Münchener Hypothekenbank eG

DISCLOSURE IN ACCORDANCE WITH ART. 26a OF THE GERMAN BANKING ACT (KWG) >>

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RISK REPORT

The ability to keep risks under control at all times is essential for the successful steering of MünchenerHyp's business development. For this reason risk management plays a very important role in the overall management of the Bank.

The business and risk strategy defines the parameters of the primary business activities. MünchenerHyp's entire Board of Management is responsible for this strategy, which is regularly updated, at least once a year. As part of its supervisory duties, the Supervisory Board examines the Bank's risk profile every quarter and refers, in particular, to the Lending Risk Report in its review.

The requirements for structuring a risk management system were defined by the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin) in its "Minimum Requirements for Risk Management" (MaRisk). MünchenerHyp fully observes the rules set out in these regulations. The effects of, or amendments to, the requirements arising from the updating of MaRisk are observed, analysed in a timely manner and implemented.

On one hand, the basis of risk management is the analysis and presentation of existing risks, and, on the other, the available coverage to cover them. To ensure this balance is maintained we put appropriate monitoring processes in place involving internal process-dependent supervision whereby the internal audit, as a process-independent unit, has the monitoring function.

The analysis and presentation of existing risks distinguishes between borrower failure, market price, liquidity and operational risks.

Borrower failure risk – also referred to as lending risk – is the most significant category of risk for MünchenerHyp. Borrower failure risk refers to the danger that a borrower or group of borrowers may delay, make partial repayment of or even default on repaying a loan to the lender.

The Credit Handbook presents the competences and procedural requirements of entities involved in lending, and catalogues the Bank's credit products. The Bank's business and risk strategy contains additional explanations pertaining to the sub-strategies regarding target customers and target markets, as well as definitions for measuring and controlling credit risks at the level of individual deals and of portfolios. A procedure based on the credit risk value-at-risk (Credit-VaR) is used to determine strategic lending limits. The specific contribution of every entity/borrower – called the Marginal Credit-VaR – to the Bank's total credit risk is limited. Furthermore, limits are also set for each category of transaction and property. There are also limits for each federal state to ensure adequate regional diversification.

The management of lending risks begins with the selection of the target business when drafting the terms of the loan, using risk-cost functions that are validated by a continuous back testing process. A variety of scoring procedures are used, depending on the type and risk content of the transaction. A computer-based early warning system is also used to spot risks on a timely basis.

A widely diversified property finance portfolio with an emphasis on private property finance, combined with our tried and tested credit approval procedures, ensures a manageable level of credit risk. Our lending business with the public sector and banks is primarily focused on central and regional governments, regional and local authorities, and banks with excellent creditworthiness in Western Europe.

Market price risks consist of the risk of possible declines in the value of positions or portfolios arising from changes in market parameters including interest rates or exchange rates. These risks are quantified as potential losses of present value using a present value model that differentiates between changes in interest rates, as well as risks arising from options and currency rates.

Interest rate risk refers to risk arising from changes in the market value of investments dependent on the level of interest rates, and which will react negatively due to changes in interest rates. It represents the most important component of market price risks for MünchenerHyp.

Market price risks also include (credit) spread risk. Credit Spread is the term used to describe the difference between the yield generated by a risk-less bond and an endangered bond. Spread risks take into account the danger that the difference in interest rates between a risky and a no-risk bond can change without any adjustment to creditworthiness. The reasons for altered yield premiums are varying opinions in the market regarding the creditworthiness of the issuer, the creditworthiness of the issuer actually changes, and macro-economic factors that influence creditworthiness categories.

Among other risks, options involve the following risks: volatility risk (Vega; risk that the value of a derivative instrument will change due to increasing or decreasing volatility impacting the volatility of the value of the underlying object), time risk (Theta; time risk measures how passage of time impacts the value of a derivative instrument when part of the value is determined by the time remaining until a contract expires), Rho risk (risk associated with a change in the value of the option due to a change in a risk-less rate of interest), and Gamma risk (risk of a change in the option's Delta due to a change in the price of the underlying asset).

Currency risk is the term used for risks arising from changes in the value of investments that are dependent on currency exchange rates, and which will react negatively to changes in currency exchange rates. MünchenerHyp's transactions outside Germany are hedged against currency risks.

