group is required to make an estimate of its obligations under the requirement to pay annual fees in compensation for the state aid received. This estimate is performed taking into account forecast financial information as well as the terms and conditions of the obligation. This estimate is subject to ongoing review and revision as required.

05 Transfer of non strategic positions to FMS Wertmanagement

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

At the end of September 2010, the HRE Group concluded the agreements necessary for the transfer with FMS Wertmanagement. The positions were transferred to FMS Wertmanagement with legal and/or economic effect as of 1 October 2010; however, no legal and/or economic transfer was originally intended for some of the positions to be transferred. Instead, they were backed by a financial guarantee of FMS Wertmanagement; any legal and/or economic transfer in this respect will only take place at a later date. The transfer was a non cash transaction between companies under common control.

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

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

Whereas most of the transferred positions have resulted in a derecognition at the HRE Group, due to the transfer of at least economic ownership to FMS Wertmanagement, this is not applicable for the positions which are merely backed by way of the financial guarantee.

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

An "upgrade" of the transfer methods is in process for the transactions which have so far not resulted in a derecognition, in order to meet the derecognition requirements at a later date. Some of the transactions which did not originally result in a derecognition have already been "upgraded" and derecognised.

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

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

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

As part of the process of transferring the positions, pbb also assumed responsibility for managing the transferred portfolios for FMS Wertmanagement as part of a co-operation agreement, whereby pbb also uses services of other subsidiaries of the HRE Group for rendering this service. The co-operation agreement will be terminated at the latest by the end of September 2013.

The transfer of positions, which reduced total assets, was partially offset by the main counter effects described below:

(a) In the case of some assets it was not possible for beneficial ownership to be transferred to FMS Wertmanagement, which meant that the criteria for derecognition were not satisfied. Furthermore, in the case of derivatives, back-to-back transactions were used to transfer the market price risks of the derivative to FMS Wertmanagement by way of taking out a derivative with identical conditions, whereas the counterparty risks were retained by the DEPFA Group. This meant that it was not possible for the original position to be derecognised. Instead, the back-to-back transaction resulted in an increase in total assets and total liabilities.
(b) FMS Wertmanagement had to provide collateral for the new derivatives, which were taken out between FMS Wertmanagement and the DEPFA Group (back-to-back transactions); which in turn, was used to finance the collateral requirements of the original derivatives.
(c) FMS Wertmanagement does not have a banking status therefore the DEPFA Group facilitated certain refinancing functions for FMS Wertmanagement, for instance with the ECB or in bilateral repo transactions. The refinancing funds were passed on to FMS Wertmanagement. The DEPFA Group received a claim against FMS Wertmanagement, which increased total assets and total liabilities. The effect on the DEPFA Group statement of financial position was reduced to € nil at 31 December 2012 (31 December 2011: €33 billion) as FMS Wertmanagement refinanced its operations on a stand-alone basis in 2012.

Within the context of the transfer of certain non strategic positions from the HRE Group to FMS Wertmanagement, the FMSA reserved the right to stipulate a payment condition of up to €1.59 billion in order to avoid distortion of competition.

The European Commission imposed a payment condition in relation to the state aid, namely the complete fulfilment of the payment of €1.59 billion payment condition to avoid distortions of competition in connection with the utilisation of the deconsolidated environment. In consequence, this payment condition resulted in a subsequent purchase price adjustment in the companies of the DEPFA Group which had transferred positions to FMS Wertmanagement.

In August 2011, the FMSA issued a decree determining that the full amount had to be borne by the DEPFA Group.

A first instalment of €800 million became due and payable in September 2011 and a second instalment of €167 million became due and payable in November 2011. A final instalment of €623 million became due and payable in March 2012. All instalments were paid on their due dates.

The purchase price adjustment did not affect the income statement.

The European Commission also imposed, subject to certain conditions, a requirement to pay further annual state aid compensation fees from the time at which the payment condition is completely settled up to the time of reprivatisation.

The precise terms and conditions of such fees are, at the time of this report, in the course of being negotiated. However, provision has been made in the financial statements for the expected future amounts payable. An amount of €59 million has been reflected in the financial statements in this regard as at 31 December 2012 (2011: € nil).

As with the purchase price adjustment, these fees do not affect the income statement.

The effects of all counter effects at 31 December 2012 and 2011 (“FMS WM counter effects”) on the statement of financial position at Group and Company level are shown below in the pro forma statements of financial position:

Pro forma statement of financial position – Group € m	**Per statement of financial position 31 December 2012**	**31 December 2012 FMS WM counter effects**	**31 December 2012 Post FMS WM counter effects**	**Per statement of financial position 31 December 2011**	**31 December 2011 FMS WM counter effects**	**31 December 2011 Post FMS WM counter effects**
Assets						
Cash reserve	1,564	–	1,564	600	–	600
Trading assets	13,364	4,225	9,139	20,517	12,177	8,340
Loans and advances to other banks	10,191	6,284	3,907	15,991	12,982	3,009
Loans and advances to customers	16,853	3,131	13,722	55,028	36,772	18,256
Allowance for losses on loans and advances	–102	–	–102	–70	–	–70
Losses on loans and advances recoverable under financial guarantees	69	–	69	–	–	–
Financial investments	25,334	2,890	22,444	31,617	6,769	24,848
Property, plant and equipment	1	–	1	1	–	1
Intangible assets	12	–	12	17	–	17
Other assets	5,798	–	5,798	6,028	249	5,779
Income tax assets	214	–	214	193	–	193
Total assets	**73,298**	**16,530**	**56,768**	**129,922**	**68,949**	**60,973**
Liabilities and equities						
Liabilities to other banks	6,631	2,006	4,625	38,057	33,863	4,194
Liabilities to customers	9,085	8,445	640	21,356	20,707	649
Liabilities evidenced by certificates	34,654	–	34,654	39,456	–	39,456
Trading liabilities	13,317	4,225	9,092	20,604	12,177	8,427
Provisions	148	–	148	112	–	112
Other liabilities	6,016	1,854	4,162	6,289	2,202	4,087
Income tax liabilities	244	–	244	230	–	230
Subordinated capital	1,082	–	1,082	1,079	–	1,079
Total liabilities	**71,177**	**16,530**	**54,647**	**127,183**	**68,949**	**58,234**
Share capital	106	–	106	106	–	106
Share premium	1,142	–	1,142	1,142	–	1,142
Capital reserve	1,500	–	1,500	1,500	–	1,500
Preferred securities	1,136	–	1,136	1,136	–	1,136
Retained earnings	–1,723	–	–1,723	–1,100	–	–1,100
Other reserves	–40	–	–40	–45	–	–45
Total equity	**2,121**	**–**	**2,121**	**2,739**	**–**	**2,739**
Total equity and liabilities	**73,298**	**16,530**	**56,768**	**129,922**	**68,949**	**60,973**

Pro forma statement of financial position - Company € m	Per statement of financial position 31 December 2012	31 December 2012 FMS WM counter effects	31 December 2012 Post FMS WM counter effects	Per statement of financial position 31 December 2011	31 December 2011 FMS WM counter effects	31 December 2011 Post FMS WM counter effects
Assets						
Cash reserve	1,331	–	1,331	587	–	587
Trading assets	20,605	3,559	17,046	26,559	9,734	16,825
Loans and advances to other banks	11,608	5,638	5,970	17,351	10,647	6,704
Loans and advances to customers	3,292	3,131	161	40,251	36,772	3,479
Allowance for losses on loans and advances	–97	–	–97	–67	–	–67
Losses on loans and advances recoverable under financial guarantees	69	–	69	–	–	–
Financial investments	4,688	2,890	1,798	8,715	6,769	1,946
Property, plant and equipment	1	–	1	1	–	1
Intangible assets	12	–	12	17	–	17
Other assets	341	–	341	719	249	470
Income tax assets	2	–	2	2	–	2
Total assets	**41,852**	**15,218**	**26,634**	**94,135**	**64,171**	**29,964**
Liabilities and equities						
Liabilities to other banks	5,765	2,006	3,759	40,180	33,863	6,317
Liabilities to customers	8,439	7,799	640	19,021	18,372	649
Liabilities evidenced by certificates	2,152	–	2,152	2,626	–	2,626
Trading liabilities	20,662	3,559	17,103	26,489	9,734	16,755
Provisions	146	–	146	112	–	112
Other liabilities	2,241	1,854	387	2,633	2,202	431
Income tax liabilities	31	–	31	40	–	40
Subordinated capital	1,687	–	1,687	1,682	–	1,682
Total liabilities	**41,123**	**15,218**	**25,905**	**92,783**	**64,171**	**28,612**
Share capital	106	–	106	106	–	106
Share premium	1,142	–	1,142	1,142	–	1,142
Capital reserve	2,403	–	2,403	2,403	–	2,403
Preferred securities	–	–	–	–	–	–
Retained earnings	–2,932	–	–2,932	–2,310	–	–2,310
Other reserves	10	–	10	11	–	11
Total equity	**729**	**–**	**729**	**1,352**	**–**	**1,352**
Total equity and liabilities	**41,852**	**15,218**	**26,634**	**94,135**	**64,171**	**29,964**

Segment reporting

06 Business segments

The internal reporting structure of the DEPFA Group was reorganised on 1 January 2012 into the following reportable primary business segments which reflect the basis on which the DEPFA Group is managed by the Board of Directors (being the chief operating decision maker) during 2012:

- DEPFA ACS BANK
- Hypo Pfandbrief Bank International S.A.
- DEPFA BANK plc and other

The business segment DEPFA ACS BANK includes the assets and liabilities in the DEPFA ACS BANK cover pool as well as other ancillary business in that entity.

The business segment Hypo Pfandbrief Bank International S.A. includes the assets and liabilities in the Hypo Pfandbrief Bank International S.A. cover pool as well as other ancillary business in that entity.

DEPFA BANK plc and other includes all other business in the DEPFA Group including asset servicing provided by the DEPFA Group on the positions transferred to FMS Wertmanagement.

The segment report of the DEPFA Group is based on the internal controlling instruments and the management information system, which is prepared in accordance with IFRSs. 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.

Included in the line item net fee and commission expense for the segment DEPFA ACS Bank is €–12 million (2011: €–14 million) relating to financial guarantees provided by the segment DEPFA BANK plc and other. The corresponding income is also reported in the line item net fee and commission expense in the segment DEPFA BANK plc and other.

Included in the line item net expense from financial investments for the segment DEPFA ACS BANK is € nil (2011: €–35 million) relating to losses on disposals of financial investments by the segment DEPFA ACS BANK to the segment DEPFA BANK plc and other. The corresponding income is also reported in the line item net expense from financial investments in the segment DEPFA BANK plc and other. Other than these items, the segments generated only the DEPFA Group external income and did not generate any income with other segments of the DEPFA Group. Accordingly, there are no further issues of consolidation between the segments. The management information is based on the accounting and valuation methods of the consolidated financial statements, prepared in accordance with IFRSs. Accordingly, reconciliation with the accounting and valuation methods used in the consolidated financial statements is not necessary.

Income/expenses by segments				**1 January – 31 December 2012**
€ m	DEPFA ACS BANK	Hypo Pfandbrief Bank International S.A.	DEPFA BANK plc and other	**Group**
Net interest income	121	8	–43	86
Net fee and commission expense	–12	–	–7	–19
Net trading income	8	20	13	41
Net expense from financial investments	–12	–	1	–11
Net income from hedge relationships	–14	–1	20	5
Other operating income	3	–	86	89
Other operating expense	–3	–	–54	–57
Total operating revenues	**91**	**27**	**16**	**134**
Provision for losses on loans and advances	–3	–	–29	–32
Recovery of losses on loans and advances under financial guarantees	–	–	69	69
General administrative expenses	–17	–6	–94	–117
Other income	-	–	14	14
Pre-tax income/loss	**71**	**21**	**–24**	**68**
Taxes on income	–9	–7	7	–9
Net income/loss	**62**	**14**	**–17**	**59**
Statement of financial position by segments				
Assets	42,195	4,344	26,759	73,298
Liabilities	41,638	4,219	25,320	71,177
Cost/Income ratio	19%	22%	>100%	87%

Income/expenses by segments				1 January – 31 December 2011
€ m	DEPFA ACS BANK	Hypo Pfandbrief Bank International S.A.	DEPFA BANK plc and other	**Group**
Net interest income	192	10	–6	196
Net fee and commission expense	–14	–	–5	–19
Net trading income	–8	1	26	19
Net expense from financial investments	–88	–	35	–53
Net income from hedge relationships	–12	–3	19	4
Other operating income	–	–	105	105
Other operating expense	–7	–	–17	–24
Total operating revenues	**63**	**8**	**157**	**228**
Reversals of/provision for losses on loans and advances	–1	–	32	31
Recovery of losses on loans and advances under financial guarantees	–	–	–	–
General administrative expenses	–16	–5	–113	–134
Other expenses	–	–	–1	–1
Pre-tax income	**46**	**3**	**75**	**124**
Taxes on income	–3	3	–5	–5
Net income	**43**	**6**	**70**	**119**
Statement of financial position by segments				
Assets	48,880	4,214	76,828	129,922
Liabilities	48,347	4,104	74,732	127,183
Cost/Income ratio	25%	63%	72%	59%

For the purpose, of Group geographical segments, a distinction is made between “Ireland”, “Germany”, “Rest of Europe” and “America/Asia” based on the registered office or location of the respective Group company or branch office.

