



IKB Deutsche Industriebank AG
Financial Statements and
Management Report 2006/2007

IKB. Committed to enterprise.

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1. Economic Environment

IKB benefited from benign macro-economic conditions during the 2006/07 financial year: this applies both to economic development in our core market, Germany, and to economic development in those countries in which IKB is involved through its structured finance business.

In Germany, GDP rose by 2.8% in 2006. Furthermore, investment in plant and equipment, an even more important indicator for IKB's domestic lending business, rose by a considerable 7.3% year-on-year during the reporting period. The main factor driving this increase was exports, which grew by 12.5%.

Due to the high volume of incoming orders from abroad, companies, as well as stepping up their investment in plant and equipment, were also motivated to expand capacity last year. And given that medium-sized companies continue to have the majority of their production sites in Germany, they duly borrowed to finance their investments and construction projects; alternatively, investments were financed via leasing or mezzanine capital solutions.

The real estate market also clearly picked up in Germany during the past financial year. Following years of stagnation, if not recession, there was a clear upward trend in demand for real estate in 2006 buoyed by the general upturn in the economy as a whole.

The economic framework also remained positive in the international markets we cover — mainly in acquisition and project finance in Western Europe. We were able to observe a high level of demand for our finance products on all of the markets due to the good state of economic development.

The market environment in acquisition finance continued to be exceptionally dynamic. Both European investors and US private equity firms have been very active worldwide. According to information from Standard & Poor's, the global volume of acquisition finance in 2006 increased to € 490 billion. Greater growth is not just in evidence among the large-scale transactions but also among the smaller transactions involving an EBITDA of between € 20 million and € 50 million in particular.

The market for international project finance is developing very fast, with growth rates reaching high double figures. According to data provided by pfi (Project Finance International), global lending for project finance has more than tripled over the last three years, and is estimated at USD 180 billion for the year 2006.

2. Financial condition and results of operations

IKB is the leading German specialist bank for long-term corporate financing. Besides our core target group of German mid-sized enterprises (the German 'Mittelstand'), our business activities are focused on larger-sized international companies, professional real estate investors and commercial real estate developers, plus other domestic and international project partners.

In terms of the granting of long-term investment loans to manufacturing companies, the bank is the market leader, with a market share of 13.5% to its name. IKB's main rivals in Germany are the major universal banks, as well as selected larger institutions from the public banking sector.

IKB's strength is to be found in its specialisation, in its skill and expertise in this area of specialisation, and in the high level of trust placed in the bank by its clients. The positive way in which income has developed over the last few years can be attributed not least to these factors.

In addition, IKB made the transition from a lender into a loan portfolio manager many years ago, and is now one of Germany's leading institutions in the area of securitisation. This presents the opportunity for the comprehensive placement of credit risks, whilst also opening up options for investing in international loan portfolios. In turn, this increases the sector-based and regional diversification of the bank's credit exposure and generates a significant rise in income.

Income

Net interest income during the period under review totalled € 509 million (2005/06: € 515 million). More than three-quarters of this amount can be at-

tributed to activities by our divisions, whilst just under one quarter was generated from the investment of the bank's capital. The slight decline compared to the previous financial year was due to the fact that the figure for 2005/06 included a non-recurring profit distribution by a real estate subsidiary.

Net commission income totalled € 115 million (€ 125 million). Half of this income resulted from structuring fees and commission earned in the Corporate Clients, Real Estate Clients and Structured Finance segments, with the other half being contributed by the Securitisation segment from advisory fees relating to the Rhineland Funding conduit. The net result from financial operations was negative, at – € 10.1 million (€ 0.5 million).

Administrative expenses rose by 14.6%, to € 260 million. The increase in personnel expenses was 12.1%, to € 146 million (mainly due to the increase in staff levels, up 61 to a full-time equivalent headcount of 1156), while other administrative expenses were € 114 million (€ 96 million). Cost increases were predominantly attributable to investments to expand IKB's international business. We have also, by further investing in infrastructure, increased the number of employees working in the corporate centres (such as controlling and risk management). This investment involved a high level of IT input and, in some cases, was associated with high consultancy costs.

Net other operating income and expenses was down by 32.5%, to € 161 million, in line with expectations. The net figure comprises the intra-group transfer of the shareholding in IKB International to IKB Lux Beteiligung S.a.r.l. This followed the spin-off to shareholdings in subsidiaries into a separate holding company, which we had initiated in the previous financial year, in order to realise tax-exempt income in the interest of our shareholders.

The risk provisioning balance was reduced by 44.3%, to € 270 million, comprising € 215 million in net loan loss provisions (€ 541 million), whilst the result from securities held as liquidity reserve was – € 55 million (€ 57 million).

All factors included, the net result totalled € 245 million (€ 168 million). Taking into account € 24 million in taxes (€ 19 million), profit after taxes was up 48.3%, to € 221 million.

We used this earnings growth to transfer € 75 million to the fund for general banking risks in accordance with section 340g of the German Commercial Code (Handelsgesetzbuch – “HGB”). The remaining net income for the year was € 146 million. A further € 71 million was attributed to reserves. Net profit for the period thus amounted to € 75 million. The Board of Managing Directors and the Supervisory Board will propose to the General Meeting that the profit be used to distribute an unchanged dividend of 85 cent per notional no-par value share.

Balance sheet

Total assets grew by 17.9%, or € 8.2 billion, to € 54.3 billion. IKB's total loan volume as at the reporting date of 31 March 2007 was € 34.1 billion, which represents a year-on-year increase of 7.2% – maintaining the growth trend of recent years. The total loan volume as at the reporting date comprises loans and advances to customers, loans and advances to banks, securitised lending in the form of bonds, and guarantees.

Loans and advances to banks rose to € 12.6 billion (31 March 2006: € 10.0 billion), whilst loans and advances to customers increased to € 25.0 billion (€ 22.2 billion). Bonds, notes and other fixed-income securities totalled € 14.5 billion (€ 12.2 billion) as at the reporting date. This figure includes € 5.0 billion (€ 4.5 billion) in securitised lending. Investments and interests in affiliated companies increased to € 1.0 billion (€ 0.9 billion), whilst other assets amounted to € 1.2 billion (€ 0.8 billion).

Refinancing

We mainly financed the expansion of our business activities by issuing bonds, so that securitised liabilities duly rose by € 6.3 billion to € 27.8 billion. The issue volume was € 15.6 billion, compared with redemptions of € 9.3 billion. We reduced our liabilities to banks by € 0.4 billion to € 16.2 billion. Liabilities payable on demand rose by € 0.9 billion, to € 2.5 billion, whilst liabilities with agreed term or period of notices amounted to € 13.7 billion (€ 15.1 billion). Liabilities to customers thus increased by € 1.9 billion to € 4.7 billion.

Subordinated liabilities were up by € 0.2 billion, to € 1.9 billion. In contrast, there was a drop in profit-participation certificates as part of scheduled redemptions, down by € 42 million to € 0.6 billion. Silent partnership contributions of € 0.4 billion were at the previous financial year's level. Following a € 75 million transfer, the fund for general banking risks grew to € 155 million.

Shareholders' equity totalled € 1.8 billion, up € 71 million following the transfer to reserves. Regulatory capital in accordance with section 10 of the German Banking Act (KWG) amounted to € 3.3 billion as at the reporting date.

3. Report on material events after the reporting date

There have been no material events subsequent to the balance sheet date that need to be disclosed in the financial statements. Risks from credit exposures affecting the financial year 2006/07 and known as at the reporting date have been taken into account in the provisions for possible loan losses.

4. Risk Report

Risk management – objectives and strategies

The willingness to assume risk in a targeted manner is a prerequisite to being able to exploit profit opportunities. IKB's risk culture is characterised by a conservative approach to the risks inherent in banking, with the bank's ability to carry and sustain risk providing a solid foundation. This culture is reflected in IKB's business and risk strategies, as well as in the risk ceilings and limits derived on that basis, and in the organisational aspects of handling risk, in terms of responsibilities and internal processes.

The bank's risk-bearing capacity is measured on the basis of our profitability, our solid capital base and our reputation on the capital market, as expressed not least by IKB's current Aa3 rating from Moody's.

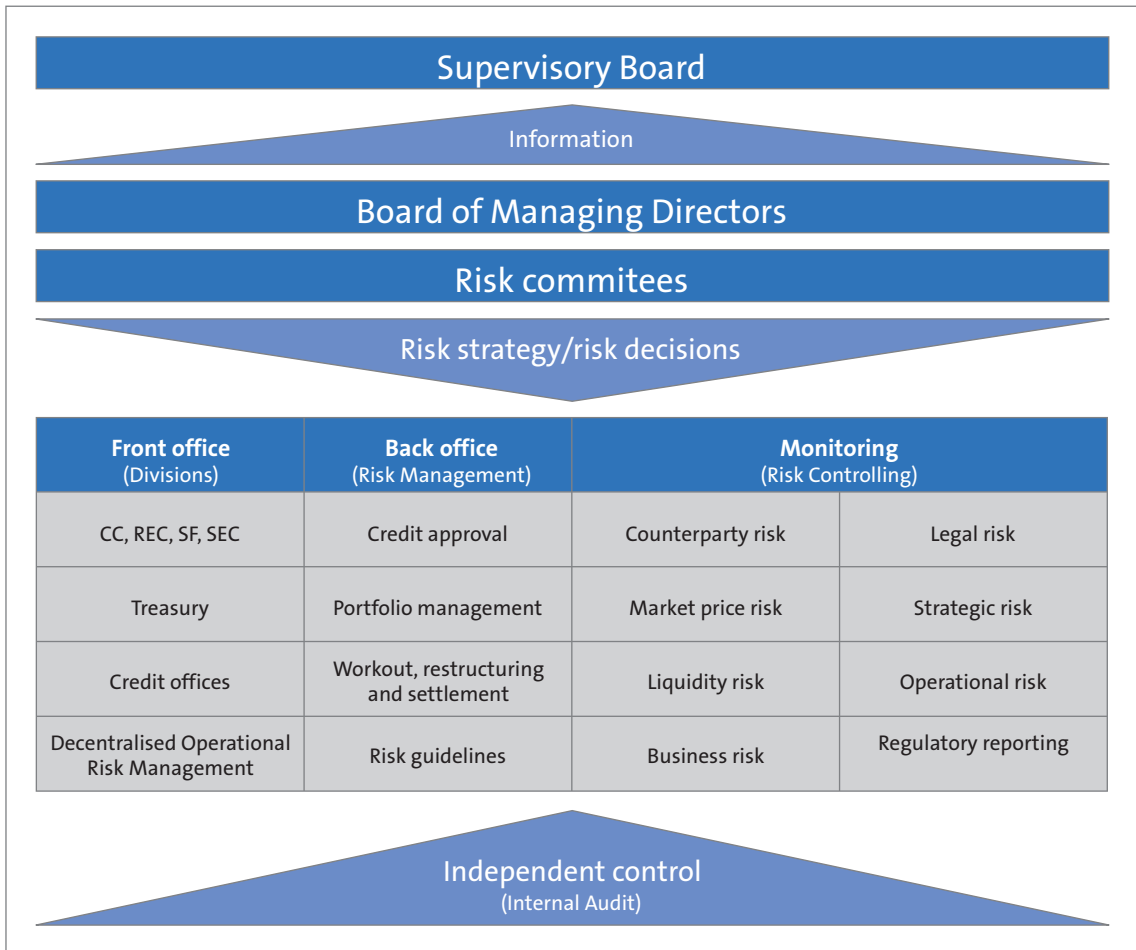
To ensure a balanced relationship between risk and return, risk management and risk control are important core elements of our approach to business. Besides being able to recognise all risks incurred within the scope of our business activities at an early stage, our objective is also to contain such risks in a targeted manner, using an effective risk management toolbox and in line with the bank's risk-bearing capacity. The successful monitoring and management of risk is thus a prerequisite for the profitable growth – and hence, long-term success – of IKB.

Risk management principles and organisation

Principles. Risk management within the IKB Group and the manner in which risks are controlled are based on five principles:

1. The Board of Managing Directors is responsible for all risks that are assumed on a Group-wide basis, as well as for actively managing such risks on an ongoing basis.
2. Our approach is geared around our risk-bearing capacity; in other words, the level of risk that we can assume on the basis of our profitability and financial strength.
3. An independent control process guarantees that the risks associated with our activities are reviewed and monitored objectively, not just at the level of individual exposures, but also at overall portfolio level across all risk types and across all of the divisions.
4. A timely, comprehensive, and objective approach to risk disclosure – to the Board of Managing Directors, the Supervisory Board, the shareholders, the supervisory authorities and the rating agencies – is the cornerstone of our risk control strategy.
5. Through constant market observation, and close contacts with clients, business partners in the capital markets, institutions and associations, we are in a good position to recognise changes in our environment at an early stage, and to swiftly take action as required.

Risk organisation



Risk management organisation. The risk management system, which is designed in terms of function and organisation to meet IKB's legal requirements and business model, forms the basis for the proper operation and effectiveness of the overall risk management process. Individual tasks and areas of responsibility are described and documented in risk management rules and regulations, which define the principles of IKB's risk management system – taking due account of all statutory and internal requirements in conjunction with credit risk strategy – and provides specific organisational instructions.

Supervisory Board. The Supervisory Board is regularly briefed in detail on the risk situation and on risk management by the Board of Managing Directors at Supervisory Board meetings.

Board of Managing Directors. The Board of Managing Directors is responsible for IKB's risk management. It sets risk policy in the form of a clearly defined business and risk strategy, including the types of business conducted, defines the reasonable total risk within the scope of the bank's overall risk-bearing capacity and incorporates risk control as an essential component into its processes and planning.

Within the Board of Managing Directors, the Chief Risk Officer is responsible for the management of counterparty risk, legal risk, and compliance risk. The Chief Financial Officer is responsible for monitoring market price risk, liquidity and funding risks, and operational risks.

The entire Board of Managing Directors is responsible for dealing with risks related to the bank's business strategy, and with reputational risks.

Risk committees. Specific committees (Interest Rate Risk Policy Committee, Credit Committee, Limit Committee) manage and monitor decisions that are relevant to risk, supporting the Board of Managing Directors in its risk management operations and decision-making. These committees are responsible both for basic policy issues as well as for decision-making on specific individual transactions, based on the parameters stipulated by the Board of Managing Directors.

The committees are composed of members of the Board of Managing Directors and representatives from the operative business divisions and the responsible corporate centres.

Risk Management. The Risk Management unit is responsible for developing, implementing and complying with Group-wide standards for lending business and for credit portfolio management, as well as for the rating systems used to determine counterparty risk. Alongside the formulation of guidelines for credit analysis and credit decision-making, one of the main tasks of the Risk Management unit lies in the overall credit approval process, with the unit exercising its own credit authority. In other words, the Risk Management unit is the back-office unit for the purposes of the Minimum Requirements for Risk Management ("MaRisk") published by BaFin.

