

Consolidated annual accounts

of the Cooperative Financial
Services Network 2005

Consolidated annual accounts

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Introduction

The power of decentralised enterprise management

In the course of the debate on the future of the financial services sector in Germany, the concept of decentralised enterprise management is taking shape. With its "Consolidated Annual Accounts for the Cooperative Financial Services Network 2005", the cooperative banking group has provided a clear picture of a strong decentralised group.

As in previous years, the consolidation ensued from the ownership perspective of the 1,290 local cooperative banks and special institutions. They are responsible for the decentralised enterprise management business model. As local, independent companies, they benefit simultaneously from the strength of a large group. The ongoing optimisation of these two elements forms the basis for the strength of the cooperative banking group.

The membership of 15.7 million people in cooperative banks, the proximity to 30 million customers via a tightly-meshed network of 14,122 banks and branch offices, and the competence of nationally operative product specialists who are the leaders in their fields are the basic factors in the success of the Cooperative Financial Services Network in Germany.

The power of our network is reflected in the sector rating of A+ and the individual rating B awarded by Fitch to each individual member bank of BVR for the first time in 2005. Furthermore, the annual profit in 2005 also confirms that a completely private organisation working on the basis of member and customer orientation as specified by law and the organisation's by-laws can succeed in a competitive market and produce absolutely solid results.

In 2005, the excellent cooperation was intensified as part of the overall strategy of the Cooperative Financial Services Network by means of the special committee program implemented with the repositioning of BVR. The special committee ("Fachrat") program correspond to the

strategic fields of operation and cover markets, information technology, products, payment transactions, management and human resources development. They are staffed with recognised experts from the cooperative banks, the affiliated companies and the associations. The special committees develop strategic programs for the local cooperative banks.

The internal rating process of the protection scheme, which is used to determine the individual contributions of the banks to the guarantee fund has become an indicator and incentive for improvement in the earnings situation of the member institutions of BVR. The results of this process are used to optimise the protection scheme, but also as an early warning system which facilitates the introduction of preventive measures to remedy undesirable developments at individual banks in timely fashion. The preventive and restructuring measures were implemented in 2005 and produced good results. The shift towards better ratings observed in 2003 and 2004 continued to accelerate in 2005. This is a major indicator of the sustained trend towards fewer cases which require restructuring. The successful efforts of the protection scheme in 2005 resulted in the reduction of the basic levy rate which determines the annual contribution to the guarantee fund. With its internal rating procedure, the Cooperative Financial Services Network has established a system that has developed an inherent dynamism, facilitating the continuous improvement of the economic situation of all primary banks.

The Cooperative Financial Services Network also focuses on investing in staff expertise by providing opportunities to pursue intensive training and continuing education. The quality of staff and management executives throughout the entire range of business activities is crucial to success in the market, particularly for the business

model employed by the cooperative banking group. The German cooperatives invested 600 million in the development of staff and management in 2005. The training seminars were carried out primarily by the educational network of the regional academies and the Academy of German Cooperatives. Qualifications were obtained by 115,000 in more than 500,000 seminar days.

The training and continuing education reflects the decentralised management of the organisation. The local cooperative banks are autonomous in matters of training and education, and are supported by the relevant regional academies in their efforts. The training and continuing education of management personnel is provided by the Academy of German Cooperatives. The local cooperative banks offer a comprehensive system of professional training and continuing education, from the initial training of 11,400 apprentices all the way to management programs and academic certification. Over 1,200 students have already made use of the courses of study for bachelor's degrees and MBAs combined with management programs as well as doctoral programs.

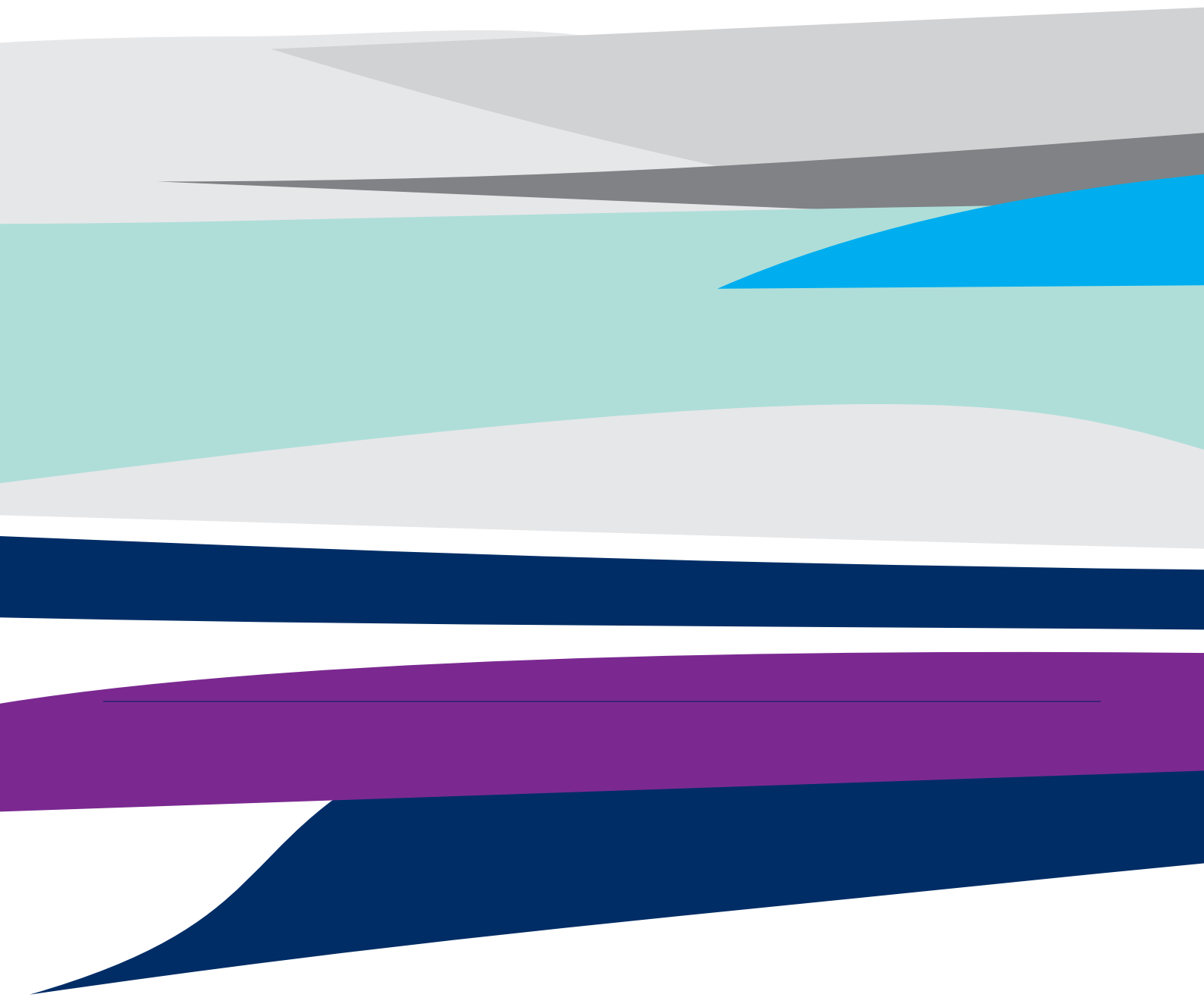
With regard to training and continuing education, the educational network instituted an e-learning system at an early stage. In the meantime, 80% of the continuing education for purposes of professional advancement is supported by the e-learning platform "VR-Bildung". This makes the cooperative educational network, which has over 144,000 registered users, the largest provider of e-learning in Europe and the second largest worldwide.