The calculation of results is based on the assumption that the DEPFA Group companies in the region are legally independent units responsible for their respective operations.

An analysis of revenue from external customers by geographical region is presented below:

Revenue from external customers by region						
€ m		Ireland	Germany	Rest of Europe	America/Asia	**Group**
Total operating revenues	2012	14	3	82	35	134
	2011	115	3	69	41	228
Non-current assets	31.12.2012	12	–	1	–	13
	31.12.2011	17	–	1	–	18

Notes to the income statement

07 Net interest income

Net interest income

€ m	2012	2011
Interest income and similar income		
Lending and money-market business	1,159	1,607
Fixed-income securities and government subscribed debt	195	242
Derivatives (net interest income)	153	18
	1,507	**1,867**
Interest expense and similar expenses		
Deposits	–407	–632
Liabilities evidenced by certificates	–1,055	–1,157
Subordinated capital	–20	–24
	–1,482	**–1,813**
Income from buyback of liabilities	**61**	**142**
Net interest income	**86**	**196**

Interest income on impaired loans amounted to €2.7 million (2011: €1.9 million).

Net interest income includes net income (net of funding expense) of €17 million (2011: €18 million) related to assets still recognised on the DEPFA Group statement of financial position as at 31 December 2012, which are not yet transferred to FMS Wertmanagement and on which guarantees from FMS Wertmanagement have been received. There is an offset for this amount included in net fee and commission expense for fees paid for the guarantees received.

Total interest income for financial assets that are not at fair value through profit or loss, amount to €1.4 billion in 2012 (2011: €1.9 billion). Total interest expenses for financial liabilities that are not at fair value through profit or loss amount to €1.5 billion in 2012 (2011: €1.8 billion).

Net interest income includes gains from the buyback of liabilities that were redeemed before maturity at prevailing market rates on a reverse enquiry basis of €61 million (2011: €142 million).

08 Net fee and commission expense

Net fee and commission expense

€ m	2012	2011
Fee and commission income		
From other lending operations	1	5
	1	**5**
Fee and commission expense		
From other lending operations	–20	–24
	–20	**–24**
Net fee and commission expense	**–19**	**–19**

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

Guarantee fees of €–17 million (2011: €–18 million) were paid in 2012 to FMS Wertmanagement in respect of financial guarantees received on assets not yet transferred and still recognised on the DEPFA Group statement of financial position as at 31 December 2012. This amount is offset in net interest income.

None of the above net fee and commission expense arose on instruments that have been designated at fair value through profit or loss.

09 Net trading income

Net trading expenses/income € m	2012	2011
From interest rate instruments and related interest and foreign exchange derivatives	33	21
From credit risk instruments and related derivatives	8	–2
Total	**41**	**19**

Included in net trading expenses/income is an amount of €51 million (2011: € nil) relating to a change in accounting estimate whereby the DEPFA Group refined its derivative valuation models in 2012 relating to counterparty risk parameters. This effect includes a measure of both the credit risk of the counterparty and the DEPFA Group's own credit risk.

10 Net expense from financial investments

Net expense from financial investments € m	2012	2011
Income from financial investments	3	2
Expense from financial investments	–14	–55
Total	**–11**	**–53**

Net expense from financial assets can be split by financial instrument category as follows:

Net expense from financial assets € m	2012	2011
Loans and receivables	–12	–53
Available-for-sale financial investments	1	–
Total	**–11**	**–53**

Net expense from financial investments comprise gains and losses from disposals.

11 Net income from hedge relationships

Net income from hedge relationships € m	2012	2011
Result from fair value hedge accounting	5	4
Result from hedged items	–290	–234
Result from hedging instruments	295	238
Result from designated at fair value through P&L investments and related derivatives	–	–
Result from dFVTPL investments	257	–251
Result from derivatives related to dFVTPL investments	–257	251
Total	**5**	**4**

12 Other operating income/Other operating expense

€m	2012	2011
Other operating income		
Recharge income from other HRE Group companies	86	100
Foreign exchange gains	2	4
Other	1	1
Total other operating income	**89**	**105**

Other operating income mainly consists of income of €81 million (2011: €93 million) from charges to pbb in relation to asset servicing provided on the positions transferred to FMS Wertmanagement and charges to the HRE Group for various supporting activities of €5 million (2011: €7 million).

€m	2012	2011
Other operating expense		
Other	–57	–24
Total other operating expense	**–57**	**–24**

Other operating expense in 2012 mainly includes provisions created by the DEPFA Group for current and expected litigation €–41 million (2011: € nil), IT separation costs of €–10 million (2011: €–17 million) and costs associated with upgrading the transfer methods of positions transferred to FMS Wertmanagement of €–6 million (2011: €–6 million).

13 General administrative expenses

General administrative expenses

€m	2012	2011
Personnel expenses	**–48**	**–53**
Wages and salaries	–39	–42
Social security costs	–5	–7
Pension expenses and related employee benefit costs	–4	–4
Other general administrative expenses	**–62**	**–75**
Depreciation/amortisation	**–7**	**–6**
On software	–7	–5
On property, plant and equipment	–	–1
Total	**–117**	**–134**

Other general administrative expenses also include auditors' remuneration of €1 million (2011: €1 million) and operating lease rentals of €10 million (2011: €11 million). The average number of persons employed by the DEPFA Group during the year was 372 (2011: 405).

Pension expenses and related employee benefit costs include €–4 million defined contribution pension plan expenses (2011: €–4 million).

The cost-income ratio is the ratio of general administrative expenses and total operating revenues.

Cost-income ratio in % is:

Cost-income ratio	2012	2011
Cost-income ratio	87%	59%

14 Other income/expenses

Other income/expenses € m	2012	2011
Reversal of restructuring provision	12	3
Other	2	–4
Total	**14**	**–1**

Other income/expenses contains an amount released against a provision for the strategic realignment and restructuring of the DEPFA Group of €12 million (2011: €3 million).

15 Taxes on income

Taxes on income € m	2012	2011
Current tax	–3	–11
Deferred tax	–6	6
Total	**–9**	**–5**

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

Expected taxes on income and actual taxes on income € m	2012	2011
Pre-tax income	68	124
Applicable (legal) tax rate as % in Ireland	12.50%	12.50%
Expected (computed) tax effect	–9	–16
Tax effects:		
Arising from foreign income	–4	–1
Arising from tax rate differences	–1	1
Arising from losses	1	8
Arising from tax free income	–	–7
Arising from deductible and non deductible items	–1	1
Arising from valuation adjustments and the non application of deferred taxes	–4	6
Arising from the write up deferred taxes	–	–1
Arising from prior years and other periodical effects	9	4
Accounted taxes on income/expense	**–9**	**–5**
Group tax ratio as %	13.56%	3.94%

Development of deferred taxes		Group		Company
€ m	2012	2011	2012	2011
Deferred taxes recognised in the statement of financial position	–1	6	–	–
Difference to prior year thereof:				
Recognised in income statement	–6	6	–	7
Recognised in equity	–	–	–	–
Other	–1	1	–	–
Disposals	–	–	–	–

The deferred tax assets and liabilities of the DEPFA Group relate to the following items:

Deferred tax assets and liabilities

		Group		Company
€ m	2012	2011	2012	2011
Loans and advances to other banks/customers (including loan loss allowances)	–	2	1	–
Financial investments	12	12	–	–
Liabilities to other banks/customers	119	100	–	–
Other assets and liabilities	79	74	–	1
Loss carryforwards	2	4	–	–
Total deferred tax assets	**212**	**192**	**1**	**1**
Loans and advances to other banks/customers (including loan loss allowances)	7	7	–	–
Financial investments	69	67	1	2
Other assets and liabilities	137	112	–	–
Total deferred tax liabilities	**213**	**186**	**1**	**2**

The deductible temporary differences giving rise to deferred tax assets are expected to reverse in the same periods as the taxable temporary differences giving rise to the deferred tax liabilities.

Notes to the statement of financial position

16 Cash reserve

Cash reserve

		Group		Company
€ m	31.12.2012	31.12.2011	31.12.2012	31.12.2011
Balances with central banks other than mandatory reserve deposits	1,522	563	1,305	563
Mandatory reserve deposits with central banks	42	37	26	24
Total	**1,564**	**600**	**1,331**	**587**

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

17 Trading assets

		Group		Company
€ m	31.12.2012	31.12.2011	31.12.2012	31.12.2011
Debt securities and other fixed-income securities				
Bonds and notes	44	44	44	44
Issued by public-sector borrowers	44	44	44	44
Thereof:				
Listed	44	44	44	44
Positive fair values from derivative financial instruments (trading book)	83	193	83	193
Interest based and foreign currency based transactions	81	97	81	97
Others	2	96	2	96
Stand-alone derivatives (banking book)	13,237	20,280	20,478	26,322
Total Trading assets	**13,364**	**20,517**	**20,605**	**26,559**
Of which due from Group companies	403	563	3,790	4,960

Stand-alone derivatives include derivatives related to FMS Wertmanagement counter effects as described in note 5 (a) to the financial statements, as well as derivatives which are economically hedging but which do not meet the detailed hedge accounting criteria under IFRSs.

Balances due from Group companies in the DEPFA Group statement of financial position include amounts receivable from other entities in the HRE Group.

18 Loans and advances to other banks

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

Loans and advances to other banks broken down by type of business

		Group		Company
€ m	31.12.2012	31.12. 2011	31.12. 2012	31.12. 2011
Public sector loans	1,774	1,943	–	–
Other loans and advances	8,417	14,048	11,608	17,351
Total	**10,191**	**15,991**	**11,608**	**17,351**
Of which due from Group companies	468	499	4,290	5,289

Balances due from Group companies in the DEPFA Group statement of financial position include amounts receivable from other entities in the HRE Group.

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

Loans and advances to other banks broken down by maturities

		Group		Company
€ m	31.12.2012	31.12. 2011	31.12. 2012	31.12. 2011
Repayable on demand	6,414	11,922	8,887	13,534
With agreed maturities				
up to 3 months	239	262	901	1,625
from 3 months to 1 year	67	135	55	369
from 1 year to 5 years	1,760	1,851	11	55
from 5 years and over	1,711	1,821	1,754	1,768
Total	**10,191**	**15,991**	**11,608**	**17,351**

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

19 Loans and advances to customers

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

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

		Group		Company
€ m	31.12.2012	31.12. 2011	31.12. 2012	31.12. 2011
Public sector loans	14,865	17,917	2,573	3,409
Other loans and advances	1,988	37,111	719	36,842
Total	**16,853**	**55,028**	**3,292**	**40,251**

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

Loans and advances to customers are broken down by maturities

		Group		Company
€ m	31.12.2012	31.12. 2011	31.12. 2012	31.12. 2011
Repayable on demand	36	41	25	31
With agreed maturities				
up to 3 months	722	35,755	–	35,669
from 3 months to 1 year	895	2,053	257	1,023
from 1 year to 5 years	3,219	4,678	185	492
from 5 years and over	11,981	12,501	2,825	3,036
Total	**16,853**	**55,028**	**3,292**	**40,251**

20 Allowance for losses on loans and advances

Movement in allowance for losses on loans and advances:

Specific allowance for losses on loans and advances		**Group**		**Company**
€ m	**31.12.2012**	**31.12. 2011**	**31.12. 2012**	**31.12. 2011**
Balance at 1 January	**–2**	**–15**	**–2**	**–16**
(Additions)/reversals of specific allowance	–69	14	–69	14
Foreign exchange retranslation	–	–1	–	–
Total specific allowance for losses on loans and advances	**–71**	**–2**	**–71**	**–2**

Portfolio allowance for losses on loans and advances		**Group**		**Company**
€ m	**31.12.2012**	**31.12. 2011**	**31.12. 2012**	**31.12. 2011**
Balance at 1 January	**–68**	**–85**	**–65**	**–83**
Releases of portfolio allowance	37	17	39	18
Total portfolio based allowance for losses on loans and advances	**–31**	**–68**	**–26**	**–65**
Total allowance for losses on loans and advances	**–102**	**–70**	**–97**	**–67**

Losses on loans and advances recoverable under financial guarantees		**Group**		**Company**
€ m	**31.12.2012**	**31.12. 2011**	**31.12. 2012**	**31.12. 2011**
Recovery of losses on loans and advances under financial guarantees	69	–	69	–
Total	**69**	**–**	**69**	**–**

The additions to specific allowances in 2012 of €69 million (2011: € nil) relate to losses on exposures which are recoverable under financial guarantee contracts with FMS Wertmanagement. The income statement effect of the financial guarantees is included in the separate line "Recovery of losses on loans and advances under financial guarantees".

Recovery of losses on loans and advances under guarantees are recognised at the same time as specific allowances for losses on assets subject to the guarantee. In the event of a specific allowance for losses being released the associated guarantee recoverable would also be derecognised.

