annual accounts
and
financial overview

2003

DEPFA
Deutsche Pfandbriefbank AG

DEPFA BANK
DEPFA Deutsche Pfandbriefbank AG

Contents

Business Development as at 31 December 2003 DEPFA Deutsche Pfandbriefbank AG

DEPFA Deutsche Pfandbriefbank AG is a subsidiary of DEPFA BANK plc, Dublin, whose shareholding amounted to 98.25% (2002: 98.25%) at the 2003 year-end. As the German subsidiary of the international public finance specialist, DEPFA Deutsche Pfandbriefbank AG concentrates on the public finance market in German-speaking countries and on long-term Group funding by issuing German asset-covered bonds (Pfandbriefe). Fitch, Moody's and Standard & Poor's have rated DEPFA Deutsche Pfandbriefbank AG on a par with the parent company; AA-/Aa3/AA-, with stable outlook. DEPFA Deutsche Pfandbriefbank AG holds a letter of comfort from DEPFA BANK plc.

Thanks to its strong focus on low-risk Public Finance business and its favourable cost/income ratio, DEPFA Deutsche Pfandbriefbank AG clearly outperformed its peers among German banks in terms of profitability.

Results of Operations

Extended net interest income was € 181.1 million in 2003, representing a minimal change of –0.4% over the previous year. This development was in line with equally stable lending volume of € 73.4 billion (+1.9%). Net commission income dropped 29% to € 7.6 million following the exit from the property business.

Personnel expenditure decreased by 41% to € 27 million. Last year's figure was affected by a number of of special factors arising from the restructuring and realignment of the DEPFA Group. Against this background, other administrative expenditure was also down significantly, by 48.7% to € 22 million. Depreciation of fixed assets was reduced by € 1.8 million to € 3 million. The 44.4% decline, to € 52 million, in total administrative expenditure reflects DEPFA Deutsche Pfandbriefbank's new position as a Group subsidiary.

At minus € 24.4 million, the balance of other operating income and expenditure was down considerably on the positive result of € 20.7 million in 2002; this swing was influenced by a decline in revenues compared with the previous year, and by deferred costs from the restructuring of the DEPFA group.

The net risk provisioning balance – which comprises several items, including expenditure for the repurchase of own Pfandbriefe and the realisation of income from the sale of Public Finance receivables was positive, at € 12.0 million (2002: +€ 12.4 million).

Operating income amounted to € 124.3 million in 2003, a decline of 5.9% from the previous year.

An amount of € 0.5 million was reported under "Change in the valuation of participations", after last year's € 532.7 million. That figure for 2002 included the realisation of capital gains within the framework of the changes in the legal structure of the Group, particularly at DePfa Bank Europe, Aareal Bank and

DePfa Property Services. These profits in 2002 were tax-exempt. Taking into account the € 2.4 million reversal of the special item with partial reserve character and tax expenses of € 56.9 million, net income amounted to € 70.3 million.

Lending business

Lending volume as at 31 December 2003 was € 73.4 billion (2002: € 72 billion). At € 67.4 billion, the bulk of this amount was accounted for by Public Finance, which in turn was divided between loans (€ 39.4 billion) and bonds (€ 28 billion). The 28.6% decline in property financing to € 4.0 billion is ascribed to the suspension of new business in that area, maturities and the transfer of the property loans to Aareal Bank. Furthermore, the risk exposure on € 2.2 billion in property loans has been neutralised using securitisation and guarantees.

Funding

At year-end 2003, DEPFA Deutsche Pfandbriefbank AG's total funding volume amounted to € 60 billion (2002: € 68.9 billion), of which € 57.4 billion were debt securities and € 2.6 billion were promissory note loans. New funds raised during the year under review amounted to € 8.4 billion (2002: € 7.9 billion).

Balance sheet

Total assets as at 31 December 2003 were € 85.1 billion, a fall of 9.9% compared with the end of 2002. Total volume of business, which also includes guarantee obligations and irrevocable loan commitments assumed by the bank, fell from € 96.6 billion to € 85.4 billion.

Liable capital

At 31 December 2003, equity capital pursuant to section 10 of the German Banking Act (KWG) amounted to € 2.2 billion. The core capital ratio according to the German Banking Act was 24.5%, on a total capital ratio of 44.7%. The equity-related limit on borrowings ("circulation limit") that must be observed by mortgage banks was utilised by between 60% and 70% during 2003.

Derivatives

DEPFA Deutsche Pfandbriefbank AG only uses derivatives for the purposes of hedging interest rate, credit and currency risks, to offset fluctuations in market prices. The nominal volume of financial derivatives held at the end of 2003 was € 111.3 billion.

Personnel report

DEPFA Deutsche Pfandbriefbank AG is part of an international banking group headquartered in Dublin. The successful expansion of the global Public Finance business demands a high level of commitment from our workforce worldwide. The career perspectives of each employee are closely linked to an attractive three-pillar compensation scheme designed to achieve a high level of staff commitment to the business model and the bank's success. DEPFA BANK has made a commitment to the capital markets to achieve a number of clearly-defined targets in the coming years; these represent the basis of the variable compensation components. Above and beyond their individual fixed salaries, staff will benefit directly from the success of the company through cash bonuses and a share ownership programme.

DEPFA Deutsche Pfandbriefbank AG employed 134 (2002: 136) persons during the period under review.

Age structure of DEPFA Deutsche Pfandbriefbank AG employees as at 31 December 2003

Age (in years)	Female	Male	Total	%	% (accumulated)
up to 29	7	7	14	10.4%	10.4%
30–39	37	42	79	59.0%	69.4%
40–49	12	15	27	20.2%	89.6%
50–59	1	12	13	9.7%	99.3%
60 and above	0	1	1	0.7%	100.0%
Total	**57**	**77**	**134**	**100.0%**	
Average age (in years)	36.1	39.3	38.0		

Outlook

Within the framework of the Group, DEPFA Deutsche Pfandbriefbank AG is responsible for the Public Finance business in German-speaking countries, and for long-term Group refinancing through asset-covered bonds issued under the German Mortgage Bank Act, as well as promissory note loans. Looking at the general development of public-sector budgets and the heightened risk awareness of investors, we envisage a continuation of rising demand in our target markets.

By virtue of its mortgage bank status, DEPFA Deutsche Pfandbriefbank AG, including its branches in Rome and Tokyo, is subject to the provisions of the German Mortgage Bank Act (Hypothekenbank-gesetz). Since the liberalisation of this Act, it can offer financing solutions to Japanese public-sector institutions through its Tokyo branch. Under the German Mortgage Bank Act however, the eligibility of Italian or Japanese assets to the cover assets pool of German mortgage banks is strongly restricted. Against this background and in line with the announcement already made in the prospectus for the restructuring of the DEPFA Group, legal ownership of the branches will be transferred to the Group parent company in the course of 2004.

The Management Board of DEPFA Deutsche Pfandbriefbank AG is confident of achieving further improvement in operating profit. Following the spin-off of the property business, the Management Board sees market risks as the main risks to which its operations are exposed. These are meticulously captured and managed by DEPFA BANK's Risk Controlling and Risk Management departments. The scheduled transfer of the property loans has resulted in a further reduction of the credit risks over the past two years. The bank is also subject to liquidity and operational risks which are typical to the sector. These are described in more detail in the Risk Report. Overall, the excellent capital base represents a very good risk/return profile for DEPFA Deutsche Pfandbriefbank AG.

In its meeting held on 27 February 2004, the Board of Directors of DEPFA BANK plc resolved to dispose of its subsidiary, DEPFA Deutsche Pfandbriefbank AG. DEPFA BANK plc owns 98.25% of DEPFA Deutsche Pfandbriefbank AG. A squeeze-out of the remaining 1.75% of the shares will be cleared at the Annual General Meeting in May this year.
DEPFA BANK plc and DEPFA Deutsche Pfandbriefbank AG anticipate closing the transaction by the end of the year 2004. The announcement of the transaction was welcomed by the financial markets. Given the uncertainty regarding the new shareholder, Fitch and Moody's have added the bank's uncovered issues to their respective watchlists, while Standard & Poor's lowered the rating from AA- to A+. The triple-A rating of covered issues was confirmed.

As the market leader in the German public finance business and a first-class funding platform, DEPFA Deutsche Pfandbriefbank AG holds obvious attractions for potential buyers. The bank's future development will, of course, depend on the identity of the acquiring entity, and its strategic goals.

Report from the Management Board on business relationships to affiliated companies

We hereby declare that DEPFA Deutsche Pfandbriefbank AG has received appropriate consideration, or was not put at a disadvantage with respect to any actions or omissions, whenever carrying out legal transactions with affiliated companies, in line with the circumstances at the time at which such legal transactions were entered into.

Risk Report

1. Integration of DEPFA Deutsche Pfandbriefbank AG into the Group's Risk Management

Transforming economic risk is an essential part of the banking business. That is why the targeted handling of risks – based on a professional and efficient risk management infrastructure – is as vital to ensuring the company's continued existence and profitability as it is important to satisfy the requirements of the environment the company operates in. The latter includes investors, analysts and rating agencies as well as legislators, regulators and auditors.

DEPFA Group has developed and established a comprehensive system to identify, measure and manage risks over recent years. This infrastructure, which includes an early warning system, is embedded in DEPFA's business processes. It is designed to comply with economic and legal requirements, and to satisfy the growing information needs of participants in the capital markets. As an almost wholly owned subsidiary of DEPFA BANK plc, DEPFA Deutsche Pfandbriefbank AG (referred to below as "Pfandbriefbank") has been fully integrated into the risk management systems of Dublin-based DEPFA Group.

The split of the former DEPFA Group and the restructuring of the new DEPFA into an Irish banking group had a multi-faceted impact on the risk management system of Pfandbriefbank.

Following the spin-off of property activities and the transfer of the largest part of related credit risks to third parties, risks arising from the property lending business are, in essence, no longer relevant for Pfandbriefbank.