Special management units operate within Risk Management to deal with higher-risk exposures and workout, restructuring and settlement cases, which require specialist know-how and intensive handling. By implementing acceptable solutions at an early stage, this special management facility aims in the first instance to preserve the company as a going concern; or, should these efforts fail, to substantially reduce the financial fallout.

Credit/transaction management teams (which are classified as front-office units) provide support to Risk Management in monitoring and managing credit risk within the relevant business divisions. With the exception of minor decisions permitted under MaRisk, credit approvals are made by the back-office unit, as long as they are outside the remit of the Board of Managing Directors.

Risk Controlling. Risk Controlling, a unit that is independent from front office units and Risk Management, is responsible for monitoring the risk policy specified by the Board of Managing Directors, for internal and external risk reporting, capital planning and risk capital allocation, and for impartial monitoring of credit, market, liquidity and business risks. The unit is subdivided into Credit Risk Controlling, Market Price Risk Controlling, Results Controlling, and Capital Controlling units.

In addition to continuous, near real-time monitoring, analysis and reporting of credit risks on a portfolio level, Credit Risk Controlling is responsible for the ongoing development and validation of models used for quantifying risks and assessing credit quality. Further key issues involve aggregating all types of risk into an overall Group risk position, which is then used as an integral part of simulating and monitoring the bank's risk-bearing capacity.

The core functions of Market Price Risk Controlling comprise the daily calculation, analysis and reporting of market price risks, monitoring the limits set by the Board of Managing Directors, as well as checking the models and procedures used to value financial instruments. Market Price Risk Controlling is also responsible for the continuous monitoring of, and reporting on, asset/liability management throughout the bank.

Results Controlling ensures the ongoing monitoring of IKB's results of operations, and related reporting, by way of monthly performance analyses of existing and new business. Detailed financial reports are prepared to identify and analyse any divergence in income and assets from target values.

Capital Controlling is responsible for an integrated capital planning process for the IKB Group, taking into account regulatory and economic aspects, and monitoring the allocation of risk capital to individual operating units subject to a risk/return perspective.

Operational Risk Management. Operational Risk Management is responsible for the monitoring of operational risk. This includes identifying, analysing, and reporting on operational risk, plus responsibility for defining the methodology used throughout the IKB Group to measure operational risk. The central Operational Risk Management unit is supported by a network of decentralised Operational Risk Managers in the business divisions and corporate centres.

Internal Audit. Group Audit is organised as an independent part of the risk management system and internal control process in accordance with the Minimum Requirements for Risk Management (MaRisk). It operates on behalf of the entire Board of Managing Directors, with no duty to comply with instructions, as an independent body that reports directly to the Board of Managing Directors. Process-based audits are, as a general rule, used to examine all activities and processes across the Group. The focus is placed on particularly risk-sensitive qualitative processes, quantitative methods and the IT processes used in the lending and trading businesses. Group Audit is

also responsible for conducting credit and business checks on individual exposures. Internal Audit submits an annual report to the Board of Managing Directors, in addition to individual audit reports comprising material and serious audit findings and their current status. In turn, the member of the Board of Managing Directors responsible for audit regularly briefs the Supervisory Board on current results and developments.

Risk management process

Risk-bearing capacity. IKB's risk management process is based on the bank's risk-bearing capacity; the use of our capital resources is assessed in terms of achieving an adequate risk/return ratio. In the context of this management process, we not only ensure that regulatory capital exceeds the minimum levels defined by the authorities at all times, but also ascertain a sufficient level of economic capital required for the individual types of risk, covering even extreme 'unanticipated'.

Regulatory capital. The regulatory capital commitment of the individual business divisions is calculated on the basis of the tied-up tier 1 and tier 2 capital in accordance with current regulatory provisions. We focus our management of regulatory capital for the bank as a whole on two key indicators:

- the tier 1 ratio (tier 1 capital to risk-weighted assets);
- the total capital ratio (total capital/"own funds" to risk-weighted assets).

To ensure adequate regulatory capital resources, actual ratios are regularly checked against target ratios projected on the basis of the bank's long-term planning, with future developments being forecast. The Board of Managing Directors decides upon measures to be taken in the event of any deviations.

Economic capital. We regularly calculate economic capital for the purpose of covering extreme and unanticipated risks. The relevant calculations take into account risk diversification and portfolio effects, using statistical simulations and stress scenario analyses. In keeping with the expectations of the capital market with regard to our rating, our calculations are based on a confidence level of 99.96%. This means that the level of simulated unanticipated risk may only exceed our limit in 0.04% of all cases. Our risk provisioning budget, plus the annual additions to risk provisions, already cover "anticipated risk" incurred in our business operations.

We calculate the economic capital required to cover credit risk, market price risks (which IKB is exposed to largely as a result of interest rate risks from the banking book), operational risk and general business risk. We use the bank's internal models to quantify credit risk, market price risk, and general business risk, whereas operational risk is quantified using a simplified procedure stipulated by the supervisory authority. Liquidity and strategic risks are also monitored and checked continuously. They are not managed through risk capital, but by means of other management tools (as detailed below).

Economic capital tied up by the individual types of risk is determined within the scope of an annual planning process, and in the course of the ongoing monitoring and reporting to the Board of Managing Directors and the Supervisory Board; it is taken into account in the bank's management and reporting tools, applying the limits approved by the Board of Managing Directors.

The limits imposed on individual risk types, portfolios and partial portfolios, clustering developments, and individual exposures, form a key component of our quantitative controls and reporting system. In this way, we ensure that the risks from ongoing business remain within the limits defined by the Board of Managing Directors, even in stress situations. We are continuously working to enhance this form of monitoring by refining the measurement methodology used.

Analysing the bank's risk-bearing capacity. Our analysis of risk-bearing capacity compares the economic risk capital required with the aggregate risk cover available. The aggregate risk cover comprises mainly equity components, unrealised measurement results, and the operating result before income taxes. It thus forms the basis for the limitations applied to the individual types of risk, which are designed to ensure that IKB can withstand even extreme, 'unexpected' risk. Using extreme stress tests incorporating worst-case parameters, we ensure that the aggregate risk cover available is sufficient to cover even the most extreme levels of unanticipated risk.

Types of risk. All of the risks resulting from our business activities are subject to an independent control process.

- **Counterparty default risk** is the risk of a loss being incurred due to the insolvency of a debtor or counterparty. It also comprises **country risk**, defined as the risk of loss incurred due to a deterioration of the economic environment, political or social unrest, nationalisation or expropriation of assets, failure or refusal by a country to recognise foreign debt, foreign exchange controls, or the devaluation or complete loss of value of a currency.

- **Market price risk** is the risk associated with negative economic changes in market values caused by changes in market parameters, with a corresponding effect on performance. IKB's exposure to market price risks is essentially related to the interest rate risk exposure from the banking book.
- The **liquidity and refinancing risk** is the risk that IKB would cease to be able to fulfil its payment obligations on time, or to be able to acquire funding on the market at reasonable conditions.
- **Operational risk** is understood by IKB as the risk of losses due to the inadequacy or failure of internal processes, individuals or systems or as a result of external incidents.
- We define **business risk** (also encompassing risk associated with **developments in the business environment and sector risk**) as unexpected negative changes in profitability as a result of a deteriorating market environment, changes in the bank's competitive position or client behaviour, or of changes to the legal framework.
- **Reputational risk** is the risk of direct or indirect losses being incurred due to events that result in a loss of confidence in the bank, irrespective of whether this loss of confidence occurs on the part of the public, rating agencies, the supervisory authorities, investors, business partners or employees. Generally speaking, risk to reputation arises from one of the above sources of risk and adds to the overall effect.
- **Strategic risk** is the risk of negative effects on performance due to investment decisions based on existing or future overall business policy. Like reputational risk, this is not a directly quantifiable type of risk, and ultimately cannot be considered in isolation, but must be dealt with and controlled in conjunction with the above risk types.

Counterparty and credit risk

Definition. A distinction is made in terms of counterparty default risk between credit risk and counterparty risk. The concept of credit risk defines the risk that a loan cannot be repaid at all, or can only be partially repaid (in line with contractual agreement), in the case of default by a contractual partner. IKB is exposed to counterparty risk as a consequence of potential replacement risks related to interest rate and currency derivatives, which may be incurred in the event of counterparty default. Issuer risk and settlement risk are further variations of counterparty risk. Issuer risk is defined as potential loss resulting from the default of the issuer of securities held by IKB, whilst the concept of settlement risk refers to the risk of non-performance of a counterparty within the framework of a settlement process, after IKB has already made payment or delivery. Given the central importance of lending business as one of the bank's core processes, credit risk is a priority.

Credit risk strategy. IKB's credit risk strategy is based on the bank's corporate culture in handling credit risk, its risk-bearing capacity, risk policy and the risk management process. The credit risk strategy defines the framework for the medium-term direction of IKB's credit business. Particular attention is paid to growth in various target groups and products, with a strong focus on containing risk concentration and risk clusters, and on portfolio management. The objectives stipulated by the credit risk strategy are implemented in the bank's operative business through guidelines for managing individual credit exposures and portfolio risks. These guidelines are applied in each individual credit decision; they ensure the quality of new business – and hence, compliance with the credit risk strategy – through minimum parameters for qualitative and quantitative standards, and continuous monitoring of compliance with these parameters.

Our main tools for managing and monitoring counterparty risks are the following:

- risk policy provisions for acquiring new business, as defined in the “Guidelines on Managing Individual Credit Risks”;
- credit approvals and credit monitoring for individual transactions;
- portfolio monitoring, management and limitation on the basis of “Guidelines on Managing Portfolio Risk” as well as extensive portfolio analyses; and
- regular checks conducted by Internal Audit.

Risk policy. The starting point for risk management in the lending business is a joint planning process involving the Board of Managing Directors and the business divisions, supported by Corporate Development, Risk Management, and Finance, Controlling and Taxation. Risk is explicitly included in the planning process on the basis of risk-bearing capacity and growth and result objectives. The derived targets, as well as encompassing volume of new business, interest and commission income and material and personnel costs, also cover risk and capital costs. The structural credit quality and securitisation structure is also agreed during the planning of risk costs with a sustained effect on new business, management of the portfolio, and portfolio structure. Another key element is imposing limitations by type of business and product or by sector, as well as regarding exposure to international borrowers, to individual counterparties, or to corporate groups.

Credit approval process and monitoring of individual exposures. Credit analysis by the independent Risk Management unit is vitally important to the lending process, not least because it separates loan approval from business development (in other words, front-office from back-office functions).

With the exception of minor decisions concerning existing exposures, the credit approval process is conducted either centrally, by duly authorised persons in the Risk Management unit, or by the Board of Managing Directors, within the scope of the regulation of approval powers; the required approval depends on the size of the Group’s existing credit exposure, the borrower’s credit quality, the collateral provided, the term, and not least, the existing and planned structure of the portfolio. The principle of dual control is always observed. Legally-trained staff members from the Legal department, who are not directly involved in the market, carry out the subsequent loan disbursement and contract implementation.

Every credit decision is based on a detailed credit analysis in which all of the information of relevance to the decision is collated, evaluated and documented in the form of a clear decision proposal.

In this respect, we use a further tool that we have developed ourselves – known as the Portfolio Adviser – with which to manage decision processes regarding our portfolio at the level of individual transactions and commitments. This tool calculates various different risk factors on the basis of the client’s credit quality, transaction-specific features such as term and collateral, and portfolio-related indicators. This means that even at the stage of acquiring new business we can generate key momentum in terms of portfolio management. At the same time, we strongly emphasise the mobility of loans – defined as their eligibility for placement with third parties. This reflects the importance of synthetic securitisation for our portfolio management process.

Existing credit exposures are treated similarly to new credit approvals; the associated processes and approval procedures are applied every twelve months and decisions are reviewed. In addition, individual sub-portfolios (including major individual exposures) are analysed within the scope of annual reviews conducted between Risk Management and the divisions, and strategies on handling exposures derived on that basis.

Rating process and procedures. Assessing the credit quality of our clients and investments is a key element of the entire credit process. We make strict demands in terms of credit quality and require substantial collateralisation of our exposure when selecting our business partners and investments. This requirement is implemented via corresponding lending guidelines.

IKB employs a computerised rating system for assessing credit quality, designed specifically for the corresponding client segment or specific type of financing solution. The corresponding model-specific risk parameters are grouped in each procedure and each customer is assigned a rating class within an 11-level internal scale ranging from 1 (best rating) in increments of 0.5 to 6.0. This rating scale is calibrated by the probability of default, on the basis of a statistical analysis of historical defaults. As well as providing an instrument with which to assess credit quality, our rating procedures therefore also enable us to calculate risk-based and risk-differentiated margins and provide an invaluable basis for determining economic capital for credit risk.

In the *Corporate Clients* division, we use our concept of rating medium-sized enterprises – known as “IKB Mittelstandsrating” – which has been subject to ongoing further development over the last few years. This concept is also applied, where appropriate, in other businesses. A mathematical and statistical process is used to assess the borrower’s economic situation on the basis of financial indicators. The specific characteristics of the individual client and sector

are then examined on the basis of an expert system, which takes into account the size of the company and exposure involved, incorporating qualitative information to an increasing extent. By combining the results from the two procedures, we ensure a very high degree of rating quality and precision.

A special rating procedure takes into account the particular features of *project finance* and *special finance*, emphasising the extent and sustainability of available cash flow to meet the interest and principal payments arising during the lifetime of the project. We employ quantitative models to assess each exposure using various scenarios and simulations; the results are complemented by qualitative criteria on sponsors, operators, sales and procurement markets, and the specifications of the transaction concerned. A special rating procedure developed on the basis of the “IKB Mittelstandsrating” concept is used for acquisition financings.

The real estate ratings that we use as part of our commercial *Real Estate Financing* business assess credit quality by means of a multitude of specific property data and investor information. This not only includes detailed information on each property’s location and condition, but also explicit details about the tenant structure and quality, individual credit quality assessment of the investors in relation to assets and liquidity, and the property’s ability to cover interest and principal payments from cash flows generated.

A *country rating* is determined using economic performance indicators, plus the liquidity situation, in conjunction with a qualitative assessment of the country’s political and social situation. We obtain our information from international databases, country reports and other external sources.

Sector risk is incorporated using a rating process which IKB carries out on a regular basis for around 370 different industry sectors. The rating process is based on an econometric model incorporating domestic and international macro-economic trends as well as cross-sectoral relationships. We leverage the vast knowledge of sector experts in our Economics department.

Validation tests carried out using available data show that our internal rating procedures classify the risks appropriately. A high degree of precision leads to better risk selection and thereby supports our portfolio management.

Quantifying credit risk. To quantify credit risk, we have developed a proprietary model that takes into account information on each individual borrower (loan amount, collateralisation, term, sector affiliation, group affiliation, rating), in addition to a variety of statistical variables, such as probabilities of default, collateral realisation proceeds and sector correlations. These variables are derived from the bank's own data history, or based on external reference data. The distribution of losses on the loan portfolio – the focus of the observation – is subdivided into 'expected losses' and 'unexpected losses'.