The total allowance for losses on loans and advances and losses on loans and advances recoverable under financial guarantees are all public sector and infrastructure loans.

Interest accrued on impaired loans at 31 December 2012 was €1.1 million (2011: € nil).

Carrying amounts of loans and receivables

Carrying amounts of loans and receivables		**Group**		**Company**
€ m	**31.12.2012**	**31.12.2011**	**31.12.2012**	**31.12.2011**
Carrying amount of loans and receivables that are neither impaired nor past due	26,954	71,017	14,810	57,600
Carrying amount of loans and receivables that are past due but not impaired	21	–	21	–
Carrying amount of individually assessed impaired financial loans and receivables	67	–	67	–
Total	**27,042**	**71,017**	**14,898**	**57,600**
Of which loans and advances to other banks	10,191	15,991	11,608	17,351
Of which loans and advances to customers	16,851	55,026	3,290	40,249

The above table includes specific allowances for losses on loans and advances and recovery of losses under financial guarantees. Portfolio allowances for losses on loans and advances are excluded.

The allowances for losses on loans and advances were exclusively created for the measurement category loans and receivables.

Ratio of allowances to total lending

Ratio of allowances to total lending		Group		Company
€ m	31.12.2012	31.12.2011	31.12.2012	31.12.2011
Loan loss allowances (net of recovery of losses under financial guarantees)	–33	–70	–28	–67
Volume of total lending	27,011	70,949	14,872	57,535
Provision ratio	**–0.12%**	**–0.10%**	**–0.19%**	**–0.12%**

Loans and advances past due but not impaired At 31 December 2012, the following amounts were noted as being past due. However, no impairment provision was made against these past due amounts as the DEPFA Group does not consider that there is any significant issue regarding their recoverability. The total book value in relation to the amounts has also been disclosed to put the size of the amounts in question into context.

Loans past due		Group		Company
€ m	31.12.2012	31.12.2011	31.12.2012	31.12.2011
Assets: past due but not impaired (due amount)				
Past due but not impaired less than 90 days	1	–	1	–
Past due but not impaired between 3 months and 6 months	–	–	–	–
Past due but not impaired between 6 months and 1 year	–	–	–	–
Past due but not impaired greater than 1 year	–	–	–	–
Total	**1**	**–**	**1**	**–**
Assets: past due but not impaired (total investment)				
Past due but not impaired less than 90 days	21	–	21	–
Past due but not impaired between 3 months and 6 months	–	–	–	–
Past due but not impaired between 6 months and 1 year	–	–	–	–
Past due but not impaired greater than 1 year	–	–	–	–
Total	**21**	–	**21**	–
Carrying amount of the individually assessed impaired financial assets				
Loans	67	–	67	–
Total	**67**	**–**	**67**	**–**

All of the above past due amounts are in relation to assets which are covered under a financial guarantee from FMS Wertmanagement.

The DEPFA Group did not obtain any assets by taking possession of collateral or calling on any other credit enhancements in relation to the above outstanding amounts.

21 Financial investments

Financial investments

€ m	Group 31.12.2012	Group 31.12.2011	Company 31.12.2012	Company 31.12.2011
AfS financial investments	**22**	**26**	**22**	**26**
Debt securities and other fixed-income securities	22	26	22	26
Group undertakings	**–**	**–**	**1,053**	**1,053**
Shares in Group undertakings	–	–	1,053	1,053
dFVTPL financial investments	**–**	**3,795**	**–**	**3,795**
Debt securities and other fixed-income securities	–	3,795	–	3,795
LaR financial investments	**25,312**	**27,796**	**3,613**	**3,841**
Debt securities and other fixed-income securities	25,312	27,796	3,613	3,841
Total	**25,334**	**31,617**	**4,688**	**8,715**

The book value of these financial investments represents the maximum exposure to credit risk on these assets. The portfolio of debt securities designated at fair value through profit or loss had been so designated to reduce the measurement inconsistency with the relevant offsetting derivative, which was an economic hedge of the position.

Financial investments are broken down by maturities as follows:

€ m	Group 31.12.2012	Group 31.12.2011	Company 31.12.2012	Company 31.12.2011
Unspecified amount	2	1	1,055	1,054
With agreed maturities				
up to 3 months	525	70	23	23
from 3 months to 1 year	1,115	1,050	307	86
from 1 year to 5 years	7,108	8,524	44	350
from 5 years and over	16,584	21,972	3,259	7,202
Total	**25,334**	**31,617**	**4,688**	**8,715**

Breakdown of debt securities and other fixed income securities at 31 December by counterparty type:

Debt securities and other fixed income securities by counterparty type

€ m	Group 31.12.2012	Group 31.12.2011	Company 31.12.2012	Company 31.12.2011
Bonds and debt securities				
By public issuers	22,354	26,991	3,615	3,517
By other issuers	2,980	4,626	20	4,145
Total	**25,334**	**31,617**	**3,635**	**7,662**

In 2008 the DEPFA Group made use of the IASB amendments to IAS 39 and IFRS 7, published on 13 October 2008 and reclassified certain financial assets. The DEPFA 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, that they were not quoted in an active market). The reclassified portfolios are disclosed under financial investments.

On 30 September 2008, the DEPFA Group reclassified retrospectively as of 1 July 2008 trading assets out of the category held-for-trading amounting to €3.4 billion (Company: €3.4 billion) and financial investments out of the category available-for-sale of €44.26 billion (Company: €33.75 billion). In addition, trading assets of €0.75 billion (Company: €0.75 billion) were reclassified prospectively into financial investments of the category loans and receivables on 1 October 2008.

Since the date of reclassification, the DEPFA Group's financial assets with a (reclassified) carrying amount of approximately €4.767 billion (Company: €2.942 billion) matured. Thereof, €3.442 billion (Company: €1.617 billion) relate to reclassified AfS financial investments and €1.325 billion (Company: €1.325 billion) relate to reclassified trading assets.

Interest income for the DEPFA Group and Company reclassified trading instruments is now shown under net interest income; before reclassification interest income was shown in net trading income. In 2012, net interest income contains €6.3 million (2011: €7.5 million) of interest income for reclassified trading instruments. The reclassification of AfS assets did not cause a disclosure change of interest income as it is still shown under net interest income.

Since the date of reclassification, Group securities with a reclassified carrying amount of €37.503 billion (Company: €32.413 billion) were transferred to FMS Wertmanagement or sold. A net loss of €–27.35 million (Company: gain of €0.38 million) was realised on the sold securities.

At the date of reclassification the effective interest rate for the reclassified trading assets of the DEPFA Group which remain on the statement of financial position was between 5.07% and 4.02% (2011: 5.07% and 3.74%) and of the Company was 5.07% and 4.02% (2011: 5.07% and 3.74%). The effective interest rate for AfS assets of the DEPFA Group was between 6.35% and 0.51% (2011: 6.35% and 0.51%) and of the Company was 6.46% and 5.04% (2011: 6.46% and 5.04%).

The following tables summarise the carrying amounts and fair values as of 31 December 2012 as well as fair value gains and losses that would have been recognised in 2012 if the financial assets had not been reclassified:

Group reclassifications 2012	into: Financial investments LaR				
		31.12.2012		Effect in reporting period if no assets would have been reclassified (2012)	
€ m	Reclass date	Carrying amount	Fair value	Income statement	Changes in AfS reserve (after taxes)
out of:	1.7.2008	–	–	–	–
HfT financial investments	1.10.2008	112	114	–	–
		112	**114**	**–**	**–**
out of: AfS financial investments	1.7.2008	7,483	7,188	–	305
Total		**7,595**	**7,302**	**–**	**305**

Company reclassifications 2012	into: Financial investments LaR				
		31.12.2012		Effect in reporting period if no assets would have been reclassified (2012)	
€ m	Reclass date	Carrying amount	Fair value	Income statement	Changes in AfS reserve (after taxes)
out of:	1.7.2008	–	–	–	–
HfT financial investments	1.10.2008	112	114	–	–
		112	**114**	**–**	**–**
out of: AfS financial investments	1.7.2008	175	202	–	–11
Total		**287**	**316**	**–**	**–11**

Group reclassifications 2011

€m	Reclass date	into: Financial investments LaR 31.12.2011 Carrying amount	Fair value	Effect in reporting period if no assets would have been reclassified (2011) Income statement	Changes in AfS reserve (after taxes)
out of: HfT financial investments	1.7.2008	–	–	–	–
	1.10.2008	203	205	–4	–
		203	**205**	**–4**	**–**
out of: AfS financial investments	1.7.2008	7,864	7,184	–	–194
Total		**8,067**	**7,389**	**–4**	**–194**

Company reclassifications 2011

€m	Reclass date	into: Financial investments LaR 31.12.2011 Carrying amount	Fair value	Effect in reporting period if no assets would have been reclassified (2011) Income statement	Changes in AfS reserve (after taxes)
out of: HfT financial investments	1.7.2008	–	–	–	–
	1.10.2008	203	205	–4	–
		203	**205**	**–4**	**–**
out of: AfS financial investments	1.7.2008	201	227	–	36
Total		**404**	**432**	**–4**	**36**

Securities listed on stock exchange

Securities listed on stock exchange – Group

€m	31.12.2012 Debt securities and other fixed income securities	Equity securities	Total	31.12.2011 Debt securities and other fixed income securities	Equity securities	Total
Listed	20,582	–	20,582	26,680	–	26,680
Unlisted	4,752	–	4,752	4,937	–	4,937
Total	**25,334**	**–**	**25,334**	**31,617**	**–**	**31,617**

Securities listed on stock exchange – Company

€m	31.12.2012 Debt securities and other fixed income securities	Equity securities	Total	31.12.2011 Debt securities and other fixed income securities	Equity securities	Total
Listed	3,292	–	3,292	6,440	–	6,440
Unlisted	343	1,053	1,396	1,222	1,053	2,275
Total	**3,635**	**1,053**	**4,688**	**7,662**	**1,053**	**8,715**

Financial investments – past due but not impaired There were no past due but not impaired financial investments for 2012 (2011: € nil).

The carrying amount of the AfS and LaR financial investments that are neither past due nor impaired comes to €25.3 billion (2011: €31.6 billion) for the DEPFA Group and €4.7 billion (2011: €8.7 billion) for the Company.

22 Property, plant and equipment

Property, plant and equipment	Group				Company			
		2012		2011		2012		2011
€ m	Fixtures and fittings	Total	Fixtures and fittings	Total	Fixtures and fittings	Total	Fixtures and fittings	Total
Cost								
At 1 January	**23**	**23**	**22**	**22**	**23**	**23**	**22**	**22**
Additions/Disposals	–	–	1	1	–	–	1	1
At 31 December	**23**	**23**	**23**	**23**	**23**	**23**	**23**	**23**
Accumulated depreciation								
At 1 January	**22**	**22**	**21**	**21**	**22**	**22**	**21**	**21**
Disposals	–	–	–	–	–	–	–	–
Charge for year	–	–	1	1	–	–	1	1
At 31 December	**22**	**22**	**22**	**22**	**22**	**22**	**22**	**22**
Net book value								
At 31 December	**1**	**1**	**1**	**1**	**1**	**1**	**1**	**1**

The DEPFA Group did not hold any property in 2012 and 2011.

23 Intangible assets

Intangible assets	Group		Company	
€ m	31.12.2012	31.12.2011	31.12.2012	31.12.2011
Cost				
At 1 January	**44**	**41**	**43**	**40**
Additions	2	3	2	3
At 31 December	**46**	**44**	**45**	**43**
Accumulated depreciation				
At 1 January	**27**	**22**	**26**	**21**
Amortisation charge for year	7	5	7	5
At 31 December	**34**	**27**	**33**	**26**
Net book value				
At 31 December	**12**	**17**	**12**	**17**

The intangible assets mostly comprise purchased and self-developed software.

24 Other assets

Other assets		Group		Company
€ m	31.12.2012	31.12.2011	31.12.2012	31.12.2011
Positive fair values from derivative financial instruments	5,781	5,992	311	630
Hedging derivatives (micro fair value hedge)	5,781	5,743	311	381
Derivatives hedging dFVTPL financial instruments	–	249	–	249
Other assets	17	36	30	89
Total	**5,798**	**6,028**	**341**	**719**
Of which due from Group companies	10	8	37	70

Balances due from Group companies in the DEPFA Group statement of financial position include amounts receivable from other entities in the HRE Group.

25 Income tax assets

Income tax assets		**Group**		**Company**
€ m	**31.12.2012**	**31.12.2011**	**31.12.2012**	**31.12.2011**
Current tax assets	2	1	1	1
Deferred tax assets	212	192	1	1
Total	**214**	**193**	**2**	**2**

26 Liabilities to other banks

Liabilities to other banks are broken down by maturities as follows:		**Group**		**Company**
€ m	**31.12.2012**	**31.12.2011**	**31.12.2012**	**31.12.2011**
Repayable on demand	3,207	1,763	4,201	1,280
With agreed maturities				
up to 3 months	239	34,219	1,095	36,948
from 3 months to 1 year	–	1,355	–	1,369
from 1 year to 5 years	2,957	395	201	199
from 5 years and over	228	325	268	384
Total	**6,631**	**38,057**	**5,765**	**40,180**
Of which due to Group companies	235	340	2,521	3,176

Included under liabilities to other banks are amounts due under repurchase agreements.