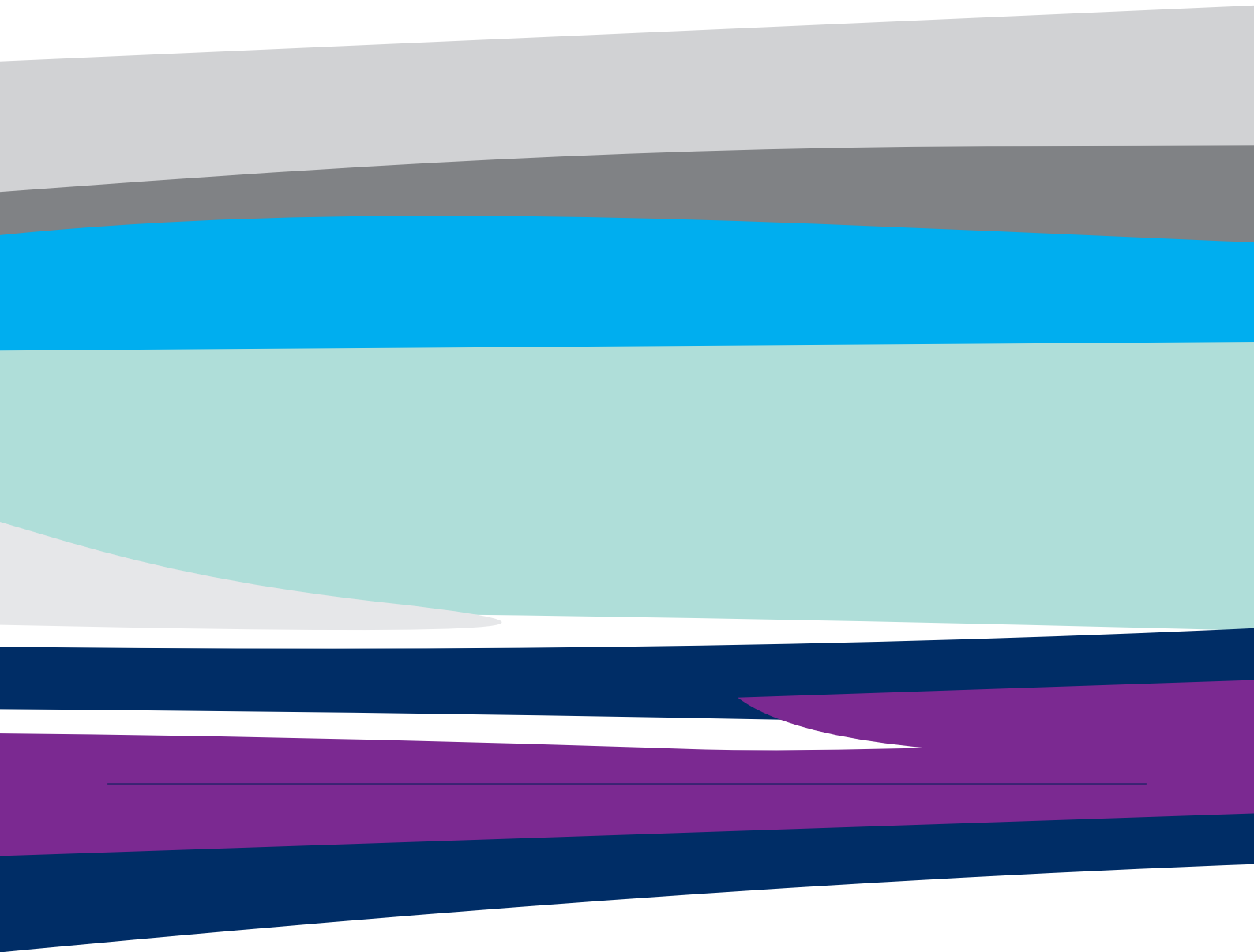
The human resources report, included in the annual financial statement for 2005 for the first time, provides details of the educational efforts of the Cooperative Financial Services Network.

The excellent performance of the Cooperative Financial Services Network in 2005 would not have been possible without the great personal commitment of the management board and the staff. Given this foundation, our task is to ensure the continuing success of the cooperative banking group in the future.

National Association of German
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The Management Board

Performance in 2005






Performance in 2005

Macroeconomic background

The German economy grew only sluggishly in 2005: gross domestic product increased in real terms by 0.9 percent. The foreign trade sector was once again the primary force driving economic growth. German exporters benefited from the lively economic activity in the United States and Asia as well as the increased competitiveness of Germany. The devaluation of the euro also had a positive influence on trade with countries outside the euro zone.

Domestic demand assisted economic development only slightly. However, the development of investment in machinery and equipment was brisk, as the increasing foreign demand required investment in replacement and expansion on the part of the export-oriented companies. The increase in company inventories also contributed to economic growth. On the other hand, the decline in construction investment, which began in the mid-1990s, had an adverse influence. Consumption remained sluggish due to the lack of significant increases in income. Private consumption stagnated in 2005.



Performance in 2005

Business performance of the Cooperative Financial Services Network

Profitable growth and functional integration

Based on the focused blend of specialisation and cooperation, the Cooperative Financial Services Network, which consists of 1,290 independent local cooperative banks, DZ BANK Group, WGZ BANK Group and Muenchener Hypothekbank eG, once again proved its worth, reflected in the successful performance in 2005. All segments continuously improved their performance during the past year. Both the two central banks as well as the affiliated companies integrated in the respective company groups posted record results last year. Moreover, DZ BANK AG won numerous awards in the past year, representing in many cases the entire Cooperative Financial Services Network.

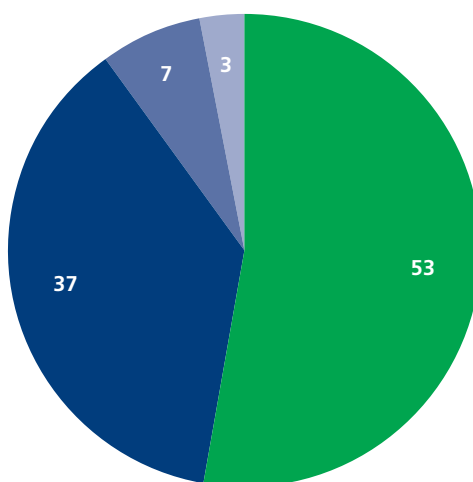
The enhanced competitiveness and performance of the DZ BANK Group and WGZ BANK Group contributed significantly to the increased market success of the local cooperative banks. Thus the market position of the Cooperative Financial Services Network was secured and expanded in attractive subsectors such as investment or the instalment credit business.

Organic growth of the balance sheet total

The consolidated balance sheet total of the Cooperative Financial Services Network as per December 31, 2005 amounted to € 909.2 billion, an increase of € 61.3 billion euros or 7.2 percent over the previous year. More than two-thirds of this growth came from the DZ BANK Group, while a large part of this was in turn accounted for by DZ BANK AG, whose balance sheet total in 2005 increased by € 34.4 billion or 18.1 percent.

The assets side of the balance sheet was characterised by a strong rise in loans and advances to other banks, holdings of securities and loans and advances to non-bank customers. The largest rise on the assets side

Assets structure of the Cooperative Financial Services Network as of 31 December 2005 (%)



Percentages shown are based on the aggregate sector balance sheets before consolidation

- Local cooperative banks
- DZ BANK Group
- WGZ BANK Group
- Muenchener Hypothekbank eG

of the consolidated balance sheet was in bonds and other fixed-interest securities. Compared to the previous year, these increased by € 29.1 billion to € 197.7 billion.

In line with their strong distribution activities, the local cooperative banks account for just under 71 percent by volume of the total lending to non-bank customers by the Cooperative Financial Services Network. Despite the

sluggish economy, total lendings to customers by the local cooperative banks rose slightly by 1.6 percent to € 343.8 billion. Loans and advances to customers increased more sharply by 4.6 percent at DZ BANK Group, WGZ BANK Group and Muenchener Hypothekenbank eG. Overall, retail lendings in the "specialised service providers" segment increased to € 143.4 billion. In the consolidated annual accounts, loans and advances to customers rose by € 12.6 billion euros (2.7 percent) to € 486.2 billion. Against the background of extremely low interest rates, the demand for variable-interest loans and loans with shorter terms was lower, while the demand for long-term loans increased considerably. As the Financial Services Network is particularly strong in providing loans with terms of more than five years, it reaped particular benefits from the preferences of customers engaged in construction. Finally, the demand for forward financing increased noticeably, as many customers wished to secure favourable interest rates for pending follow-up loans. In addition, the flat interest rate structure was very beneficial for the new business result in the residential property sector. Many local cooperative banks used the favourable market situation and intensified their active cultivation of the market in this area with the support of the cooperative mortgage banks.

The growth on the liabilities side of the balance sheet was due primarily to a considerable increase in liabilities to financial institutions of 23.2 percent and in securitised liabilities of 8.5 percent. Furthermore, the increase in the liabilities side of the consolidated balance sheet was characterised by a gratifying increase in liabilities to customers of € 18.7 billion to € 531.9 billion. Within the customer deposits, the local cooperative banks account for slightly more than four fifths of these balance sheet items, as in the previous year. The increase in customer deposits is due

primarily to the sharp rise in liabilities due on demand. This is attributable to the wait-and-see attitude of the customers, who prefer to invest their money in short-term, easily accessible options while the yield curve remains relatively flat. Securitised liabilities increased at a rate similar to that of the customer deposits. Thus the Cooperative Financial Services Network's aggregate stock of securitised liabilities rose to € 101.8 billion, up from the previous year.