Pfandbriefbank's parent company, DEPFA BANK plc, has established several committees at Group level, which are concerned with the management of risks:

- **Executive Committee:** The Executive Committee is responsible for the cross functional management of the Group.
  Objectives: implement strategies and controls; cross-functional coordination.
- **Asset & Liability Committee:** The Asset & Liability Committee implements the market risk strategy of the bank and allocates capital by setting risk limits.
  Objective: manage interest rate and liquidity risk, minimize funding costs.
- **Asset Management Committee:** The Asset Management Committee is responsible for determining the overall make-up/diversification of the assets and optimizing return in the context of risk.
  Objective: diversification, asset optimization, rating preservation and capital growth.
- **Credit Committee:** The Credit Committee is responsible for counterparty credit risk. It focuses on credit review and approval of individual obligors and on counterparty and country limits.
  Objective: manage credit risk.
- **The Strategic Planning Committee:** The Strategic Planning Committee is responsible for assisting the Office of the Chairman in the assessment of the overall strategy of the Bank and the budgeting and budget/monitoring process.
  Objective: anticipate industry trends and implement appropriate strategy for the Bank.

The Management Board of Pfandbriefbank is responsible for the management of risks within the Pfandbriefbank. Its decisions are based on proposals set out by the Group Committees described above. Responsibilities within Pfandbriefbank's Management Board have been assigned in compliance with the Minimum Requirements for the Trading Activities of Credit Institutions. The compliance with limits set by the Management Board is monitored by the Market Risk, Accounts, Operations and Credit departments, who measure risks for this purpose.

2. Credit Risks

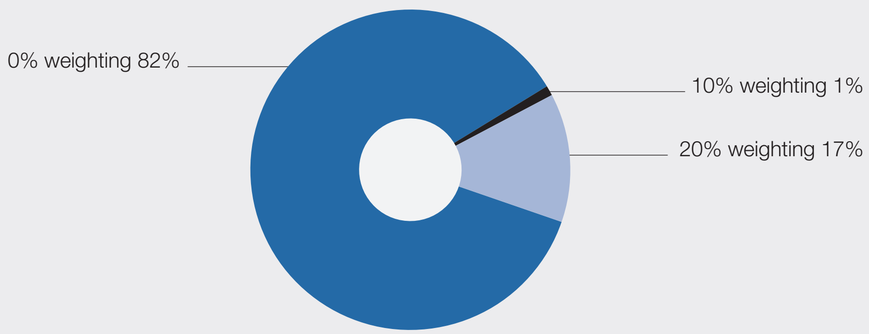
Credit Risk is defined as the risk of impairment and partial or total loss of a receivable due to deterioration of credit quality on the part of a business partner. The relevant receivable may be based on traditional on-balance sheet lending business or off-balance sheet business, e.g. counterparty risk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

Credit Risks in Public Finance

New business entered into by Pfandbriefbank is exclusively in the Public Finance sector. The business is clearly focused on sovereign and sub-sovereign borrowers, and on public sector-supported financial and specialist entities. In addition, business is transacted with selected private-sector financial institutions.

The risk weighting of the Pfandbriefbank's portfolio of assets clearly reflects the characteristics of the Public Finance business:
82% of the Pfandbriefbank's on-balance sheet assets are zero-weighted according to BIS rules. This illustrates the focus on sovereign and sub-sovereign institutions. The next-largest category carries a 20% weighting; these counterparties are predominantly municipalities and state-guaranteed banks.

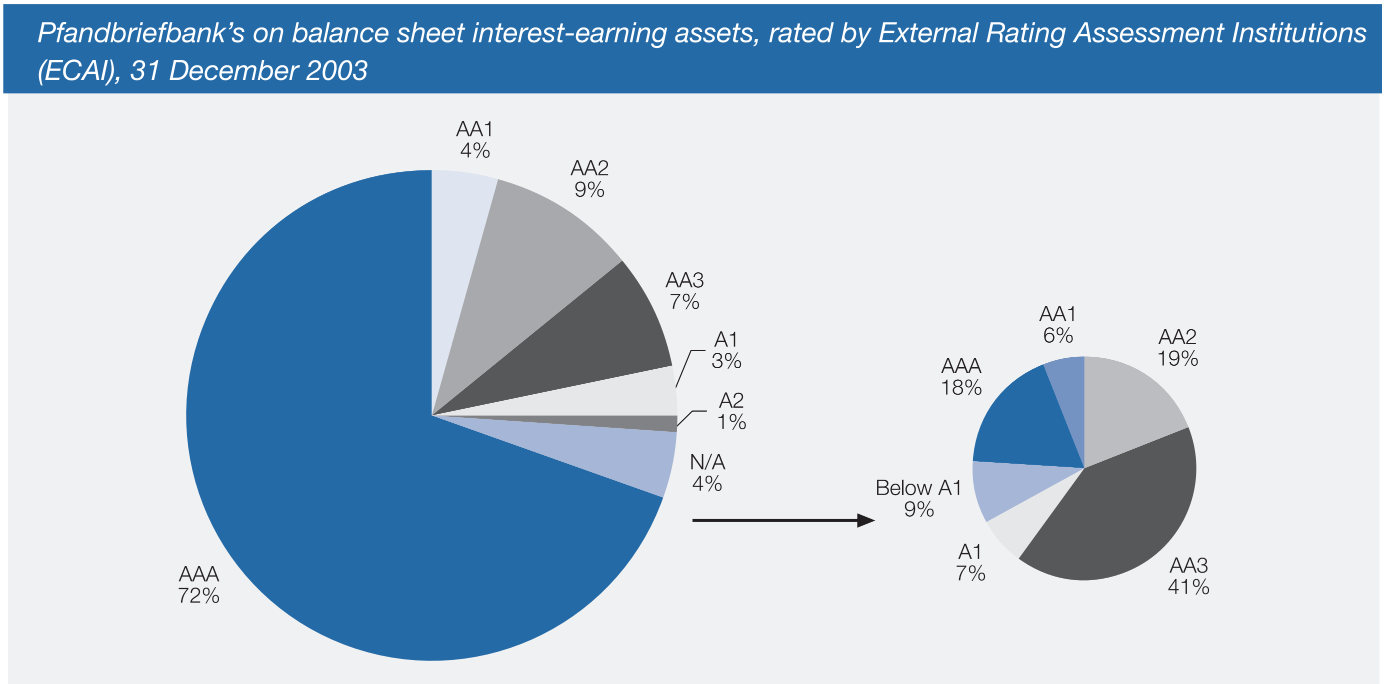
BIS Risk Weightings DEPFA Deutsche Pfandbriefbank AG (31 Dec 2003)



The portfolio is broadly diversified, with public sector counterparties in 19 countries. In order to ensure the top ratings for the Pfandbrief covered assets pool and a high rating for the bank, the business is focused on clients and counterparties with the highest credit quality.

The rated clients and counterparties account for a very high proportion of the Pfandbriefbank's assets. Almost 72% of the Pfandbriefbank's portfolio of on-balance sheet interest earning assets relates to counterparties with triple-A ratings by ECAIs while a further 20.22 % of assets relate to double-A ratings by ECAIs. 4.03% of the total portfolio is unrated by ECAIs. In this analysis, the rating is taken as the highest awarded by the three major ECAIs.

Pfandbriefbank's on balance sheet interest-earning assets, rated by External Rating Assessment Institutions (ECAI) 31 December 2003



Assessing credit risk – the internal rating systeme in DEPFA Group

The Pfandbriefbank applies the Group's rating system to the measurement and management of credit risks. The parent company's credit department prepares and provides the required analyses and decision proposals on the basis of an agency agreement.

Credit scoring of counterparties is critical to DEPFA's business. The scoring model of the Pfandbriefbank mirrors that of the Group and it is reviewed continuously. In recent years, DEPFA moved to a unitary scoring system for its four main credit risk pools (sovereign, sub-sovereign, financial institutions and infrastructure finance). Originally the unitary scoring model had 12 rating grades. The grading has now been extended to 22 grades. This change introduces a more accurate risk evaluation and is designed specifically to prepare for the implementation of the New Basel Accord.

DEPFA BANK's 22-grade internal rating system is similar to the grading system used by the External Credit Assessment Institutions ("ECAI").

All counterparties across all risk groups are graded in accordance with this system. The steps to assign and test the robustness of the internal rating involve:

- Grading individual counterparties through the analysis of balance sheet strength, the historic and budgeted relationship of direct tax and central allocation (grant) revenues with expenses, the relationship of debt to operating surpluses, indebtedness per capita, political stability and to guarantee structures.
- The analysis of the sub-sovereign legal framework including the delegation of powers from the sovereign and financial and regulatory support of its activities.
- Mapping internally derived ratings against the ECAI ratings for externally rated borrowers.

The credit approval process

In the Pfandbriefbank, the sole approval power for Public Finance loans lies with the Management Board. Its decisions are taken on the basis of recommendations by the Group Credit Committee. At Group level there is a complete separation between credit assessment and loan approval on the one hand, and business development and client coverage on the other, both in terms of organisation and reporting lines.

Pfandbriefbank distinguishes the following risk categories:

- Sovereign risks:
  Lending to federal governments, federal government agencies and central banks

- Sub-sovereign risks
  Lending to regions, municipalities or to regional and local authorities

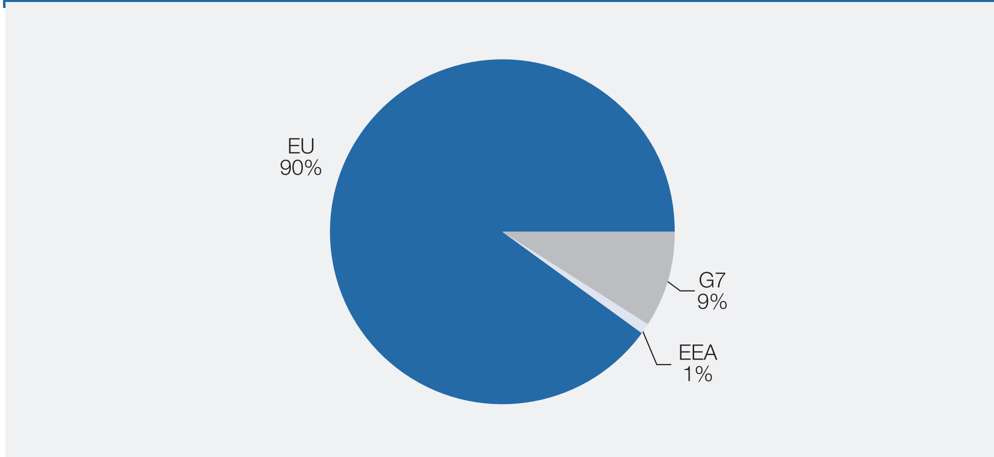
- Lending to public sector institutions
  With or without explicit government guarantee, but supported by additional security features

2.1 Sovereign Risks

The Management Board approves country limits, based on the recommendations of the Credit and Country Risk Committees, and taking into account the restrictions set out in the German Mortgage Bank Act (Hypothekenbankgesetz). Following the liberalisation of the Act in 2002, the bank is now permitted to carry exposure to country risks in North America, Japan and the EU accession candidate countries.