Balances due to Group companies in the DEPFA Group statement of financial position include amounts payable to other entities in the HRE Group.

27 Liabilities to customers

Liabilities to customers are broken down by maturities as follows:		**Group**		**Company**
€ m	**31.12.2012**	**31.12.2011**	**31.12.2012**	**31.12.2011**
Repayable on demand	4,571	11,400	3,926	9,066
With agreed maturities				
up to 3 months	54	55	54	54
from 3 months to 1 year	–	11	–	11
from 1 year to 5 years	35	16	35	16
from 5 years and over	4,425	9,874	4,424	9,874
Total	**9,085**	**21,356**	**8,439**	**19,021**

28 Liabilities evidenced by certificates

Liabilities evidenced by certificates are broken down by type of business as follows:		**Group**		**Company**
€ m	**31.12.2012**	**31.12.2011**	**31.12.2012**	**31.12.2011**
Debt securities in issue	33,414	38,277	2,152	2,626
Public sector bonds	31,254	35,630	–	–
Other debt securities	2,127	2,607	2,119	2,586
Money market securities	33	40	33	40
Registered notes in issue	1,240	1,179	–	–
Public sector bonds	1,240	1,179	–	–
Total	**34,654**	**39,456**	**2,152**	**2,626**

Liabilities evidenced by certificates are broken down by maturities as follows:	Group		Company	
€ m	31.12.2012	31.12.2011	31.12.2012	31.12.2011
With agreed maturities				
up to 3 months	158	3,418	12	16
from 3 months to 1 year	4,158	1,259	60	421
from 1 year to 5 years	14,557	17,307	830	807
from 5 years and over	15,781	17,472	1,250	1,382
Total	**34,654**	**39,456**	**2,152**	**2,626**

29 Trading liabilities

Trading liabilities	Group		Company	
€ m	31.12.2012	31.12.2011	31.12.2012	31.12.2011
Negative fair values from derivative financial instruments (trading book)	69	175	69	175
of which:				
Interest based and foreign currency based transactions	69	79	69	79
Credit-related transactions	–	96	–	96
Other trading liabilities	112	119	76	80
Stand-alone derivatives (banking book)	13,136	20,310	20,517	26,234
Total	**13,317**	**20,604**	**20,662**	**26,489**
Of which due to Group companies	63	297	5,173	5,001

Stand-alone derivatives include derivatives related to FMS Wertmanagement counter effects as described in note 5 (a) to the financial statements, as well as derivatives which are economically hedging but which do not meet the detailed hedge accounting criteria under IFRSs.

Balances due to Group companies in the DEPFA Group statement of financial position include amounts payable from other entities in the HRE Group.

30 Provisions

Provisions	Group		Company	
€ m	31.12.2012	31.12.2011	31.12.2012	31.12.2011
Provisions for pensions and similar obligations	1	1	1	1
Restructuring provisions	26	43	25	42
Other provisions	121	68	120	69
Total	**148**	**112**	**146**	**112**

The DEPFA Group operates two types of pension schemes – defined benefit schemes and defined contribution schemes. Provisions for pensions and similar obligations are for defined benefit schemes for which the employees receive a direct commitment from their respective company and a pension provision is created for this purpose. The pension obligation is unfunded.

Discount rate and valuation parameters The principal actuarial assumptions used were as follows:

Discount rate and valuation parameters		Group		Company
%	31.12.2012	31.12.2011	31.12.2012	31.12.2011
Discount rate	3.25	4.75	3.25	4.75
Rate of increase in pension obligations	2.00	2.00	2.00	2.00
Rate of increase in future compensation and vested rights	2.50	2.50	2.50	2.50
Rate of increase over career	0–1.5	0–1.5	0–1.5	0–1.5

Development of pension obligations

Pension obligations		Group		Company
€ m	2012	2011	2012	2011
At 1 January	**1**	**1**	**1**	**1**
Total expense	–	–	–	–
Transfer to Group company	–	–	–	–
Contributions paid	–	–	–	–
At 31 December	**1**	**1**	**1**	**1**

Expenses in relation to defined benefit schemes was € nil (2011: € nil).

The vast majority of employees have defined contribution plans. This means a defined percentage of fixed salary is paid into externally managed pension funds for employees as part of defined contribution pension schemes.

Expenses in respect of contribution-based plans amounted to €4 million (2011: €4 million).

Development of restructuring and other provisions

Provisions	Group				Company			
		2012		2011		2012		2011
€ m	Restructuring provisions	Other provisions	Restructuring provisions	Other provisions	Restructuring provisions	Other provisions	Restructuring provisions	Other provisions
At 1 January	**43**	**68**	**49**	**46**	**42**	**69**	**50**	**46**
Additions	–	61	–	38	–	59	–	39
Transfer	–	17	–	–	–	17	–	–
Reversals	–12	–	–3	–	–12	–	–4	–
Amounts used	–6	–26	–4	–17	–6	–26	–5	–17
Unwind of discount	1	1	1	1	1	1	1	1
At 31 December	**26**	**121**	**43**	**68**	**25**	**120**	**42**	**69**

Restructuring provisions mainly relate to obligations relating to the strategic management and restructuring of the DEPFA Group. The main components of the expenses are personnel expenses including severance payments, expenses for closure of locations and expenses for consulting.

Other provisions contain obligations in connection with the transfer of the assets and liabilities to FMS Wertmanagement amounting to €36 million (2011: €41 million) and IT separation provision of €17 million (2011: €17 million). Also included in other provisions are amounts provided for in relation to litigation risks and obligations arising from the sale of certain receivables.

Legal and arbitration proceedings The DEPFA Group is exposed to potential risks arising from litigation and other proceedings in which it is currently involved. In particular, risks may arise from the following proceedings and where considered necessary, appropriate provisions have been recorded:

Legal action is pending before the High Court in England as a result of two credit default swap transactions with Kommunale Wasserwerke Leipzig GmbH ("KWL"). DEPFA BANK plc, a further bank and KWL are involved. The former managing directors of KWL are alleged to have exceeded their powers when the transactions were concluded. The alleged damage was originally quantified at approximately €116 million.

One employee and one former employee of DEPFA BANK plc Rome branch (together with certain employees of 3 other banks) were convicted (with suspended sentences) of having defrauded the City of Milan in connection with derivative transactions entered into by the banks with the City between 2005 and 2007. Summary judgement was handed down on 19th December 2012. DEPFA BANK plc was fined €1 million and a further sum of €24 million ordered to be confiscated relating to alleged "profits from the crime". The criminal trial started in May 2010 at the Criminal Court of First Instance in Milan. The prosecutor alleged that the derivative transactions included hidden fees for the banks causing unjustifiable enrichment for the banks to the detriment of the City of Milan. DEPFA BANK plc, as well as the other banks, was joined as an accused party under Italian Administrative law no. 231 for allegedly failing to have appropriate organisational controls in place to avoid crimes of their employees. DEPFA BANK plc intends to appeal the judgement and the convictions and fines will remain suspended during the appeal process.

Certain other derivative transactions with public sector counterparties are already or may become the subject of litigation or other legal proceedings.

The DEPFA Group considers that appropriate provision has been made for the obligations related to litigation and other legal risks.

31 Other liabilities

Other liabilities

		Group		Company
€ m	31.12.2012	31.12.2011	31.12.2012	31.12.2011
Negative fair values from derivative financial instruments	5,782	6,013	2,008	2,353
Hedging derivatives	5,782	5,714	2,008	2,054
Micro fair value hedge	5,783	5,715	2,008	2,054
Cash flow hedge	–1	–1	–	–
Derivatives hedging dFVTPL financial instruments	–	299	–	299
Other liabilities	234	272	233	276
Deferred income	–	4	–	4
Total	**6,016**	**6,289**	**2,241**	**2,633**
Of which due to Group companies	224	199	181	196

Balances due to Group companies in the DEPFA Group statement of financial position include amounts payable to other entities in the HRE Group.

32 Income tax liabilities

Income tax liabilities

		Group		Company
€ m	31.12.2012	31.12.2011	31.12.2012	31.12.2011
Current tax liabilities	31	44	30	38
Deferred tax liabilities	213	186	1	2
Total	**244**	**230**	**31**	**40**

33 Subordinated capital

Subordinated capital		Group		Company
€ m	31.12.2012	31.12.2011	31.12.2012	31.12.2011
Subordinated liabilities	1,082	1,079	1,687	1,682
Total	**1,082**	**1,079**	**1,687**	**1,682**
Of which due to Group companies	–	–	640	637

Balances due to Group companies in the DEPFA Group statement of financial position include amounts payable to other entities in the HRE Group.

Subordinated capital are broken down by maturities as follows:		Group		Company
€ m	31.12.2012	31.12.2011	31.12.2012	31.12.2011
With agreed maturities				
from 1 year to 5 years	660	660	660	660
from 5 years and over	422	419	1,027	1,022
Total	**1,082**	**1,079**	**1,687**	**1,682**

The subordinated debt are analysed by nominal, maturity and interest rate below:

Subordinated liabilities			Group		Company
€ m	Interest rate	31.12.2012	31.12.2011	31.12.2012	31.12.2011
DEPFA BANK plc, 26/03/24	5.40%	20	20	20	20
DEPFA BANK plc, 22/07/14	CPI – Index Linked%	10	10	10	10
DEPFA BANK plc, 15/12/15	Euribor + 0.70%	500	500	500	500
DEPFA BANK plc, perpetual note	Euribor + 1.00%	360	360	360	360
DEPFA BANK plc, 28/11/16	Euribor + 1.02%	40	40	40	40
DEPFA BANK plc, 21/12/16	Euribor + 1.02%	110	110	110	110
Hypo Pfandbrief Bank International S.A., 18/05/26	6.80%	25	25	–	–
DEPFA BANK plc, 30/10/28	6.55%	–	–	280	280
DEPFA BANK plc, 8/06/30	Euribor + 0.88%	–	–	250	250
DEPFA BANK plc, 21/3/32	5.099% until 2017, thereafter Euribor + 1.94%	–	–	90	90
Total		**1,065**	**1,065**	**1,660**	**1,660**

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

34 Share capital and share premium

Share capital and share premium – Group and Company				
€ m	Number of Shares in issue	Ordinary Shares	Share premium	**Total**
At 31 December 2011	353,019,720	106	1,142	1,248
At 31 December 2012	353,019,720	106	1,142	1,248

The total authorised number of ordinary shares at year end was 16,666,333,330 (2011: 16,666,333,330) with a par value of €0.30 per share (2011: €0.30 per share). All issued shares are fully paid.

The total authorised number of non-cumulative redeemable preference shares at year end was 10,000,000 (2011: 10,000,000) with a par value of €0.01 per share (2011: €0.01 per share). No non-cumulative redeemable preference shares have been issued to date.

35 Capital reserve

Capital reserve		Group		Company
€ m	2012	2011	2012	2011
At 1 January and at 31 December	**1,500**	**1,500**	**2,403**	**2,403**

Capital contributions of € nil were received in cash from the parent company, Hypo Real Estate Holding AG in 2012 (2011: € nil).

36 Preferred securities

Preferred securities		Group		Company
€ m	31.12.2012	31.12.2011	31.12.2012	31.12.2011
Hybrid capital instruments	1,136	1,136	–	–
Total	**1,136**	**1,136**	**–**	**–**

The hybrid capital instruments are analysed by nominal, maturity and interest rate below:

Hybrid capital instruments			
Nominal € m	Interest rate	31.12.2012	31.12.2011
DEPFA Funding II LP, perpetual note	6.50%	400	400
DEPFA Funding III LP, perpetual note	7% until 2008, thereafter CMS 10 yr + 0.1%	300	300
DEPFA Funding IV LP, perpetual note	5.029% until 2017, thereafter Euribor + 1.87%	500	500
Total		**1,200**	**1,200**

Hybrid capital instruments in particular include issues in the form of preferred shares 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.

The above hybrid instruments of the DEPFA Group are recognised as capital instruments in accordance with IAS 32.16. The classification of financial instruments as capital instruments or debt instruments depends on whether the DEPFA Group has a contractual obligation to make payments from an issued financial instrument. The above instruments are subordinated debt issued in the form of undated bonds via the issuance vehicles DEPFA Funding II LP, DEPFA Funding III LP and DEPFA Funding IV LP on which the DEPFA Group has no contractual obligation to make interest payments.

Accordingly, the carrying amount of these hybrid capital instruments is classified as equity.

On 6 March 2012 DEPFA BANK plc determined that the perpetual preferred securities issuing vehicle, DEPFA Funding IV LP, would not make payments on its €500,000,000 Preferred Securities (XS0291655727) on the next distribution payment date scheduled for 21 March 2012.

Similarly, on 24 May 2012 DEPFA BANK plc determined that DEPFA Funding III LP would not make payments on its €300,000,000 Preferred Securities (DE000A0E5U85) on the next distribution payment date scheduled for 8 June 2012.