Market price risks are controlled by determining the present value of each and every MünchenerHyp transaction on a daily basis. Transactions whose values are established by discounting cash flows are evaluated by the bank's SAP inventory system. The valuation of structured transactions – mainly interest rate capping, swaptions and termination rights that are lawful and agreed – is carried out in a dedicated system. The backbone of our risk control operations is the Delta-vector, which is calculated on a daily basis. This figure is determined by the present value of the loss incurred per range of maturities when the mid-swap curve is raised by one basis point. MünchenerHyp uses the value-at-risk figure to identify and limit market risks. Stress scenario analysis is used to measure the effect of extreme shifts in market risk factors on present value.

Because MünchenerHyp was officially established as a trading book institution (only for futures) in 2008, we use special applications to control potential risks in this area, also on an intra-day basis.

Liquidity risks include all risks arising from incomplete payment of obligations that could endanger the Bank's net income and capital. MünchenerHyp differentiates between short-term liquidity protection and short, mid-term, and long-term structural liquidity planning. The purpose of short-term liquidity protection is to ensure that the Bank is fully able to meet its required payment obligations as agreed on a daily basis (payment willingness). In meeting this obligation the Bank fully implements all of the applicable supervisory requirements regarding liquidity reserves that must be held by banks. The purpose of structural liquidity planning is to ensure short, mid-term, and long-term liquidity. A liquidity forecast is used to identify structural liquidity gaps at early stage in order to close them with appropriate refinancing measures. Callable balance sheet items are taken into account for liquidity outlook scenario analyses as required: by next redemption date, by legal termination date, or weighted with the probability of their being redeemed. Because a mortgage bank's liquidity management is closely linked to the cover requirements for Pfandbriefe, the outlooks for liquidity and cover are technically linked by IT systems.

Operational risks refer to possible losses caused by personal misconduct, weaknesses in procedural or project management, technical failure or negative outside influences. They also include legal risks and other general risks. Personal misconduct also includes unlawful actions, improper sales practices, unauthorised actions and transaction errors.

We minimise our operational risks by qualifying our employees, by using transparent procedures, by automating standard procedures, and by having fixed working instructions, comprehensive functional testing and appropriate emergency plans and preventive measures. Insurable risks are covered by insurance to the normal extent required by banks.

The professional concepts and models used to calculate abilities to bear risks were further developed in accordance with legal supervisory requirements.

USE OF FINANCE INSTRUMENTS FOR HEDGING PURPOSES

We engaged in hedging activities – interest rate and currency derivatives – in order to further reduce our risks and to hedge our business activities. We did not employ credit derivatives. At the level of individual transactions, we use asset swaps as micro-hedges. Structured fundamental transactions such as callable securities were hedged accordingly with structured asset swaps. Interest-currency swaps are used to hedge exchange rate risks arising from commitments outside Germany. At the portfolio level, the main hedging instruments we use are interest swaps. Bermudan options on interest swaps (swaptions) or interest options (caps and floors) were used as macro-hedges for embedded legal termination rights or arrangements to limit interest rates.

1. STRUCTURE OF LIABLE EQUITY CAPITAL

Münchener Hypothekenbank eG is legally operated as a registered cooperative. Participation in our cooperative takes place in the form of shares in the business. A single share costs € 70.00 with a guaranteed amount of € 255.65 per share. As of December 31, 2008, the volume of these shares was € 144.1 million, of which € 1.4 million was called.

In addition, the Bank has undisclosed holdings amounting to € 245.4 million in assets, of which € 232.9 million can be considered liable equity capital. The average interest for these undisclosed holdings is 6.17 percent; their expiration dates fall from December 31, 2009 to an unlimited term of validity.

In addition to the cooperative's premium for the guaranteed amount, the supplementary capital primarily includes lower-ranked liabilities with an average interest of 6.20 percent and expiration dates from October 25, 2010 to March 20, 2018. The profit participation certificates included in the supplementary capital have an average interest of 7.35 percent, with terms running from December 31, 2011 to December 31, 2017.