'Expected loss' is a statistically anticipated value (which is also referred to as 'standard risk costs'), that is covered by the calculated risk premium.

In contrast, 'unexpected loss' (also known as 'credit value at risk') reflects the potential risk that may exceed the expected loss. This risk is covered by the economic risk capital allocated within the scope of the bank's risk-bearing capacity.

Quality assurance. Ratings and mathematical models are increasingly being integrated into the entire credit process. Given their resulting impact on the management of the bank as a whole, quality assurance has become crucially important. Regular validation and benchmarking processes are applied to the systems for assessing credit ratings, as well as to the approval, monitoring and management processes within the lending business. The ensuing results not only serve as the basis for developing the credit processes, taking the aforementioned regulatory requirements (MaRisk and Basel II) into consideration. We also use them for optimisation according to our own requirements.

Portfolio monitoring and management. In terms of portfolio monitoring, the focus is on the credit portfolio as a whole. Our task is to monitor the portfolio such that the concentration of risk in individual exposures, countries, target groups and products is duly limited. Consequently, we employ a set of management tools which regularly monitor all credit risks, taking into consideration any association within corporate groups. The portfolio is oriented by country, business division, rating class and industry.

The structural credit quality of our loan portfolio has gradually improved over recent years, thanks to the consistent implementation of the guidelines formulated in our risk policy when acquiring new business, the use of loan securitisation to transfer credit risk, and the economic recovery staged by the German Mittelstand in the recent past.

IKB's Economics department is responsible for the timely monitoring of sectors and market changes. Our experts' extensive sector know-how is a core element of cluster analyses carried out as part of the bank's risk management process. The purpose of such analyses – which incorporate our expectations – is to identify and contain sector risks as early as possible.

Regular portfolio monitoring by the Limit Committee (comprising representatives of Risk Management, the Economics department, Credit Risk Controlling, and the business divisions) is the starting point for determining concentration limits, which are oriented on the target figures set by our business strategy, as well as by risk policy guidelines. Limits are defined in terms of volume and risk contribution, taking into account the existing structure, historical performance, and risk quantification of the loan portfolio and their changes over time, as well as sector-specific risks and the impact of economic trends identified by the economists. Additional maximum thresholds for individual loans or loans to corporate groups are defined to prevent concentration risk.

In combination with risk placements carried out by IKB, this approach ascertains a high degree of diversification and granularity in the loan portfolio. Accordingly, the potential impact of recessions in individual sectors is kept to a minimum.

Country risk limits apply to the total exposure in all countries. This means that transactions involving country risk may only be approved if there is still scope within the country risk limit, even in cases where the clients concerned have a good or very good

credit standing. The limits are stipulated by the Limit Committee and apply to all transactions in the country concerned. Utilisation of these limits is monitored in near-real time, using a reporting system which provides information on a regular basis.

In addition to its lending business, IKB invests in securitised international loan portfolios, in order to further enhance the diversification of its loan assets and the profitability of its portfolio. These investments are made in broadly diversified portfolios and cover a wide variety of asset classes, almost exclusively with a rating in the upper investment grade range.

[Collateral, risks placed with third parties, and securitisation.](#) In terms of IKB's traditional long-term lending business, classic forms of collateral (real property liens, transfer of ownership by way of security and guarantees) continue to be very important. Irrespective of whether a lending decision is imminent, the valuation of collateral provided in each case is continuously reviewed and updated.

This form of risk mitigation is supported by the portfolio-oriented placement of risks from individual exposures to third parties, by syndicating loans to other banks, or by placing risk through securitisation.

IKB is one of the leading issuers in securitisations of loans and advances to small and medium-sized enterprises. This is complemented by the securitisation of international structured finance and real estate finance exposures. We make use of such placements for the purposes of targeted portfolio management. This enables us to avoid any clustering of risks, and to optimise our use of regulatory capital.

Such placements of domestic and foreign credit exposures in the capital market are conducted synthetically: whilst remaining in our balance sheet and continuing to be looked after by us in terms of the lending side, the counterparty risk exposure has been neutralised.

Identification and specific handling of exposures in danger of default. All exposures subject to credit risk are monitored on a permanent basis, providing the bank with an up-to-date assessment of borrower credit quality and, consequently, the risk structure of the lending portfolio. We employ a computerised system to facilitate early risk recognition, in order to implement suitable measures even earlier, on the basis of risk indicators identified using sample patterns.

Specialist management units are responsible for managing exposures in danger of default. By implementing acceptable solutions at an early stage, this special management facility aims to preserve the company's ability to continue trading; or – should these efforts fail – substantially reduce the financial fallout.

Particular focus is placed on *non-performing loans*. We define a loan as being *non-performing* if insolvency proceedings have been instigated, if interest or principal payments are more than 90 consecutive days in arrears, or in the event of other clear signs that the debtor is unable to meet the contractual obligations and in the absence of any objective indications of subsequent payments or the realisation of collateral. In such cases account is taken of the liquidation value of the available collateral.

Risk provisioning. The corresponding value adjustments – which are determined by Risk Management – take into account both expected future cash flow and the value of collateral available. Each case is assessed individually by Risk Management, which in turn determines the workout strategy and estimates the incoming payments achievable in future.

We also analyse receivables carried on our books to check for the existence of any deferred impairment. For portfolios with similar credit risk characteristics we engage in lump-sum risk provisioning if there are objective indications that loans may be at risk of being non-performing but cannot yet be individually calculated.

The consistent reduction of problem exposures, together with the continuing economic recovery have also brought about significant relief in terms of risk during the period under review: the risk provisioning balance was reduced by 44%, to € 270 million.

Liquidity risk and market price risk

Liquidity risk. The bank distinguishes between two types of liquidity risk: the risk that current or future payment obligations cannot be met on time, or in full; and the risk that required funding can only be obtained at unfavourable market conditions.

Regular liquidity analyses and cash flow forecasts – as part of professional liquidity management – ensure sufficient liquidity is available at all times. Furthermore, to ensure adequate liquidity over and above that required for our business operations, we hold negotiable, variable-rate securities that can be sold or used as collateral at any time, thus eliminating short-term liquidity risks. The regulatory requirements (as defined by the liquidity ratio according to the German Banking Act – Grundsatz II) form the external framework for liquidity management. To minimise any maturity mismatch exposure, our assets are refinanced mainly with matched-maturity funds.

The long-term refinancing requirement is calculated and regularly updated in a process coordinated between the Treasury and the Finance, Controlling and Taxation department, on the basis of how we expect business to develop. The funding requirements derived from this process are met in such a way that ensures a balanced maturity structure is maintained between our assets and liabilities. Given our broad refinancing basis and placement strength on the capital market, we can be confident of being able to procure adequate refinancing for all lending operations in terms of the required maturity structure and conditions – even in difficult market phases.

Market price risk. Market price risks comprise interest rate, volatility, currency and price risks for shares and other assets. We manage these risks as part of a risk management process that conforms with the Minimum Requirements for Risk Management (MaRisk).

Limit system. Daily reporting to the Board of Managing Directors forms a cornerstone of managing market price risk, backed by a differentiated limit system that is geared primarily towards a market value-oriented limitation of interest rate, equity and exchange rate risks, and of risks from options positions. The Board of Managing Directors sets limits for the Treasury Division, on the basis of the bank's risk-bearing capacity. Using this limit system (and taking into consideration the rules determined according to the regulatory framework), Treasury translates its market expectations into investment and refinancing strategies.

IKB differentiates between the portfolios of proprietary trading, proprietary investment (further broken down into two sub-portfolios: fixed-income fund and investment portfolio), and refinancing of lending operations. These portfolios are valued daily in relation to market risks. Their risk content is measured using a value-at-risk (VaR) system based on present values, which forms the basis for limiting market risks. The limit system combines performance and VaR limits for various scenarios, and is strictly governed by the bank's risk-bearing capacity.

Quantifying market price risks. IKB employs various mathematical models to quantify interest rate risks. These models use historical simulation in order to determine the risk exposure inherent in the bank's major positions. To ensure that the characteristics of each product are properly taken into account, this historical simulation also incorporates a revaluation of instruments, using observed yield curve data, and incorporating correlation effects. The exposure to currency risks in the total portfolio is insignificant. Currency risks are limited by means of restrictions with regard to the volume of open currency positions.

Risk measurement in proprietary trading. The basis for the quantification of the interest rate risk is a Value at Risk model which uses a variance-covariance approach with a confidence level of 95% and a holding period of ten days. During the risk measurement process, historical observation periods of 510 and 60 days are used. The higher Value at Risk value of the values calculated during the risk measurement process is used for risk reporting. In addition, the risk is calculated for worst-case scenarios which can be derived from historical interest rate developments. A scenario matrix approach implemented in the Kondor+ system is applied by IKB for options, in order to take account of interest rate and interest volatility risks. The equity price risk is calculated on the basis of the standard procedure as defined in the capital ratio according to the German Banking Act (Grundsatz I).

Risk measurement in the fixed-income fund, and in the investment portfolio. The main risks assumed by the bank in these two portfolios are interest rate and volatility risks. Risks associated with equity prices and currency exchange rate movements are less important. A historical simulation is primarily used to measure risk. When quantifying the risk exposure to own funds invested on a long-term horizon in the fixed-income fund, for the purpose of optimising net interest income, the simulation is based on corresponding assumptions regarding maturity and return. Simulation parameters are mirrored (and the number of simulation scenarios thus doubled) to determine VaR within the scope of stress testing. Maturity assumptions regarding the own funds invested in the fixed-income fund are not taken into account for stress test analyses.

Risk measurement in loan refinancing. In order to calculate the currency and interest rate risks associated with loan refinancing, IKB uses the discounted balances from the interest rate gap analyses and historical simulation.

Aggregation of risk measurement figures. For the purposes of risk aggregation, the risks of the trading book and the banking book are taken into account. The aggregation of the risk measures is performed by adding the VaR figures of the sub-portfolios, assuming full correlation of the results. This conservative procedure tends to result in an overestimation of risk.

Quality assurance. We regularly conduct backtesting in order to verify the accuracy of projections made by our models. The results are reported to the Board of Managing Directors. Our backtesting shows that the value-at-risk projections accurately forecast the daily profit fluctuations, in proprietary trading, proprietary investment, and lending refinancing.

Reporting. To monitor market risk and to support Market Risk Management, detailed information on the results of operations and risk exposure of the above-mentioned portfolios are submitted to the responsible members of the Board of Managing Directors and Treasury on a daily basis. Once a month, the member of the Board of Managing Directors responsible for Finance, Controlling and Taxation provides a dedicated report to the entire Board on market developments, results and risk situation of these positions. In this context, the fundamental framework and interest rate assessment presented by our economists are reported, and their potential impact analysed jointly with representatives from Treasury and from Finance, Controlling and Taxation.

Operational and reputational risks

Operational risks reflect the risk of a loss being incurred due to a shortcoming or failure of internal processes, individuals or systems, or due to external events outside of the bank's control, irrespective of whether such loss was caused intentionally or by chance, or whether it occurred naturally.

Management of operational risks. The management of operational risk is coordinated and monitored by Operational Risk Management (ORM), which reports directly to the Board of Managing Directors. ORM is also responsible for analysing the loss potential throughout the Group, and for developing Group-wide operational risk training concepts.

Each business division and corporate centre is responsible to manage risk on an operative level, within their respective area of control. In this context, the emphasis is not only on regular analysis and identification of deficiencies, and on approaches for optimising all business procedures and processes, but also on the development of the bank's security organisation and on adapting the underlying processes. This ongoing development takes into account the increasingly complex and international nature of IKB's business. For this purpose, ORM arranges for annual business impact analyses, the purpose of which is not only to reflect specific risk profiles of individual divisions or departments, but also to highlight potential risk areas.

All business units must report all losses that have occurred – or almost occurred – to Operational Risk Management, which maintains a central loss database. Any incidents involving operational risks are analysed to determine their cause and their impact on our control principles.

Operational Risk Management is also responsible for business continuity planning, which is kept up to date by means of regular business impact analyses. To guarantee transparency throughout the Group, all emergency plans are detailed in the bank's intranet, and in printed form in the Business Continuity Planning manuals.

Regular emergency tests conducted throughout all divisions ensure the quality of these emergency plans.

The risk audits conducted to date have shown that the bank does not face any disproportionate risks from its operational risk fields. All identified risks are covered by avoidance measures, systems for the early detection of incidents, and emergency planning. Where necessary, corresponding insurance cover has been arranged.

Legal risks. Also included as a form of operational risk is legal risk, in other words the risk of losses being incurred as a result of new statutory regulations and as a result of amendments to or interpretations of existing statutory provisions (such as supreme court judgements) that are detrimental to the bank. The responsibility for limiting legal risks lies with our Legal department, which in turn relies on the support of external legal advisors where necessary. All standard contracts are continuously monitored to determine whether adjustments are required on the basis of changes to the statutory provisions or to case law.

IT risks. IT risks focus on the measures required to develop our business continuity planning, as well as on the security of the bank's IT systems and of its data inventory. Measures taken in this context have included the implementation of a uniform safety standard (ISO 17799 "Code of practice for information security management" and ISO 27001 "Information technology – Security techniques – Information security management systems – Requirements"); the roll-out of new technologies to avert external threats in order to enhance the bank's network security and to comply with increasing requirements regarding the mobility and availability of IT systems; as well as the extension of backup systems which allow the further reduction of operational risk exposure concerning the bank's communications, IT and settlement systems. At the same time, our IT employees undergo continuous training, in order to be prepared for every eventuality. IKB's implementation of a suitable management system for information security was certified by TÜV Rheinland during the past financial year.

All of these measures are further reinforced through regular reviews and emergency drills. By means of the measures taken, we have accounted for all material risks.

Compliance risks. Very strict statutory provisions apply to the financial sector in particular. In addition, we have imposed further regulations aimed at ensuring that the conduct of our employees is always appropriate and complies with the law: most importantly, conflicts of interest need to be avoided and market manipulation or insider trading prevented. This was the reason behind our developing a Code of Conduct which reflects IKB's values and beliefs. The principles laid down in the IKB Code of Conduct

represent the minimum standards of conduct which apply to all members of staff throughout the IKB Group. These rules form a binding framework, guiding us in our day-to-day business. They are designed to ascertain that the bank remains as successful as it has been to date.

Personnel risks. Operating entities – in cooperation with Human Resources – are responsible for managing personnel risks. Besides making sure that adequate personnel cover is available to fulfil operational and strategic requirements, this also includes ascertaining that staff have the skills and experience they need to perform their duties and fulfil their responsibilities. To maintain the high level of staff qualification, IKB employs an extensive, continuous system to manage training and Continuing Professional Development (CPD) measures. The risks of staff fluctuation or absence – i.e. the risk of sustained disruption of operations caused by absence of employees, or staff leaving the company – are contained by IKB through clearly-defined substitution regulations and guidelines to preserve functional availability. These are reviewed on a regular basis, and amended if necessary.