Finally, on 15 October 2012 DEPFA BANK plc determined that DEPFA Funding II LP would not make payments on its €400,000,000 Preferred Securities (XS0178243332) on the next distribution payment date scheduled for 30 October 2012.

37 Retained earnings

Retained earnings

€m	Group 2012	Group 2011	Company 2012	Company 2011
At 1 January	**–1,100**	**–256**	**–2,310**	**–1,470**
Net income/loss	59	119	60	–31
FMSA payment condition, net of tax	–623	–963	–623	–809
Annual state aid compensation	–59	–	–59	–
At 31 December	**–1,723**	**–1,100**	**–2,932**	**–2,310**

38 Other reserves

Other reserves

€m	Group 31.12.2012	Group 31.12.2011	Company 31.12.2012	Company 31.12.2011
Unrealised gains/losses from cash flow hedges	–	–	–	–
Unrealised losses/gains from available-for-sale investment securities	–42	–47	2	2
Accumulated currency translation reserve	2	2	8	9
Total	**–40**	**–45**	**10**	**11**

Unrealised gains/losses from cash flow hedges

€m	Group 2012	Group 2011	Company 2012	Company 2011
At 1 January	**–**	**–**	**–**	**–**
Net losses from changes in fair value, net of tax	–	–7	–	–
Net gains transferred to net income, net of tax	–	7	–	–
At 31 December	**–**	**–**	**–**	**–**

Unrealised losses/gains from available-for-sale investment securities

€m	Group 2012	Group 2011	Company 2012	Company 2011
At 1 January	**–47**	**–59**	**2**	**6**
Net gains/losses from changes in fair value, net of tax	5	12	–	–4
Net gains/losses transferred to net income, net of tax	–	–	–	–
Change due to transfer to FMS Wertmanagement	–	–	–	–
At 31 December	**–42**	**–47**	**2**	**2**

Accumulated currency translation reserve

€m	Group 2012	Group 2011	Company 2012	Company 2011
At 1 January	**2**	**–**	**9**	**5**
Net gain from currency translation	–	2	–1	4
At 31 December	**2**	**2**	**8**	**9**

39 Foreign currency assets and liabilities

The following table represents the carrying value of foreign currency assets and liabilities:

Foreign currency assets	Group		Company	
€ m	31.12.2012	31.12.2011	31.12.2012	31.12.2011
USD	11,024	15,818	5,444	9,943
JPY	3,165	5,113	1,678	5,036
GBP	4,538	8,357	4,338	7,990
CHF	2,354	3,169	1,413	2,034
Others	3,004	6,198	925	5,903
Total	**24,085**	**38,655**	**13,798**	**30,906**

Foreign currency liabilities	Group		Company	
€ m	31.12.2012	31.12.2011	31.12.2012	31.12.2011
USD	11,032	15,830	5,453	9,913
JPY	3,169	5,100	1,677	5,035
GBP	4,535	8,342	4,337	7,978
CHF	2,332	3,151	1,414	2,039
Others	2,987	6,170	910	5,880
Total	**24,055**	**38,593**	**13,791**	**30,845**

As described in the “Risk management” section of the Directors’ report, the general strategy of the DEPFA Group is to hedge foreign currency risks as far as possible.

Note to the cash flow statements

40 Notes to the items in the cash flow statement and undiscounted cash flows of financial liabilities

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

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

Cash flow from investing activities comprises payments for investment securities, receipts from sales and maturities of investment securities, as well as payments for property, plant and equipment.

Cash flow from financing activities comprises the settlement of the FMSA payment condition as described in Note 5.

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

Contractual undiscounted cash flows of the financial liabilities

		Group		Company
€ bn	31.12.2012	31.12.2011	31.12.2012	31.12.2011
up to 3 months	**9**	**53**	**9**	**49**
Of which from derivatives	1	1	1	1
Of which from non derivatives	8	52	8	48
from 3 months to 1 year	**7**	**6**	**2**	**5**
Of which from derivatives	2	2	2	3
Of which from non derivatives	5	4	–	2
from 1 year to 5 years	**27**	**30**	**10**	**12**
Of which from derivatives	7	9	8	10
Of which from non derivatives	20	21	2	2
from 5 years and over	**47**	**59**	**32**	**41**
Of which from derivatives	18	28	20	30
Of which from non derivatives	29	31	12	11

Notes to the financial instruments

41 Derivative financial instruments

Derivative financial instruments

		Group		Company
€ m	2012	2011	2012	2011
Assets				
Trading assets (note 17)	13,320	20,473	20,561	26,515
Other assets (note 24)	5,781	5,992	311	630
Total assets	**19,101**	**26,465**	**20,872**	**27,145**
Liabilities				
Trading liabilities (note 29)	13,205	20,485	20,586	26,409
Other liabilities (note 31)	5,782	6,013	2,008	2,353
Total liabilities	**18,987**	**26,498**	**22,594**	**28,762**

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

Derivatives may be used for trading purposes or for risk management purposes. The DEPFA Group uses derivative financial instruments primarily as a means of hedging the risk associated with asset/liability management in the context of interest bearing transactions. Interest rate derivatives are primarily entered into to hedge the fair value interest rate risk in fixed-rate available-for-sale securities, loans extended, promissory note loans and debt securities in issue. Derivatives are also entered into, to a lesser extent, for the purpose of hedging foreign currency risks. Foreign exchange risks are primarily hedged by means of suitable fair value hedges for available-for-sale securities, loans extended and debt securities in issue. However, some derivatives used for risk management purposes do not qualify for hedge accounting and are therefore classified as part of the "trading portfolio" in the DEPFA Group financial statements.

Derivatives used by the DEPFA Group include:
- Interest rate and cross currency swaps
- Interest rate options
- Forward foreign exchange contracts
- Credit default swaps

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

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

Interest rate risks reflect the material risks associated with such contracts. Where these are OTC transactions, counterparty default risk also exists.

Interest rate options are contracts that allow the purchaser to enter into contracts on financial instruments or to buy or sell an underlying variable, at a specified price at a specified point of time. The option writer is obligated to buy, sell or enter into a financial instrument if the purchaser chooses to exercise the option. Option contracts purchased or written by the DEPFA Group include caps and floors which are interest rate hedging instruments, as the agreed payment covers the difference in interest between the agreed interest rate and the market rate. Exposure to current and future movements in interest rates and the ability of the counterparties to meet the terms of the contracts represent the primary risks associated with interest rate options.

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

Credit default swaps are contracts which transfer credit risk on an underlying reference asset or group of assets from one party to another in exchange for a fee. The material risk from credit default swaps is exposure to changes in the credit risk of the underlying reference asset and the ability of the counterparties to meet the terms of the contracts.

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

Volume of derivatives – Group at 31 December 2012	Notional amount				Fair value	
	Remaining maturities					
€ m	Less than 1 year	1 to 5 years	More than 5 years	Total	Positive fair values	Negative fair values
Interest based transactions						
OTC products	**15,394**	**48,963**	**81,883**	**146,240**	**17,556**	**18,396**
Interest rate swaps	15,281	48,043	81,764	145,088	17,432	18,255
Call options	–	394	–	394	–	3
Put options	3	374	119	496	4	–
Other interest rate contracts	110	152	–	262	120	138
Total	**15,394**	**48,963**	**81,883**	**146,240**	**17,556**	**18,396**
Foreign currency based transactions						
OTC products	**5,217**	**3,570**	**2,637**	**11,424**	**1,421**	**469**
Spot and forward currency transactions	2,884	–	–	2,884	25	32
Interest rate/currency swaps	2,333	3,570	2,637	8,540	1,396	437
Total	**5,217**	**3,570**	**2,637**	**11,424**	**1,421**	**469**
Other transactions						
OTC products	**78**	**96**	**3,404**	**3,578**	**124**	**122**
Credit derivatives	78	96	3,404	3,578	124	122
Total	**78**	**96**	**3,404**	**3,578**	**124**	**122**
Total	**20,689**	**52,629**	**87,924**	**161,242**	**19,101**	**18,987**

Volume of derivatives – Group at 31 December 2011	Notional amount				Fair value	
	Remaining maturities					
€ m	Less than 1 year	1 to 5 years	More than 5 years	Total	Positive fair values	Negative fair values
Interest based transactions						
OTC products	**14,146**	**72,751**	**138,928**	**225,825**	**23,976**	**25,151**
Interest rate swaps	14,081	72,111	138,285	224,477	23,845	24,998
Call options	52	309	244	605	13	–
Put options	13	331	352	696	–	13
Other interest rate contracts	–	–	47	47	118	140
Exchange traded products	**541**	**1**	**–**	**542**	**3**	**–**
Interest rate futures	541	1	–	542	3	–
Total	**14,687**	**72,752**	**138,928**	**226,367**	**23,979**	**25,151**
Foreign currency based transactions						
OTC products	**6,403**	**9,661**	**4,933**	**20,997**	**2,185**	**1,046**
Spot and forward currency transactions	3,551	–	–	3,551	44	45
Interest rate/currency swaps	2,852	9,661	4,933	17,446	2,141	1,001
Total	**6,403**	**9,661**	**4,933**	**20,997**	**2,185**	**1,046**
Other transactions						
OTC products	**77**	**472**	**5,510**	**6,059**	**301**	**301**
Credit derivatives	77	472	5,510	6,059	301	301
Total	**77**	**472**	**5,510**	**6,059**	**301**	**301**
Total	**21,167**	**82,885**	**149,371**	**253,423**	**26,465**	**26,498**

Volume of derivatives – Company at 31 December 2012				Notional amount	Fair value	
		Remaining maturities				
€ m	Less than 1 year	1 to 5 years	More than 5 years	Total	Positive fair values	Negative fair values
Interest based transactions						
OTC products	**22,676**	**64,005**	**89,233**	**175,914**	**19,234**	**20,832**
Interest rate swaps	22,563	63,085	89,108	174,756	19,110	20,691
Call options	–	394	–	394	–	3
Put options	3	374	125	502	4	–
Other interest rate contracts	110	152	–	262	120	138
Total	**22,676**	**64,005**	**89,233**	**175,914**	**19,234**	**20,832**
Foreign currency based transactions						
OTC products	**11,711**	**6,721**	**3,876**	**22,308**	**1,514**	**1,640**
Spot and forward currency transactions	7,674	–	–	7,674	28	136
Interest rate/currency swaps	4,037	6,721	3,876	14,634	1,486	1,504
Total	**11,711**	**6,721**	**3,876**	**22,308**	**1,514**	**1,640**
Other transactions						
OTC products	**78**	**96**	**3,404**	**3,578**	**124**	**122**
Credit derivatives	78	96	3,404	3,578	124	122
Total	**78**	**96**	**3,404**	**3,578**	**124**	**122**
Total	**34,465**	**70,822**	**96,513**	**201,800**	**20,872**	**22,594**

Volume of derivatives – Company at 31 December 2011				Notional amount	Fair value	
		Remaining maturities				
€ m	Less than 1 year	1 to 5 years	More than 5 years	Total	Positive fair values	Negative fair values
Interest based transactions						
OTC products	**11,275**	**81,297**	**142,431**	**235,003**	**24,243**	**26,028**
Interest rate swaps	11,213	80,679	141,788	233,680	24,112	25,875
Call options	49	309	244	602	13	–
Put options	13	309	352	674	–	13
Other interest rate contracts	–	–	47	47	118	140
Exchange traded products	**541**	**1**	**–**	**542**	**3**	**–**
Interest rate futures	541	1	–	542	3	–
Total	**11,816**	**81,298**	**142,431**	**235,545**	**24,246**	**26,028**
Foreign currency based transactions						
OTC products	**13,122**	**13,046**	**6,492**	**32,660**	**2,598**	**2,433**
Spot and forward currency transactions	9,064	–	–	9,064	275	50
Interest rate/currency swaps	4,058	13,046	6,492	23,596	2,323	2,383
Total	**13,122**	**13,046**	**6,492**	**32,660**	**2,598**	**2,433**
Other transactions						
OTC products	**77**	**472**	**5,510**	**6,059**	**301**	**301**
Credit derivatives	77	472	5,510	6,059	301	301
Total	**77**	**472**	**5,510**	**6,059**	**301**	**301**
Total	**25,015**	**94,816**	**154,433**	**274,264**	**27,145**	**28,762**

Derivatives counterparties – Group	31 December 2012		31 December 2011	
€m	Positive fair values	Negative fair values	Positive fair values	Negative fair values
OECD banks	11,795	12,847	10,619	17,792
OECD financial institutions	7,260	6,076	15,797	8,641
Other companies and private individuals	46	64	49	65
Total	**19,101**	**18,987**	**26,465**	**26,498**

Derivatives with Group companies included in the above are:

Derivatives with Group companies – Group	31 December 2012		31 December 2011	
€m	Positive fair values	Negative fair values	Positive fair values	Negative fair values
OECD banks	408	150	568	286

Derivatives counterparties – Company	31 December 2012		31 December 2011	
€m	Positive fair values	Negative fair values	Positive fair values	Negative fair values
OECD banks	14,562	17,065	14,026	20,583
OECD financial institutions	6,264	5,465	13,070	8,114
Other companies and private individuals	46	64	49	65
Total	**20,872**	**22,594**	**27,145**	**28,762**

Derivatives with Group companies included in the above are:

Derivatives with Group companies – Company	31 December 2012		31 December 2011	
€m	Positive fair values	Negative fair values	Positive fair values	Negative fair values
OECD banks	3,807	5,215	4,974	4,967

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

42 Cash flows from hedge accounting

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

Cash flows of the hedged items	Group		Company	
€m	31.12.2012	31.12.2011	31.12.2012	31.12.2011
from 2 years to 5 years	–	–59	–	–
from 5 years and over	–	–3	–	–

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 note 38 to the financial statements.