COMPONENTS OF LIABLE EQUITY CAPITAL

	December 31, 2008 in millions of euros	
Core capital		**642.3**
Members' capital holding	142.7	
Reserves	273.3	
Silent participations	232.9	
Other deducted items	-6.6	
Supplementary capital		**373.4**
Information only: Deducted items as per Art. 10 para. 6 of the KWG	0.0	
Total available capital and reserves		**1,015.7**

2. LOWER LIMIT OF EQUITY CAPITAL

The capital holdings of the remaining members saw an increase of € 16.7 million; profit participation included in the supplementary capital remained at € 21.5 million.

In total, the core capital grew by € 8.6 million, since silent participations that became callable were replaced by new contracts.

A total ratio of 8.9 percent provided the regulatory basis for existing weighted risk assets with an equity capital of 8 percent.

		Equity requirement in millions of euros	Total in millions of euros
Standard projection for credit risk			**899.1**
1.	Central governments	10.1	
2.	Regional governments and local authorities	2.5	
3.	Other public offices	3.9	
4.	Multilateral development banks	0.0	
5.	International organisations	0.0	
6.	Institutions	83.6	
7.	Covered bonds issued by credit institutions	20.8	
8.	Companies	321.6	
9.	Volume business	67.1	
10.	Positions collateralised with real estate	343.1	
11.	Investment shares	3.9	
12.	Participation	6.8	
13.	Securitisation	3.7	
14.	Other items	17.0	
15.	Overdue items	15.0	
Operational risks			**15.1**
	Projection of basic indicators	15.1	
Market risks			**0.8**
	Overall currency position	0.8	
	Risk of change in interest rate for trading book	0.0	
	Other risks	0.0	
Total equity requirement			**915.0**
Total ratio			**8.88 %**
Core capital rate			**5.65 %**

3. DERIVATIVE BORROWER FAILURE RISK ITEMS AND OFFSET ITEMS

Like all of the other borrower failure risks in the Treasury business sector, these risks are limited by choosing appropriate contracting parties; for the most part, this means banks. Limits on contracting parties and issuers are made on a case-by-case basis after a presentation and vote by the market and the transaction management departments by the entire Board of Management.

After netting, derivatives are offset against the contracting-party limit using their market values. The limit is monitored on a daily basis and reported to the management board responsible, particularly in the event that the limit is exceeded. The management board is regularly informed of the utilisation of the limit. Furthermore, a monitoring list is provided to the management board on a monthly basis, and creditworthiness and the set limits are also reviewed annually.

In creating offset agreements, MünchenerHyp orients itself according to usances common for the market. Only cash deposits in euros are accepted as collateral. To a small extent, some offset agreements have exemptions that are dependent on creditworthiness. Their effects on liquidity risk are a component that may be disregarded.

In terms of internal risk management, exposure for derivatives is taken into account using the market evaluation method (plus add-on). Netting agreements are also taken into account.

DERIVATIVES AND OFFSET ITEMS

	Derivatives in millions of euros
Total positive replacement values before offsetting and before deposits	**1,702.2**
of these, interest-related contracts	1,483.7
of these, currency-related contracts	218.5
Offset opportunities	1,336.4
Deposits	168.5
Total positive replacement values after offsetting and after deposits	**197.3**

4. GENERAL CREDIT RISK

MünchenerHyp defines nonperforming credits and/or credits in arrears as credit obligations with shortfalls or a risk of default on the basis of other objective risk factors (i.e. threatened or initiated insolvency proceedings).

This forms the basis for creating value adjustments for the mortgage credit business.

We consider the criteria used in creating in-house value adjustments for MünchenerHyp to be conservative.

Mortgage loans are reviewed to determine the need for creating or increasing a specific provision if one of the following conditions exists:

>> At least one individual value adjustment was created or retained in the previous year.
>> Foreclosures or forced administration proceedings are pending.
>> A credit obligation is in arrears by more than 45 days.
>> The client was given a warning without success and the arrears for performance exceed certain minor limits, based on coverage provided by the credit.
>> The credit obligation is in danger of default because of other objective criteria (threatened or initiated insolvency).

As a matter of principle, the portion of the credit exceeding 60 percent of the mortgage value, the interest in arrears, and the costs in arrears are to be taken into account in the value adjustments.