Sovereign risks are managed by the Country Risk Committee. Reviews of sovereign risks are carried out at least annually, with detailed reports on the social, political and economic situation of all countries presented to the Group Credit Committee for approval. All sovereigns/countries are rated in accordance with the Group internal rating grades. 48.89% of the Pfandbriefbank's on balance sheet interest earning assets represents direct or supported sovereign obligations.

On balance sheet income earning assets by country of risk (31 December 2003)



2.2 Sub-Sovereign Risk:

The Credit Risk Unit, a specialized team of professionals based in Dublin, carries out sub-sovereign risk analysis. This team is independent from business origination/relationship management. This unit is responsible for assessing and rating (in accordance with the DEPFA internal grading system) the credit risk for all sub-sovereign entities in the countries in which the Pfandbriefbank is operative. 35.39% of the Pfandbriefbank's on balance sheet and interest earning exposures represents obligations of sub-sovereigns.

2.3 Financial Institution Risk:

DEPFA Group's counterparty risk exposure from its Treasury business is associated with securities transactions, money-market dealings and interest rate derivatives entered into with other banks as counterparties. The extent of the resulting credit risk depends on the structure of the particular transaction. Whilst the credit exposure for on-balance sheet instruments is denoted by their current market value, the credit risk of derivative financial instruments corresponds to the "potential" replacement costs – those that could arise from the replacement of an equivalent position in the event of potential counterparty default.

Business with counterparties is only permitted if a limit has been approved.
The Credit Risk Unit also carries out assessment of DEPFA's exposure to financial institutions. Specialized professionals' work with the front office personnel to evaluate the credit risks involved in these counterparties. The approval process applied is the same as for sub-sovereign counterparties. In addition, all financial institutions are rated internally. All counterparties must have pre-approval limits in place as a prerequisite to conducting transactions with the Pfandbriefbank.

2.4 Limit Monitoring

The monitoring of country limits or cross border exposures is carried out on a daily basis by a dedicated team of professionals based in Dublin. Limit monitoring is performed on both a Group-wide basis as well as on a local entity basis. These exposure reports are made available to management and all business sectors of the Group.

2.5 Discontinued operations - property risk

Following the Group's reorganisation, property risks were almost totally transferred to Aareal Bank AG or third parties. The property lending business of the former DEPFA Group was spun off during the financial year 2002. At the year-end 2003, DEPFA Deutsche Pfandbriefbank AG (the "Pfandbriefbank") had a remaining property financing portfolio in the amount of € 4.0 billion of which € 1.8 billion was transferred to third parties via securitisation agreements.

Aareal Bank AG and the Pfandbriefbank have agreed that Aareal Bank AG will acquire the property-financing portfolio held by the Pfandbriefbank. In addition, Aareal Bank AG has extended guarantees to DEPFA in respect of individual exposures. These guarantees cover principal exposures totalling € 0.4 billion, plus interest payments in certain cases. The external auditors of both banks have confirmed that any future provisioning requirements will have to be set aside in the accounts of Aareal Bank AG, unless for individual exposures that cannot be transferred for reasons outside the banks' control.

In addition, the Pfandbriefbank and Aareal Bank AG have entered into an Agency Agreement whereby Aareal Bank AG administers, on behalf of the Pfandbriefbank, the loans that have not yet been transferred. This Agency Agreement takes into account the legal requirements pursuant to Section 25a of the German Banking Act and provides for protection with regard to the proper administration of the loan portfolio.

3. Market Risk

Market risk refers to the risk of potential loss arising from changes in interest rates, foreign currency exchange rates, equity prices, price or rate volatilities and other relevant market rates and prices such as commodity prices. DEPFA Deutsche Pfandbriefbank AG (Pfandbriefbank) defines its market risk as changes to fair value of financial instruments as a result of rate, price and volatility movements.

The Pfandbriefbank's market risk policies and procedures follow three core principles as applied throughout DEPFA Group:

- A policy framework for all key market risk activities approved by the Board of the Pfandbriefbank.
- The market risk management is centralized in the treasury units, managed by specialized personnel and monitored using appropriate systems and controls,
- The market risk control function measures and monitors the risks independently of the risk-taking units.

The market risk control function has sub-categorized market risk into risk factors. The relevant risk factors for Pfandbriefbank are interest rate and foreign exchange risk. As a bank focusing on Public Sector Finance, the Pfandbriefbank is not generally exposed to equity or commodity risk. With regard to foreign exchange risk, the Pfandbriefbank has a strict policy that treasury must match all foreign currency assets with liabilities in the same currency or swap out the foreign exchange exposure. Hence, the risk factor for Pfandbriefbank is interest rate change.

For the quantification and control of these risks, Pfandbriefbank's market risk control unit determines daily Value at Risk (VaR) figures for the banking book in line with industry wide practice using the variance/co-variance methodology. A ten-day holding period with a 99 % confidence interval is used to derive the calculation. The correlation and volatility frequencies for the calculation are annualized to 250 trading days. The choice of a ten-day holding period was selected to give a conservative VaR measure in relation to hedging the risk of the portfolio's positions. Senior management recognizes that VaR has certain inherent limitations. The past may not always provide a reliable indicator of future market movements and the statistical assumptions employed may understate the probability of very large market moves. For this reason additional management tools such as sensitivity measures, back-testing and stress testing are used to supplement VaR.

The following table shows VaR statistics for the year 2003 and the VaR exposure on 31 December 2003 relating to the Pfandbriefbank's banking book.

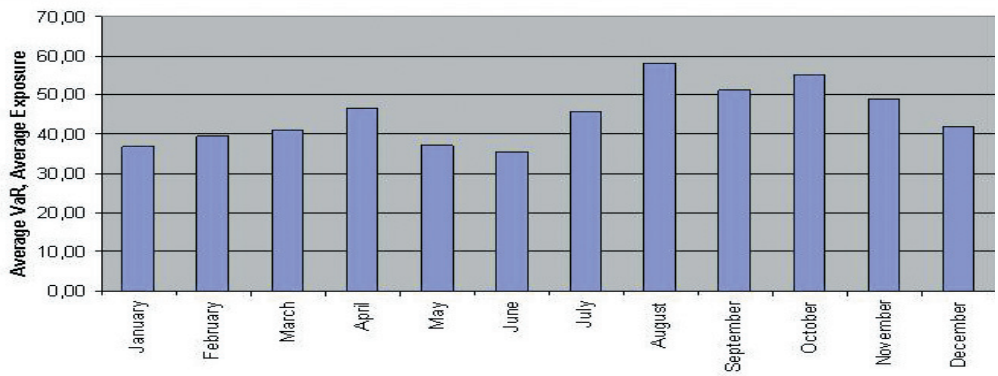
Interest Rate and Credit Spread Risk

	10 Day 99% VaR (€ m)
Average	44.9
High	67.9
Low	30.3
31 Dezember 2003	41.8

The average exposure in Pfandbriefbank's banking book amounted to € 44.9 m and the total exposure never exceeded € 67.9 m throughout the year 2003.

The following graph shows the VaR profiles of Pfandbriefbank's interest rate exposure during the year 2003.

Monthly average interest rate risk exposure and Value-at-Risk 2003 in € m



The graph above highlights the average monthly VaR for Pfandbriefbank's banking book. As can be seen from the above graph monthly average levels varied between € 35m and € 58m

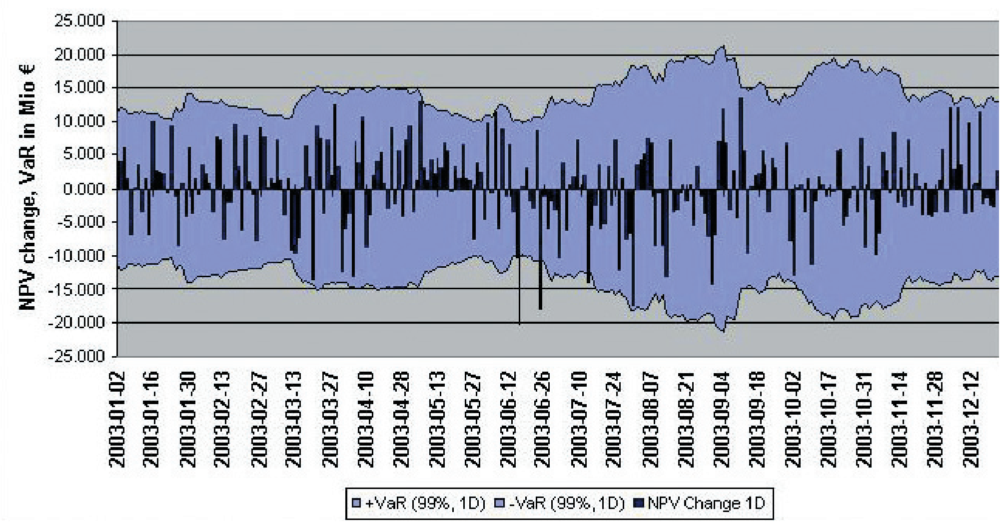
Reports detailing Pfandbriefbank's VaR as well as the limit utilization are prepared daily for senior management. The setting of risk limits is the responsibility of Pfandbriefbank's Board of Managing Directors.

Validity of the VaR Model – back testing

The accuracy of Pfandbriefbank's VaR model is calibrated by means of back testing to ensure the quality of the statistical process. This process entails the comparison of changes in portfolio value incurred against the most likely range of such changes forecasted by the VaR model. Back testing is based on the 1 day 99% VaR figures. In this case, actual losses would not be expected to exceed the forecast by the VaR model on more than three occasions in any one-year (250 trading days).

The graphical representations below show the back-testing results for Pfandbriefbank's interest rate exposure in 2003.