The reported equity (capital and reserves) of the Cooperative Financial Services Network amounted to € 34.4 billion as of December 31, 2005, an increase of € 1.4 billion over the previous year-end figure. The increase in capital and reserves was due essentially to the allocation of € 706 million to revenue reserves. An increase in the membership shares of the local cooperative banks also contributed to the growth in equity. The further increase in membership of the cooperative banks reflects their continued appeal to the public. At the end of 2005, local cooperative banks had 15.7 million members – an increase of 220,000 (+1.4%) over 2004. In addition, the increased capital reserve and rise in net income for the year helped to strengthen their equity base.

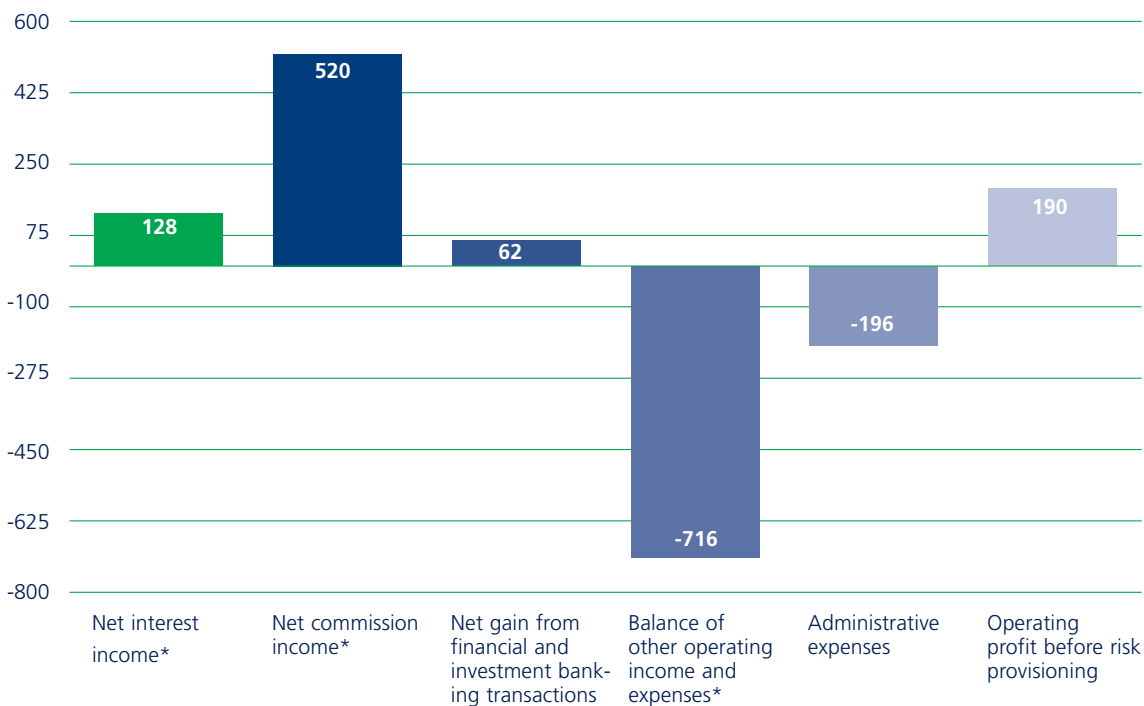
The capital resources of the Cooperative Financial Services Network amounted to € 54.2 billion. The total capital ratio of 11.4 percent clearly exceeded the minimum standard specified by Principle I. Compared to the previous year, the capital ratio remained constant at 12.4 percent. The Tier I capital ratio rose by 0.3 percentage points to 8.0 percent.

Base profitability improved further

The operating result of the Cooperative Financial Services Network was well above the high figure of the previous year. Operating profit (before risk provisioning) rose by € 190 million to € 8.1 billion. The local cooperative banks were responsible for just under three quarters of the operating profit (before risk provisioning). The changes in the operating revenues of the Cooperative Financial Services Network can be attributed primarily to the following devel-

opments: Net interest income rose by € 128 million compared to the previous year. This development is due primarily to the favourable refinancing based on the rising volume of demand deposits, which earn much lower rates of interest compared to other forms of deposit. Furthermore, the increase was characterised by a rise in interest income from lending and money market transactions. Net commission income (including income from insurance operations) rose principally as a result of the positive stock market environ-

Operating profit before risk provisioning: absolute changes 2004/05 (in millions)



*Net interest income includes income from participations, net commission income includes net income from insurance operations, special effects from the other operating income and expenses.

ment based on the successful securities business. Moreover, the profit contributions from the areas of payment transactions, asset management, lending (brokerage) and international operations increased. The increase of € 520 million makes net commission income the fastest-growing component of operating profit before risk provisioning. After the price losses that occurred in the financial markets following unusually high equity prices, and in view of the continuing difficult economic situation overall, customers were still seeking a sense of security in the year under review, so that the investors were correspondingly restrained with regard to direct investments in stocks and other risk investments.

In proprietary trading with securities and derivatives as well foreign exchange trading, the good results of the previous year were once again achieved in 2005. The net gain from financial and investment banking transactions of € 480 million was well above that of the previous year (€ 418 million). The net gain from financial and investment banking transactions is essentially determined by the trading activities of DZ BANK AG. The increase in the net gain from financial and investment banking transactions is also due to the proprietary trading result of the local cooperative banks, which rose from € 34 million in the preceding year to the current figure of € 50 million. However, their proprietary trading items still account for less than 1 percent of the total operating profit of the local cooperative banks, so that they play a relatively minor role compared to customer-driven business. Administrative expenses were reduced last year by a total of € 196 million to € 15.4 billion – an improvement of 1.3 percent.

Cost/income ratio further improved

The positive development of operative income is also reflected in the cost/income ratio: at the level of the “specialised service providers”, this figure was reduced from 58.7 percent in the previous year by 3.5 percentage points to 55.2 percent in 2005. At the level of the Cooperative Financial Services Network, the cost/income ratio improved by 0.8 percentage points compared to the previous year to 65.6 percent.

Risk provisioning further reduced

The Cooperative Financial Services Network's risk provisioning requirement has again been reduced from the previous year, falling by € 192 million to € 3.3 billion. Lower risk provisioning combined with the increased result of operations to increase operating profit after risk provisioning by € 382 million to € 4.8 billion in 2005.

Rise in net income before taxes

The net income before taxes amounted to € 4.6 billion in 2005, an increase of € 321 million over the previous year.

The tax expenditures of the Cooperative Financial Services Network amounted to € 2.1 billion in 2005. Net income rose by € 380 million to € 2.5 billion.

Segment report for the Cooperative Financial Services Network

This report focuses on the network's business segments in order to provide more detailed insight into their net worth, financial and earnings situation. The reporting segments reflect the structure of the Cooperative Financial Services Network by distinguishing between the “primary bank” segment (which aggregates the financial statements of the local cooperative banks) and the “specialised service

provider" segment (which includes the financial statements of DZ BANK Group, WGZ BANK Group and Muenchener Hypothekenbank eG). All other activities and consolidation procedures are described in the "Other/Consolidation" section (see also the details of the comments on the consolidated annual accounts).

Primary bank segment

Last year, the operating profit after risk provisioning of the primary bank segment amounted to € 2.1 billion. Thanks to their successful performance, the local cooperative banks made the largest contribution overall (44%) to the operating profit after risk provisioning of the cooperative banking group.

The net interest income achieved by the local cooperative banks and special institutions declined by € 94 million to € 14.1 billion in 2005. The drop in interest income was not compensated by the reduction in interest expenditures. The lending business in this segment was characterised by the flat yield curve as well as the ongoing rapid elimination of high-risk and therefore higher-yield assets. On the liabilities side of the balance sheet, the primary cooperative banks once again benefited from investors' strong preference for liquid investments and the resulting significant increase in the volume of low-interest sight deposits.

The net commission income in the primary bank segment rose by 5.9 percent to € 3.9 billion in 2005, so that the net commission income of the local cooperative banks remained stable. The principal driver of this revenue stream for local cooperative banks is once again payment transactions. The net gain from financial and investment banking transactions is a relatively minor factor in the primary bank segment. At the end of 2005, the local cooper-

ative banks posted a net gain from financial and investment banking transactions in the amount of € 50 million.

The balance of other operating income and costs incurred (including commodities trading) remained stable at € 938 million compared to the previous year.

Administrative expenses – particularly personnel expenses – rose primarily due to the higher allocation of pension provisions as a result of the reduction of the discount factor below the previously applied interest rate of six percent per year permitted under the tax laws. With this non-recurring expense, realistic reserves for the actually expected pension expenses were established.