As a precaution for latent credit risks, the Bank creates a general value adjustment. This general value adjustment is calculated on the basis of the letter from the German Federal Ministry of Finance dated January 10, 1994.

In calculating the standard default rate, 60 percent of the average bad debt from the last ten years is compared with the average risk-carrying credit volume during this time. The general value adjustment is calculated by multiplying the default rate by the risk-carrying credit volume as of the accounting date.

5. DISCLOSURE BY TYPE OF CLAIMS

The following overviews show the total amount and/or the distribution of claims, without allowances for credit-reducing measures. Since these amounts do not differ significantly from the average amounts, the average amounts are not given.

Type of claims	Total
Item values before CRM (in millions of euros)	36,436.3
Average amount	36,436.3

ANALYSIS OF TOTAL CLAIMS BY REGION IN MILLIONS OF EUROS

	Credits collateralised with real securities (incl. commitments)	Other credits (incl. commitments)	Securities	Derivatives	Securitisation
Federal Republic of Germany	13,573.3	9,669.2	3,053.9	114.6	0.0
EEA (minus FRG), Switzerland	1,567.9	1,025.3	3,963.2	78.5	218.0
North America	2,920.8	90.5	86.2	4.2	0.0
Jersey	0.0	0.0	60.4	0.0	10.3
Total	**18,062.0**	**10,785.0**	**7,163.7**	**197.3**	**228.3**

DISTRIBUTION OF TOTAL CLAIMS BY SECTOR IN MILLIONS OF EUROS

	Credits collateralised with real securities (incl. commitments)	Other credits (incl. commitments)	Securities	Derivatives	Securitisation
Banks	108.8	4,045.4	5,350.1	194.9	0.0
Companies	7,665.9	962.4	499.5	2.4	228.3
Economically independent private persons	2,298.7	36.8	0.0	0.0	0.0
Economically dependent individuals and other private persons	7,971.5	2.9	0.0	0.0	0.0
Public budgets	0.0	5,629.0	1,314.1	0.0	0.0
Other	17.1	108.5	0.0	0.0	0.0
Total	**18,062.0**	**10,785.0**	**7,163.7**	**197.3**	**228.3**

DISTRIBUTION OF TOTAL CLAIMS (EXCLUDING DERIVATIVES) BY THEIR REMAINING TERMS OF MATURITY IN MILLIONS OF EUROS

	Credits collateralised with real securities (incl. commitments)	Other credits (incl. commitments)	Securities	Securitisation
Less than 1 year	1,228.0	2,658.3	542.9	46.4
1 to 5 years	3,306.1	2,257.6	2,925.1	181.9
5 to 10 years	2,657.4	1,788.5	2,711.6	0.0
More than 10 years	10,870.5	3,858.8	984.1	0.0
No term of maturity	0.0	221.8	0.0	0.0
Total	**18,062.0**	**10,785.0**	**7,163.7**	**228.3**

6. RISK MANAGEMENT DISCLOSURE

The following overview contains non-performing claims and credits, or those in arrears, according to significant sectors and regions that demonstrate a need for value adjustment.
Claims of more than € 50.00 that are in arrears by more than 90 days are considered to be "defaulted items."

NON-PERFORMING AND DEFAULTED CLAIMS BY SECTOR IN MILLIONS OF EUROS

	Total claim	Assets with individual value adjustments (capital)	In arrears without individual value adjustments
Banks	0.0	0.0	0.0
Companies	67.5	24.9	42.6
Economically independent private persons	59.1	12.6	46.5
Economically dependent individuals and other private persons	66.6	8.2	58.4
Public budgets	0.0	0.0	0.0
Other	0.0	0.1	0.0
Total	**193.2**	**45.7**	**147.5**

NON-PERFORMING AND DEFAULTED CLAIMS BY REGION IN MILLIONS OF EUROS

	Total claim	Assets with individual value adjustments	In arrears without individual value adjustments
Federal Republic of Germany	136.7	31.8	104.9
EEA (minus FRG), Switzerland	16.6	1.7	14.9
North America	39.9	12.2	27.7
Total	**193.2**	**45.7**	**147.5**