Reputational risks. Reputational risks are the risks of losses, falling revenues or loss in value due to a deterioration in the bank's public reputation, and particularly in its reputation amongst clients, shareholders, rating agencies, and employees. Risks to reputation frequently arise from other risk types, reinforcing the original risk through the related publicity.

Therefore, all measures and circumstances that could result in a loss of confidence in IKB, or in damage to the bank's reputation, are carefully identified in Corporate Development and Communications (Investor/Public Relations), and necessary measures decided upon. Notwithstanding the above, all divisions are ultimately directly responsible for the risks to reputation arising from their respective activity.

Ultimately, all measures and activities relating to business policy are thus always carefully reviewed regarding their external impact.

Strategic risks

Strategic risks are defined as potential threats to the bank's long-term profitability. These can be triggered not only by changes in the legal or social environment, but by the market or competitive environment, our customers, or our refinancing partners.

Since there is no regularity to strategic risks, they are difficult to quantify as special risks in an integrated system. They are therefore specially monitored by the Board of Managing Directors and Corporate Development, and are subject to constant analysis. This includes regular checking of business division strategies within the framework of the strategic planning process, and of the resulting strategic initiatives and investments.

IKB uses a comprehensive approach to managing opportunities and risks, whereby the early recognition, assessment and management of risks and opportunities are integrated components of planning, management and control systems throughout the Group. To achieve its objectives, IKB consistently exploits opportunities arising in the markets, taking into account the related risks. In line with the bank's risk policy, risks are only assumed in a controlled manner, and only if a corresponding added value can be expected from taking a risk. IKB employs the Balanced Scorecard concept as an integrated planning and reporting tool. This involves defining objectives, targets, and strategic measures on the basis of five Balanced Scorecard 'perspectives' (Financial – Portfolio – Clients/Market – Processes – Staff), and measuring target achievement. Within the scope of the strategic planning process conducted at overall bank level, as

well as by individual front office units or corporate centres, the strategic aspects and operative measures mapped in the Balanced Scorecard are reviewed annually, taking into account sector developments and IKB's current strategy, and making changes as appropriate. The degree to which Balanced Scorecard targets have been achieved is regularly reported to the Board of Managing Directors.

IKB has successfully implemented its strategy as a long-term provider of finance to well-established medium-sized enterprises, and as an active portfolio manager. In light of the prevailing structure of competition, combined with the legal, statutory and tax environment IKB operates in, the bank does not identify any material risks in this respect.

Business risk

Business risk is defined as the risk of negative deviations from target levels of income (comprising commissions and interest) and expenses.

Each business division and corporate centre is responsible to manage general business risk – defined as the threat of deteriorating profitability, within the framework defined by the business strategies agreed upon with the Board of Managing Directors – on an operative level, within their respective area of control. The Results Controlling unit, part of Finance, Controlling and Taxation, monitors earnings and cost developments during the course of a financial year, via on-going target/actual comparison, and reports its results to the Board of Managing Directors and to the divisions on a monthly basis.

General business risk is quantified by way of statistical analysis, using empirical volatility data for earnings and costs. The model employed calculates the extent by which actual net commission income and net interest income, and costs, have deviated historically from the corresponding targets. In line with the procedures applied to the other types of risk, the underlying confidence interval is 99.96%. The economic capital tied up as a result is taken into account for the regular analysis of the bank's risk-bearing capacity.

Risk reporting and communication

For the purpose of early risk identification, analysis and control, we process and examine all relevant information compiled from the trading and credit businesses, from Risk Management, from Finance, Controlling and Taxation, and from Human Resources. This is then presented and explained in detail, at least once a month, to the Board of Managing Directors, and to the heads of divisions. In addition, a comprehensive risk report is submitted to the Supervisory Board and to the regulatory authorities at least on a quarterly basis.

The credit risk report contains all of the information relevant to the Group's total risk position, and contains comprehensive information on the credit risk to which the bank is exposed. Besides structural developments within the portfolio (credit quality data, collateralisation, loan terms, sector and country diversification), it also outlines the development of impaired or non-performing receivables, and the loan loss provisioning, in an up-to-date and comprehensive presentation. Details on group interdependence among borrowers provide additional information on the clustering of risk within the portfolio. In addition to the presentation and explanation of special exposures and developments, the report also contains an

overview (including a quantification) of all individual types of risk, to monitor the bank's risk-bearing capacity also in stress scenarios, and information regarding utilisation of all economic capital limits.

We regularly match the risk/return figures of the lending business with up-to-date planning and target figures, and report the results to the Board of Managing Directors and to the heads of business divisions. This allows us to counter deviations at an early stage. All business divisions and corporate centres therefore have access to extensive, necessary and up-to-date information.

Within the scope of market price risk reporting, in addition to daily monitoring of, and reporting on, limit utilisation, Risk Controlling prepares a daily briefing for the responsible members of the Board of Managing Directors, Treasury and other units involved. This includes marking the bank's positions to market, together with accrued and risk-free net interest income generated from the bank's refinancing activities and proprietary investments. This briefing also includes a statement of the present value exposure under a stress scenario, the utilisation of various market price risk limits, and comments on particular developments.

Operational Risk Management keeps the Board of Managing Directors informed regarding operational risk, as well as individual losses and their distribution amongst the divisions.

Overall statement on the risk situation and outlook

Overall statement on the risk situation. The methodology, measurement systems and processes implemented within IKB's framework of risk monitoring and management are suitable for early identification and adequate capture of risk. Accordingly, they provide a fundamental basis for IKB's professional risk management.

Overall, the aggregate risk cover available to IKB provides sufficient scope for continued strategic growth. The observation of the bank's risk-bearing capacity indicates that aggregate risk cover is sufficient even in cases of extreme unexpected risks materialising (worst-case scenario). No developments arising from individual types of risk which would impede the bank's development or impair its ratings have been recognisable, or are being identified.

Within the scope of the annual review, we adjusted the credit risk strategy during the 2006/07 financial year where necessary, in line with the strategic orientation of the credit business. We thus continued to adopt a forward-looking approach with regard to our loan portfolio; this is based on the credit risk strategy, and is a driving force for further developing the loan portfolio in our core business franchises. We continued to limit risk through diversification, within the scope of our securitisation activities.

The strategy for managing operational risk was updated during the financial year under review, and implemented throughout the IKB Group; reporting lines were harmonised and linked with the various sources of operational risk data.

All remaining projects for the implementation of Minimum Requirements for Risk Management (MARisk) were completed during the 2006/07 financial year. We have maintained our strong commitment to the implementation project regarding the

Basel II framework. Accordingly, we do not envisage any risk of Basel II requirements not being implemented in good time.

Outlook. One of the focal points in the current financial year will be to finalise implementation of the Basel II regulatory framework. For this purpose, we will conclude the implementation of the standardised approach for credit risk, to subsequently establish the prerequisites for approval and application of the advanced approaches under Basel II, for a more differentiated, risk-adjusted capital backing. Besides the ongoing methodical development of our internal models and rating procedures in the credit business, and of our early risk detection tools, this will also include building the historical loss database required to develop estimation procedures for the key parameters used in the Basel II framework.

Within the scope of a comprehensive project to upgrade the infrastructure in our Treasury business, we are currently in the process of introducing a state-of-the-art system that will continuously enhance our methods and processes for assessing and measuring market price risks. This will also involve segregating the back office valuation infrastructure from the front office systems environment, which will provide further efficiency gains in the Treasury.

We will continue to develop and enhance management framework for the entire bank and our portfolio, with a focus on risk/reward relationships and a continued strong emphasis on the securitisation of receivables. The active management of our credit portfolio, on an ongoing basis, will enhance the diversification and granularity of the portfolio, thus creating growth potential for the future.

5. Outlook

Business environment

The Board of Managing Directors expects that the basic economic parameters at national and international level will remain positive for the bank's business over the next two years. As far as IKB's core market is concerned, namely Germany, the following developments are expected in the economy as a whole:

- GDP will grow by 2.4% in 2007. We expect a similar rate of GDP growth for 2008. The main reason for this stable economic growth, in our view, lies in the fact that German companies are continuing to profit from the positive development of the global economy thanks to their excellent range of production and their high technological standing.
- We estimate that exports will grow by 9% in 2007, followed by a rise in the region of 7.5% in 2008. For our medium-sized companies, the majority of which are strongly export-oriented, this means that their capacity utilisation will rise further and/or orders will increase.
- There will not, in our view, be any fundamental change in the interest rate situation on the national and international money and capital markets over the next two years compared with the situation at the beginning of 2007. The main reason for this is that inflation is not very likely to increase worldwide, which means that the central banks (particularly the US Federal Reserve, Fed, and ECB) will not be moving towards a restrictive monetary policy. Oil prices remain a source of uncertainty, in our view. Should the price of oil return to USD 70/barrel (or more), we cannot exclude the possibility of the Fed – followed by the ECB – raising money market rates again. However, we put the probability of this scenario at less than 40%.
- In view of the continued upward movement in the German economy – led by exports – and with little change expected in interest rates, the Board of Managing Directors assumes that the most important economic factor for the bank's lending business, namely investment in plant and equipment by the corporate sector, will rise by about 5 to 6% per year in 2007 and 2008. Our lending business with both German companies and real estate investors will benefit from this development.
- The economic development in our major foreign markets will continue to head upwards. We expect GDP in Western Europe to grow by 2% (with a low of 1.7% in Italy and a high of 3% in Spain), with an average increase in Central Eastern Europe of 6.2%, with Hungary recording the lowest level, at 2.5%, and Slovakia the highest, at 8%. In the USA, we expect to see a slight weakening in economic growth to 2.3 % (on the back of a figure of 3.4% in 2006).

These remain excellent basic parameters for sustained growth in volumes and income in our business activities in international acquisition and project finance and in equipment leasing.

Market developments and IKB's perspective

There will be no let-up in the competition situation in the German banking sector in 2007, not least in the market relevant to IKB, namely long-term corporate lending. The volume of long-term loans in the manufacturing sector was € 75 billion in Germany at the end of 2006 following several years of a consistent downward trend. Despite the healthy state of the economy and strong domestic investment activity on the part of German companies, there was only a minor reversal of this trend. The reason for this lies in the fact that the larger companies in Germany's medium-sized segment are in a good enough income position to finance many investments from cash flow.

As a parallel development, medium-sized companies have recently been rediscovered as a target group by many banks. Additionally, in the current environment of low margins, calculations are being based on lower risk costs due to clients' improved income situation. Furthermore, in some cases long-term credit is being used as an 'entry product' so that additional products can subsequently be placed with clients. Overall, this means that we are once again competing in domestic lending business with the major banks, selected Landesbanken and the major savings banks. We therefore assume that the pressure on the interest margin will be maintained. The entry onto the German market of new competitors, particularly from abroad, looking to offer long-term finance to medium-sized companies is something we only expect to see to a limited extent.

However, we do expect intensive competition to continue in the area of international finance this financial year, above all due to what remain high liquidity levels on the capital markets. Consequently, we do not expect to see any improvement in margins in international structured finance and international real estate finance.

In terms of the *Corporate Clients* segment, Germany will remain the core market. However, our aim is to further increase the acquisition potential of this market by offering long-term investment loans to companies with annual sales of € 7.5 million upwards (previous starting point € 10 million) as of the 2007/08 financial year. In particular, we intend using our IKB Direct finance platform, which comprises a simplified standardised credit process, to acquire new clients. Moreover, we will design our range of promissory note loans, mezzanine capital and ABS finance in such a way that it is also made attractive for smaller companies. Promissory note loans, for example, are to be available as of the 2007/08 financial year in amounts from € 2 million upwards, with mezzanine capital also available from € 2 million and ABS finance from € 5 million per company. Against this background, our plan is to further increase our market share in the manufacturing sector. This is a very ambitious goal, particularly as practically all of our competitors have rediscovered medium-sized companies with good credit ratings as one of their target groups.

In terms of *real estate financing*, our goal is to triple the volume of new business over the next three years. Significantly more than half of this growth should come from the European real estate platform established during the last financial year, which will focus primarily on syndicated finance. In Germany, we will support the project development of individual selected properties with the full range of our services – this will generate attractive commission income. We are currently involved in 15 such project developments.

In the *Structured Finance* division, we will be continuing to pursue our successful internationalisation strategy. Building on the foreign markets in which we already have a presence, we are also looking to capture the Russian market this financial year. This will

done via a representative office. Based on the current situation, we expect that we will also be able over the next two years to generate around 70% of our income from the Structured Finance division on foreign markets.

Of increasing importance over the coming years will be *securitisation* business. This applies both to the external placement of credit risks and investments in international loan portfolios. We will synthetically place around one third of our new business every year, thereby freeing up credit risks and equity capital.

We will devote a great deal of attention to the refinancing of our lending business. We will once again be issuing more than € 10 billion on the national and international capital markets in the form of bonds. Given the good state of the capital markets and our outstanding rating, we continue to expect to enjoy good conditions for the placement of our bond issues. Additionally, as in the past, we will refinance a portion of our lending by taking up funds from the public development banks: KfW, LfA, and EIB.

We plan to increase the bank's own funds once more by making an allocation to retained earnings. It is also our intention to take up further hybrid capital. To improve our capital ratio according to the German Banking Act (Principle I) and our solvency ratio, our plan – as indicated – is for parts of our national and international lending business to be securitised so that risks can be placed externally, thereby freeing up equity capital. There are no plans for a capital increase through the issue of shares.

Our aim is to continue IKB's successful business strategy over the coming years. In order to further increase our income potential, we will be focusing on developing innovative finance products, capturing new markets and further improving our processes.

We expect to achieve our goals thanks to our strategy, our growth momentum, and our capital management. Having attained a leading position in our core businesses, we have demonstrated our ability to generate good results in a benign business environment as well as in challenging conditions. Based on our expectations for the development of the economy and the capital markets, we are confident that we will generate another positive result in the financial year 2007/08.

6. Remuneration Report

The remuneration report takes into account the regulations of the German Commercial Code as amended by the German Act on the Disclosure of Remuneration of Management Board Members (Vorstandsvergütungsoffenlegungsgesetz – “VorstOG”), as well as by the general principles of the German Corporate Governance Code.

The remuneration system for the members of the Board of Managing Directors

The total remuneration of the members of the Board of Managing Directors consists of a fixed annual basic remuneration, a performance-based variable remuneration as well as additional benefits and pension commitments. There are no stock option plans or similar schemes. The structure of the remuneration system for the Board of Managing Directors is subject to regular discussion and review by the Supervisory Board, as proposed by the Executive Committee of the Supervisory Board. The remuneration of the Board of Managing Directors is individually determined by the executive Committee.