Backtesting – VaR of the Pfandbriefbank, 2 January 2003 – 31 December 2003



As can be seen from the above graph there were only 3 back testing exceptions (2 in June, 1 in July) in 250 business days. Therefore, the number of observed exceptions did not exceed the number of stochastically permissible exceptions in a 1-year time range.

4. Operational Risk

Operational risk is the risk of direct or indirect losses due to inadequacy or failure of internal processes, people or systems or due to external events. The objective of Pfandbriefbank is to minimize operational risk by:

- Application of a robust and reliable system environment
- Maintaining and further developing business continuity plans and procedures
- Documentation of all relevant policies, procedures and processes and keeping them under constant supervision.
- Identification and rectification of sources of errors and weaknesses
- Employing suitably qualified and experienced personnel
- The annual appraisal process and regular review of goals and objectives
- Sound and independent control systems.

Management of operational risk is the responsibility of all operational units. The Pfandbriefbank has appointed an Operational Risk Officer reporting to Pfandbriefbank's Managing Board of Directors. Both the Operational Risk Officer and DEPFA Group's Operational risk unit analyze and monitor the operational risk profile of the Pfandbriefbank. The Operational Risk unit reviews the banks procedures and processes on a regular basis by systematically collecting and evaluating data on potential operational weaknesses.

Thorough evaluation and selection of new personnel, regular reviews with regard to training needs and ongoing on-the-job training are integral parts of the Pfandbriefbank's approach to human resource management.

Pfandbriefbank shares the whole IT infrastructure with DEPFA Group. All major system components, such as computer hardware, communication links or trading sites are duplicated, synchronized and hosted in different locations. This is an integral part of the Group (and therefore also the Pfandbriefbank's) Business Continuity Plan, protecting DEPFA from an externally caused major disaster. Business continuity plans and procedures are under regular review and further development.

Pfandbriefbank complies with the Minimum Requirements for the Conduct of Trading Activities of Credit Institutions (Mindestanforderungen für das Betreiben von Handelsgeschäften der Kreditinstitute) with regard to the monitoring and containment of operational risks involved in trading financial instruments, and with respect to personnel risks. This includes the principle of segregation of duties between trading, posting, control and settlement functions. This principle is crucially important for the prevention of trading errors and fraudulent activities. Compliance with the related guidelines is assured by way of organizational measures, and is verified by Internal Audit.

To avoid legal risks from trading, Pfandbriefbank has established "Legal Documentation", a dedicated unit integrated in the business process chain that specialises in the verification and improvement of master agreements and individual contracts, and provides standardised documentation.

Internal Audit, reporting both to the Group Audit Committee and to Pfandbriefbank's Board of Managing Directors supports senior management by its audit activities and evaluation of all Pfandbriefbank activities and by adding value and improving operations and procedures. Internal Audit brings a systematic disciplined approach to the evaluation of the effectiveness of risk management, internal control, procedures and governance processes.

5. Liquidity risk

Liquidity risk defines the threat that current and future payment obligations may not be met in full, or in good time. Pfandbriefbank's Treasury department is responsible for the management of liquidity risk. Liquidity management involves controlling incoming and outgoing payments in a manner so as to maintain process efficiency and optimise related earnings. For this purpose, DEPFA Group conducts a Group-wide liquidity management integrating all relevant Group units. The Group's funding operations are based on several components,

- including the issue of asset-covered bonds (Pfandbriefe), uncovered bearer bonds, promissory note loans or Commercial Paper;

- entering into securities repurchase agreements ("repos");

- participating in open-market transactions of central banks; and money-market dealings.

A significant portfolio of liquid, high-quality securities is additionally available to secure the bank's liquidity. Liquidity balance sheets and cash flow forecasts are used to maintain the ability of the Group, and its various entities, to meet payment obligations at all times.

The requirements of Liquidity Principle II of the German Banking Act, which is relevant to liquidity management, were complied with throughout the year.

Balance sheet as at 31 December 2003
of DEPFA Deutsche Pfandbriefbank AG, Frankfurt/Main

Assets	€	€	€	Comparative figure of the previous year T €
1. Cash reserve				
a) cash on hand		3,769		2
b) balance with central banks		264,604,945		275,998
including: Deutsche Bundesbank € 148,620,577			**264,608,714**	**276,000**
2. Public-sector debt instruments and bills, which are admitted for refinancing at central banks				
a) treasury bills, non-interest-bearing treasury notes and similar sovereign debt		0		0
including: eligible for refinancing with Deutsche Bundesbank € nil				
b) bills of exchange		0		0
including: eligible for refinancing with Deutsche Bundesbank € nil			**0**	**0**
3. Loans and advances to banks				
a) mortgage loans		0		7
b) public-sector loans		5,323,569,545		6,262,030
c) other loans and advances		8,841,234,818		16,890,996
including: payable on demand € 739,907,668 collateralised by securities € nil			**14,164,804,363**	**23,153,033**
4. Loans and advances to customers				
a) mortgage loans		3,899,754,408		5,583,908
b) public-sector loans		35,149,439,020		38,687,219
c) other loans and advances		48,158,430		193,028
including: collateralised by securities € nil			**39,097,351,858**	**44,464,155**
5. Debt securities and other fixed-income securities				
a) money market instruments				
aa) by public-sector issuers	0			0
including: eligible as collateral with Deutsche Bundesbank € nil				
ab) by other issuers	0			0
including: eligible as collateral with Deutsche Bundesbank € nil		0		0

Liabilities

	€	€	€	Comparative figure of the previous year T €
1. Liabilities to banks				
a) registered mortgage bonds issued		247,172,843		243,353
b) registered public-sector covered securities		276,745,640		252,834
c) other liabilities		17,478,890,573		18,311,252
including: payable on demand € 220,238,744 registered mortgage bonds (€ nil) and registered public-sector covered securities (€ 2,556,459) pledged to lenders as collateral			**18,002,809,056**	**18,807,439**
2. Liabilities to customers				
a) registered mortgage bonds issued		858,334,121		1,627,745
b) registered public-sector covered securities		2,738,040,282		2,354,862
c) savings deposits				
ca) with agreed notice period of three months	0			5
cb) with agreed notice period of more than three months	0			7
		0		12
d) other liabilities		1,808,347,125		1,182,539
including: payable on demand € 12,710,090 registered mortgage bonds (€ 12,214,345) and registered public-sector covered securities (€ 44,993,686) pledged to lenders as collateral			**5,404,721,528**	**5,165,158**
3. Certificated liabilities				
a) bonds issued				
aa) mortgage bonds (Hypothekenpfandbriefe)	308,715,396			474,830
ab) public-sector covered securities	51,263,171,087			56,379,159
ac) other debt securities	3,230,588,614			4,492,980
		54,802,475,097		61,346,969
b) other certificated liabilities		3,486,815,653		5,514,044
including: money market instruments € 3,486,815,653			**58,289,290,750**	**66,861,013**
4. Trust liabilities			**131,144,234**	**132,014**
including: Trustee loans € 10,172,575				
5. Other liabilities			**167,004,193**	**336,889**

Assets	€	€	€	Comparative figure of the previous year T €
b) bonds and notes				
ba) by public-sector issuers including : eligible as collateral with Deutsche Bundesbank 9,454,259,077 €	14,863,244,864			12,723,027
bb) by other issuers including : eligible as collateral with Deutsche Bundesbank 10,704,246,040 €	14,621,434,021	29,484,678,885		11,640,777 24,363,804
c) own bonds		1,141,298,194		1,170,539
nominal amount 1,103,354,810 €			**30,625,977,079**	**25,534,343**
6. Equities and other non-fixed income securities			**729,567**	**1,678**
7. Participations			**1**	**3**
including: in banks 45,436 € in financial service institutions 0 €				
8. Interests in affiliated companies			**423,931**	**655**
including: in banks 0 € in financial service institutions 0 €				
9. Trust assets			**131,144,234**	**132,014**
including: Trustee loans 10,172,575 €				
10. Equalisation claims on the public-sector including debt securities after conversion			**2,570,395**	**3,979**
11. Intangible assets			**0**	**0**
12. Property and equipment			**9,717,368**	**11,462**
13. Unpaid contributions to subscribed capital			**0**	**0**
including: called contributions 0 €				
14. Treasury shares			**0**	**0**
nominal amount 0 €				
15. Other assets			**24,670,251**	**24,521**
16. Interest deferral, and prepaid expenses				
a) from new issues business and lending		563,528,672		496,623
b) other		255,799,153		368,651
			819,327,825	**865,274**
17. Deficit not covered by capital			**0**	**0**
Total assets			**85,141,325,586**	**94,467,117**

Liabilities

	€	€	€	Comparative figure of the previous year T €
6. Interest deferral, and deferred income				
a) from new issue business and lending		119,796,820		156,636
b) other		565,471,573		625,845
			685,268,357	**782,481**
7. Provisions				
a) accrued pension liabilities and similar obligations		41,987,536		38,787
b) tax provisions		93,265,571		89,242
c) other provisions		57,928,623		38,193
			193,181,730	**166,222**
8. Special item with partial reserve character			**0**	**2,394**
9. Subordinated liabilities			**110,692,218**	**117,593**
10. Profit-participation certificates			**926,519,913**	**926,520**
including: maturing within two years 0 €				
11. Fund for general banking risks			**0**	**0**
12. Shareholders' equity				
a) subscribed capital		108,000,000		108,000
b) capital reserve		416,093,607		416,094
c) retained earnings				
ca) reserve for treasury shares	0			0
cb) other retained earnings	310,600,000			327,300
		310,600,000		327,300
d) net profit		396,000,000		318,000
			1,230,693,607	**1,169,394**
Total Shareholders' equity and liabilities			**85,141,325,586**	**94,467,117**
1. contingent liabilities liabilities from guarantees and indemnity agreements			**43,446,885**	**62,356**
2. other commitments irrevocable loan commitments			**169,465,318**	**2,064,061**

Profit and Loss Account
of DEPFA Deutsche Pfandbriefbank AG, Frankfurt/Main
for the period from 01 January until 31 December 2003