RISK MANAGEMENT BY SECTOR IN MILLIONS OF EUROS

	Net allocation from individual and general value adjustments (capital)	Direct amortisation	Receipts of written-off claims
Banks	0.0	0.0	0.0
Companies	9.0	0.0	0.0
Economically independent private persons	0.7	1.9	0.0
Economically dependent individuals and other private persons	1.6	3.8	0.4
Public budgets	0.0	0.0	0.0
Other	2.7	0.0	0.0
Total	**14.0**	**5.7**	**0.4**

TOTAL CREDIT BUSINESS IN MILLIONS OF EUROS

	Opening balance	Adjustment	Dissolution	Usage	Changes related to exchange rate and other factors	Closing balance
Individual value adjustments	51.7	20.8	9.9	16.1	0.0	46.5
General value adjustments	13.5	3.0	0.0	0.0	0.0	16.5
Provisions	0.0	0.0	0.0	0.0	0.0	0.0

7. STANDARD CREDIT RISK MODELS

For external evaluations of the creditworthiness of standard credit risk models for claims, as per Art. 25 of the German Solvency Regulation (SolvV), ratings are used from the following agencies: S&P, Moody's and Fitch.

The following classes of claims are taken into account: central governments, LRG, other public offices, MPs, institutions, covered bonds, companies, investment shares and securitisation.

The following overview contains the total for each item value that is assigned a fixed regulatory risk weight. For the standard credit risk model, item values are given before and after the inclusion of credit-risk reduction measures arising from securities.

	Item values in millions of euros	
Creditworthiness level	Before CRM	After CRM
0%	8,757.3	9,587.6
10%	2,605.1	2,605.1
20%	5,747.8	5,741.0
35%	10,349.8	10,349.8
50%	1,698.9	1,711.5
75%	1,285.8	1,229.0
100%	5,958.6	5,185.0
150%	33.0	27.3
Total	**36,436.3**	**36,436.3**

8. OPERATIONAL RISK

Operational risk is the danger of loss resulting from the inappropriate nature or failure of internal processes and systems, human error or external events. This definition includes legal risks.

MünchenerHyp uses the base indicator model to calculate the amount to be offset for operational risk. As of December 31, 2008, the requirement for capital and reserves was € 15.1 million.

9. INVESTMENTS IN THE ASSET LEDGER

MünchenerHyp's investments are made primarily for strategic reasons. Since the investments are kept in the asset ledger, an annual review is carried out to monitor any lasting reductions in value. If such a reduction occurs, amortisation takes place at fair value. The investments in the MünchenerHyp asset ledger are neither listed investments nor investments in a diversified portfolio. The asset value is € 73.9 million.

10. RISK OF A CHANGE IN INTEREST RATES IN THE ASSET LEDGER

The risk of a change in interest rate is controlled by determining the present value of each and every MünchenerHyp transaction on a daily basis. Transactions whose values are established by discounting cash flows are first aggregated and then evaluated jointly.

Structured transactions are generally insured by a micro-hedge, creating an equivalence in order to evaluate a synthetic floater when considering the risk of a change in interest rate. The valuation of structured transactions – mainly interest rate capping, swaptions and termination rights that are lawful and agreed – is also carried out in relation to the present value. Capital contributions do not play any role at MünchenerHyp.

MünchenerHyp uses the value-at-risk figure (VaR) to identify and limit risks arising from changes in the interest rates. Scenario analysis is used to measure the effect of extreme shifts in market risk factors on present value. As of the reporting date, December 31, 2008, the VaR for the asset ledger as a whole is € minus 11.7 million (holding period of 10 days, confidence level at 99.5 percent). The maximum present-value loss in the asset ledger, caused by an interest shock of +130/-190 BP, is € minus13.6 million. This corresponds to 1.34 percent of the liable capital and reserves.

11. MARKET PRICE RISKS IN THE ASSET LEDGER

The standard method is used to calculate for capital and reserve requirements for market price risks in the asset ledger.

MünchenerHyp's activities in the asset ledger exclusively involve futures transactions. As of December 31, 2008, there were no risk items.

No significant risks exist in foreign currencies.

There are no other risks to which they are subject, such as raw materials risks.