The criteria for the reasonableness of remuneration are, in particular, the tasks of the respective member of the Board of Managing Directors, his personal performance, the performance of the Board of Managing Directors as a whole, as well as the economic situation, the performance and outlook of the Company, taking into account its peer companies. The reasonableness of the respective total remuneration is also reviewed regularly. Any remuneration from offices held within the Group is taken into account for this purpose. The remuneration was last adjusted on 13 February 2007, with effect from 1 July 2007. The Supervisory Board last discussed the remuneration system for the Board of Managing Directors during its meeting held on 28 June 2006.

Non-performance-related remuneration components

The non-performance-related basic annual remuneration is paid monthly in form of a salary. In addition, the Board members receive additional benefits in form of remuneration in kind which mainly consist of property value to be applied in accordance with tax laws, insurance premiums and the use of a company car. These additional benefits have to be disclosed in the tax return by each Board member as part of the remuneration. The actual amount of these benefits varies according to the individual situation of each Board member. Loans and advances were not granted to the Board members in the year under review.

Performance-based remuneration components

The amount of the variable remuneration is determined by a target agreement system: for financial year 2006/2007, this included targets that depend on the success of the Company (65%) and individual targets (35%). The targets depending on the company's success relate to the operating result, the cost/income ratio and the return on equity. The individual targets include divisional, functional, and project-related targets. The first step in this process is to determine a target bonus. The bonuses earned are then determined according to the extent to which the targets have been achieved. In case the targets have been achieved to a degree of 100%, the bonus to be paid corresponds to the contractual target bonus. The maximum bonus amounts to 200% of the target bonus, the minimum bonus is 30% of the target bonus. As a rule, it is not possible to change the agreed performance targets retroactively. In the financial year 2006/07, the share of the variable remuneration in the total remuneration amounted to approximately 63%.

In accordance with the recommendations of the German Corporate Governance Code, the monetary components of the total remuneration thus comprise fixed and variable components. The variable remuneration component is risk-based, as it does not constitute guaranteed remuneration. As a rule, it is not possible to change the agreed performance targets retroactively.

Pension provisions

Having retired from the company, the members of the Board of Managing Directors are entitled to pension payments in the following cases: upon reaching the standard retirement age limit of currently 63 years, permanent disability, early retirement or the non-renewal of the service contract. In the case of the latter, the member of the Board of Managing Directors receives a reduced pension payment, as a so-called transition payment, until the end of the 63rd year of life. This payment is made provided early retirement or non-renewal is not attributable to the member or induced by the rejection of equal or more favourable terms offered in relation to extending the contract.

The annual pension claim amounts to between 50 and 75% of the previous basis annual remuneration and is dependent on the member's term of office on the Board of Managing Directors. The transition payment, which amounts to between 5 and 75% of the last basic annual remuneration, depends on the age of the member of the Board of Managing Directors and on his term of office on the Board. Pension claims and earnings otherwise acquired will be offset to a certain extent against the pension payments made by the company. Current pensions will be adjusted annually in accordance with the performance of the German consumer price index.

After the death of an active or former member of the Board of Managing Directors, a reduced pension is paid out as a provision for dependants. Widows receive up to 60% of the pension for the rest of their lives. The widow's benefit is discontinued upon remarriage. Dependant children receive 15% of the pension until

their 18th year, continuing up to their 25th year for the term of their education, including national or civil service. If the aggregate of the widow's benefit and orphan's allowance exceeds the pension payment, the orphan's allowance is reduced by the amount exceeded.

The company has recognised pension provisions in accordance with the German Commercial Code for future pension claims of members of the Board of Managing Directors.

Change of control

In the event of a term of office as member of the Board of Managing Directors being ended prematurely due to a change of control, the members of the Board, with the exception of any new members who assumed their position on 1 March 2007, shall have a general entitlement until their contract to payment of a one-off settlement payment and severance pay. Under the standard ruling applicable to members of the Board of Managing Directors, a change of control is deemed to have occurred in the event that a third party, either alone or through the voting rights attributable to that third party in accordance with section 22 of the German Securities Trading Act (Wertpapierhandelsgesetz – "WpHG"), acquires a share of voting rights that, at an ordinary general meeting of the Company, would have led to that third party holding a share of voting rights in the amount of at least half of the share capital present at the meeting and entitled to vote. If a change of control leads to the early termination or non-renewal of the service contract, regardless of whether under the instruction of the company or of a member of the Board of Managing Directors, because the change of control impacts significantly on the Board member in question, the member is entitled to severance of at least three years of the variable annual remuneration as well as a transition payment until the end of their 63rd year. The member is subsequently entitled to pension payment in accordance with the aforementioned regulations on pension provisions. Additional settlement payments may result from individual termination agreements.

The remuneration for the members of the Board of Managing Directors

A number of changes took place on the Board of Managing Directors in the financial year 2006/07. Frank Schönherr and Joachim Neupel retired from the Board of Managing Directors as at 30 November 2006 and 31 December 2006, respectively. Dr. Volker Doberanzke was newly appointed to the Board of Managing Directors with effect from 1 June 2006 and Frank Braunsfeld with effect from 1 March 2007.

No member of the Board of Managing Directors received payments from or benefits committed upon by third parties, by reference to the office held as member of the Board of Managing Directors.

Details for the remuneration of the members of the Board of Managing Directors for the financial year 2006/2007 are shown in the following table:

in € thousand	Annual remuneration			Total	Pensions	
	Fixed remuneration	Variable remuneration components	Value of ancillary payments*		Annual remuneration at retirement as at 31 Mar 2007	Additions to pension provisions during the financial year
Stefan Ortseifen	504	1 000	93	1 597	378	232
Frank Braunsfeld (since 1 Mar 2007)	25	35	14	74	180	437
Dr. Volker Doberanzke (since 1 Jun 2006)	300	750	32	1 082	270	113
Dr. Markus Guthoff	384	750	59	1 193	288	89
Claus Momburg	384	750	53	1 187	288	116
Joachim Neupel ** (until 31 Dec 2006)	288	563	96	947		
Frank Schönherr (until 30 Nov 2006)	256	470	31	757		
Total	2 141	4 318	378	6 837	1 404	987

*) Including remuneration of € 225 000 received for directorship functions carried out at subsidiaries

** The pension payments of Joachim Neupel are included in the total remuneration of the former members of the Board of Managing Directors and their surviving dependants

For the financial year 2005/06, the annual remuneration of the entire Board of Managing Directors amounted to € 5 886 thousand, of which € 2 186 thousand related to fixed remuneration components, and € 3 700 thousand to variable remuneration.

Former and retired members of the Board of Managing Directors

Total remuneration paid to former and retired members of the Board of Managing Directors and their surviving dependants in the form of disbursements and pension provisions amounted to € 5 345 thousand (previous year: € 2 871 thousand). A total of € 29 680 thousand in provisions was recognised for pension obligations to former members of the Board of Managing Directors and their surviving dependants.

Further information on the remuneration package for members of the Board of Managing Directors is disclosed in the Notes to the Consolidated Financial Statements.

The remuneration system for the members of the Supervisory Board

The remuneration of the Supervisory Board is specified in Section 11 of the Memorandum and Articles of Association of IKB. In line with legal requirements and in accordance with the provisions of the German Corporate Governance Code, this remuneration takes into account the responsibility and the scope of activities of the Supervisory Board members as well as the economic situation and the performance of the IKB Group. The members of the Supervisory Board receive a fixed remuneration component as well as two variable, performance-based remuneration components. The short-term remuneration component depends on dividends, while the long-term component is based on the three-year average of net income per share for the year. The fixed remuneration component of the members of the Supervisory Board amounts to € 20 000 and additionally comprises reimbursement of outlays, including value-added tax incurred on their remuneration. In addition, the Supervisory Board members receive a variable remuneration for each financial year in the amount of € 200 for each € 0.01 by which the dividend distributed to shareholders exceeds € 0.30 per share for the past financial year. Furthermore, the Supervisory Board members receive another variable remuneration in the amount of € 90 for each € 0.01 by which the three-year average of net income per share for the year exceeds € 0.30.

The Chairman of the Supervisory Board receives twice this amount, and each Deputy Chairman receives one and a half times this amount. The remuneration is further increased for each membership in a Supervisory Board committee by 25% of the remuneration of a Supervisory Board member, and for each chairmanship in a committee by 25% of the remuneration of a Supervisory Board member. The additional remuneration for committee work may not exceed the amount of the remuneration for a Supervisory Board member. For members of the Supervisory Board who have not been Board or committee members for the full financial year, remuneration is paid on a pro-rata basis for each commenced month of their activities.

The remuneration of the Supervisory Board depends on other key figures than the remuneration of the Board of Managing Directors, which means that an unintended harmonisation of the remuneration interests of both corporate bodies is not possible. The fixed annual remuneration of € 20 000 is intended to take account of the Supervisory Board's independence, which is necessary for the Board to perform its supervisory function. The new system is also supposed to ensure an appropriate minimum remuneration which does not depend on the economic success of the company. The aim of the dividend-based remuneration component is to result in a harmonisation of the Supervisory Board's remuneration interest with the return expectations of shareholders. By linking another part of the variable remuneration to the three-year average of the net income for the year, the Supervisory Board's remuneration also contains a component which is based on the Company's long-term success.

The remuneration for the members of the Supervisory Board

The Supervisory Board remuneration for the financial year 2006/07 was calculated on the basis of the proposed dividend of € 0.85 and average Group net income per share of € 1.86 for the financial years 2004/05 – 2006/07.

In the year under review, the Supervisory Board members did not receive any further remuneration or benefits for personally rendered services, in particular advisory and agency services.

Details for the remuneration of the members of the Supervisory Board for the financial year 2006/07 are shown in the following table:

in € thousand	Fixed component	Short-term variable component	Long-term variable component	Total
Dr. Ulrich Hartmann	55	30	40	125
Detlef Leinberger (since 31 Aug 2006)	30	17	21	68
Hans W. Reich (until 31 Aug 2006)	19	10	13	42
Dr. Alexander v. Tippelskirch	40	22	28	90
Dieter Ammer	20	11	14	45
Jörg Asmussen	20	11	14	45
Dr. Jens Baganz	20	11	14	45
Dr. Jürgen Behrend	20	11	14	45
Wolfgang Bouché	23	13	16	52
Hermann Franzen	20	11	14	45
Dr. Mathias Kammüller	20	11	14	45
Wilhelm Lohscheidt (until 31 Aug 2006)	8	5	6	19
Jürgen Metzger	20	11	14	45
Roland Oetker	20	11	14	45
Dr. Eberhard Reuther	20	11	14	45
Randolf Rodenstock	20	11	14	45
Rita Röbel	20	11	14	45
Dr. Michael Rogowski	20	11	14	45
Jochen Schametat (since 31 Aug 2006)	13	7	9	29
Dr. Carola Steingräber	22	12	16	50
Dr. Martin Viessmann	20	11	14	45
Ulrich Wernecke	20	11	14	45
Andreas Wittmann	20	11	14	45
Subtotal	510	281	359	1 150
Travel expenses/VAT (all Supervisory Board members)				189
Total				1 339

For the financial year 2005/06, the annual remuneration of the entire Supervisory Board amounted to € 1 247 thousand, of which € 510 thousand related to fixed remuneration components, and € 571 thousand to variable remuneration. A further amount of € 166 thousand related to travel expenses and VAT.

Further details can be found in the Notes to the Financial Statements.

7. Other financial information

Disclosures required under sections 289 (4) and 315 (4) of the German Commercial Code (Handelsgesetzbuch – “HGB”)

The Company’s share capital as at 31 March 2007 was € 225 280 000. It is divided into 88 000 000 bearer notional no-par value shares (‘unit shares’). All shares entitle the holder to the same rights. Each share grants the holder one vote and determines the participation in profit.

The Federal Republic of Germany holds an 80% stake in the KfW Banking Group, based in Frankfurt/Main. Through its wholly-owned subsidiary KfW-Beteiligungsholding GmbH, Frankfurt/Main, the KfW Banking Group holds 37.8% of the voting rights in IKB. The Stiftung zur Förderung der Forschung für die gewerbliche Wirtschaft (Industrial Research Foundation), Cologne, also holds an 11.8% interest in the Company. The remaining capital is held by institutional and private shareholders.

The members of the Board of Managing Directors are appointed and dismissed by the Supervisory Board in accordance with Section 84 of the German Public Limited Companies Act (Aktiengesetz – “AktG”) and Article 6 of the Memorandum and Articles of Association. The Board of Managing Directors is composed of at least two members, with the number of members being determined by the Supervisory Board. The appointment is made for a maximum term of office of five years. This term of office may be renewed or extended for a maximum of five years in each case. The Supervisory Board may revoke the appointment of a member of the Board of Managing Directors on

serious grounds. The Articles of Association may only be amended by means of a resolution adopted at the General Meeting in accordance with section 179 (1) of the AktG and Article 17 of the Memorandum and Articles of Association. Any resolution to amend the Memorandum and Articles of Association must be supported by two thirds of the share capital represented at the meeting, with the exception of cases where the German Public Limited Companies Act prescribes a larger majority. Any changes to the Memorandum and Articles of Associations that only affect the wording thereof may also be adopted by the Supervisory Board.

Pursuant to a resolution adopted at the General Meeting of 31 August 2006, the Company is authorised to purchase and sell its own shares (treasury shares) for the purpose of securities trading up until 31 January 2008. The volume of shares acquired for this purpose must not exceed 5% of the issued share capital at the end of any given day. Furthermore, any shares acquired under this authorisation, together with other treasury shares held by the Company, or to be attributed to the Company pursuant to sections 71a et seq. of the AktG, must not exceed 10% of the issued share capital at any given time.

The Company was also authorised to acquire up until 31 January 2008 treasury shares up to an amount of 10% of its issued share capital for purposes other than securities trading and for specific purposes as described in more detail in the resolution of 31 August 2006. Furthermore, any shares acquired under this authorisation together with other treasury shares held for trading purposes or for other reasons by the Company, or to be attributed to the Company pursuant to sections 71a et seq. of the AktG, must not exceed 10% of the issued share capital at any given time.

Pursuant to a resolution adopted by the General Meeting of 9 September 2004, the Board of Managing Directors was authorised, subject to approval by the Supervisory Board, to issue convertible bonds and/or bonds with warrants with an aggregate nominal value of up to € 300 000 000 with or without a limited term, and to grant the holders of such bonds conversion or option rights relating to shares in the Company accounting for up to € 22 528 000 of the share capital in accordance with the stipulated conditions up until 8 September 2009. No use has been made to date of this authorisation or of the related conditional capital.

Pursuant to a resolution of the General Meeting of 30 August 2002, the Board of Managing Directors was authorised, subject to approval by the Supervisory Board, to increase the issued share capital by up to € 76 800 000 by issuing new, bearer unit shares against cash contributions as part of one or several issues up to 30 August 2007. Any use of the authorised capital is subject to the shareholders being granted a subscription right. This subscription right may only be excluded for residual amounts and to preserve the rights of holders of conversion and option rights. No use has been made to date of the authorised capital.