Expenses	€	€	€	2002 T €
1. Interest expenditure			3,548,374,625	4,202,184
2. Commission expenditure			1,717,520	4,717
3. Net expenditure on financial operations			0	0
4. General administrative expenditure				
a) staff costs				
aa) wages and salaries	17,308,983			39,304
ab) social security costs and expenses for pensions and support	9,646,011			6,460
including: for pensions € 7,915,560		26,954,994		45,764
b) other administrative expenses		21,989,694		42,899
			48,944,688	88,663
5. Deprecation, amortisation or write-offs of intangible and fixed assets			3,037,536	4,793
6. Other operating expenditure			32,351,491	17,745
7. Depreciation/write-offs on claims and certain securities, additions to loan loss provisions			0	0
8. Depreciation of, and write-downs on participating interests, shares in affiliated companies and securities held as fixed assets			0	0
9. Expenditure for assumption of losses			0	41,646
10. Additions to special items with partial reserve character			0	0
11. Extraordinary expenses			0	0
12. Income taxes			56,733,748	36,046
13. Other taxes not reported under item #6			149,482	243
14. Profits transferred under a profit-pooling agreement, profit transfer agreement or partial profit transfer agreement			0	0
15. Net income for the year			70,300,000	589,300
Total expenses			**3,761,609,090**	**4,985,337**
1. Net income for the year			70,300,000	589,300
2. Profit carried forward			0	0
3. Withdrawals from retained earnings				
a) from reserve for treasury shares			0	23,018
b) from other retained earnings			325,700,000	0
4. Transfer to retained earnings				
a) to other retained earnings			0	294,318
5. Net profit			396,000,000	318,000

Income	€	€	2002 T €
1. Interest income from			
a) lending business and money market transactions	2,504,422,305		3,169,718
b) fixed-income securities and government debt	1,223,407,273		1,214,248
		3,727,829,578	4,383,966
2. Current income from			
a) equities and other non fixed-income securities	0		0
b) participations	4,870		7
c) interests in affiliated companies	1,640,000		0
		1,644,870	7
3. Income from profit-pooling agreements, profit transfer agreements and partial profit transfer agreements		0	0
4. Commission income		9,365,815	15,384
5. Net profit on financial operations		0	0
6. Income from amounts written back on claims and certain securities and from the reversal of loan loss provisions		11,997,865	12,471
7. Income from write-ups to participating interests, shares in affiliated companies and securities held as fixed assets		466,160	532,698
8. Other operating income		7,910,354	38,417
9. Income from the reversal of special items with partial reserve character		2,394,448	2,394
10. Extraordinary income		0	0
11. Income from transfer of losses		0	0
12. Net loss for the year		0	0
Total income		**3,761,609,090**	**4,985,337**

Notes to the Financial Statements of DEPFA Deutsche Pfandbriefbank AG

The financial statements as at 31 December were prepared in accordance with the provisions of the German Commercial Code (Handelsgesetzbuch – "HGB") and the supplementary regulations of the German Stock Corporation Act (Aktiengesetz – "AktG"), the German Banking Act (Kreditwesengesetz), the German Mortgage Bank Act (Hypothekenbankgesetz) and the German Accounting Directive for Banks (Verordnung über die Rechnungslegung der Kreditinstitute – "RechKredV"). Furthermore, the provisions of the Law on Corporate Governance and Transparency (Gesetz zur Kontrolle und Transparenz im Unternehmensbereich – "KonTraG") were applied. Where the provisions of the law require further details on individual items in the balance sheet and profit and loss account, these are shown in the notes.

A. Accounting and valuation principles

Receivables are valued at nominal value under section 340e (2) HGB. Any difference between the nominal value and the actual payment amount is shown as a deferred item in accordance with section 340e (2) HGB.

All recognisable individual risks on the loans side were covered by specific loan loss provisions. Additional provisions were set aside in accordance with Section 340f HGB.

These instruments are allocated to the liquidity reserve or fixed assets and are either valued strictly at the lower of cost or market value (section 253 (3) and section 280 (2) HGB) or in accordance with the principles applicable to fixed assets (section 253 (2) HGB) and take into account currency hedging instruments. In accordance with the principles on zero coupon bonds laid down by the Main Committee of the Institute of Chartered Accountants in Germany (HFA 1/1986), the bank began recognition of the difference between purchase price and nominal value of securities held as liquidity reserve over the term of such securities from this year onwards. The amounts to be reversed in accordance with this procedure (net expense of € 15.9 million) in the past years are shown under the item 'Depreciation / write-offs on claims and certain securities, additions to loan loss provisions'. The ongoing reversal during the reporting period is recorded in net interest income. As in previous years, any premiums or discounts of securities in the investment portfolio have been amortised over the respective terms.

Participations and interests in affiliated companies were valued at the lower of acquisition cost or their value as at the reporting date.

Fixed assets were valued at acquisition or historical cost less scheduled depreciation. As far as is permissible under tax legislation, depreciation was calculated on a diminishing basis. Low-cost assets are written off in full during the year of acquisition.

Liabilities are shown on the balance sheet at the amount due for repayment. The difference between the nominal value and the initial carrying amount of liabilities is recognised under deferred items. Zero bonds are shown at their issue value, plus pro-rata interest in line with the yield at the time of issue.

Contingent liabilities are covered by provisions equalling the anticipated amount of the liability. Provisions for pensions have been determined using an interest rate of 6% based on the guideline tables issued by Heubeck in 1998 using the cost ("Teilwert") method in accordance with the actuarial principles.

Off-balance sheet financial instruments and associated underlying transactions hedged were treated as a single valuation unit to the extent permissible. For interest-related transactions, interest was deferred over the term of the loan.

Currency conversion in respect of fixed assets, current assets, liabilities and open positions in futures contracts was carried out in accordance with section 340h HGB and use was made of the valuation option under section 340 h (2) HGB. The underlying spot rate and swap points were recorded separately for foreign exchange forwards. Income and expenditure from swap contracts have been deferred over the term of the transaction.

B. Notes to the balance sheet

Breakdown of remaining times to maturity

	Residual term					
Balance sheet item **€ m**	**Up to 3 months**	**Between 3 months and 1 year**	**Maturing in the following year**	**Between 1 year and 5 years**	**More than 5 years**	**Indefinite maturity**
Loans and advances to banks	6,620.0	3,255.0		2,317.6	1,972.2	
Loans and advances to customers	2,574.9	3,102.9		16,214.7	17,204.9	–
Debt securities and other fixed-income securities			3,145.8			
Liabilities to banks	12,046.9	3,351.5		1,870.4	734.0	
Liabilities to customers						
· Savings deposits with agreed notice period	–	–		–	–	
· Pfandbriefe issued and other liabilities	1,512.3	400.3		1,629.8	1,862.3	
Certificated liabilities						
· Bonds issued			8,475.2			
· Other certificated liabilities	2,074.0	1,412.8		–	–	

Receivables/liabilities to/from affiliated companies and associated companies

	To/from affiliated companies 31.12.2003 € m	To/from affiliated companies 31.12.2002 € m	To/from associated companies 31.12.2003 € m	To/from associated companies 31.12.2002 € m
Loans and advances to banks	4,184.5	10,700.4	–	–
Loans and advances to customers	–	–	–	–
Debt securities and other fixed-income securities	10.6	11.9	–	–
Liabilities to banks	3,190.0	4,506.0	–	–
Liabilities to customers	–	–	–	–
Certificated liabilities	274.9	688.6	–	–
Subordinated liabilities	110.0	50.0	–	–

Securities negotiable at the stock exchange

	Negotiable € m	Listed € m	Unlisted € m
Debt securities and other fixed-income securities	30,626.0	26,729.6	3,896.4
Equities and other non-fixed income securities	0.7	–	0.7
Participations	–	–	–
Investments in affiliated companies	0.0	–	0.0

The amount of negotiable debt securities and other fixed-income securities, which are not valued at the lower of cost or market, amounted to € 1,249.6 million.

Fixed assets

The individual fixed assets positions developed as follows in the reporting period:

T €	Investments held as fixed assets	Participations	Investments in affiliated companies	Fixed assets Office furniture and equipment	Land and property
Acquisition/historical cost (01.01.03)	1,316,900	55	838	13,805	1,936
Additions	–	–	0	1,346	–
Disposals	67,298	3	414	25	–
Transfers	–	–	–	–	–
Amortisation/depreciation (accumulated)	–	52	–	6,220	1,125
Book value (31.12.03)	1,249,602	0	424	8,906	811
Book value (31.12.02)	1,316,900	3	654	10,651	811
Amortisation/depreciation during the year	–	–	–	3,038	–

No land and property was used within the scope of the company's own activities at year-end 2003.

Shareholdings

At the balance sheet date, the shareholdings of DEPFA Deutsche Pfandbriefbank AG within the meaning of section 285(11) HGB comprised the following companies:

Company name	Registered Office	Interest held %	Shareholders' equity € m	Results € m
DEPFA Finance N.V.	Amsterdam	100.0	6.1	2.8
DEPFA Funding LLC	Wilmington	100.0	220.0	9.0
DEPFA Funding Trust	Wilmington	100.0	0.0	9.0
DEPFA Zweite GmbH	Frankfurt	100.0	0.3	0.0
DEPFA Erste GmbH	Frankfurt	100.0	0.1	0.0

Trust assets/liabilities

The total amounts reported are distributed across balance sheet items as follows:

	€ m
Trust assets	
Loans and advances to customers	8.3
Other assets	122.8
Trust liabilities	
Liabilities to banks	8.3
Liabilities to customers	122.8

Other assets

In addition to claims not associated with the banking business and balances in clearing accounts, this item (reported at € 24.7 million) primarily includes receivables from tax authorities and affiliated parties.

Deferred items

	€ m
Assets	
Discounts on debt securities	275.0
Premium on loans	288.5
Aggregate of new issues and lending businesses	563.5
Liabilities	
Premium on debt securities	47.7
Discount on loans	72.1
Aggregate of new issues and lending businesses	119.8

Subordinated assets

No subordinated assets are recognised in the balance sheet (in 2002, debt securities and other fixed-income securities included subordinated assets amounting to € 0.8 million).

Assets pledged under repurchase agreements

At 31 Dec 2003, the book value of securities shown in the balance sheet and pledged under repurchase agreements amounted to € 3,912.9 million. Open market transactions to the tune of € 500 million were pending at 31 Dec 2003.