The increase in risk provisioning is due primarily to the high allocation to the fund for general banking risks. Risk provisions amounted to € 3.5 billion at the end of 2005.


The cost/income ratio rose by 1.4 percentage points to 70.2 percent. On the other hand, the return on equity improved in the primary bank segment. The net profit before taxes as a percentage of the balance sheet capital and reserves rose from 9.7 percent in 2004 to 11.5 percent in 2005.

Specialised service provider segment

The net interest income in the specialised service provider segment rose by 10.9 percent compared to the previous year to € 2.8 billion. The interest earned from lending and money market operations provided a major contribution to the interest result. The net interest income in the specialised service provider segment rose by 13.9 percent to € 1.3 billion. The net gain from financial and investment banking transactions increased compared to the previous year's result by 11.0 percent to € 427 million. Administrative expenses increased slightly by 1.1 percent to € 2.7 bil-

lion. At the end of 2005, the specialised service provider segment achieved a cost/income ratio of 55.2 percent as a result of all the aforementioned factors, corresponding to an improvement of 3.5 percentage points over the previous year. This figure reflects the operational strength of the specialised service provider segment.

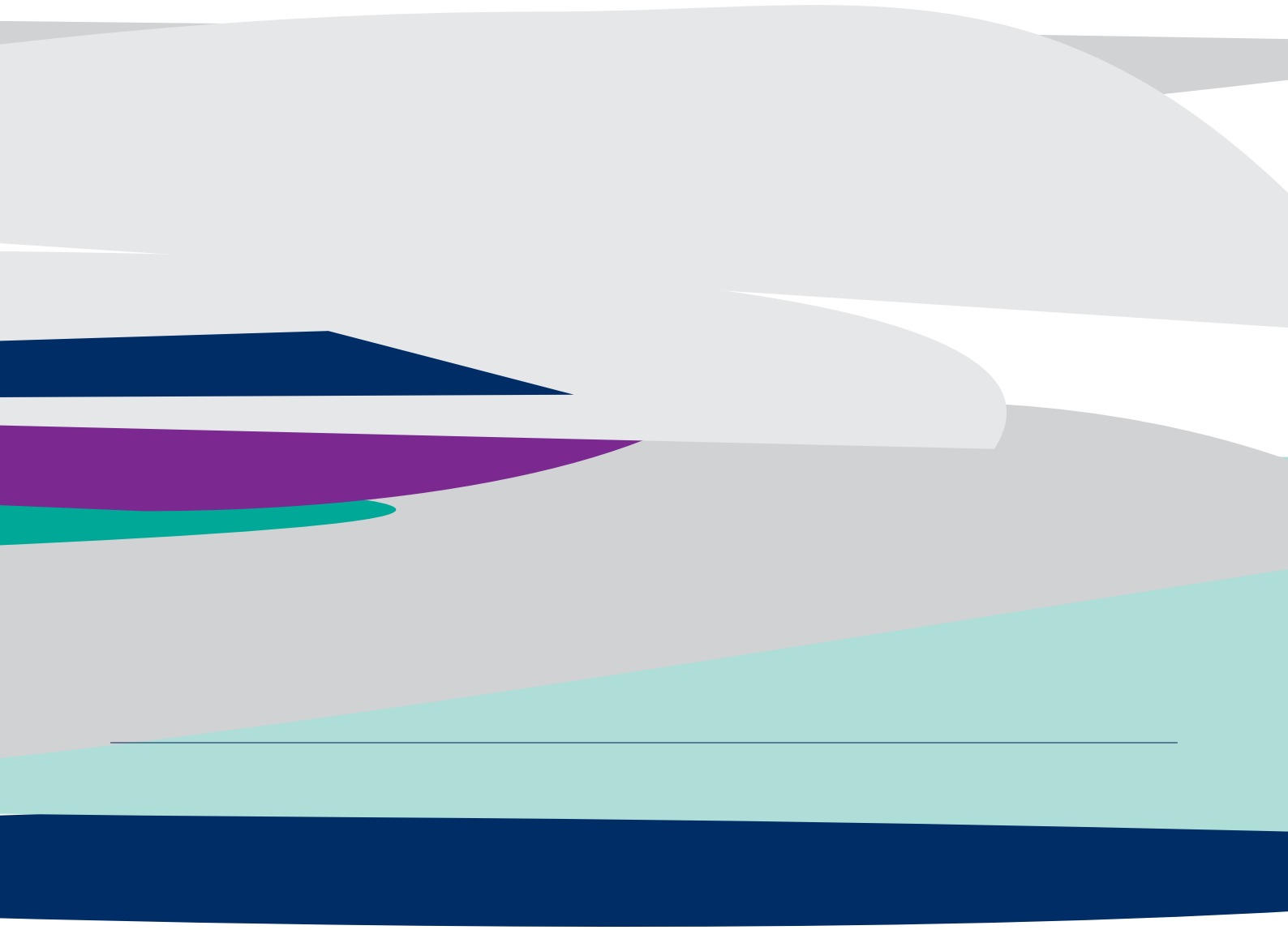
The net risk provisioning in fiscal year 2005 amounted to € 631 million for this segment. As a result of all the factors determining earnings, operating profit after risk provisioning rose to € 1.5 billion. The net profit of the specialised service provider segment – taking into account tax expenditures of just under € 600 million – amounted to € 769 million (previous year: € 561 million). The return on equity after taxes increased by 1.1 percentage points to 8.7 percent.





Consolidated annual accounts





Consolidated balance sheet of the Cooperative Financial Services Network as of 31 December 2005 (in millions)

Assets	31.12.2005	31.12.2004
1. Cash reserve	13,528	13,828
a) Cash on hand	4,766	4,698
b) Balances with central banks, including: at Deutsche Bundesbank 8,504, prior year 8,791	8,761	9,129
c) Balances with Postal Giro and Savings Offices	1	1
2. Debt instruments of public-sector entities and bills of exchange eligible for refinancing at central banks	229	354
a) Treasury bills and non-interest-bearing treasury notes as well as similar debt titles of public-sector entities, including at the Deutsche Bundesbank: refinanceable 10, prior year 86	29	92
b) Bills of exchange including: at the Deutsche Bundesbank: refinanceable 200, prior year 262	200	262
3. Placements with and loans and advances to other banks	100,276	86,527
a) Due on demand	6,539	7,300
b) Other placements, loans and advances	93,737	79,227
4. Loans and advances to non-bank customers	486,158	473,553
5. Bonds and other fixed-interest securities	197,731	168,680
a) Money market securities	1,537	2,115
aa) From public issuers	202	202
ab) From other issuers	1,335	1,913
b) Bonds and debentures	180,101	153,791
ba) From public issuers	48,941	39,149
bb) From other issuers	131,160	114,642
c) Proprietary bonds Nominal amount 16,148; prior year 12,757	16,093	12,774
6. Equity shares and other variable-yield securities	32,684	30,460
6a. Inventory	193	184
7. Insurance-related investments	41,253	38,196
8. Other insurance-specific assets	1,799	2,318
9. Participations	2,283	2,307
a) Participations	2,157	1,655
b) Operating balances at cooperatives	126	652
10. Participations in associated companies	372	283
11. Shares in affiliated companies	1,665	1,301
12. Trust assets including: trustee loans 4,618; prior year 4,377	6,156	5,927
13. Equalization claims against government agencies including claims converted into bonds	0	54
14. Intangible assets	14,329	14,354
15. Tangible assets	24	24
16. Other assets	5,994	6,032
17. Deferred tax assets	1,532	1,696
18. Accrued income and deferred taxes	2,761	2,445
Total assets	909,179	847,855