43 Transfers of financial assets and collateral pledged or held

In the ordinary course of its business the DEPFA Group enters into transactions that result in the transfer of financial assets that consist primarily of debt securities classified as financial investments, loans and advances to other banks and loans and advances to customers. In accordance with note 2, the transferred assets continue either to be recognised in their entirety or to the extent of the DEPFA Group's continuing involvement or are derecognised in their entirety.

As described in note 5, in addition to the transfer of financial assets in the ordinary course of business, in 2010 the HRE Group, including the DEPFA Group, transferred certain non strategic positions to a deconsolidated environment, FMS Wertmanagement.

Transferred financial assets that are not derecognised

Sale and repurchase agreements Sale and repurchase agreements ("repos") are transactions in which the DEPFA Group sells a security and simultaneously agrees to repurchase it at a fixed price on a future date. The DEPFA Group continues to recognise the securities in their entirety in the statement of financial position because it retains substantially all the risks and rewards of ownership. The obligation to pay the repurchase price is recognised as a financial liability. As the DEPFA Group sells the contractual rights to the cash flows of the securities it does not have the ability to use the transferred assets during the term of the arrangement.

The following table sets out an overview of carrying amounts related to transferred financial assets that are not derecognised in their entirety and the associated liabilities:

	Group		Company	
€ m	31.12.2012	31.12.2011	31.12.2012	31.12.2011
Trading assets	11	–	11	–
Financial investments	3,292	2,057	70	52
Total	**3,303**	**2,057**	**81**	**52**

Carrying amounts of associated liabilities	Group		Company	
€ m	31.12.2012	31.12.2011	31.12.2012	31.12.2011
Liabilities to other banks	2,970	1,822	87	46
Total	**2,970**	**1,822**	**87**	**46**

In addition to the above assets that are transferred, the DEPFA Group has also pledged assets with a carrying amount of €301 million (2011: €332 million) in relation to certain Guaranteed Investment Contract liabilities and €899 million (2011: € nil) of assets are pledged to central banks where no funding has been drawn at 31 December 2012 or 31 December 2011.

Transferred assets that are derecognised in their entirety

In general, the DEPFA Group has no continuing involvement in transferred and derecognised assets.

As described in note 5, the DEPFA Group has transferred certain non strategic assets to the deconsolidated environment FMS Wertmanagement. As part of the process of transferring positions, pbb also assumed the responsibility for providing certain servicing activities for the transferred portfolios and pbb also uses services of other subsidiaries of the HRE Group including DEPFA BANK plc for rendering this service. DEPFA BANK plc receives compensation on an arms length basis for providing the servicing activities. The DEPFA Group has recorded income of €81 million in 2012 (2011: €93 million) for the servicing activities. Cumulatively as at 31 December 2012 the DEPFA Group has recorded income of 212m. The asset servicing by the DEPFA Group is expected to be completely discontinued by the end of September 2013.

In relation to the transferred assets to which the continuing involvement of the servicing activity relates, the carrying value and fair value of the continuing involvement at 31 December 2012 is € nil. The DEPFA Group has no exposure to loss on the related assets and there are no obligations to repurchase the derecognised assets.

Collateral held that may be sold or repledged

The fair value of collateral received that may be resold or pledged in the absence of default amounted to €0.23 billion as of 31 December 2012 (2011: €38 billion). The DEPFA Group received the collateral as part of repurchase agreements and is principally obliged to return the collateral to the grantor. In 2011 the majority of the collateral which could be sold or repledged in the absence of default resulted from collateral received from FMS Wertmanagement which were pledged for funding at central banks or in bilateral repo. The funding was transferred to FMS Wertmanagement which did not have direct access to ECB funding. The fair value of the transferred collateral from FMS Wertmanagement at 31 December 2012 amounts to € nil (2011 €38 billion).

Other pledges and charges on assets

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

1. On 5 February 2010, first floating charges were placed in favour of the Central Bank of Ireland ("CBI") over all of DEPFA BANK plc and DEPFA ACS BANK's right, title, interest and benefit, present and future, in and to the balances then or at any time standing to the credit of DEPFA BANK plc and DEPFA ACS BANK's accounts held as TARGET 2 participants with the CBI (the "Charged Account Property").
   These floating charges contain provisions whereby during the subsistence of the security, otherwise than with the prior written consent of the CBI, DEPFA BANK plc and DEPFA ACS BANK shall:
   (a) not create or attempt to create or permit to arise or subsist any encumbrance on or over the Charged Account Property or any part thereof; or
   (b) not, otherwise than in the ordinary course of business, sell, transfer, lend or otherwise dispose of the Charged Account Property or any part thereof or agree to do so whether by means of one or a number of transactions related or not and whether at one time or over a period of time.

2. On 5 February 2010, first floating charges were placed in favour of the CBI over all DEPFA BANK plc and DEPFA ACS BANK's right, title, interest and benefit, present and future, in and to certain segregated securities (the "Charged Securities Property") listed in Eligible Securities Schedules kept by DEPFA BANK plc and DEPFA ACS BANK for the purpose of participating in TARGET 2.

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

   (a) not create or attempt to create or permit to arise or subsist any encumbrance on or over the Charged Securities Property or any part thereof; or

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

DEPFA ACS BANK terminated its participation in Target 2 with effect from 12 December 2011 and its charges created in favour of the CBI, as described above, were released with effect from 8 March 2012. DEPFA BANK plc remains a participant in Target 2 and the charges described above remain in place.

In the normal course of business relationships with banking and custodian counterparties, other liens and encumbrances can arise on certain assets from time to time.

44 Fair values of financial assets and liabilities

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

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

Fair value of financial assets and liabilities – Group	31 December 2012		31 December 2011	
€ m	Carrying value	Fair value	Carrying value	Fair value
Assets				
Cash reserve	1,564	1,564	600	600
Trading assets	13,364	13,364	20,517	20,517
Loans and advances to other banks	10,191	10,068	15,991	15,832
Loans and advances to customers (net of allowance)	16,751	15,186	54,958	52,807
Loans and advances recoverable under financial guarantees	69	69	–	–
Financial investments	25,334	24,089	31,617	29,489
Category available-for-sale	22	22	26	26
Category dFVTPL	–	–	3,795	3,795
Category LaR	25,312	24,067	27,796	25,668
Other assets – Derivatives	5,781	5,781	5,992	5,992
Total	**73,054**	**70,121**	**129,675**	**125,237**
Liabilities				
Liabilities to other banks	6,631	6,597	38,057	37,988
Liabilities to customers	9,085	9,139	21,356	21,403
Liabilities evidenced by certificates	34,654	29,847	39,456	32,741
Trading liabilities	13,317	13,317	20,604	20,604
Other liabilities – Derivatives	5,782	5,782	6,013	6,013
Subordinated capital	1,082	777	1,079	549
Total	**70,551**	**65,459**	**126,565**	**119,298**
Other items	Contract amount	Fair value	Contract amount	Fair value
Contingent liabilities & loan commitments	120	–2	295	–7

Fair value of financial assets and liabilities – Company	31 December 2012		31 December 2011	
€m	Carrying value	Fair value	Carrying value	Fair value
Assets				
Cash reserve	1,331	1,331	587	587
Trading assets	20,605	20,605	26,559	26,559
Loans and advances to other banks	11,608	11,458	17,351	17,200
Loans and advances to customers (net of allowance)	3,195	3,021	40,184	39,874
Loans and advances recoverable under financial guarantees	69	69	–	–
Financial investments	4,688	4,496	8,715	8,353
Category available-for-sale	1,075	1,075	1,079	1,079
Category dFVTPL	–	–	3,795	3,795
Category LaR	3,613	3,421	3,841	3,479
Other assets – Derivatives	311	311	630	630
Total	**41,807**	**41,291**	**94,026**	**93,203**
Liabilities				
Liabilities to other banks	5,765	5,732	40,180	40,114
Liabilities to customers	8,439	8,494	19,021	19,068
Liabilities evidenced by certificates	2,152	1,788	2,626	2,065
Trading liabilities	20,662	20,662	26,489	26,489
Other liabilities – Derivatives	2,008	2,008	2,353	2,353
Subordinated capital	1,687	1,218	1,682	665
Total	**40,713**	**39,902**	**92,351**	**90,754**
Other items	Contract amount	Fair value	Contract amount	Fair value
Contingent liabilities & loan commitments	1,191	61	1,878	146

In the case of certain positions which had not been physically transferred to FMS Wertmanagement but which had been synthetically transferred to FMS Wertmanagement by way of a financial guarantee as of the statement of financial position date, the fair values are determined as follows:

The above tables have taken account of the financial guarantees for calculating the fair values (economic view). If these financial guarantees were to be disregarded for both DEPFA Group and Company, the item loans and advances to customers would show a fair value which was €987 million lower and a contingent receivable from the financial guarantee of €987 million would have to be shown. This is also applicable for the position contingent liabilities and loan commitments, for which the value would decline by €9 million if a financial guarantee is not taken into consideration.

In addition, as part of the process of transferring positions to FMS Wertmanagement, the HRE Group has been provided with liquidity facilities for which the fair value in the above table has been shown with the carrying amount as part of an economic view (because these facilities are not realisable). If these were to be valued in the same way as an unsecured liability position of the DEPFA Group, the fair value of the position liabilities to customers would be €3,050 million lower for both DEPFA Group and Company.

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

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

b) **Loans and advances to other banks and customers** Loans and advances are net of provisions for impairment and include amounts recoverable under financial guarantees. The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received. Expected cash flows are discounted at current market interest rates as adjusted for movements in credit to determine fair value. As many of these positions are not traded on an active market, judgement is required as to the appropriate credit adjustment.

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

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

Financial assets and liabilities according to measurement categories		**Group**		**Company**
€ m	**31.12.2012**	**31.12.2011**	**31.12.2012**	**31.12.2011**
Loans and receivables (net)	52,323	98,745	18,485	61,376
Available-for-sale	22	26	1,075	1,079
Held-for-trading	13,364	20,517	20,605	26,559
dFVTPL assets	–	3,795	–	3,795
Cash reserve	1,564	600	1,331	587
Derivatives (hedging)	5,781	5,992	311	630
Total	**73,054**	**129,675**	**41,807**	**94,026**
Held-for-trading	13,317	20,604	20,662	26,489
Financial liabilities at amortised cost	51,452	99,948	18,043	63,509
Derivatives (hedging)	5,782	6,013	2,008	2,353
Total	**70,551**	**126,565**	**40,713**	**92,351**

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

As per the amendment to IFRS 7 "Financial Instruments: Disclosures" issued in March 2009, all financial assets and liabilities of the DEPFA Group that are measured at fair value should be grouped into the fair value hierarchy. The three-level hierarchy is based on the degree to which the input for the fair value measurement is observable.

Level 1 – quoted prices (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 – Group				**31 December 2012**				**31 December 2011**
€ m	**Total**	Level 1	Level 2	Level 3	**Total**	Level 1	Level 2	Level 3
Assets								
Financial assets at fair value through P&L								
Trading assets	13,364	44	12,857	463	20,517	47	19,753	717
Financial investments	–	–	–	–	3,795	–	–	3,795
Hedging derivatives	5,781	–	5,779	2	5,743	–	5,736	7
Derivatives hedging dFVTPL	–	–	–	–	249	–	–	249
Available-for-sale			–					
Financial investments	22	22	–	–	26	26	–	–
Total assets	**19,167**	**66**	**18,636**	**465**	**30,330**	**73**	**25,489**	**4,768**
Liabilities								
Financial liabilities at fair value through P&L								
Trading liabilities	13,317	–	12,855	462	20,604	–	19,765	839
Hedging derivatives	5,782	–	5,740	42	5,714	–	5,688	26
Derivatives hedging dFVTPL	–	–	–	–	299	–	–	299
Total liabilities	**19,099**	**–**	**18,595**	**504**	**26,617**	**–**	**25,453**	**1,164**

Fair value hierarchy – Company				**31 December 2012**				**31 December 2011**
€ m	**Total**	Level 1	Level 2	Level 3	**Total**	Level 1	Level 2	Level 3
Assets								
Financial assets at fair value through P&L								
Trading assets	20,605	44	20,080	481	26,559	47	25,791	721
Financial investments	–	–	–	–	3,795	–	–	3,795
Hedging derivatives	311	–	309	2	381	–	374	7
Derivatives hedging dFVTPL	–	–	–	–	249	–	–	249
Available-for-sale								
Financial investments	22	22	–	–	26	26	–	–
Total assets	**20,938**	**66**	**20,389**	**483**	**31,010**	**73**	**26,165**	**4,772**
Liabilities								
Financial liabilities at fair value through P&L								
Trading liabilities	20,662	–	20,182	480	26,489	–	25,684	805
Hedging derivatives	2,008	–	1,987	21	2,054	–	2,035	19
Derivatives hedging dFVTPL	–	–	–	–	299	–	–	299
Total liabilities	**22,670**	**–**	**22,169**	**501**	**28,842**	**–**	**27,719**	**1,123**

There have been transfers from Level 2 to Level 1 of € nil for the DEPFA Group (2011: €45 million) and of € nil for the Company (2011: €45 million). There have been no transfers from Level 1 to Level 2 for either the DEPFA Group or the Company for either 2012 or 2011.