Other liabilities

This item is reported at € 167 million and includes predominantly deferred items from financial derivatives as well as deferred items from non-banking liabilities and from balances in clearing accounts

Subordinated liabilities

Subordinated capital is made up as follows:

Nominal value (€ m)	Currency	Interest rate in %	Maturity date
50.0	EUR	3.76	30.06.2025
60.0	EUR	6.54	30.10.2028

In the event of insolvency or liquidation, the subordinated principal and interest claims on the bonds shall be paid back only after satisfaction of all creditors whose claims are not subordinated. Claims from the bonds may not be offset against claims of the debtor. Neither the creditor nor the debtor is entitled to terminate the bonds.

Interest expenditure on subordinated liabilities amounted to € 2.885 million.

Special item with partial reserve character

The new rules applying to a subsequent revaluation (section 6 (1) no. 1 sentence 2 of the German Income Tax Act (EStG)) introduced by the Tax Relief Act 1999/2000/2002 led to unrealised profits in 1999. The bank has opted to spread these unrealised profits over five years, and has therefore allocated four-fifths thereof to special reserves with partial reserve character. One fourth of such special reserve will be released in each of the years between 2000 and 2003.

Profit-participation certificates

The bank records profit-sharing certificates to the tune of € 863.4 million. Of this total, € 102.3 million were issued in 1986, € 255.6 million in 1994, € 383.5 million in 1996 as well as € 45.0 million and € 77.0 million in 2000. The profit-participation rights expire on 31 December 2010, 31 December 2008, 31 December 2011, 31 December 2009, and 31 December 2014, respectively. They are admitted for Official Trading and the Regulated Market at the Frankfurt Stock Exchange.

Subscribed capital

As at 31.12.03, DEPFA Deutsche Pfandbriefbank AG had subscribed capital of € 108.0 million, divided into 36,000,000 unit shares.

Authorised capital

Resolution passed	Original amount € m	Utilisation in the reporting year € m	Amount still available € m	Time limit	Note
2002	54.0	–	54.0	18.06.2007	–

Conditional capital

Resolution passed	Original amount € m	Utilisation in the reporting year € m	Amount still available € m	Time limit	Note
1999	12.0	–	12.0	–	see below

The conditional capital increase was resolved to enable the Bank to grant conversion or option rights to the holders of convertible bonds or warrants which will be issued up until 16 June 2004 by the Bank or by a direct or indirect majority holding of DEPFA Deutsche Pfandbriefbank AG. The total amount of debt securities may not exceed a nominal amount of € 600 million, or € 2,000 million in the case of issuance of low-yield bonds or long-term debt securities without regular interest payments. The debt securities may be denominated in € as well as in any legal tender of an OECD country up to an amount equivalent to the corresponding € value euro equivalent.

Purchase of treasury shares

The Annual General Meeting of 19 June 2002 authorised the company to purchase treasury shares in accordance with section 71 paragraph 1 no. 7 AktG until 18 December 2003. Revoking this resolution, the Bank has been authorised by the Annual General Meeting on 4 June 2003 to purchase own shares pursuant to section 71 paragraph 1 no. 7 AktG until 3 December 2004 for the purposes of securities trading. The volume of shares acquired for this purpose was not exceed 2 % of the Bank's share capital at the end of any day. The lowest price at which a share may be acquired was determined by the closing price of the shares in Xetra (or a comparable successor system) on the trading day prior to such purchase, less 10%. The highest price shall not exceed such average closing price, plus 10%. Said authority was not utilised in the reporting period.

The Annual General Meeting of 19 June 2002 furthermore authorised the company to purchase treasury shares in accordance with section 71 paragraph 1 no. 8 AktG until 18 December 2003. Revoking this resolution, the bank has been authorised by the Annual General Meeting on 4 June 2003 to purchase own shares to the tune of 2 % of subscribed capital for other purposes than securities trading until 3 December 2004. Shares may be acquired via the stock market or through a public offer to buy directed at all shareholders. Neither the purchase price (excluding ancillary costs), if the acquisition takes place via the stock market, nor the offering price (excluding ancillary costs), in case of a public offer to buy, may exceed or fall below the average closing price of the Bank's shares in Xetra (or a comparable successor system) during the three trading days prior to the purchase or the commitment to purchase by more than 10%. Exclusion of shareholders' pre-emptive rights was possible under certain circumstances.

Reserves

The Bank's reserves developed as follows:

T €	Capital reserve	Reserve for treasury shares	Other retained earnings
Balance at 31.12.2002	416,094	–	327,300
Transfer from net retained profits for 2002 aproved by the AGM	–	–	309,000
Withdrawal due to the transfer of net retained profit	–	–	(325,700)
Balance at 31.12.2003	416,094	–	310,600

Contingent liabilities

Liabilities from guarantees and indemnities primarily comprise loan guarantees extended during the period before the conversion to a public limited company.

Other commitments

€ 150.0 million of irrevocable loan commitments of € 169.5 million refer to loans granted to other public authorities and mortgage loans.

Foreign currency

Total assets denominated in foreign currencies amounted to € 15,211.8 million at the balance sheet date, liabilities denominated in foreign currencies totalled € 15,888.2 million. The difference has almost entirely been hedged using foreign exchange forwards and currency swaps.

Transactions subject to market risk

The following transactions were outstanding and awaiting settlement on the balance sheet date:

€ m	Nominal amount Remaining time to maturity				Counterparty risk
	<= 1 year	1–5 years	> 5 years	Total	
Interest rate and currency swaps	20,247	36,630	43,070	99,947	2,457
Interest rate futures and forward rate agreements	500	–	–	500	0
Interest rate options purchased	–	26	87	113	1
Interest rate options written	918	643	526	2,087	–
Other interest rate contracts	787	1,905	3,992	6,614	176
Forward foreign exchange contracts	0	–	–	0	0
Credit derivatives	–	2,039	–	2,039	7
Total	22,452	41,243	47,605	111,300	2,641

Counterparties to derivative contracts as at 31 December 2003

Type of counterparty	Counterparty risk € m
OECD banks	2,464
OECD financial institutions	177

To determine the counterparty risk, the figures are based on replacement costs, which were calculated in line with the market value method as the sum of all positive market values excluding netting arrangements.

All forward transactions were designed exclusively to hedge foreign exchange and interest rate risks.

Contingencies

DEPFA Deutsche Pfandbriefbank AG has furnished an absolute and irrevocable guarantee for the proper payment of capital and interest amounts for debt securities issued by DEPFA Finance N.V., Amsterdam. It will ensure that DEPFA Funding LLC, Delaware, is able to meet its contractual obligations.

C. Notes to the profit and loss account

Other operating expenses

This item comprises, in particular, expenditure on compensation payments in the context of the split as well as currency translation expenses.

Commission income

This item refers mainly to commission income from guarantees for one subsidiary.

Other operating income

Other operating income includes, in particular, income from the agency business for Group companies as well as interest on tax refunds and the release of provisions.

Geographic breakdown of income

The
- interest income,
- current income from equity and other non-fixed-income securities, participations and Interests in affiliated companies,
- commission income,
- other operating income

are divided between the geographical sales office regions as follows:

	€ m
Germany	3,662.2
Rest of Europe	49.5
Japan	35.0

D. Notes to mortgage bank business

Coverage	T €
A. Mortgage bonds (Hypothekenpfandbriefe)	
Ordinary cover	
1. Loans and advances to banks (Mortgage loans)	–
2. Loans and advances to customers (Mortgage loans)	–
3. Equalisation claims against the government	–
Total	–
Substitute cover	
1. Other loans and advances to banks	–
2. Debt securities and other fixed-income securities	1,421,554
Total	1,421,554
Total cover assets	1,421,554
Total value of mortgage bonds subject to coverage requirements	1,369,844
Excess cover	**51,710**
B. Public sector covered securities	
Ordinary cover	
1. Loans and advances to banks (Public sector loans)	4,965,918
2. Loans and advances to customers (Public sector loans)	30,244,293
3. Debt securities and other fixed-income securities from public issuers	18,264,506
Total	53,474,717
Substitute cover	
1. Other loans and advances to banks	300,000
2. Debt securities and other fixed-income securities	–
Total	300,000
Total cover assets	53,774,717
Total value of public sector bonds subject to coverage requirements	51,874,702
Excess cover	**1,900,015**

Mortgages serving as cover

On the balance sheet date, no mortgages were recorded in the register of mortgages to cover mortgage bonds.

Mortgage repayments

Repayments during the year under review comprised	€ m
Scheduled repayments	161.3
Extraordinary repayments	1,673.3
Total	**1,834.6**

Extraordinary repayments include € 1.2 billion in transfers of loans to Aareal Bank AG.

Due and unpaid mortgage interest

Due to corresponding guarantees and indemnities, no overdue interest accumulated during the year under review.

Repossessions

Pending as at 31 December 2003	Forced sales	Forced administration	Forced sales and forced administration	Total no. of cases	Forced sales carried out in 2003
Residential property	306	181	342	829	184
Commercial property	42	58	56	156	41
Total	**348**	**239**	**398**	**985**	**225**

E. Other information

Consolidated financial statements

The parent company of the Group, DEPFA BANK plc, 3, Harbourmaster Place Dublin 1, Ireland, draws up its consolidated financial statements pursuant to US GAAP (United States Generally Accepted Accounting Principles) and in accordance with the EU Bank Accounts Directive (86/635/EEC) and EU Gruop Directive (83/359/EEC). The consolidated financial statements include DEPFA Deutsche Pfandbriefbank AG as well as its subsidiaries which must be consolidated. In accordance with section 291 (1) HGB, the bank is exempt from preparing its own consolidated financial statements. The consolidated financial statements can be obtained from the parent company in Dublin.

Significant differences between the German Commercial Code (HGB) and US GAAP

The differences between the German Commercial Code and US GAAP are set out below as stipulated in section 291 (2) no 3:

Securities

In accordance with SFAS 115 (Accounting for Certain Investments in Debt and Equity Securities), securities are classified into three categories depending on the purpose for which they were purchased: “held to maturity”, “available for sale” and “trading”.

Securities held to maturity are recorded at amortised cost. In connection with the valuation of available-for-sale securities, any changes in market value are reported, with no impact on the profit and loss account, under “Other comprehensive income”, while changes in the market value of trading securities are recognised in the profit and loss account. In the case of permanent impairment, the book value is written off with an impact on the profit and loss account. For held-to-maturity securities, these write-downs cannot be subsequently reversed (write-ups). Write-ups for available for sale securities shall be recorded under other comprehensive income, write-ups for trading securities in the profit and loss account.