12. SECURITISATION

With regard to the securitisation market, MünchenerHyp is currently only participating as an investor in mortgage backed securities (MBS). MBS investments are fundamentally carried out in order to develop a portfolio that is complementary to the mortgage business. MünchenerHyp only invests in papers that have at least two external ratings from Moody's, S&P or Fitch, and that have fundamental asset values which bore up well against an internal credit analysis comparable to that of the credit business. The credit risk model currently has a weight of 20 percent in the investment ratings.

The supervisory report is carried out in accordance with the standard credit risk model and is based on the external ratings. Currently, MBS investments are playing a lesser role in terms of volume than the mortgage business.

So far, MünchenerHyp has not carried out its own securitisations, but it does have the appropriate instruments to do so.

13. CREDIT-RISK REDUCTION

13.1 NETTING

In creating offset agreements, MünchenerHyp orients itself according to usances common for the market. Only cash deposits in euros are accepted as collateral. Derivatives that are used to cover mortgage-related or public Pfandbriefe as per Art.19 of the PfandBG are subject to separate netting evaluations for each contractor and collateral.

13.2 PRINCIPLES OF COLLATERALISATION

Because of its strategic goals, MünchenerHyp primarily uses mortgage securities for completed security objects, or for security objects that are to be completed by the time the credit has been paid out in full. MünchenerHyp's principles of collateralisation are an integral part of its business and risk strategy, and are supplemented by internal organisational guidelines.

The business and risk strategy, in the sections entitled "Fundamentals of the mortgage business", "Properties" and "Securitisation", primarily provides information about the type and fundamental framework conditions of the securities that are accepted by MünchenerHyp as a Pfandbrief Bank.

13.3 TYPES OF SECURITIES

The securities that should be taken into consideration are named in Art. 155ff of the SolvV.

The securities in question are separated using detailed information about country, property type, intended usage and other characteristics. More information about this can be found in the organisation handbook/credit handbook. This also contains the internal regulations that must be observed for ordering processes and methods (i.e. forms), and for the monitoring, administration and valuation of securities.

Other securities, such as the assignment or pledging of rights and entitlements arising from building loan agreements, life insurance, assets, deposits, etc., are considered subordinate and generally serve as repayment or as a temporary stopgap until the mortgages are recorded.

In selected individual cases in the area of commercial property financing, the traditional mortgage coverage is replaced by other accepted hedging instruments, such as the pledging of business shares or the assigning of claims for repayment of expenses.

13.4 GUARANTORS AND COUNTERPARTIES FOR CREDIT DERIVATIVES

No credit derivatives were used.

13.5 RISK CONCENTRATIONS

MünchenerHyp carefully monitors all risk concentrations that it undertakes as part of its strategic course as a Pfandbrief Bank.

Size categories, property type and the regional distribution of properties all play a role in this. These risk drivers are subject to strict supervision.

As an additional risk management tool, MünchenerHyp uses a limit system to oversee risk-bearing capacity. The most important goal in overseeing risk-bearing capacity is to design profit, cost and risk structures – to ensure the Bank's independence – in such a way that they can be controlled without external help. The limit system allows limits for both credit-user units and countries to be established and controlled regularly. Furthermore, we would like to draw attention to our publication as per Art. 28 of the PfandBG, which clearly lays out the risk concentrations in our reserve fund on a quarterly basis.

14. SCOPE AND SECURITISATION THROUGH FINANCIAL SECURITIES AND GUARANTEES

The following securities are taken into account in the credit risk model:

STANDARD MODEL FOR CLASSES OF CLAIMS BEFORE SECURITISATION

		Item values of securities/the securitised items in millions of euros	
		Financial securities	Guarantees
1.	Central governments		0.0
2.	Regional governments and local authorities		0.3
3.	Other public offices		10.8
4.	Multilateral development banks		0.0
5.	International organisations		0.0
6.	Institutions		735.1
7.	Secured bonds issued by credit institutions		0.0
8.	Companies		686.6
9.	Volume business		56.6
10.	Items securitised through real estate		0.0
11.	Investment shares		0.0
12.	Derivatives		0.0
13.	Securitisation		0.0
14.	Other items		0.0
15.	Overdue items		0.6

Im FinanzVerbund der
Volksbanken Raiffeisenbanken

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