Equity and liabilities	31.12.2005	31.12.2004
1. Deposits from other banks	160,474	130,272
a) Due on demand	12,286	8,945
b) Amounts owed to other depositors	148,188	121,327
2. Liabilities to non-bank customers	531,860	513,172
a) Savings deposits	216,687	214,688
aa) subject to agreed 3-month withdrawal notice	161,568	159,865
ab) subject to agreed withdrawal notice of more than 3 months	24,853	26,652
ac) Building society deposits	30,266	28,171
b) Other liabilities	315,173	298,484
ba) Due on demand	149,417	137,012
bb) With agreed term or withdrawal notice	165,756	161,472
2a. Liabilities from commodities transactions and commodity lending	29	27
3. Securitised liabilities	101,773	93,783
a) Negotiable bonds	92,834	88,008
b) Other securitised liabilities	8,939	5,775
4. Liabilities arising from trust operations including trustee loans 4,618; prior year 4,377	6,156	5,927
5. Other liabilities	5,297	4,380
6. Accrued expenses and deferred income	3,955	3,864
7. Provisions	9,844	9,748
a) Provisions for pensions and similar obligations	4,395	4,073
b) Tax provisions	963	1,235
c) Other provisions	4,486	4,440
8. Fund for building society coverage	493	470
9. Insurance-related provisions	38,335	34,967
10. Other insurance-specific liabilities	3,732	4,619
11. Subordinated liabilities	5,976	6,470
12. Participatory capital, including amounts due within a period of two years 1,506; prior year 961	4,682	5,302
13. Fund for general banking risks	2,169	1,846
14. Capital and reserves	34,404	33,008
a) Subscribed capital	9,699	9,339
b) Capital reserve	1,650	1,354
c) Revenue reserves/retained earnings	19,281	18,575
ca) Statutory reserves	9,080	8,601
cb) Reserves for equity shares	24	24
cc) Reserves prescribed by the by-laws	246	47
cd) Other revenue reserves	9,931	9,903
d) Adjustment for minority interests	2,079	2,283
f) Net income for the year/Consolidated income	1,695	1,457
Total liabilities	909,179	847,855
1. Contingent liabilities	27,026	25,263
a) Liabilities from sureties and guarantee agreements	26,903	25,254
b) Liability from the ordering of securities for third-party liabilities	123	9
2. Other liabilities	43,440	34,709
a) Placement and underwriting commitments	180	13
b) Committed credit facilities	43,260	34,696
3. Special assets managed on behalf of shareholders	129,278	113,267
Total inventory values	129,278	113,267
Number of special assets managed	622	636

Consolidated income statement for the Cooperative Financial Services Network for the period from 1 January to 31 December 2005 (in millions)

	2005	2004
1. Interest income	35,897	35,702
2. Interest expenses	20,452	20,238
3. Current income	1,251	1,106
4. Income from profit pools, profit transfer agreements or profit sharing agreements	84	82
5. Commission income	5,689	5,035
6. Commission expenses	797	825
7. Net gain from financial and investment banking transactions	480	418
7a. Gross profit from commodities trading	164	143
8. Income from insurance operations	10,993	10,089
9. Expenses from insurance operations	10,553	9,487
10. Other operating income	2,797	2,830
11. General administrative expenses	14,370	14,489
12. Depreciation and valuation allowances on participations, shares in related companies and	1,032	1,109
13. Other operating expenses	2,062	1,358
14. Depreciation and valuation allowances on loans and advances and certain securities as well as additions to provisions for the lending business	6,016	6,066
15. Transfers to the fund for general banking risks as per § 340 g of the German Commercial Code	323	109
16. Income from write-ups on loans and advances and certain securities plus releases of provisions for the lending business	2,592	2,537
17. Depreciation and valuation allowances on participations, shares in affiliated companies and securities treated as fixed assets	197	65
18. Income from write-ups on participations, shares in affiliated companies and securities treated as fixed assets	637	204
19. Expenses from the assumption of losses	84	27
20. Result of ordinary operations	4,698	4,373
21. Extraordinary income	5	2
22. Extraordinary expenses	77	71
23. Net extraordinary income	-72	-69
24. Taxes on income and earnings	2,014	2,073
25. Other taxes	54	54
26. Earnings paid out under profit pools and profit transfer or profit sharing agreements	56	55
27. Consolidated net income for the year	2,502	2,122
28. Attributable to minority interests	113	114
29. Retained earnings brought forward	49	32
30. Withdrawals from revenue reserves	101	81
31. Withdrawals from participatory capital	0	1
32. Allocations to revenue reserves	844	665
33. Consolidated net income for the year	1,695	1,457

Segment reporting by business segment

Fiscal year 2005

In € millions unless otherwise specified	Primary banks* 2005	Specialised service providers 2005	Other/ Consolidation 2005	Cooperative Financial Services Network 2005	Cooperative Financial Services Network 2004
Net interest income	14,062	2,789	-71	16,780	16,652
Net commission income (including insurance operations)	3,889	1,296	147	5,332	4,812
Net gain from financial and investment banking transactions	50	427	3	480	418
Balance of other operating income and expenses (including commodities trading)	938	350	-389	899	1,615
Administrative expenses	13,301	2,682	-581	15,402	15,598
Operating profit before risk provisions	5,638	2,180	271	8,089	7,899
Risk provisions	3,516	631	-840	3,307	3,499
Operating profit after risk provisions	2,122	1,549	1,111	4,782	4,400
Pre-tax profit for the year	3,697	1,350	-477	4,570	4,249
Net income for the year	2,209	769	-476	2,502	2,122
Segment assets	559,744	470,986	-157,301	873,429	812,729
Segment liabilities	534,610	458,044	-156,480	836,174	776,814
Equity	32,148	8,817	-6,561	34,404	33,008
Balance sheet total	585,564	487,802	-164,187	909,179	847,855
Cost/income ratio (CIR) (%)	70,2	55,2		65,6	66,4
ROE, Return on Equity (%) (before taxes)	11,5	15,3		13,3	12,9
ROE, Return on Equity (%) (after taxes)	6,9	8,7		7,3	6,4
Number of employees	162,550	25,846	39	188,435	189,748
Average number of employees over the year	130,550	25,635	39	156,224	158,771

*Includes local cooperative banks, specialist institutions, Sparda and and PSD banks

Capital structure of the Cooperative Financial Services Network as of 31 December 2005

In € millions	Primary banks* 2005	Specialised service providers 2005	Other/ Consolidation 2005	Cooperative Financial Services Network 2005	Cooperative Financial Services Network 2004
Capitalisation					
Tier 1 capital	32,088	10,367	-7,388	35,068	34,012
Tier 2 capital	16,086	6,115	-339	21,861	22,520
Liable equity capital	45,195	16,747	-7,726	54,216	54,310
Tier 3 capital	231	0	0	231	359
Total own funds	45,426	16,747	-7,726	54,196	54,669
Risk assets					
Risk weighted assets	352,404	124,083	-37,994	438,494	438,904
Capital adequacy ratios					
Tier 1 capital ratio	9.1%	8.4%		8.0%	7.7%
Equity capital ratio	12.8%	13.5%		12.4%	12.4%
Total capital ratio as defined in Principle I	12.7%	10.7%		11.4%	11.8%

* Includes local cooperative banks, specialist institutions, Sparda and PSD banks

Consolidated annual accounts

Comments on the consolidated annual accounts

Companies included in the consolidation

These consolidated annual accounts for the Cooperative Financial Services Network as prepared by BVR incorporate the data for

- the local cooperative banks,
- BVR's protection scheme,
- DZ BANK Group,
- WGZ BANK Group and
- Muenchener Hypothekenbank eG.

The financial data of DZ BANK Group, WGZ BANK Group and Muenchener Hypothekenbank eG were collected from the banks' responses by means of questionnaires created specifically for this purpose, which were based largely on the published annual reports. BVR's annual inter-organisation comparison study served as the basis for the calculation of the aggregated balance sheet and the aggregated income statement of the local cooperative banks. At the end of 2005, there were 1,290 local cooperative banks, of which 1,269 were included in the annual inter-organisation comparison study. The study ultimately covered 98.4 percent of the combined total assets of all local cooperative banks. The remainder not covered by the study was extrapolated on the basis of the total assets identified. The aggregated financial statements of the local cooperative banks also included specialist institutions such as BAG Hamm, Deutsche Apotheker- and Ärztebank eG, the Sparda banks and the PSD banks. The data for norisbank AG is incorporated in that of the DZ BANK Group.

Consolidation activities

The consolidation measures undertaken as part of the preparation of the annual accounts focused primarily on the assets side of the balance sheet; these items included

primarily loans and advances to other banks, bonds and other fixed-interest securities and holdings. On the liabilities side, these items included primarily liabilities to other banks, securitised liabilities, subordinated liabilities, participatory capital and equity. The required data was collected by means of a survey of the relevant banks. The consolidation information for the local cooperative banks was partially identified as the mirror image of the items reported by DZ BANK Group, WGZ BANK Group, Muenchener Hypothekenbank eG and BVR's protection scheme. Part of the consolidation information for the local cooperative banks was gathered through a separate survey as part of the annual inter-organisation comparison study. A separate survey was conducted to establish the book values of the local cooperative banks' stakes in DZ BANK AG and WGZ BANK AG. The resulting average price of a DZ BANK or WGZ BANK share then formed the basis for calculating the book value of a stake in the two central banks. With regard to Muenchener Hypothekenbank eG, it was assumed that the local cooperative banks would carry their holdings in this affiliated bank at nominal value. The book values of the holdings determined in this manner were fully offset against capital and reserves. Finally, as part of the capital consolidation, the indirect links of the local banks were taken into account for the first time, which resulted in a reduced minority interest in capital and reserves. In order to draw a comparison with the previous year, the previous year's values had to be partially adjusted in the balance sheet.