The following table presents the changes in Level 3 instruments for the year:

Changes in Level 3 financial assets – Group

€ m	Trading assets	Loans & advances to customers	Financial investments	Hedging derivatives	Derivatives dFVTPL	Total
						Financial assets
Balance at 1 January 2011	**977**	**–**	**3,405**	**11**	**271**	**4,664**
Comprehensive income recognised in Income Statement	279	–	286	–2	–36	527
Purchases	–	–	1,822	–	–	1,822
Sales	–	–	–1,647	–	14	–1,633
Change due to transfer to FMS Wertmanagement	–321	–	–	–	–	–321
Settlements	–	–	–71	–	–	–71
Reclassifications into Level 3	14	–	–	–	–	14
Reclassifications out of Level 3	–232	–	–	–2	–	–234
Balance at 31 December 2011	**717**	**–**	**3,795**	**7**	**249**	**4,768**
Balance at 1 January 2012	**717**	**–**	**3,795**	**7**	**249**	**4,768**
Comprehensive income recognised in Income Statement	–72	–	–18	–	65	–25
Purchases	–	–	1,175	–	–	1,175
Sales	–23	–	–1,131	–5	–65	–1,224
Change due to transfer to FMS Wertmanagement	–159	–	–3,821	–	–249	–4,229
Settlements	–	–	–	–	–	–
Reclassifications into Level 3	–	–	–	–	–	–
Reclassifications out of Level 3	–	–	–	–	–	–
Balance at 31 December 2012	**463**	**–**	**–**	**2**	**–**	**465**

Changes in Level 3 financial liabilities – Group

€ m	Trading liabilities	Hedging derivatives	Derivatives hedging dFVTPL	Total
				Financial liabilities
Balance at 1 January 2011	**1,191**	**43**	**37**	**1,271**
Comprehensive income recognised in Income Statement	296	3	290	589
Purchases	66	–	–	66
Sales	–125	–	–28	–153
Change due to transfer to FMS Wertmanagement	–311	–	–	–311
Settlements	–67	–	–	–67
Reclassifications into Level 3	19	–	–	19
Reclassifications out of Level 3	–230	–20	–	–250
Balance at 31 December 2011	**839**	**26**	**299**	**1,164**
Balance at 1 January 2012	**839**	**26**	**299**	**1,164**
Comprehensive income recognised in Income Statement	–78	–1	16	–63
Purchases	–	–	–	–
Sales	–25	–	3	–22
Change due to transfer to FMS Wertmanagement	–158	–	–318	–476
Settlements	–6	–	–	–6
Reclassifications into Level 3	–	17	–	17
Reclassifications out of Level 3	–110	–	–	–110
Balance at 31 December 2012	**462**	**42**	**–**	**504**

Changes in Level 3 financial assets – Company

€ m	Trading assets	Loans & advances to customers	Financial investments	Hedging derivatives	Derivatives dFVTPL	Total
						Financial assets
Balance at 1 January 2011	**919**	**–**	**3,405**	**8**	**271**	**4,603**
Comprehensive income recognised in Income Statement	274	–	285	–1	–36	522
Purchases	–	–	1,823	–	–	1,823
Sales	–	–	–1,647	–	14	–1,633
Change due to transfer to FMS Wertmanagement	–282	–	–	–	–	–282
Settlements	–	–	–71	–	–	–71
Reclassifications into Level 3	14	–	–	–	–	14
Reclassifications out of Level 3	–204	–	–	–	–	–204
Balance at 31 December 2011	**721**	**–**	**3,795**	**7**	**249**	**4,772**
Balance at 1 January 2012	**721**	**–**	**3,795**	**7**	**249**	**4,772**
Comprehensive income recognised in Income Statement	–59	–	–18	–	65	–12
Purchases	–	–	1,175	–	–	1,175
Sales	–23	–	–1,131	–4	–65	–1,223
Change due to transfer to FMS Wertmanagement	–159	–	–3,821	–	–249	–4,229
Settlements	–	–	–	–	–	–
Reclassifications into Level 3	–	–	–	–	–	–
Reclassifications out of Level 3	–	–	–	–	–	–
Balance at 31 December 2012	**480**	**–**	**–**	**3**	**–**	**483**

Changes in Level 3 financial liabilities – Company

€ m	Trading liabilities	Hedging derivatives	Derivatives hedging dFVTPL	Total
				Financial liabilities
Balance at 1 January 2011	**1,118**	**20**	**37**	**1,175**
Comprehensive income recognised in Income Statement	293	–1	289	581
Purchases	7	–	–	7
Sales	–31	–	–27	–58
Change due to transfer to FMS Wertmanagement	–310	–	–	–310
Settlements	–45	–	–	–45
Reclassifications into Level 3	23	–	–	23
Reclassifications out of Level 3	–250	–	–	–250
Balance at 31 December 2011	**805**	**19**	**299**	**1,123**
Balance at 1 January 2012	**805**	**19**	**299**	**1,123**
Comprehensive income recognised in Income Statement	–64	2	16	–46
Purchases	–	–	–	0
Sales	–23	–	3	–20
Change due to transfer to FMS Wertmanagement	–158	–	–318	–476
Settlements	–6	–	–	–6
Reclassifications into Level 3	–	–	–	–
Reclassifications out of Level 3	–74	–	–	–74
Balance at 31 December 2012	**480**	**21**	**–**	**501**

Although the DEPFA Group believes that its estimates of fair value are appropriate, using reasonably possible alternative input factors changes the fair value. The following tables shows the fair value sensitivities of the Level 3 instruments as of 31 December 2012 and 31 December 2011, which have been quantified on the basis of the specified valuation parameters taking account of standard scenarios.

Sensitivities of Level 3 instruments	**Group**				**Company**			
	31 December 2012		**31 December 2011**		**31 December 2012**		**31 December 2011**	
€ m	Favourable changes	Unfavourable changes	Favourable changes	Unfavourable changes	Favourable changes	Unfavourable changes	Favourable changes	Unfavourable changes
Assets								
Financial assets at fair value through P&L								
Trading assets	–	–	–	–	1	–1	24	–4
Loans and advances to customers	–	–	–	–	–	–	–	–
Financial investments	–	–	39	–39	–	–	39	–39
Derivatives	1	–1	29	–29	–	–	29	–29
Available-for-sale								
Financial investments	–	–	–	–	–	–	–	–
Total assets	**1**	**–1**	**68**	**–68**	**1**	**–1**	**92**	**–72**
Liabilities								
Financial liabilities at fair value through P&L								
Trading liabilities	–	–	6	–6	–	–	47	–67
Derivatives	–	–	29	–29	–	–	29	–29
Total liabilities	**–**	**–**	**35**	**–35**	**–**	**–**	**76**	**–96**

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

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

Further offsetting effects due to compensating derivatives and hedge relationships attenuate both favourable and unfavourable changes.

In 2012, the DEPFA Group has refined its derivative valuation models in relation to counterparty risk parameters resulting in a change of accounting estimate as described in Note 9. Other than this change in accounting estimate, the methods and valuation techniques used for the purpose of measuring fair value are unchanged compared to the previous reporting period. In the following paragraphs, the valuation methods on the level of product classes are described in detail:

- The fair values of certain financial instruments reported at nominal values are almost identical to their carrying amounts. These include for example cash reserve, receivables and liabilities without fixed interest rates and which 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 exchange traded derivatives and, where available, for securities and quoted debt instruments. The fair value of 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 rate swap and cross currency swap agreements are determined on the basis of discounted future expected cash flows. The market interest rates applicable for the remaining maturity of the financial instruments are used for the purpose of the calculation. The fair value of forward exchange transactions is determined on the basis of current forward rates.
- Options are valued using exchange rate quotations or recognised models for determining option prices. For simple European options, the current Black-Scholes models (currency and index instruments) or lognormal models (interest instruments) are used as the valuation models. In the case of more exotic instruments, the interest rates are simulated via one and multi-dimensional 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 multi-factor models are used for interest-currency products.
- Widely accepted standard valuation models are used for credit derivatives, e.g. credit default swaps.
- Gaussian copula models which are usual in the market and appropriate adjustments thereof are used for determining fair values for structured credit products. In parallel the expected loss of these products was calculated on the basis of the underlyings and the subordination. A detailed separate credit analysis was performed for the tranches being held in the event of significant expected losses. Counterparty risk adjustments are taken into account for the measurement of customer derivatives.

Other notes

45 Contingent liabilities and commitments

(a) Contingent liabilities and loan commitments

Contingent liabilities and other commitments		Group		Company
€ m	31.12.2012	31.12.2011	31.12.2012	31.12.2011
Contingent liabilities				
Guarantees and indemnity agreements				
Loan guarantees	50	83	1,098	1,666
Other commitments				
Irrevocable loan commitments				
Lending business	70	212	70	212
Liquidity facility	–	–	23	–
Total	**120**	**295**	**1,191**	**1,878**

The above amounts represent nominal exposures.

(b) Operating lease commitments Where a Group company is the lessee, the future minimum lease payments under non-cancellable building operating leases are as follows:

Future minimum lease payments		Group		Company
€ m	31.12.2012	31.12.2011	31.12.2012	31.12.2011
Up to 12 months	8	10	7	9
Greater than 1 year but less than 5 years	21	27	18	24
Over 5 years	27	33	25	31
Total	**56**	**70**	**50**	**64**

46 Contingent assets

Contingent assets	Group		Company	
€ m	31.12.2012	31.12.2011	31.12.2012	31.12.2011
Guarantees and indemnity agreements	4,238	4,519	4,423	4,638
Total	**4,238**	**4,519**	**4,423**	**4,638**

The above table refers to nominal values of guaranteed assets including guaranteed undrawn commitments of €64 million (2011: €157 million) for both DEPFA Group and Company. All above guarantees are provided by FMS Wertmanagement.

47 Exchange rates as at 31 December 2012

European Central Bank exchange rates as at 31 December 2012 were:

Exchange rates 1€ =		31.12.2012	31.12.2011
Great Britain	GB£	0.8161	0.8353
Japan	JP¥	113.6100	100.2000
United States of America	US$	1.3194	1.2939

48 Capital management

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

- To comply with the capital requirements set by the regulators of the banking markets where the entities within the DEPFA Group operate;
- To safeguard the DEPFA Group's ability to continue as a going concern; and
- To maintain a strong capital base to support the company strategy of the DEPFA Group.

Capital adequacy and the use of regulatory capital are monitored daily by the DEPFA Group's management, employing techniques based on the guidelines developed by the Basel Committee and the European Community Directives, as implemented by the Central Bank of Ireland (the "Authority"), for supervisory purposes. The required information is filed with the Authority on a quarterly basis.

The Authority requires each bank or banking group to: (a) hold the minimum level of the regulatory capital of €6 million, (b) maintain a ratio of total regulatory capital to the risk-weighted asset (the "Total capital ratio") at or above the internationally agreed minimum of 8.5% for the DEPFA Group or 8% for the Bank and (c) maintain additional levels of own funds if required under the Supervisory Review and Evaluation Process. In addition, those individual banking subsidiaries or similar financial institutions not incorporated in the European Union are directly regulated and supervised by their local banking supervisor, the requirements of which may differ from country to country.

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

- **Tier 1 capital** Share capital (net of any book values of the treasury shares), minority interests arising on consolidation from interests in permanent shareholders' equity, retained earnings and reserves created by appropriations of retained earnings. The book value of goodwill is deducted in arriving at Tier 1 capital; and
- **Tier 2 capital** Qualifying subordinated loan capital, collective impairment allowances and unrealised gains arising on the fair valuation of equity instruments held as available-for-sale.

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

There were no breaches by the DEPFA Group or the Bank of the capital requirements during 2012 (2011: no breaches).

49 Group auditors' fee (excluding VAT)

Group auditors' fee (excluding VAT)		
€'000	**2012**	**2011**
Audit of Parent Company accounts	310	330
Other assurance services	370	524
Tax advisory services	101	31
Other non-audit services	275	166
Total	**1,056**	**1,051**

Other assurance services include fees for the audit of subsidiary companies.

50 Related party transactions

(a) Key management compensation

Group and Company		
€	**2012**	**2011**
Short-term employee benefits	2,176,590	3,750,497
Post employee benefits	83,936	203,518
Total	**2,260,526**	**3,954,015**

Key management is the Board of Directors of DEPFA BANK plc.

Included above is directors' compensation as follows:

Directors' compensation		
€	**2012**	**2011**
Directors' fees	440,400	454,200
Other remuneration	1,820,126	3,499,815
Total	**2,260,526**	**3,954,015**

Other remuneration includes compensation for loss of office of €400,000 (2011: €500,000).