The Board of Managing Directors was also authorised, up until 30 August 2007, to issue profit-participation certificates – including with conversion or option rights – for a total nominal value of up to € 300 000 000 with a maximum maturity of 15 years and to grant the holders of these profit-participation certificates conversion or option rights relating to treasury shares for up to € 22 528 000 of the issued share capital in accordance with the stipulated conditions. Use of this authorisation was made through the issuing of profit-participation certificates (without conversion or option rights), leaving an unused amount of € 70 000 000. The conditional capital currently exists in the full amount.

Report of the Board of Managing Directors in accordance with sections 289 (4) and 315 (4) HGB

The Board of Managing Directors has made disclosures in the Company's Management Report and in the Group Management Report in accordance with sections 289 (4) and 315 (4) of the HGB, with reference to which it comments as follows:

- The composition of share capital is based on Article 5 of the Memorandum and Articles of Association. The Company has only issued ordinary shares. No preference shares vesting special rights for individual shareholders have been issued.
- IKB has a group of shareholders that is committed to medium-sized enterprises and that supports the focus on long-term corporate finance. Together with the KfW Banking Group, which holds approximately 38% of our share capital, we share the common goal of further improving the finance options open to medium-sized companies. The Stiftung Industrieforschung, which holds just under 12% of our capital, primarily supports research and development projects for medium-sized companies. A good 50% of our share capital is held by institutional and private investors and partners who uphold the bank's strategy and direction.
- Members of the Board of Managing Directors are appointed and dismissed in accordance with the statutory regulations and pursuant to the conditions of our Memorandum and Articles of Association. In accordance with the Internal Rules of Procedure for the Board of Managing Directors, the Board itself elects one of its members as its Chairman. This appointment requires the approval of the Supervisory Board. Changes to the Memorandum and Articles of Association are made to the extent permitted by law.

- The powers of the Board of Managing Directors to raise the share capital from authorised and conditional capital, to issue convertible bonds and bonds with warrants or profit-participation certificates and to buy back own shares enable the Company to react to any change in its capital requirements in an appropriate way and in good time.
- The arrangements in place with the members of the Board of Managing Directors relating to a potential change of control are also set out in the Remuneration Report and do not require further clarification. The employment contracts of the employees do not contain any provisions relating to a change of control.

Disclosures in accordance with section 312 of AktG

IKB has prepared a subordinate status report in accordance with section 312 of the AktG. This report is not published. According to the final declaration of the Board of Managing Directors within the subordinate status report, “IKB received appropriate consideration for transactions identified in the report entered into with affiliated companies. This assessment was based on the conditions known to us at the time such reportable transactions were undertaken. We did neither take nor omit to take any measures within the meaning of Section 312 of the German Stock Corporation Act (AktG).”

Financial statements of IKB Deutsche Industriebank AG

- Balance sheet
- Profit and loss account
- Notes to the financial statements
- Auditors' Report

Balance sheet of IKB Deutsche Industriebank AG

Assets	in € thousand *	31 Mar 2007 in € thousand	31 Mar 2006 in € thousand
Cash reserve			
a) Cash on hand		30	37
b) Balances with central banks		28 253	43 969
of which: with Deutsche Bundesbank	28 090 (43 907)		
c) Balances in postal giro accounts		102	27
		28 385	44 033
Loans and advances to banks			
a) Payable on demand		590 632	1 477 483
b) Other loans and advances		11 983 287	8 515 857
		12 573 919	9 993 340
Loans and advances to customers		24 962 650	22 231 093
of which: Loans to local authorities	1 531 686 (1 567 807)		
Debt securities and other fixed-income securities			
a) Bonds and notes			
aa) Public-sector issuers		866 251	315 380
ab) Other issuers		13 562 175	11 830 551
		14 428 426	12 145 931
of which: Securities eligible as collateral with Deutsche Bundesbank	4 031 209 (5 556 287)		
b) Own bonds issued		45 095	50 861
Nominal amount	44 645 (49 481)		
		14 473 521	12 196 792
Equities and other non-fixed income securities		2 300	1 186
Equity investments		12 886	436
of which: Interests in banks	263 (263)		
Interests in affiliated companies		1 020 663	898 128
of which: Interests in banks	– (264 839)		
of which: Interests in financial services providers	8 000 (–)		
Trust assets		1 804	3 175
of which: Trustee loans	1 160 (2 431)		
Intangible assets		15 889	5 700
Tangible fixed assets		32 157	44 842
Other assets		1 069 523	537 771
Prepaid expenses		110 664	116 069
Total assets		54 304 361	46 072 565

* Previous year's figures shown in brackets

as at 31 March 2007

Shareholders' Equity and Liabilities	in € thousand *	31 Mar 2007 in € thousand	31 Mar 2006 in € thousand
Liabilities to banks			
a) Payable on demand		2 509 983	1 566 386
b) With agreed term or period of notice		13 723 863	15 064 676
		16 233 846	16 631 062
Liabilities to customers			
Other liabilities			
a) Payable on demand		567 208	290 224
b) With agreed term or period of notice		4 126 627	2 529 154
		4 693 835	2 819 378
Securitised liabilities			
Bonds issued			
		27 822 135	21 516 009
Trust liabilities			
		1 804	3 175
of which: Trustee loans	1 160 (2 431)		
Other liabilities			
		495 063	391 012
Deferred income			
		92 526	99 434
Provisions			
a) Provisions for pensions and similar obligations		141 686	131 698
b) Tax provisions		127 738	97 684
c) Other provisions		173 136	156 248
		442 560	385 630
Subordinated liabilities			
Profit-participation certificates			
of which: Due within two years	81 807 (173 839)		
Fund for general banking risks			
		155 000	80 000
Shareholders' equity			
a) Subscribed capital		225 280	225 280
Conditional capital:	22 528 (22 528)		
b) Silent partnership contributions		400 000	400 000
c) Capital reserve		567 416	567 416
d) Retained earnings			
da) Legal reserves		2 399	2 399
db) Other retained earnings		573 992	502 493
		576 391	504 892
e) Net profit (Bilanzgewinn)		74 800	74 800
		1 843 887	1 772 388
Total shareholders' equity and liabilities		54 304 361	46 072 565
Contingent liabilities			
a) Contingent liabilities from discounted forwarded bills		351	567
b) Liabilities from guarantees and indemnity agreements		4 021 659	4 896 401
		4 022 010	4 896 968
Other commitments			
Irrevocable loan commitments			
		12 685 729	11 582 804

* Previous year's figures shown in brackets

Profit and loss account of IKB Deutsche Industriebank AG

Expenses	in € thousand *	2006/07 in € thousand	2005/06 in € thousand
Interest expenses		4 476 398	3 702 195
Commission expenses		29 917	7 399
Net expenditure on financial operations		10 138	–
General administrative expenses			
a) Personnel expenses			
aa) Wages and salaries		115 063	103 067
ab) Compulsory social security contributions and expenses for pensions and other employee benefits		30 831	27 105
of which: Pension expenses	17 079 (14 766)		
		145 894	130 172
b) Other administrative expenses		106 334	88 578
		252 228	218 750
Amortisation/depreciation and write-downs of intangible and tangible fixed assets		7 309	7 759
Other operating expenses		31 805	43 943
Amortisation/depreciation and write-downs of receivables and specific securities, as well as additions to loan loss provisions		269 598	484 179
Transfers to the fund for general banking risks (section 340g of the HGB)		75 000	–
Taxes on income		22 965	17 908
Other taxes not reported under Other operating expenses		1 018	573
Annual net profit		146 300	149 200
Total expenses		5 322 676	4 631 906
Annual net profit		146 300	149 200
Transfer to retained earnings			
To other retained earnings		– 71 500	– 74 400
Net profit		74 800	74 800

* Previous year's figures shown in brackets

for the period from 1 April 2006 to 31 March 2007

Income	2006/07 in € thousand	2005/06 in € thousand
Interest income from		
a) Lending and money market transactions	4 299 047	3 708 045
b) Fixed-income securities and debt register claims	587 200	388 366
	4 886 247	4 096 411
Current income from		
a) Equities and other non-fixed income securities	1 448	215
b) Investments	6 570	175
c) Interests in affiliated companies	20 999	90 338
	29 017	90 728
Income from profit-pooling, profit transfer, and partial profit transfer agreements	69 916	29 535
Commission income	144 399	132 066
Net result from financial operations	–	509
Other operating income	193 097	282 657
Total income	5 322 676	4 631 906

Notes to the financial statements

Notes to the single-entity financial statements

The single-entity financial statements of IKB Deutsche Industriebank AG for the financial year 2006/07 are prepared in accordance with the provisions of the German Commercial Code (Handelsgesetzbuch – “HGB”), in conjunction with the German Accounting Directive for Banks (Verordnung über die Rechnungslegung der Kreditinstitute – “RechKredV”) as well as with the relevant provisions of the German Public Limited Companies Act (Aktiengesetz – “AktG”). The financial statements also comply with the provisions of the EU Bank Accounts Directive (86/635/EC).

Accounting policies

Loans and advances

Loans and advances to banks and customers are disclosed at their nominal value, less specific and general loan loss provisions (risk provisioning). Differences between repayment amounts and nominal values are included in deferred income reversed on schedule.

We have formed general loan loss provisions to cover expected loan losses which have been incurred but not identified as such at the balance sheet date. General loan loss provisions are based on proprietary historical loan loss data and weightings.

Securities

Securities are disclosed under the heading “Debt securities and other fixed-income securities”, as well as “Equities and other non-fixed income securities”; to the extent that they form part of current assets, they are valued at the lower of cost or market, i.e. at their costs of purchase or the lower market price. Pursuant to section 280 of the HGB, we were obliged to write up the value of securities that had been written down in previous years to their current market value to a maximum amount of their historical costs of purchase.

Individual securities holdings, together with allocated interest rate hedges (interest rate swaps) form a valuation unit (micro hedge). In these cases, as a result of the interest rate hedges, it is permitted to waive securities write-downs if these are based on changes in market interest rates; if the issuer’s creditworthiness is sustainably impaired, partial write-downs are made.

Long-term investment securities exclusively comprise issues from international industrial companies (corporate bonds and credit-linked notes), which we purchased intending to hold them up to the final maturity.

Participations and interests in affiliated companies/Tangible fixed assets

Interests in affiliated companies and enterprises with a participatory interest, as well as in associated enterprises, are carried at amortised cost.

Tangible fixed assets are valued at their costs of purchase or historical cost, less scheduled depreciation. In the case of sustained impairment, the assets are subject to unscheduled write-downs. Low-value assets are written off in full during their year of purchase.

Liabilities

Liabilities are carried at their repayment amount. Any difference between the repayment amount and the amount received is carried as prepaid expenses and reversed according to schedule.

Provisions

Provisions for pensions and similar obligations are carried as a liability in accordance with actuarial principles, based on Prof. Dr. Heubeck's mortality tables and a 6% rate of interest, and using the cost (German "Teilwert") method for pension expectancies and the net present value of current pensions.

We form provisions for taxes and uncertain liabilities in the amount in which these are likely to be incurred. We have discounted provisions for anniversary bonus commitments – to the extent needed – in accordance with the tax regulations at 5.5%.

At the end of March 2007, assets assigned as cover for pension obligations were spun off through an external Contractual Trust Agreement (CTA). There are no net effects under German commercial and tax law; the corresponding assets and obligations continue to be carried on a gross basis.

Derivatives transactions

Derivative transactions (swaps, futures/forwards, options) are pending items and are not subject to a compulsory disclosure requirement on the balance sheet. They are allocated to the banking or trading book when they are concluded, in line with their purpose. To the extent that derivative financial transactions are to be allocated to the trading book, these are valued in line with the principle of imparity and realisation based on their current market values. In order to hedge and manage interest rate and market risks for the banking book, together with financial transactions recognised on the balance sheet, derivative financial transactions implemented are subject to uniform control and evaluation of the risk of interest rate changes. Changes to the market value of these transactions are thus not subject to monitoring on an individual basis.

Currency translation

On and off-balance sheet transactions denominated in foreign currency are translated in accordance with the principles of section 340h of the HGB. Fixed assets denominated in foreign currency that are not specifically hedged have been translated at their historic exchange rates at the time of their acquisition.

All other assets, liabilities and other outstanding spot transactions denominated in foreign currency are valued at the reference rate of the European Central Bank (ECB) on the balance sheet date. If foreign exchange forwards are concluded to hedge interest-bearing items on the balance sheet, premiums and discounts on the spot rate are offset against the net interest income on a pro-rata basis. Hedged income or expenses are translated at the contracted forward rate.

In the income statement only expenses from currency translation according to section 340 h (2) of the HGB are taken into account.

Currency translation adjustments related to balance sheet items are directly recognised in other assets or other liabilities.

Notes to the balance sheet

Maturities of select balance sheet items by residual terms

in € million		up to three months	more than three months until one year	more than one year until five years	more than five years
Loans and advances to banks*)					
	31 Mar 2007	8 057	3 454	111	361
	31 Mar 2006	6 010	2 255	111	140
Loans and advances to customers					
	31 Mar 2007	2 931	3 145	10 871	8 016
	31 Mar 2006	3 158	2 675	9 580	6 818
Liabilities to banks*)					
	31 Mar 2007	2 820	3 203	4 317	3 384
	31 Mar 2006	6 301	2 344	3 426	2 994
Liabilities to customers*)					
	31 Mar 2007	819	101	1 008	2 199
	31 Mar 2006	219	182	871	1 257

*) Excluding loans and advances or liabilities payable on demand

Of the debt securities and other fixed-income securities, € 856 million (2005/06: € 961 million) will mature in the next financial year. Of the debt securities included in securitised liabilities, € 9.2 billion (€ 6.4 billion) will mature in the next financial year.

Fixed assets

in € million	Purchase or/production cost	Additions	Disposals	Depreciation cumulative	Depreciation financial year	Net book value 31 Mar 2007	Net book value 31 Mar 2006
Tangible fixed assets	114.1	4.1	27.4	58.6	5.2	32.2	44.8
Intangible assets	6.5	12.5	–	3.1	2.4	15.9	5.7
Equity investments	0.4	12.5	0.0	–	–	12.9	0.4
Interests in affiliated companies	957.3	450.0	327.5	59.1	–	1 020.7	898.1
Equities and fixed income securities	7 639.1	1 282.3	672.8	19.3	19.3	8 229.3	7 639.1

Tangible fixed assets include debt securities and other fixed-income securities, plus equities of € 8.2 billion (€ 7.6 billion). These are issues by international industrial companies (corporate bonds and credit-linked notes) which we have acquired as part of our credit business. As we intend to hold these until maturity, we treat these holdings in line with loans. At the reporting date, there were € 232 million in unrealised losses on these securities holdings.

On 31 March 2007, the book value of the land and buildings used by the bank amounted to € 17.5 million (€ 17.8 million).

Operating and office equipment is included under the fixed assets item, and totals € 12.9 million (€ 14.8 million).