As part of the consolidation of the elimination of internal income and expenses, income and expenses arising from the provision of services between the consolidated companies were offset against each other. The earnings items interest income and commissions earned were offset



against the expense items interest expenses, commission expenses and expenses from insurance operations. The dividends received from consolidated companies in the year under review were eliminated. Income realised in previous fiscal years, from a consolidation perspective, were offset against the revenue reserves. The required data was gathered from the same sources as the data for the balance sheet consolidation activities. The (extraordinary) income earned from contribution transactions in the area of central bank participations during the change in legal form of WGZ BANK from a registered cooperative to a stock corporation with a cooperative character were consolidated.

The capital resources and the capital adequacy data for the Cooperative Financial Services Network were obtained by consolidating the raw capital and reserves data and the items for which inclusion is mandatory. Capital consolidation was a two-stage process. In the specialised service provider segment, cross-shareholding relationships between DZ BANK Group, WGZ BANK Group and Muenchener Hypothekenbank eG were consolidated. The cross-shareholding relationships between the specialised service providers and the primary banks were accounted for in the "Other/Consolidation" item. In the case of items for which inclusion is mandatory, the consolidation accounted for overlaps in the balance sheet assets, the traditional off-balance-sheet and derivative transactions as sub-categories of risk assets, and counterparty default risk items within the market risk items. The required data were collected using specific questionnaires.

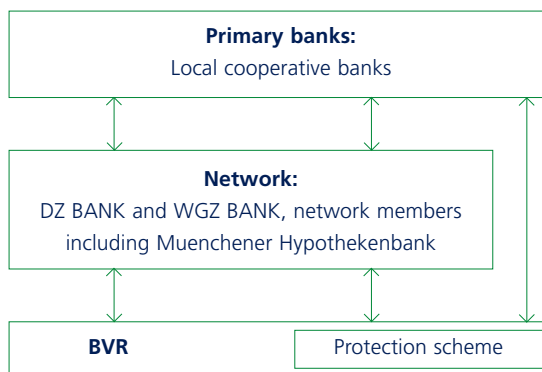
Distinctions and definitions of terms in segment reporting

The Cooperative Financial Services Network is a democratic network based on principles of subsidiarity. The foundation

of the network is formed by the local cooperative banks, which are supported in their work by the two central banks – DZ BANK AG and WGZ BANK AG – and by various affiliated companies which are integrated in the two central bank groups, with the exception of Muenchener Hypothekenbank eG. The benefit gained by the credit cooperatives from their cooperation with the affiliated companies and the two central banks consists primarily of access to the comprehensive range of integrated financial products and services from a single source. Almost all local cooperative banks work with the product specialists from the Financial Services Network (see graphic below).

This cooperation with the Cooperative Financial Services Network is also reflected in segment reporting as part of the consolidated annual accounts, in that the local cooperative banks are viewed as an operative segment and the central banks and affiliated companies are viewed as a product-oriented segment. The characteristic property used to define the product-oriented segment is the uniformity of the provision of products and services of the affiliated companies to the credit cooperatives. Against this back-

The Cooperative Financial Services Network



ground, the segment report is divided into three segments:

1. The "primary bank" segment" includes the annual accounts of the local cooperative banks in aggregated form.
2. The "specialised service provider" segment includes the annual accounts of DZ BANK Group, WGZ BANK Group and Muenchener Hypothekenbank eG. Transactions among these three business units were consolidated in this section.
3. "Other/consolidated" includes the annual accounts of BVR's protection scheme as well as the consolidation transactions between the "primary bank business" and "specialised service provider business" segments as well as the consolidations with the BVR protection scheme. The remit of BVR's protection scheme is to avert threatening or existing financial difficulties in the member banks by means of preventive or restructuring measures.

The components aggregated to represent the earnings situation of the segments included the net interest income, the net commission income including the surplus from insurance operations, the net gain from financial and investment banking transactions, administrative expenses and the balance of other income and expenses. Risk provisioning was the final factor included in this regard.

The net worth and financial situation of the segments was reported under "segment assets" and "segment liabilities". The "segment assets" include the cash reserve, receivables from banks and non-bank customers, bonds and other fixed-interest securities, equity shares and other variable-yield securities, insurance-related capital investments and other insurance-specific assets. The "segment liabilities" include all liabilities to other banks and non-

bank customers, securitised liabilities, insurance reserves and other insurance-specific liabilities. The reported capital and reserves comprise the balance sheet capital and reserves of the Cooperative Financial Services Network, including the consolidated net income for the year.

The twin benchmarks for measuring the performance of the Cooperative Financial Services Network are the return on equity and the cost/income ratio. The return on equity is shown as the ratio of the annual net income (before/after taxes) to shareholder equity. The cost/income ratio shows the relationship between total administrative expenses and total operating income, reflecting the cost efficiency of each segment.

Berlin, July 1, 2006

National Association of German
Cooperative Banks · BVR
The Management Board

Dr. Christopher Pleister Jochen Lehnhoff Hubert Piel

Certificate for the National Association of German Cooperative Banks (BVR)

The National Association of German Cooperative Banks (BVR), Berlin, has voluntarily combined the information provided in the consolidated annual financial statements of DZ BANK AG and WGZ BANK AG, prepared in accordance with German commercial law and issued with unqualified audit certificates, as well as the annual financial statements of the Muenchener Hypothekbank eG and BVR's protection scheme, prepared in accordance with German commercial law and issued with unqualified audit certificates, as well as the annual financial statements of the credit cooperatives, prepared in accordance with German commercial law, for the period from January 1 to December 31, 2005. Combining this information involved aggregating the relevant balance sheets and income statements for fiscal year 2005, adjusting for intra-network items and publishing the results as "Consolidated Annual Accounts for the Cooperative Financial Services Network".

The "Consolidated Annual Accounts for the Cooperative Financial Services Network" incorporate the following components combined on the basis of certain assumptions and simplifications:

- balance sheet as of December 31, 2005
- income statement for the period from January 1 to December 31, 2005
- segment reporting for 2005,
- capital resources and Principle I statement,
- comments on the consolidated annual accounts.

The "Consolidated Annual Accounts for the Cooperative Financial Services Network" are supplemented by a report on business performance, a human resources report, a risk report and the outlook for 2006.

BVR is not legally obligated to prepare consolidated

financial statements. The credit cooperatives' membership shares are held by their members. The credit cooperatives hold their cooperative shares and/or equity shares in the sector's central institutions either directly or through intermediate holding companies. The Cooperative Financial Services Network does not qualify as a group as defined by the German Commercial Code or the German Stock Corporation Act.

As part of the preparation, selected specific procedures are carried out which reflect the unique structure of the Financial Services Network to eliminate intra-network balance sheet and income statement items. Sections 290 et seq. of the German Commercial Code were applied subject to certain assumptions and simplifications. The "Consolidated Annual Accounts for the Cooperative Financial Services Network" are therefore not equivalent to group accounts as defined by the German Commercial Code.

The purpose of the "Consolidated Annual Accounts for the Cooperative Financial Services Network" is to portray the business performance of the cooperative financial services sector, viewed as a single economic entity from a risk and strategy perspective on a consolidated basis.

The following companies were included in the "Consolidated Annual Accounts for the Cooperative Financial Services Network":

- DZ BANK Group
- WGZ BANK Group
- Muenchener Hypothekbank eG,
- BVR's protection scheme and
- 1,334 cooperative banks.



The data for DZ BANK Group, WGZ BANK Group, Muenchener Hypothekenbank eG and BVR's protection scheme were gathered using specific survey questionnaires.

The relevant data for the cooperative banks were gathered by BVR as part of its annual sector study, based on the unaudited annual accounts prepared by its member banks as of December 31, 2005. As of December 31, 2005 there were 1,290 independent cooperative banks, of which 1,269 were covered by the annual sector study. In quantitative terms, the results of the survey incorporate 98.4% of the balance sheet totals of all 1,290 cooperative banks. The unsurveyed remainder of 1.6% was extrapolated pro rata based on the balance sheet totals.

The preparation of the "Consolidated Annual Accounts for the Cooperative Financial Services Network" is the responsibility of the BVR management board.

We conducted a limited review in accordance with the generally accepted German standards for the limited review of financial statements promulgated by the Institute of Public Auditors in Germany (Institut der Wirtschaftspruefer (IDW) A limited review is restricted primarily to inquiries of company personnel and analytical assessments, and thus does not provide the assurance obtainable from an audit of financial statements. In accordance with our assignment, we have not performed an audit and therefore cannot issue an audit certificate.