Pursuant to the German Commercial Code securities are broken down in the categories non-trading portfolio (Anlagebestand), liquidity reserve (Liquiditätsreserve), and trading portfolio (Handelsbestand). Securities of the non-trading portfolio are carried at amortised cost. Where the value of securities of the non-trading portfolio is permanently impaired, they must be written down. Where the value is only temporarily impaired, there is no obligation to write down. Securities of the liquidity reserve and of the trading portfolio must be recorded in accordance with the provisions on valuing current assets, i.e. at the lower of acquisition cost or fair value. Where the reasons for the write-down no longer apply, such securities must be written up.

Repurchased own debt securities

Under US GAAP, repurchased debt securities will reduce outstanding liabilities in the balance sheet. This takes place irrespective of whether the securities are intended for resale or not. The difference between the cost of acquisition and the book value is reported in the profit and loss account. Any resale will be treated as a new issue in the balance sheet.

Under the German Commercial Code, own debt securities are capitalised and valued strictly at the lower of cost or market. The purchase of own debt securities itself hence will not affect the profit and loss account. The profit and loss account will only be affected upon the resale of such securities.

Derivative financial instruments

Pursuant to SFAS 133 all derivatives must be recorded in the balance sheet and valued at fair value with an effect on the profit and loss account. Derivatives which are used as hedging instruments must comply with extensive effectiveness and documentation requirements before they may be recorded in accordance with the provisions applicable to hedge accounting. The effectiveness of the hedging relationship must be demonstrated on a quarterly basis at least. Contributions to the result of the underlying transaction and the hedge transaction will be determined in relation to the hedge effectiveness of the derivative used. Where the fair value of an underlying transaction is hedged using a fair value hedge, changes in the fair value of the derivative are recorded in the profit and loss account together with the fair value changes relating to the hedged risk of the underlying transaction. Future cash flows from an underlying transaction are hedged with cash flow hedges. Fair value changes of a derivative (effective portion) will be recorded under other comprehensive income (using interim entries) with no impact on the profit and loss account, while the ineffective portion of the hedge must be recorded in the profit and loss account immediately.

According to the German Commercial Code derivative financial instruments are pending transactions and are thus not to be recorded in the balance sheet. Independent derivatives positions not used for hedging purposes will only be reflected to the extent that the Commercial Code provides for transfers to provisions for impending losses from pending transactions. When compared to US GAAP, the German Commercial Code provides for less stringent provisions for hedge transactions related to underlying transactions, i.e. to the extent that single valuation units are created for the purposes of accounting for derivatives. An impact on the balance sheet only occurs in cases where the derivative hedge transaction is expected to yield unrealised losses, which are not compensated for by unrealised profits from the underlying transaction. The underlying transactions must be valued to the extent that there are no offsetting effects from the derivative.

Provision for loan losses

The provision for general banking risks as permitted pursuant to sections 340 f and 340 g of the German Commercial Code is not permissible under US GAAP.

Fixed assets

Under US GAAP, fixed assets are carried at the historic cost less scheduled depreciation. Where the permanent impairment of value is probable, a special depreciation must be carried out. Pursuant to US GAAP, a subsequent revaluation does not lead to any write-up.

With the exception of the write-up requirement following previous special depreciation and the permissibility of tax-induced depreciation, the provisions of the HGB correspond to those of US GAAP.

Deferred taxes

Under US GAAP, deferred taxes must be provided for all differences between tax reporting and commercial reporting in the accounting balance sheet, irrespective of when the differences are settled (temporary concept).

Under the German Commercial Code, differences in results, which are likely to be reversed in the foreseeable future (timing concept), are supported by deferred taxes. The bank may choose if it wants to record deferred tax assets.

Pension provisions

Forward-looking assumptions such as future salary and pension developments as well as career expectations are to be taken into account upon determination of pension provisions under US GAAP. Interest rates used for the valuation of benefit obligations are based on the prevailing capital market rate. The expenditure for the period is determined on the basis of the values forecasted at the beginning of the accounting period. A change in forecasts will only influence the amounts transferred to provisions in the following period.

Forward-looking assumptions are not to be taken into account pursuant to the German Commercial Code. The discount rate used for tax purposes is also used for accounting purposes. The amount of provisions and the resulting expenditure for the period will be determined on the basis of the net present value calculated at the end of the year.

Trust business

Trust transactions and trust liabilities may not be recorded in the balance sheet pursuant to US GAAP.

Executive bodies of DEPFA Deutsche Pfandbriefbank AG, giving details of membership of Supervisory Boards and other supervisory bodies in accordance with section 285 no. 10 of the HGB.

Management Board

Marcel Morschbach

Carsten Samusch

DEPFA Finance N. V.	Member of the Supervisory Board

Supervisory Board

Thomas M. Kolbeck
Chairman
Vice Chairman and Deputy CEO of DEPFA BANK plc

Depfa-Bank Europe plc	Member of the Board of Directors
DEPFA Capital Japan K. K.	Member of the Board of Directors
DEPFA Investment Bank Ltd.	CEO and Chairman of the Board of Directors
Imperial Grundstücks AG	Member of the Supervisory Board

Jürgen Karcher
Deputy Chairman
Member of the Board of Directors of DEPFA BANK plc

Depfa-Bank Europe plc	Member of the Board of Directors
Cytonet GmbH	Member of the Supervisory Board

Matthias Achilles (until 29.05.2003)
DEPFA BANK plc

Gerhard Bruckermann
Chairman and CEO of DEPFA BANK plc

Depfa-Bank Europe plc	Chairman of the Board of Directors
DEPFA Capital Japan K. K.	Member of the Board of Directors
DEPFA Investment Bank Ltd.	Member of the Board of Directors

Dermot Cahillane (until 29.05.2003)

Member of the Board of Directors of DEPFA BANK plc

DBE Property Holdings Ltd.	Member of the Board of Directors
DEPFA Asset Management Ireland Ltd.	Member of the Board of Directors
DEPFA ACS Bank	Non-Executive Chairman
Depfa-Bank Europe plc	Member of the Board of Directors
DEPFA Capital Japan K. K.	Member of the Board of Directors
DEPFA Hold One Ltd.	Member of the Board of Directors
DEPFA Hold Two Ltd.	Member of the Board of Directors
DEPFA Hold Three Ltd.	Member of the Board of Directors
DEPFA Hold Four Ltd.	Member of the Board of Directors
DEPFA Investment Bank Ltd.	Member of the Board of Directors
DEPFA Investment Fund plc	Member of the Board of Directors

Fulvio Dobrich (until 29.05.2003)

Member of the Board of Directors of DEPFA BANK plc

Depfa-Bank Europe plc	Member of the Board of Directors
DEPFA Funding Trust	Member of the Board of Directors
DEPFA Funding LLC	Member of the Board of Directors
DEPFA Investment Bank Ltd.	Member of the Board of Directors
DEPFA UK Ltd.	Chairman of the Board of Directors
DLF Inc.	Member of the Board of Directors
Galileo Fund Ltd.	Member of the Board of Directors
Malibar Ltd.	Member of the Board of Directors
Segundo Ltd.	Member of the Board of Directors

Uta Maria Fredebeil (from 30.05.2003 until 31.01.2004)

DEPFA Deutsche Pfandbriefbank AG

Reinhard Grzesik

Member of the Board of Directors of DEPFA BANK plc

Depfa-Bank Europe plc	Member of the Board of Directors

Martina Heep (from 30.05.2003)

DEPFA Deutsche Pfandbriefbank AG

Willie Holohan (until 29.05.2003)
DEPFA BANK plc

Noel Kavanagh (until 29.05.2003)
DEPFA BANK plc
Paul Leatherdale (until 29.05.2003)
DEPFA BANK plc

Nicholas Pheifer (until 29.05.2003)
DEPFA BANK plc

Volker Rapp (until 29.05.2003)
DEPFA BANK plc

Noel Reynolds (until 29.05.2003)
DEPFA BANK plc

Rainer Ulm (until 29.05.2003)
DEPFA Deutsche Pfandbriefbank AG

Total remuneration of officers of DEPFA Deutsche Pfandbriefbank AG

Total remuneration of the Management Board of DEPFA Deutsche Pfandbriefbank AG amounted to € 603,610.85 in the financial year 2003. Remuneration of the Supervisory Board amounted to € 5,193.49.

Pension payments of € 821,212.17 were made to former members of the Management Board or their surviving dependants. The pension provisions for this group of persons amounted to € 11,328,170.00 at 31 December 2003.

Loans to officers of DEPFA Deutsche Pfandbriefbank AG

At the end of 2003, there was no loan outstanding to any Board member.

Declaration of Compliance pursuant to section 161 of the German Stock Corporation Act (AktG)

The Management Board and the Supervisory Board have given and provided the shareholders with a Declaration of Compliance as stipulated in section 161 of the German Stock Corporation Act (Aktiengesetz – AktG).

Average number of employees

	Female	Male	Total
Full-time employees	51	76	127
Part-time employees	8	–	8
Permanent staff	59	76	135
Temporary staff	3	2	5
Vocational trainees	–	–	–

Appropriation of profits

We shall make a proposal to the Annual General Meeting to distribute the entire net profit of € 396,000,000 to pay a dividend of € 11.00 per share (including a special dividend of € 10.50 per share) on the issued share capital comprising 36,000,000 shares.

Frankfurt, 1 March 2004

The Management Board

Marcel Morschbach **Carsten Samusch**

Auditors' Certificate

Pursuant to the final results of our audit, we have granted the following unqualified auditor's certificate on 8 March 2004:

Unqualified Auditor's Certificate

We have audited the annual financial statements, together with the bookkeeping system, and the management report of DEPFA Deutsche Pfandbriefbank AG, Frankfurt am Main, for the business year from 1 January to 31 December 2003. The maintenance of the books and records and the preparation of the annual financial statements and the management report in accordance with German commercial law are the responsibility of the Bank's Board of Managing Directors. Our responsibility is to express an opinion on the annual financial statements, including the book-keeping system, and the management report based on our audit.