Securities negotiable at a stock exchange

The negotiable securities contained in the following balance sheet items listed below are differentiated as follows:

in € million	Total	Listed	Unlisted
Debt securities and other fixed-income securities	14 129.2	12 850.2	1 279.0
Equities and other non-fixed income securities	2.3	2.0	0.3
Interests in affiliated companies	58.6	0.0	58.6

Loans and advances, and liabilities to associated and affiliated companies

in € million	Affiliated companies	Equity investments
Loans and advances to banks	8 069.4	2.9
Loans and advances to customers	1 397.8	243.2
Liabilities to banks	2 683.2	5 885.6
Liabilities to customers	373.4	6.4
Subordinated liabilities	475.1	0.0

Trustee business

in € million	31 Mar 2007	31 Mar 2006
Loans and advances to customers	1.2	2.4
Equity investments	0.6	0.8
Trust assets	1.8	3.2
Liabilities to customers	1.8	3.2
Trust liabilities	1.8	3.2

Subordinated assets

Subordinated assets are included in the following balance sheet asset items:

in € million	31 Mar 2007
Loans and advances to banks	100.0
Loans and advances to customers	380.4
Debt securities and other fixed-income securities	119.1

Foreign currency assets and liabilities

The recognised foreign currency balances, translated into euro, are shown in the following overview. The differences between assets and liabilities are mostly covered by currency hedging transactions.

in € million	31 Mar 2007	31 Mar 2006
Assets	10 456.3	6 115.8
Liabilities	6 327.8	4 811.3

Other assets and other liabilities

The largest single item in Other assets constitutes proportionate interest from interest rate swaps and cross-currency-swaps totalling € 381 million. Tax refund claims were recognised in the amount of € 53 million. The remaining amount disclosed under this item mostly relates to receivables under profit transfer agreements, and trade accounts receivable.

Other liabilities include € 35 million in amounts distributed on profit-participation certificates for the financial year 2006/07, as well as € 45 million in pro rata interest for subordinated liabilities and silent partnership contributions. At € 314 million, pro rata interest on interest rate swaps accounted for the largest single item of Other liabilities. The remaining amount under this item mostly relates to trade liabilities.

Prepaid expenses and deferred income

Prepaid expenses include € 82 million in differences pursuant to section 250 (3) of the HGB and section 340e (2) sentence 3 of the HGB (discounts from liabilities carried at their nominal value).

Deferred income includes € 35 million in differences pursuant to section 250 (2) of the HGB and section 340 e (2) sentence 2 of the HGB (discounts from loans and advances carried at their nominal value).

Subordinated liabilities

Subordinated liabilities are eligible as equity within the meaning of the German Banking Act (Kreditwesengesetz – “KWG”) and thus qualify as liable capital. There is no early repayment commitment. In the event of bankruptcy proceedings or liquidation, they may not be redeemed until all unsubordinated creditors have been satisfied.

Subordinated liabilities therefore amounted to € 1.9 billion; related interest expenses totalled € 85.3 million (2005/06: € 79.6 million) in the financial year under review.

Individual items which exceed 10 % of the total amount:

Year of issue	Book value in € million	Issue- currency	Coupon in %	Maturity
2004/2005	400.0	EUR	4.06	29 Jul 2033
2003/2004	310.0	EUR	4.50	9 Jul 2013

Profit-participation certificates

Profit-participation certificates totalling € 608.6 million meet the requirements set out in section 10 (5) of the KWG in the amount of € 523.6 million and thus qualify for inclusion in the bank's liable capital. The total amount of these certificates may be used to cover losses. Interest payments are made solely on the basis of any net retained profits. The rights of holders of profit-participation certificates to redemption of capital are subordinated to the rights of other creditors.

Profit-participation certificates can be broken down as follows:

Year of issue	Book value in € million	Currency of issue	Coupon in %	Maturity
1995/1996	81.8	DM	8.40	31 Mar 2007
1997/1998	102.3	DM	7.05	31 Mar 2009
1999/2000	20.0	EUR	7.23	31 Mar 2010
2001/2002	100.0	EUR	6.50	31 Mar 2012
2001/2002	74.5	EUR	6.55	31 Mar 2012
2004/2005	30.0	EUR	4.50	31 Mar 2015
2005/2006	150.0	EUR	3.86	31 Mar 2015
2006/2007	50.0	EUR	4.70	1 Aug 2017
	608.6			

For the financial year 2006/07, interest on profit-participation certificates in the amount of € 37.3 million (€ 41.7 million) was incurred and recognised as interest expenses.

The Board of Managing Directors was authorised at the Annual General Meeting on 30 August 2002 to issue profit-participation certificates until 30 August 2007, with a total nominal value of up to € 300 million. Having been used for issues in an aggregate amount of € 230 million, the remaining authorisation amounts to € 70 million.

The holders of such profit-participation certificates may be granted conversion or option rights for up to 8 800 000 bearer shares of IKB Deutsche Industriebank AG with an interest in the Company's share capital of up to € 22 528 000. No use has been made of this authorisation to date.

Changes in capitalisation

1. Treasury shares

The General Meetings held on 9 September 2005 and 31 August 2006 authorised the bank to acquire its own shares for the purpose of securities trading.

During the financial year 2006/07, a total of 1 017 230 treasury shares were purchased at an average price of € 29.88 per share, and the same quantity was sold at an average price of € 29.78 per share. The net loss from these transactions totals € 0.1 million and has been recognised in the net result from financial operations. The largest amount of treasury shares held on any one day totalled 0.21% of the share capital. Affiliated companies did not sell or purchase IKB shares. No treasury shares were held by the bank as at the reporting date.

In order to allow employees to purchase employee shares, 13 683 shares were purchased at an average price of € 27.60 in the financial year under review. 9 910 shares were resold to employees of IKB Deutsche Industriebank AG, at a preferred price of € 13.20. A further 4 300 shares were acquired by employees of the Group, at the same conditions. The resulting charges amounted to € 0.2 million, and are included in personnel expenses.

2. Shareholders' equity

Subscribed share capital amounted to € 225 280 000 on the reporting date and comprises 88 000 000 notional no-par value bearer shares ("bearer unit shares").

There is conditional capital totalling € 22.5 million for the purpose of granting conversion or option rights to the bearers of convertible bonds or bonds with warrants to be issued until 8 September 2009 with an aggregate nominal value of € 300 million. In addition, there is conditional capital totalling € 22.5 million for the purpose of granting conversion or option rights to the bearers of profit-participation certificates with conversion or option rights to be issued until 30 August 2007. Furthermore, authorised capital totalling € 76.8 million was authorised. This authorisation is limited to 30 August 2007.

None of these authorisations has been exercised to date.

3. Hybrid capital

Hybrid tier 1 capital of € 400 million as at 31 March 2007 was unchanged compared to the previous financial year. This capital complies with the requirements of section 10 (4) of the KWG and is therefore attributed to our tier 1 capital for regulatory purposes.

Hybrid capital includes issues in the form of capital contributions made by silent partners. In the case of silent participations – basically issued as perpetuals – only the issuer is allowed to terminate the contract after 10 years at the earliest.

Moreover, in the case of insolvency hybrid capital instruments are subordinated to all subordinated liabilities and profit-participation certificate issues.

The interest expenses for hybrid capital issues amounted to € 28.4 million (2005/06: € 29.4 million).

4. Changes in capitalisation

in € million	2007	2006
Balance on 1 April of the previous period	1 772.4	1 693.6
Disbursement of net profit from previous year	-74.8	-70.4
Appropriation of net income to retained earnings	71.5	74.4
Net profit as at 31 March	74.8	74.8
Balance at 31 March	1 843.9	1 772.4

The regulatory capital in accordance with the German Banking Act (KWG) totalled € 3.3 billion.

Contingent liabilities and other commitments

Contingent liabilities in € million	31 Mar 2007	31 Mar 2006
Guarantees, warranties, other	3 852.0	4 677.0
Assumptions of liability	170.0	220.0
Total	4 022.0	4 897.0

Other commitments in € million	31 Mar 2007	31 Mar 2006
Commitments for up to one year	10 139.5	9 668.0
Commitments for more than one year	2 546.2	1 915.0
Total	12 685.7	11 583.0

At the reporting date, Contingent liabilities also comprised credit default swaps (where IKB has assumed the position of protection seller) amounting to € 1.3 billion (2005/06: € 1.6 billion), within the Guarantees, warranties, other item. As seller of protection we have assumed the risk of counterparty default for certain credit portfolios, given the occurrence of pre-defined credit events. More than two-thirds of the individual portfolios are rated in the best rating classes Aaa to A by the independent external rating agency Moody's.

Other commitments comprise loan commitments to special purpose entities for a total equivalent of € 8.1 billion. These commitments can only be drawn upon by these entities in the case of short-term liquidity bottlenecks, or upon events of default (as defined in agreements entered into).

Notes to the profit and loss account

Geographical analysis of sources of income (information as defined in section 34 (2) of the RechKredV)

The aggregate of (i) interest income; (ii) current income on equities and other non-fixed income securities, and on equity investments and interests in affiliated companies; (iii) commission income; and (iv) other operating income is broken down by geographic region below:

in € million	2006/07	2005/06
Federal Republic of Germany	3 111.0	2 915.0
Europe excl. Germany	2 226.0	1 717.0
Total	5 337.0	4 632.0

We allocate income to geographic regions according to the respective location of our offices.

Administration and intermediation services rendered to third parties

We provide management services for lending and custodial accounts, in particular for guarantees. The income from these services is included under commission income.

Other operating income

Other operating income mainly comprises profits from the disposal of investment securities, and of investments (€ 180.2 million; 2005/06: € 270.6 million), plus € 6.0 million (€ 5.9 million) in Group overheads charged, and € 2.4 million (€ 3.7 million) in rental income.

Other operating expenses

Other operating expenses mainly comprise € 9.5 million (2005/06: € 22.8 million) in value adjustments on options transactions, € 8.9 million (€ 11.6 million) for buildings used by third parties, € 2.0 million (€ 1.7 million) in social security costs, as well as € 1.1 million (€ 1.3 million) in Group overheads paid.

Other Information

Shareholding in accordance to § 285 sentence 1 no. 11 HGB	Letter of comfort	Equity-interest	Equity in € thousand	Results in € thousand
1. Foreign banks				
IKB International S.A., Luxembourg	x	100	530 652 ⁴⁾	94 200 ³⁾
2. German companies				
AIVG Allgemeine Verwaltungsgesellschaft mbH, Düsseldorf	x	100	5 811	355
IKB Autoleasing GmbH, Hamburg	x	100	4 000	– ^{1) 3)}
IKB Beteiligungen GmbH, Düsseldorf	x	100	401 515	0
IKB Credit Asset Management GmbH, Düsseldorf	x	100	8 000	– ¹⁾
IKB Data GmbH, Düsseldorf	x	100	20 000	– ¹⁾
IKB Grundstücks GmbH, Düsseldorf	x	100	89	19
IKB Grundstücks GmbH & Co. Objekt Degerloch KG, Düsseldorf	x	100	6 663	71
IKB Grundstücks GmbH & Co. Objekt Hamburg KG, Düsseldorf	x	100	2 715	–282
IKB Grundstücks GmbH & Co. Objekt Holzhausen KG, Düsseldorf	x	100	9 734	325
IKB Grundstücks GmbH & Co. Objekt Uerdinger Straße KG, Düsseldorf	x	100	8 620	–158
IKB Immobilien Management GmbH, Düsseldorf	x	75	948	572
IKB Leasing Berlin GmbH, Erkner	x	100	8 000	– ^{1) 3)}
IKB Leasing GmbH, Hamburg	x	100	30 000	– ^{1) 3)}
IKB Private Equity GmbH, Düsseldorf	x	100	97 500	– ^{1) 3)}
IKB Projektentwicklung GmbH & Co. KG, Düsseldorf	x	100	20 040	1 422
IKB Projektentwicklungsverwaltungs-ges. mbH, Düsseldorf	x	100	22	1
IMAS Grundstücks-Vermietungs-ges. mbH, Düsseldorf	x	100	268	62
ISTOS Beteiligungsverwaltungs- und Grundstücks-Vermietungs-ges. mbH, Düsseldorf	x	100	34	2
ISTOS Erste Beteiligungsverwaltungs- und Grundstücks-Vermietungs-ges. mbH & Co. KG, Düsseldorf	x	100	2 485	–12
Movesta Lease and Finance GmbH, Düsseldorf		50	10 335	4 021 ³⁾
3. Foreign companies				
IKB Capital Corporation, New York		100	48 508	7 075
IKB Finance B. V., Amsterdam	x	100	11 060	1 482
IKB Financière France S. A., Paris	x	100	72 083	1 923
IKB Funding LLC I, Wilmington	x ²⁾	100	75 057 ⁴⁾	–37
IKB Funding LLC II, Wilmington	x ²⁾	100	400 064 ⁴⁾	12
IKB Lux Beteiligungen S.á.r.l., Luxembourg	x	100	428 878	0

¹⁾ There is a profit and loss transfer agreement

²⁾ Subordinated letter of comfort

³⁾ Indirect shareholding

⁴⁾ Incl. silent partnership contributions/preferred shares

The full list of shareholdings will be submitted to the German Electronic Federal Gazette (elektronischer Bundesanzeiger) and made available on the website of the company register. It may be obtained from IKB free of charge.

Disclosure of auditors' fees pursuant to section 285 sentence 1 no. 17 of the HGB

The following auditors' fees were paid during the financial year 2006/07:

in € million	2006/07
Auditing fees	1.7
Other audit or valuation services	0.5
Tax advisory services	0.4
Other services	0.2
Total	2.8

Other financial obligations

Funding commitments from shares, interests in German limited liability companies (GmbHs), and interests in associated companies which have not been fully paid up, amounted to € 1 000 as at the reporting date.

The bank has a pro rata additional funding obligation for the investment in Liquiditäts-Konsortialbank GmbH, Frankfurt/Main, Germany. IKB is also contingently liable pro rata for the fulfilment of the additional funding obligations of other shareholders belonging to the Association of German Banks (Bundesverband deutscher Banken e.V.). In addition, pursuant to Section 5 (10) of the Statutes for the Joint Fund for Securing Customer Deposits (Statut für den Einlagensicherungsfonds), the Bank has committed itself to indemnify the Association of German Banks from any losses arising due to measures in favour of banks in which it owns a majority interest.

Letters of comfort

In accordance with section 285 no. 11 of the HGB, IKB ensures, excluding political risk, that subsidiaries carried in the list of investments of IKB Deutsche Industriebank AG and marked as being covered by the letter of comfort, will be able to meet their contractual liabilities.

Collateral for own liabilities

IKB has assigned or transferred assets and accepted collateral for the following liabilities:

in € million	31 Mar 2007
Liabilities to banks	6 336
Liabilities to customers	18
Total	6 354

IKB provides collateral predominantly for loans granted by KfW Banking Group and other development banks. These institutes have made the issue of such loans contingent upon the provision of collateral.