We have performed a limited review of the consolidation methods described in the "Comments on the Consolidated Annual Accounts" and the aggregation of the raw data derived from the surveys supporting the "Consolidated Annual Accounts for the Cooperative Financial Services Network" for the year 2005.

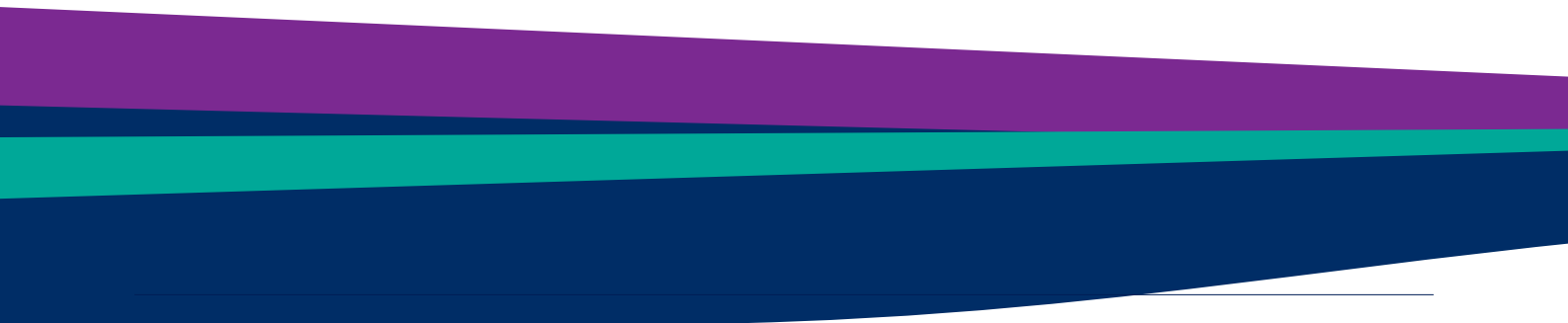
Based on our limited review, nothing has come to our attention that causes us to believe that

- the methodological approach and the data collection procedures might be inappropriate,
- the group of companies included might be incomplete,
- the consolidation of intra-network transactions based on certain assumptions and simplifications might not have been performed properly,
- the combined balance sheet and income statement might not be presented accurately, or that
- the comments on the consolidated annual accounts, the report on business performance, the human resources report, the risk report or the outlook for 2006 might be unclear or misleading.

Eschborn/Frankfurt am Main, 6 July 2006

Ernst & Young AG,
Wirtschaftsprüfungsgesellschaft

Mueller-Tronnier	Wagner
Chartered Accountant	Chartered Accountant



Human Resources Report

Our staff are the guarantors of collective success

A crucial factor in the success of the Cooperative Financial Services Network is its human resources: the 190,000 staff members of the banks and affiliated companies. Thus the companies offer their employees an extensive range of training and continuing education programs throughout Germany. Currently, the Cooperative Financial Services Network is the second largest provider of professional education for bankers and it is training 11,400 young people to become qualified German bankers with recognised qualifications and attractive career opportunities. Thus the Financial Services Network is fulfilling its regional social responsibility as promulgated in the cooperative philosophy even in times of difficult economic environment.

Qualified staff provide high-quality service

Thirty million customers, including 15.7 million members in Germany, expect high-quality service and expert advice from their cooperative banks. Only staff who have enjoyed an outstanding education and are trained in entrepreneurial thinking can provide such services. For this reason, the local cooperative banks invested € 600 million in the training and continuing education of staff and management last year. Over 115,000 participants in training and continuing education seminars on over 500,000 participant days demonstrate the cooperative banking group's belief that investment in personnel is an essential strategy for the future.

Using a model of competence as the basis, a tightly-meshed network of internal bank-related training and continuing education supported by the regional academies and the national management institute of the Academy of German Cooperatives has been developed. As part of the

overall strategy of "combining forces", the educational network integrated its requirements profiles to an even greater degree in 2005. National certificates of competence were developed and a model implemented to facilitate the uniform yet decentralised provision of new content.

In the meantime, just under 80 percent of the continuing education program for professional advancement known as "GenoPE" (cooperative personnel development) is supported by the joint project of the cooperative education network known as "VR-Bildung". With 144,000 registered users, VR-Bildung is now the largest e-learning provider in Europe and the second largest in the world. The content of the continuing education program for professional advancement is developed in regional competence centres and implemented in uniform fashion nationwide under the project management of the Academy of German Cooperatives.

The quality of management staff across the entire range of operations is crucially important to market success, especially for a decentralised banking group. The Academy of German Cooperatives thus unites the expertise of 800 instructors from the areas of theory, consulting and management practice. Moreover, in cooperation with the renowned Steinbeis University, internal group management programs have been completely integrated with academic courses of study for the first time in Germany.

Thus a comprehensive alternative to public universities, ranging from a course of study integrated in vocational training to bachelor's and MBA programs in finance all the way to a doctoral degree, has been established and is also integrated in the educational programs of the Cooperative Financial Services Network. Thus, as part of the decentralised management system, each cooperative bank can link its individual personnel development strategy to

Carefully evaluated certified programs from the region as well as national and international advanced training programs for the elite.

Personnel development: The example of VR FinanzPlan Mittelstand (VR FinancialPlanning SME)

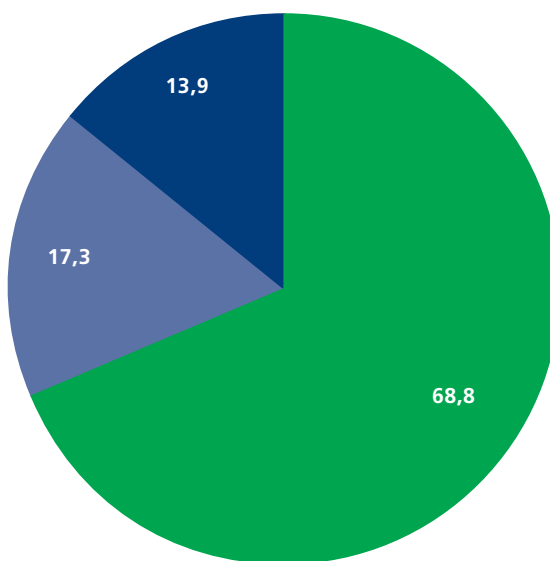
In the coming years, it is imperative to reinforce and expand the culture of achievement as well as sales and marketing in the cooperative banks. All of the human resources management personnel in the individual local banks as well as the regional and national training programs must be committed to the pursuit of this objective. New sales and marketing concepts enable management and employees to approach customers more proactively than in the past and to advise them in targeted fashion to achieve optimal results. One example of this is the new sales and marketing concept for the corporate customer business, known as VR FinanzPlan Mittelstand (VR FinancialPlanning SME). In this context, the task profiles of the staff in the corporate customer segment are adapted and appropriate training measures developed.

The cooperative financial institutions also receive support in the form of motivation and incentive systems such as the collective agreement on performance and/or success-based remuneration. This is already available to the institutions and will be optimised to meet market requirements in the future as well.

Professional training remains a high priority

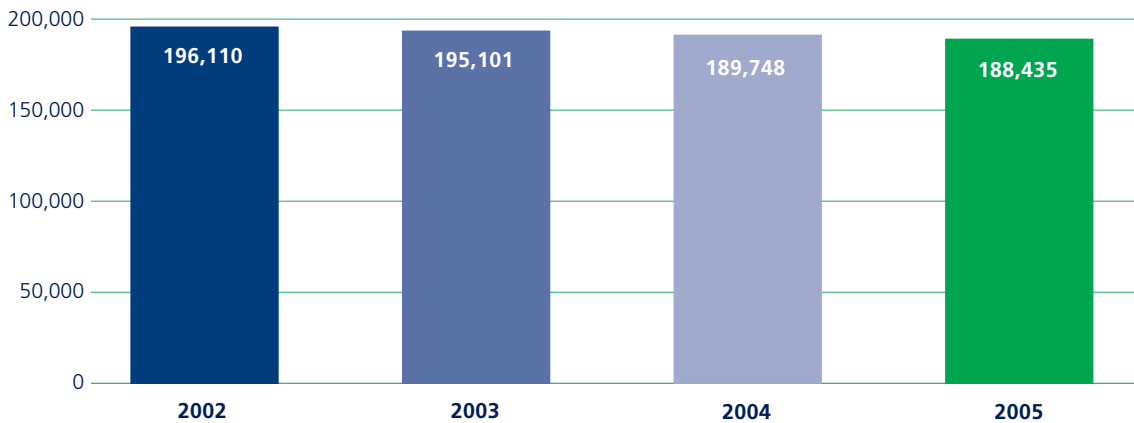
The local cooperative banks provide an enormous range of education and training year after year: as the second largest training institution in Germany, the cooperative banks train one third of all banking personnel. At the end of 2005, 11,400 career entrants completed a course of training;

Hiring of trainees after their successful completion of the examination in 2005 (%)



The cooperative banking sector still provides an enormous amount of professional training and education. Last year the training ratio reached 7.3 percent, significantly above that of other economic sectors. In 2005, upon passing their final examinations, more than two-thirds of the trainees were hired by their local cooperative banks.