We have conducted our audit of the annual financial statements in accordance with section 317 HGB and the German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer in Deutschland (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the annual financial statements in accordance with German principles of proper accounting and in the management report are detected with reasonable assurance. Knowledge of the Bank's business activities and its economic and legal environment and evaluations of possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the books and records, the annual financial statements and the management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by the Board of Managing Directors, as well as evaluating the overall presentation of the annual financial statements and the management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

"In our opinion, the annual financial statements give a true and fair view of the net assets, financial position and results of operations of the Bank in accordance with the German principles of proper accounting. On the whole, the management report provides a suitable understanding of the Bank's position and suitably presents the risks of future development."

Frankfurt am Main on 8 March 2004

PwC Deutsche Revision
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

(Bielefeld)	(p.pro. Mauß)
Wirtschaftsprüfer (German Chartered Account)	Wirtschaftsprüfer (German Chartered Account)

Report of the Supervisory Board of DEPFA Deutsche Pfandbriefbank AG, Frankfurt/Main

During the year under review, the Supervisory Board fulfilled the obligations incumbent upon it under applicable statutes and the bank's Memorandum and Articles of Association, and continually monitored the management of the bank. The Supervisory Board met on four occasions during the year under review; in addition, two resolutions were passed in writing. In the course of the meetings, the Supervisory Board was kept informed in detail, and held comprehensive discussions on current events. The Supervisory Board was kept informed by the Management Board regularly, promptly and extensively, both orally and in writing, regarding the company's business development and its overall situation, as well as on the business policies contemplated by the Management Board, on corporate planning issues as well as on significant transactions. The Supervisory Board also dealt with issues that required its approval, pursuant to applicable statutes, the company's Memorandum and Articles of Association, and the Supervisory Board's internal rules of procedure. In its meeting held on 4 December 2003, the Supervisory Board discussed the German Corporate Governance Code and related issues in detail; jointly with the Management Board, the Supervisory Board confirmed the bank's compliance with the majority of the Code's recommendations and proposals. Any non-compliance with individual recommendations or proposals laid down in the Code are particularly due to the bank's special status as a subsidiary. The Supervisory Board's deliberations also focused on the bank's strategy in the Public Finance business and the progress made regarding the transfer of the property loan portfolio.

The smooth and steady flow of information between the Supervisory Board and the Management Board was ensured by regular business discussions held by the Chairman of the Supervisory Board with the Management Board.

Following its reduction to six members, the Supervisory Board constituted an Accounts and Audit Committee only, and amended its internal rules of procedure accordingly. In accordance with the duties incumbent upon it, the Accounts and Audit Committee reviewed accounting matters and evaluated the external auditors' reports, in the course of three meetings held during the year under review. The Committee also reported to the Supervisory Board about its assessments of the statements in the external auditors' reports, in particular with respect to the future development of the Company. The Committee analysed these reports in detail, and discussed the reasonability of measurements with the external auditors.

The Executive Committee, which was in office during the first half of the year, passed one resolution in writing.

The bank's Financial Statements as at 31 December 2003, together with the accounting records and the Business Development, have been examined and certified without qualification by PwC Deutsche Revision Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Frankfurt, the external auditors appointed by the Supervisory Board. The corresponding reports prepared by the auditors were made available to all members of the Supervisory Board. The results of the audit were fully endorsed by the Supervisory Board.

The Supervisory Board has examined the Financial Statements, the Business Development, as well as the proposal of the Management Board for the appropriation of net retained profit, and discussed these in the presence of the auditors. Having completed the examination, no objections were raised by the Supervisory Board. The Supervisory Board reviewed the options exercised in connection with the Financial Statements and identified in the Notes. Within the scope of its duties of monitoring the management of the company, the Supervisory Board has not become aware of any risks that have not been appropriately accounted for in the Financial Statements. The Supervisory Board has endorsed the assessments made by the Management Board in preparing the Business Development. The Supervisory Board has approved the Financial Statements, which are thus confirmed, and has endorsed the proposal for the appropriation of net retained profit as submitted by the Management Board.

The Management Board has submitted its report on the bank's relationships with related parties, pursuant to section 312 of the German Stock Corporation Act (Aktiengesetz – "AktG"), to the Supervisory Board, together with the corresponding report prepared by the external auditors. The external auditors' opinion reads as follows:

"Having duly examined and assessed this report in accordance with professional standards, we confirm that:

1. the report is free from factual mis-representations;

2. the company did not pay any excessive consideration or compensation for disadvantages with regard to the transactions identified in the report; and

3. there are no circumstances which, with respect to the measures stated in the report, would justify an assessment that materially differs from that presented by the Management Board."

The Supervisory Board has examined the report on the company's relationships with related parties and duly noted the auditors' opinion submitted in this respect. Having completed its examination, the Supervisory Board raised no objections against the declaration made by the Management Board at the end of the report on the company's relationships with related parties.

The Annual General Meeting held on 19 June 2002 passed a resolution to reduce the number of members of the Supervisory Board from twenty-one to six; this resolution came into effect on 29 May 2003. At this date, all members of the Supervisory Board retired from their office. The Annual General Meeting on 19 June 2002 had already re-elected Messrs. Bruckermann, Grzesik, Karcher and Kolbeck as members upon said resolution coming into effect. Both the shareholders' representatives and the newly-elected employee representatives, Ms. Uta Fredebeil and Ms. Martina Heep, commenced their terms of office on 30 May 2003. The Supervisory Board re-elected Mr. Kolbeck as its Chairman, and Mr. Karcher as its Deputy Chairman.

Ms. Uta Fredebeil has moved to a different function within the DEPFA Group, and thus retired from office on 31 January 2004. Elections to appoint a new employee representative will therefore be held.

The Supervisory Board would like to thank those members who retired from the Supervisory Board for the trusting cooperation.

Frankfurt/Main, March 2004

The Supervisory Board

Thomas M. Kolbeck
(Chairman)

DEPFA Deutsche Pfandbriefbank AG

The Management Board
The Chairman of the Supervisory Board

Declaration of Conformity and Report on the German Corporate Governance Code

I.

As far back as 1999, the DEPFA Deutsche Pfandbriefbank AG has been one of the first institutions to adopt in Germany Corporate Governance Principles for the former DEPFA-Group. We revoked the bank's own Corporate Governance Principles following the passing of the German Corporate Governance Code by the Government Commission.

The bank welcomes and supports the objectives of the German Corporate Governance Code. The Management Board and Supervisory Board therefore decided to comply with the vast majority of its recommendations and proposals. Where we do not adhere individual recommendations and proposals stipulated on the Code, this is largely attributable to the special situation of DEPFA Deutsche Pfandbriefbank AG, as a Group subsidiary whose free float on the Regulated Market segment has fallen to a very low level.

II.

DEPFA Deutsche Pfandbriefbank AG complies with the **recommendations** of the German Corporate Governance Code, as published by the Government Commission on 7 November 2002 with the exceptions described in the Declaration of Compliance dated 6 December 2002 and 24 April 2003 respectively.

The German Federal Ministry of Justice published the German Corporate Governance Code, as amended on 21 May 2003, in the official section of the electronic Federal Gazette (Bundesanzeiger) on 4 July 2003. The bank complies with these recommendations, with certain exceptions set out below:

DEPFA BANK plc, parent company of the DEPFA Group, has chosen not to arrange for a deductible in the D & O Liability Insurance policy that it has procured for the DEPFA Group.
(Section 3.8 sentence 3)

The company's Management Board is comprised of two people. There is neither a Chairman nor a Speaker.
(Section 4.2.1 sentence 1)

The corporate bodies and committees of the bank's parent company are responsible for discussing and regularly reviewing the compensation system for the entire DEPFA Group.
(Section 4.2.2)

Section 4.2.3 of the Code is adhered to subject to the following proviso:
Shares in the bank's parent company, DEPFA BANK plc, are the only form of variable compensation components with long-term incentive effects and risk exposure. These shares are granted subject to a lock-up period of several years. In the interest of retaining a certain level of flexibility, retroactive adjustments of performance targets have not been explicitly excluded. No cap on such compensation was agreed upon.
(Section 4.2.3)

The re-appointment of members of the Management Board prior to twelve months before the end of the appointment period together with a simultaneous termination of the current appointment is permitted even in the absence of special circumstances.
(Section 5.1.2 sentence 5)

There is no stipulated age limit for a Member of the Management Board.
(Section 5.1.2 sentence 6)

There is no stipulated age limit for a Member of the Supervisory Board.
(Section 5.4.1 sentence 2)

There are more than two former members of the Management Board in the Supervisory Board of DEPFA Deutsche Pfandbriefbank AG. As a result of the restructuring of the group, former Members of the Management Board of the bank are now members of the Board of the parent company and also members of the Supervisory Board of the Pfandbriefbank.
(Section 5.4.1 sentence 1 and section 5.4.2)

The remuneration of each Supervisory Board member is 500 annually. A performance-related remuneration is not paid.
(Section 5.4.5 sentence 3 to 5)

DEPFA Deutsche Pfandbriefbank AG does not intend to note in the Report of the Supervisory Board if a member of the Supervisory Board took part in less than half of the meetings of the Supervisory Board in a financial year.
(Section 5.4.6)

DEPFA Deutsche Pfandbriefbank AG does not prepare consolidated financial statements. For this reason the recommendations in the Code are not applicable.

III.

DEPFA Deutsche Pfandbriefbank AG complies with the **suggestions** of the Government Commission German Corporate Governance Code with the exceptions described below.

The company will not make it possible for the shareholders (appr. 2 % freefloat) to follow the Annual General Meeting on the internet.
(Section 2.3.4.)

The shareholders' representatives in the Supervisory Board of the company are former members of the Management Board of the company, and are now members of the Management Board of the parent company. Thus the Chairman of the Audit Committee is a former member of the Management Board of the company.
(Section 5.3.2 sentence 2)

The election of the members of the Supervisory Board will not take place at different times nor for different periods.
(Section 5.4.4.)

DEPFA Deutsche Pfandbriefbank does not prepare consolidated financial statements. For this reason, the corresponding suggestions in the Code are not applicable.

Frankfurt, 4 December 2003

(Carsten Samusch)

(Marcel Morschbach)

(Thomas M. Kolbeck)

DEPFA BANK

DEPFA Deutsche Pfandbriefbank AG

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