Assets pledged as collateral for own liabilities

Fixed-income securities totalling € 6.0 billion (2005/06: € 5.3 billion) have been pledged with Deutsche Bundesbank as collateral for the European Central Bank's repurchase agreement process (collateral pool). As at the reporting date, credit facilities amounting to € 0.8 billion (€ 3.3 billion) had been drawn upon.

We have provided various banks with cash collateral in connection with credit derivative transactions, in the amount of € 290.0 million (€ 540.0 million).

We have provided cash collateral for interest rate derivatives as part of the Company's collateral management, in the amount of € 217.6 million (€ 210.7 million).

In order to fulfil payment obligations for securities transactions, securities with a market value of € 3.5 million (€ 3.5 million) have been deposited as collateral at Clearstream Banking AG, Frankfurt, and a security with a nominal value of € 7.0 million (€ 7.0 million) has been deposited as collateral at Clearstream Banking S.A., Luxembourg. Within the scope of trading at Eurex Germany, securities with a nominal value of € 20.0 million (€ 5.0 million) have been pledged with BHF-Bank AG, Frankfurt/Main and Berlin, as well as to Citigroup, London, to cover margin requirements.

In addition, securities with a nominal value of USD 67 million were pledged with WestLB AG, London branch, as collateral within the scope of an issue. USD 390 million in securities have been pledged to KfW Banking Group, Frankfurt/Main, as additional cover supporting joint business concepts.

Forward transactions/market value of derivatives/interest rate risks

IKB engages in forward transactions (swaps, forward rate agreements, and futures); these are predominantly used to manage and hedge interest rate risks, predominantly in the loan refinancing portfolio and the investment portfolio. These instruments are used for trading purposes only to a limited extent. The bank's interest rate risk exposure is restricted by a limit system adopted by the Board of Managing Directors, and is constantly monitored by our Risk Management unit. In addition, counterparty limits apply to the volume of forward and derivative transactions.

The loan refinancing portfolio is used to manage interest rate risk exposure on loans granted, and on the corresponding refinancing. For this purpose, long-term loans are largely refinanced on a matched-maturity basis. Derivatives are used to neutralise or reduce maturity mismatches, and interest rate or currency risks.

The investment portfolio largely comprises liquid securities, most of which are eligible as collateral for transactions with ECB (such as repo tenders). The portfolio includes floating-rate notes, which offer price stability due to regular coupon resets; derivatives are used to optimise interest income generated from these securities.

Market values of derivatives in € million	Nominal value	Positive market value	Negative market value
Interest-based transactions	27 771	211	-606
Currency-based transactions	8 034	95	-137
Equity/index-based transactions	0	0	0
Total	35 805	306	-743

Negative market values are incurred on interest rate derivatives in the loan refinancing portfolio where the bank is a net interest payer, and the market level of interest rates has fallen between the trade date and the balance sheet date (as the bank would otherwise have been able to enter into a similar transaction on the balance sheet date, at more favourable terms). Negative market values in the bank's investment portfolio are incurred in a similar way, however, these derivatives are used to hedge interest income rather than expenditure.

As explained above, these derivatives are generally used to manage interest rate risks. Expenditure incurred on the derivatives are balanced by income from loans and fixed-income securities, in a similar amount. Negative market values of derivatives are offset by positive valuation effects on fixed-rate loans and securities. Given the bank's intention to hold the derivatives until maturity, such negative market values are not recognised in income unless positions must be closed out in the event of limit transgressions.

Positive or negative market values are calculated – as far as possible – on the basis of stock exchange prices. Where no stock exchange prices are available, fair values are determined using the discounted cash flow method, based on a comparison with similar market transactions, or using other valuation models. The discounted cash flow method is based on the estimated future cash flows and applicable discount rates. The valuation models include parameters such as yield curve data, time values and volatility factors. The fair values reported include interest accrued, in accordance with market practice.

Remuneration and loans to executive bodies

A detailed description of the remuneration for the members of the Board of Managing Directors and of the Supervisory Board (together with the corresponding remuneration principles) is included in the Remuneration Report, which is included in the Management Report.

The remuneration for the members of the Board of Managing Directors

For the financial year 2006/07, the remuneration of the entire Board of Managing Directors amounted to € 7 824 thousand, of which € 6 837 thousand related to annual remuneration, and € 987 thousand to additions to pension provisions.

Former and retired members of the Board of Managing Directors

Total remuneration paid to former and retired members of the Board of Managing Directors and their surviving dependants in the form of disbursements and pension provisions amounted to € 5 345 thousand (previous year: € 2 871 thousand). A total of € 29 680 thousand in provisions was recognised for pension obligations to former members of the Board of Managing Directors and their surviving dependants.

The remuneration for the members of the Supervisory Board

For the financial year 2006/07, the remuneration of the entire Supervisory Board amounted to € 1 339 thousand, including € 189 thousand related to travel expenses and VAT.

Remuneration of the Advisory Board

The members of the Advisory Board received € 403 thousand (2005/06: € 390 thousand), including VAT.

Loans extended to members of executive bodies and of the Advisory Board

No loans were extended to members of the Board of Managing Directors. Loans to members of the Supervisory Board and of the Advisory Board were granted in an aggregate amount of € 1.4 million (2005/06: € 2.4 million).

Average number of employees for the financial year

(based on full-time employees)

	2006/07	2005/06
Male	715	682
Female	441	413
	1 156	1 095

Corporate Governance

The bank has issued the Declaration of Compliance as stipulated in section 161 of the AktG, and made it continuously available to shareholders.

Executive bodies

The following list of members of the Supervisory Board and Board of Managing Directors shows:

- a) their membership in other statutory Supervisory Boards; and
- b) similar offices held in comparable governing bodies of German and foreign companies.

Supervisory Board

Chairman

Dr. h. c. Ulrich Hartmann, Düsseldorf
Chairman of the Supervisory Board of
E.ON AG

- a) *E.ON AG (Chairman)*
 - Deutsche Bank AG*
 - Deutsche Lufthansa AG*
 - Hochtief AG*
 - Münchener Rückversicherungs-Gesellschaft AG*
- b) *Henkel KGaA*

Deputy Chairmen

Hans W. Reich, Frankfurt/Main
Chairman of the Board of Managing Directors of
KfW Banking Group (retired)
(until 31 August 2006)

- a) *Aareal Bank AG (Chairman)*
 - HUK-COBURG Haftpflicht-Unterstützungs-Kasse
kraftfahrender Beamter Deutschlands a.G.*
 - HUK-COBURG-Holding AG*
 - ThyssenKrupp Steel AG*
- b) *Citigroup Inc.*
DePfa Bank plc.

Detlef Leinberger, Frankfurt/Main
Member of the Board of Managing Directors of
KfW Banking Group
(since 31 August 2006)

- b) *Europäischer Investitionsfonds (EIF)*

Dr. Alexander v. Tippelskirch, Düsseldorf
Deputy Chairman of the Supervisory Board of
IKB Deutsche Industriebank AG

- a) *Alba AG (Chairman)*
GELITA AG (Chairman)
P-D INTERGLAS TECHNOLOGIES AG (Deputy Chairman)
- b) *Hako-Holding GmbH & Co.*
Hako-Werke Beteiligungsgesellschaft mbH
Krono-Holding AG
nobilis-Werke J. Stickling GmbH & Co.
Schmolz & Bickenbach KG
Schmolz & Bickenbach AG
Hans Martin Wälzholz-Junius Familienstiftung
Eckart Wälzholz-Junius Familienstiftung
Dietrich Wälzholz Familienstiftung

Members

Dieter Ammer, Hamburg
Businessman

- a) *Beiersdorf AG* (Chairman)*
- Conergy AG (Chairman)*
- Tchibo GmbH* (Chairman)*
- GEA AG*
- Heraeus Holding GmbH*
- tesa AG**
- (* Group boards)*

Jörg Asmussen, Berlin
Ministerial Director
German Federal Ministry of Finance

- a) *Euler Hermes Kreditversicherungs-AG*
- Postbank AG*
- b) *Bundesanstalt für Finanzdienstleistungsaufsicht*
(Deputy Chairman)

Dr. Jens Baganz, Düsseldorf
State Secretary in the Ministry for
Economic Affairs and Energy
in the State of North-Rhine Westphalia

- a) *Messe Düsseldorf GmbH*
- b) *GfW Gesellschaft für Wirtschaftsförderung*
Nordrhein-Westfalen GmbH (Chairman)
- NR W. International GmbH (Chairman)*
- Entwicklungsgesellschaft Zollverein mbH*
- Forschungszentrum Jülich GmbH*
- NRW.BANK*
- NRW Japan K.K.*
- ZENIT GmbH*

Dr. Jürgen Behrend, Lippstadt
Managing Director and General Partner of
Hella KGaA Hueck & Co.

- a) *Leoni AG*

Wolfgang Bouché, Düsseldorf
Employee representative

Hermann Franzen, Düsseldorf
General Partner of
Porzellanhaus Franzen KG

- a) *SIGNAL IDUNA Allgemeine Versicherung AG*
(Deputy Chairman)
- IDUNA Vereinigte Lebensversicherung aG*
- SIGNAL IDUNA Holding AG*

- b) *BBE Unternehmensberatung GmbH (Chairman)*

Dr.-Ing. Mathias Kammüller, Ditzingen
Chairman of the Management of
TRUMPF Werkzeugmaschinen GmbH + Co. KG

- b) *Bürkert GmbH & Co.*
- HUBER VERPACKUNGEN GmbH & Co. KG*

Wilhelm Lohscheidt, Düsseldorf
(until 31 August 2006)
Employee representative

Jürgen Metzger, Hamburg
Employee representative

Roland Oetker, Düsseldorf
Managing Partner of
ROI Verwaltungsgesellschaft mbH

- a) *Mulligan BioCapital AG (Chairman)*
- Deutsche Post AG*
- Volkswagen AG*

- b) *Dr. August Oetker KG (Deputy Chairman)*

Dr.-Ing. E.h. Eberhard Reuther, Hamburg
Chairman of the Supervisory Board of
Körber Aktiengesellschaft

- a) *Körber AG (Chairman)*

Randolf Rodenstock, Munich
 Managing Partner of
 Optische Werke G. Rodenstock KG

*a) E.ON Energie AG
 Rodenstock GmbH*

Rita Röbel, Leipzig
 Employee representative

Dr. Michael Rogowski, Heidenheim
 Chairman of the Supervisory Board of
 Voith AG

*a) Voith AG (Chairman)
 Carl Zeiss AG
 HDI Haftpflichtverband der Deutschen
 Industrie V.a.G.
 Klöckner & Co. AG
 Talanx AG*

*b) European Aeronautic Defence and Space
 Company EADS N.V.
 Freudenberg & Co.*

Jochen Schametat, Düsseldorf
 (since 31 August 2006)
 Employee representative

Dr. Carola Steingräber, Berlin
 Employee representative

Dr. Martin Viessmann, Allendorf (Eder)
 Chairman of the Managing Board of
 Viessmann Werke GmbH & Co. KG

*a) Messe Frankfurt GmbH
 Schott AG
 Sto AG*

Ulrich Wernecke, Düsseldorf
 Employee representative

Andreas Wittmann, Munich
 Employee representative

Board of Managing Directors

Frank Braunsfeld
(since 1 March 2007)

- b) *IKB Credit Asset Management GmbH*
IKB Capital Corporation
IKB Immobilien Management GmbH

Dr. Volker Doberanzke
(since 1 June 2006)

- b) *IKB Data GmbH (Chairman)*
IKB Credit Asset Management GmbH
IKB Capital Corporation
IKB Autoleasing GmbH
IKB Leasing GmbH
IKB Leasing Berlin GmbH
IKB Private Equity GmbH
IKB International S. A.

Dr. Markus Guthoff

- a) *Carl Zeiss Meditec AG*
- b) *IKB Capital Corporation (Chairman)*
IKB Credit Asset Management GmbH (Deputy Chairman)
IKB Private Equity GmbH (Chairman until 31 March 2007)
IKB International S. A. (since 1 April 2007)
Movesta Lease and Finance GmbH
Poppe & Potthoff GmbH

Claus Momburg

- b) *IKB Autoleasing GmbH (Chairman)*
IKB Leasing Berlin GmbH (Chairman)
IKB Leasing GmbH (Chairman)
IKB Private Equity GmbH (Chairman since 1 April 2007)
Movesta Lease and Finance GmbH (Deputy Chairman)
Argantis GmbH
IKB International S. A.

Joachim Neupel
(until 31 December 2006)

- a) *Aareal Bank AG*
- b) *IKB Immobilien Management GmbH (Chairman)*
IKB Movesta Lease and Finance GmbH (Chairman)
IKB Leasing GmbH
IKB Leasing Berlin GmbH
IKB Autoleasing GmbH
IKB Private Equity GmbH

Stefan Ortseifen

- a) *Coface Deutschland AG*
Coface Holding AG
- b) *IKB International S. A. (Chairman)*
IKB Credit Asset Management GmbH (Chairman)
DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH (Deputy Chairman)
IKB Autoleasing GmbH (Deputy Chairman)
IKB Capital Corporation (Vice Chairman)
IKB Leasing Berlin GmbH (Deputy Chairman)
IKB Leasing GmbH (Deputy Chairman)
IKB Private Equity GmbH (Deputy Chairman)
KfW Banking Group

Frank Schönherr
(until 30 November 2006)

- b) *IKB Capital Corporation (Chairman)*
IKB Financière France S.A. (Président Directeur Général)

Offices held by employees of IKB Deutsche Industriebank AG

Information within the meaning of section 340a (4) no. 1
of the HGB

Klaus Reineke
GKD Gebr. Kufferath AG

Düsseldorf, 15 May 2007
The Board of Managing Directors of
IKB Deutsche Industriebank AG
Düsseldorf

B. A. Falenke Jüttgen

Heinly Reineking

Auditor's Report

We have audited the annual financial statements, comprising the balance sheet, the income statement and the notes to the financial statements, together with the bookkeeping system and the management report of IKB Deutsche Industriebank Aktiengesellschaft, Düsseldorf, for the business year from 1 April 2006 to 31 March 2007. The maintenance of the books and records and the preparation of the annual financial statements and management report in accordance with German commercial law are the responsibility of the Company's management. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, and the management report based on our audit.

We conducted our audit of the annual financial statements in accordance with Article 317 HGB ("Handelsgesetzbuch": "German Commercial Code") and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (Institute of Public Auditors in Germany, IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of 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 business activities and the economic and legal environment of the Company and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the 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 management, 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, based on the findings of our audit, the annual financial statements comply with the legal requirements and give a true and fair view of the net assets, financial position and results of operations of the Company in accordance with German principles of proper accounting. The management report is consistent with the annual financial statements and as a whole provides a suitable view of the Company's position and suitably presents the opportunities and risks of future development.

Düsseldorf, 4 June 2007

KPMG Deutsche Treuhand-Gesellschaft
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Wohlmannstetter	Ufer
Wirtschaftsprüfer	Wirtschaftsprüfer

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