There have been no loans to members of the Board in 2012 and 2011, nor are there any loans outstanding to members of the Board at 31 December 2012 (2011: € nil).

(b) Letters of comfort and guarantees to related parties

DEPFA BANK plc, as the parent company of the DEPFA Group, has issued a letter of comfort to DEPFA ACS BANK. This letter of comfort provides that the Bank will provide financial support to DEPFA ACS BANK, to the extent that it is unable to fulfil its contractual obligations.

DEPFA BANK plc has executed a guarantee whereby it has irrevocably and unconditionally guaranteed the performance by Hypo Pfandbrief Bank International S.A. of all its obligations issued up to 31 May 2010.

(c) Balances and transactions with HRE Group companies

Balances due to and from Group companies are disclosed in the notes to the statement of financial position. Transactions with HRE Group companies included in the income statement categories below consisted of:

Group's transactions with HRE Group companies

€ m	2012	2011
Interest and similar income	73	133
Interest expense and similar expenses	–56	–51
Net fee and commission expense	–2	–3
Other operating income	94	103
General administrative expenses	–25	–31

The amounts above arise on intercompany borrowings and lending, and transfers of assets between the Bank and other HRE Group entities, hedging derivatives, as well as recharges for certain services provided. All related party transactions are entered into at an arm's length basis.

In addition, the net trading expense/income and net income from hedge relationships includes derivative transactions traded on an arm's length basis with HRE Group entities which are used to hedge certain of the DEPFA Group's assets and liabilities and to offset other derivative positions.

Company balances due to and from DEPFA Group companies are disclosed in the notes to the statement of financial position. Company transactions with DEPFA Group and HRE Group companies included in the income statement categories consisted of:

Company's transactions with HRE and DEPFA Group companies

€ m	2012	2011
Interest and similar income	180	56
Interest expense and similar expenses	–445	–57
Net fee and commission expense	6	–5
Other operating income	108	103
General administrative expenses	–24	–30

In addition the Company has traded derivative transactions on an arm's length basis with HRE Group and DEPFA Group entities which are used to hedge certain assets and liabilities in the Company or those entities or are offset by the other derivatives in the Company.

These amounts arise on intercompany borrowings and lending and transfers of assets between DEPFA BANK plc and other DEPFA Group entities as well as recharges for certain services provided.

(d) Other related party transactions

As a result of HRE Holding being controlled by SoFFin, a special estate of the German Federal Government (according to section 2 FMStFG), the DEPFA Group 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 DEPFA Group has various relationships with its sister company FMS Wertmanagement, for example, due to the synthetic transfer of positions. The relationships are described in note 5 "Transfer of non strategic positions to FMS Wertmanagement". The DEPFA Group is acting as sub-service provider for pbb, which has entered into various service level agreements with FMS Wertmanagement. Under these agreements, pbb provides the servicing for positions that have been transferred to FMS Wertmanagement. The different servicing tasks are clearly outlined in specific servicing agreements. The majority of the departments in the DEPFA Group are affected by the servicing agreements. Both pbb and the DEPFA Group will completely discontinue

this servicing by the end of September 2013. DEPFA Group received income of €81 million in relation to asset servicing provided by the DEPFA Group on positions transferred to FMS Wertmanagement (2011: €93 million).

51 Group undertakings

Shares in DEPFA Group undertakings are included in the financial statements on a historical cost basis.

The DEPFA Group undertakings at 31 December 2012 were:

Group undertakings

Name	Principal Activity	Country of Incorporation	Registered Office	Share in Capital
DEPFA ACS BANK	Issuance and ongoing administration of Asset Covered Securities	Ireland	1 Commons Street, Dublin 1, Ireland	100%
DEPFA Ireland Holding Ltd	Holding company	Ireland	1 Commons Street, Dublin 1, Ireland	100%
DEPFA Funding II LP	Special purpose vehicle for Tier 1 capital raising	UK	105 Wigmore Street, London W1U 1QY, UK	100%
DEPFA Funding III LP	Special purpose vehicle for Tier 1 capital raising	UK	105 Wigmore Street, London W1U 1QY, UK	100%
DEPFA Funding IV LP	Special purpose vehicle for Tier 1 capital raising	UK	105 Wigmore Street, London W1U 1QY, UK	100%
DEPFA Hold One Ltd	Holding company	Ireland	1 Commons Street, Dublin 1, Ireland	100%
DEPFA Hold Two Ltd	Holding company	Ireland	1 Commons Street, Dublin 1, Ireland	100%
DEPFA Hold Six	Holding company	Ireland	1 Commons Street, Dublin 1, Ireland	100%
DEPFA Finance N.V.	Funding vehicle	Netherlands	De Entree 99-197, 1101 HE, Amsterdam, the Netherlands	0%
DBE Property Holdings Ltd	Procurement of office equipment	Ireland	1 Commons Street, Dublin 1, Ireland	100%
Hypo Public Finance Bank	Public Finance Banking and Capital Markets activities	Ireland	1 Commons Street, Dublin 1, Ireland	100%
Hypo Dublin Properties Ltd	Property Management Services	Ireland	3 Harbourmaster Place, Dublin 1, Ireland	100%
Hypo Public Finance USA, LLC	Public Finance Banking	USA	c/o Corporation Service Company, 2711 Centerville Road, Suite 400, Wilmington, New Castle County, Delaware 19808, USA	100%
Hypo Pfandbrief Bank International S.A.	Public Finance Banking	Luxembourg	8-10 Rue Jean Monnet, 2099 Luxembourg	100%
Pallas Capital Corp	Funding vehicle	USA	c/o Lord Securities Corporation, One Commerce Center, 1201 North Orange Street, Suite 800, Wilmington, North Castle County, Delaware 19801-1186, USA	0%
San Sabia Capital Corporation	Funding vehicle	USA	c/o Corporation Service Company, 2711 Centerville Road, Suite 400, Wilmington, New Castle County, Delaware 19808, USA	0%

There was no significant change in the DEPFA Group structure during 2012.

52 Credit risk exposure to certain European countries

The following table provides an overview of the DEPFA Group's direct sovereign exposure to selected European countries:

DEPFA Group's direct sovereign exposure of selected European countries as at 31 December 2012			Book value							
€ m	Counterparty	IAS 39 measurement category	Repayable on demand	Up to 3 months	From 3 months to 1 year	From 1 year to 5 years	From 5 years and over	**Total**	Notional value	Fair value
Ireland	Sovereign	LaR	–	1,294	41	–	–	**1,335**	1,335	1,335
	Sub-sovereign	LaR	–	100	109	–	8	**217**	216	215
	State-guaranteed	LaR	–	–	–	–	–	**–**	–	–
Italy	Sovereign	LaR	–	–	–	1,518	55	**1,573**	1,229	1,502
	Sub-sovereign	LaR	–	–	1	172	489	**662**	589	533
	State-guaranteed	LaR	–	–	–	–	–	**–**	–	–
Spain	Sovereign	LaR	–	–	–	24	–	**24**	22	22
	Sub-sovereign	LaR	–	15	274	505	2,640	**3,434**	3,205	2,496
	State-guaranteed	LaR	–	–	–	–	217	**217**	217	198
Belgium	Sovereign	LaR	–	–	–	–	706	**706**	500	656
	Sub-sovereign	LaR	–	–	–	40	282	**322**	292	293
	State-guaranteed	LaR	–	–	–	–	1,233	**1,233**	915	1,071

DEPFA Group's direct sovereign exposure of selected European countries as at 31 December 2011			Book value							
€ m	Counterparty	IAS 39 measurement category	Repayable on demand	Up to 3 months	From 3 months to 1 year	From 1 year to 5 years	From 5 years and over	**Total**	Notional value	Fair value
Ireland	Sovereign	LaR	–	510	–	37	–	**547**	547	547
	Sub-sovereign	LaR	–	103	108	12	–	**223**	221	192
	State-guaranteed	LaR	–	–	–	–	–	**–**	–	–
Italy	Sovereign	LaR	–	–	410	1,590	56	**2,056**	1,692	1,806
	Sub-sovereign	LaR	–	21	5	216	560	**802**	735	699
	State-guaranteed	LaR	–	–	–	53	–	**53**	51	52
Spain	Sovereign	LaR	–	–	–	–	150	**150**	147	89
	Sub-sovereign	LaR	–	–	29	760	2,729	**3,518**	3,321	2,581
	State-guaranteed	LaR	–	–	–	–	284	**284**	284	254
Belgium	Sovereign	LaR	–	–	110	–	675	**785**	608	719
	Sub-sovereign	LaR	–	–	–	25	296	**321**	297	259
	State-guaranteed	LaR	–	–	–	–	1,179	**1,179**	934	835

Company's direct sovereign exposure of selected European countries as at 31 December 2012			Book value							
€ m	Counterparty	IAS 39 measurement category	Repayable on demand	Up to 3 months	From 3 months to 1 year	From 1 year to 5 years	From 5 years and over	**Total**	Notional value	Fair value
Ireland	Sovereign	LaR	–	1,294	25	–	–	**1,319**	1,319	1,319
	Sub-sovereign	LaR	–	–	–	–	–	**–**	–	–
	State-guaranteed	LaR	–	–	–	–	–	**–**	–	–
Italy	Sovereign	LaR	–	–	–	–	–	**–**	–	–
	Sub-sovereign	LaR	–	–	–	–	–	**–**	–	–
	State-guaranteed	LaR	–	–	–	–	–	**–**	–	–
Spain	Sovereign	LaR	–	–	–	–	–	**–**	–	–
	Sub-sovereign	LaR	–	–	142	–	–	**142**	145	142
	State-guaranteed	LaR	–	–	–	–	–	**–**	–	–
Belgium	Sovereign	LaR	–	–	–	–	–	**–**	–	–
	Sub-sovereign	LaR	–	–	–	–	–	**–**	–	–
	State-guaranteed	LaR	–	–	–	–	–	**–**	–	–

Company's direct sovereign exposure of selected European countries as at 31 December 2011			Book value							
€ m	Counterparty	IAS 39 measurement category	Repayable on demand	Up to 3 months	From 3 months to 1 year	From 1 year to 5 years	From 5 years and over	**Total**	Notional value	Fair value
Ireland	Sovereign	LaR	–	510	–	24	–	**534**	534	534
	Sub-sovereign	LaR	–	–	–	–	–	**–**	–	–
	State-guaranteed	LaR	–	–	–	–	–	**–**	–	–
Italy	Sovereign	LaR	–	–	–	–	–	**–**	–	–
	Sub-sovereign	LaR	–	–	–	–	–	**–**	–	–
	State-guaranteed	LaR	–	–	–	–	–	**–**	–	–
Spain	Sovereign	LaR	–	–	–	–	–	**–**	–	–
	Sub-sovereign	LaR	–	–	–	134	–	**134**	145	137
	State-guaranteed	LaR	–	–	–	–	–	**–**	–	–
Belgium	Sovereign	LaR	–	–	–	–	–	**–**	–	–
	Sub-sovereign	LaR	–	–	–	–	–	**–**	–	–
	State-guaranteed	LaR	–	–	–	–	–	**–**	–	–

All of the above positions are included in the IFRS measurement category loans and receivables. The DEPFA Group tests financial assets which are not measured at fair value for impairments. Allowances for loans and advances or impairments for securities 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. As at 31 December 2012 there was no such objective evidence.

The DEPFA Group did not have any sovereign credit risk exposure to Greece, Portugal or Hungary as at 31 December 2012 (31 December 2011: € nil).

The exposure to selected European countries shown in the table contains loans and advances and securities. State-guaranteed contains for example loans and advances to banks and corporations which are guaranteed by sovereigns or sub-sovereigns. As of 31 December 2012 the DEPFA Group did not have any credit default swaps whose underlyings are linked to sovereigns, sub-sovereigns and state-guaranteed exposures of the countries shown above.

For the total portfolio as of 31 December 2012 and as of 31 December 2011 the exposure at default according to regions is disclosed in the Risk Management section.

The fair values of the exposure to selected European countries were determined by applying the measurement methods disclosed in the note 44 “Fair values of financial assets and liabilities”.

53 Dividends per share

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

No dividend is proposed for the year ended 31 December 2012.

54 Events after the reporting date

On 6 March 2013 DEPFA BANK plc determined that the perpetual securities issuing vehicle DEPFA Funding IV LP would not make payments on its €500,000,000 Preferred Securities (XS0291655727) on the next distribution payment date, scheduled for 21 March 2013.

Apart from the above, there have been no other notable events after 31 December 2012.

55 Ultimate parent company

Hypo Real Estate Holding AG, a company registered in Germany, is the parent company of the Bank. The largest and smallest Group into which the results of the Bank are consolidated is that headed by Hypo Real Estate Holding AG. Copies of the financial statements of Hypo Real Estate Holding AG can be obtained from The Secretary, Hypo Real Estate Holding AG, Freisinger Str. 5, 85716 Unterschleisseim, Germany.

56 Approval of financial statements

The financial statements were approved by the directors on 14 March 2013.

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