- Hired
- Not hired
- Possibility of hiring under review

Number of employees

Between 2002 and 2005 the number of people employed in the cooperative banking sector declined moderately. This was due primarily to the fact that positions vacated by retiring employees were not filled. The cooperative banking sector provides many jobs in the various regions, with a total of 190,000 employees in 2005.

most of them became qualified bankers. The member institutions of the Cooperative Financial Services Network also train people for careers in information technology or offer certifications in investment fund management or office communications. In first-class, contemporary professional training programs, the trainees acquire a solid background in their field as well as personal, social and methodological skills.

The banks offer an attractive educational program for young people with German university entrance qualifications. Various dual programs of study enable staff members to earn a state-recognised bachelor's degree or a German university diploma while they are completing their vocational training or while working thereafter.

After completion of their vocational training, the young German bankers have good chances of being hired and outstanding development opportunities in a wide variety of fields. In contrast to most major banks, the flat hierarchies in the cooperative banks offer opportunities for fast promotion, whether in sales and marketing, private or corporate customer business, controlling, bank management, or IT.



Risk report





Risk report

The Cooperative Financial Services Network has developed a variety of instruments for the effective management of the risks arising from its wide range of business activities. Our risk management strategy distinguishes among credit risk, market risk, liquidity risk, operational risk and other risks. These risks are managed with the aid of a defined set of principles relating to exposure, organisational structures and operating processes. In the following report, credit risk and market risk will be discussed in particular detail, as these are of crucial importance to the cooperative banks. Risk management instruments operate both at the primary bank level and the network level. The core elements of this set of risk management principles include VR Control, the BVR-II rating system, BVR's protection scheme and the cooperative central banks' risk transfer instruments.

VR-Control

With VR Control, the cooperative banking group has developed its own comprehensive solution for present-value-based bank management that unites a series of controlling instruments which are both established in the market and widely used in practice. VR Control has been installed in most of the local cooperative banks. Its primary purpose is the management of proceeds, costs and risks in the bank's individual business divisions. In VR Control, the Cooperative Financial Services Network has succeeded not only in finding a common language for bank controlling, but also in developing effective instruments with which to safeguard the banks' ability to deal with risks and to optimise operations management. VR Control is a functional solution that can be tailored to the individual bank's needs and structures. The individual modules that comprise the

complete system combine to provide views of everything from individual transactions to portfolios to an overview of overall banking operations.

BVR II rating procedures

The BVR II rating procedures were created to facilitate harmonisation of the rating results with the Cooperative Financial Services Network. The BVR II rating procedures meet the requirements imposed on state-of-the-art rating systems. One required quality feature of contemporary, statistics-based rating systems is a specific focus on the individual customer segments. Each different segment has its own unique features which must be taken into account and mapped, so that a single rating system for all customer segments would never be accurate enough. Every single rating will be connected with the BVR master scale and so

Customer segments in the BVR II rating system

Retail clients	Overdrafts
	Consumer loans
	Home loans
Corporate clients	Start-ups
	Industrial and commercial trades/Self-employed
	SMEs
	Large SMEs
	Large corporate customers
	Not-for-profit enterprises
Banks	Food and agriculture
	Banks and financial institutions
state sector	"Countries" (states)
	Central, regional, local authorities
Specialist finance	Project finance
	Commercial real estate

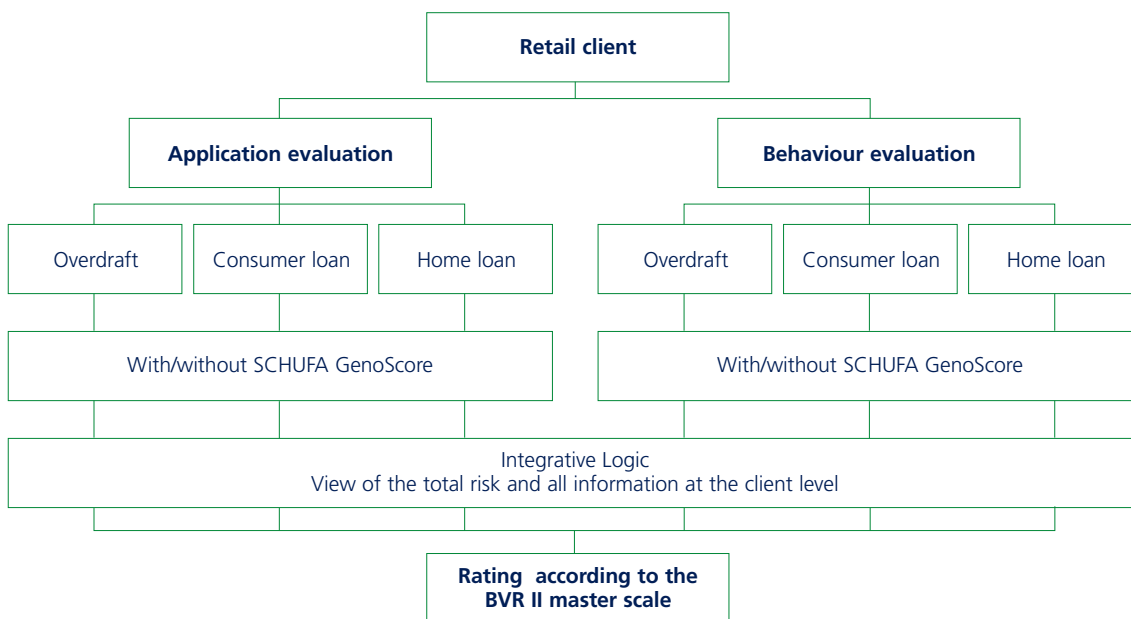
it is comparable to each other. The rating procedures are used to determine the probability of default of an individual borrower for the risk premium calculation as well as for setting the parameters for the portfolio model in VR Control.

The BVR II rating procedures are developed on an empirical and statistical basis using best practice methods, whereby priority is given to tailoring the procedures specifically to the lending processes of the banks. All of the rating systems are based on pooled, anonymised data from the Cooperative Financial Services Network, which originate from comprehensive databases.

Another quality characteristic of a rating system is its discriminatory power. This designates a rating system's ability to distinguish accurately between high and low

probabilities of default. This predictive accuracy is usually measured by reference to ratios such as PowerStat or the Gini coefficient. Finally, a rating system should always produce the same results given identical circumstances and equal scores on the relevant criteria. The BVR II rating procedures are highly discriminatory systems: they are very likely to correctly distinguish customers with a high probability of default from those with a low probability. In order to ensure the quality of the rating procedures, they are regularly updated in dedicated competence centres and subjected to backtesting for purposes of validation as well.

The BVR II rating procedures for corporate customer business have been in use at local cooperative banks since 2003. The procedures for the core SME customers are used by the banks to cover a major part of the overall



assessment of the financial standing and credit risks of corporate customers.

The BVR II rating procedure for retail clients was introduced to the local cooperative banks at the end of 2005. It covers the areas of current accounts, consumer credit and construction finance, and provides a fast assessment of creditworthiness thanks to the integrated application and credit record analysis. The rating procedure was developed using a very wide range of data from the cooperative banks and is thus tailored specifically to the portfolio of the primary banks. The extensive available data are also used to derive the average portfolio default rates and to determine the calibration functions in the development of the retail client ratings.

The BVR II rating procedure for retail clients ensures a streamlined lending process which is automated to the fullest extent possible. It thus meets the needs of retail banking for fast decisions on loans and conditions. The linkage of the procedure to the contribution accounting in VR Control facilitates risk-oriented pricing, assisting in the management of the lending business.

The internal country rating forms the basis for the assessment of country risks. The BVR II country rating procedure meets the requirements of contemporary risk management systems as well as those of Basel II. The BVR II country rating takes into account macroeconomic risk factors which are relevant to the assessment of credit standing as well as qualitative factors which facilitate an appraisal of the political risks and the general institutional conditions in a particular country.

Management of retail lending

The rating procedure is used to identify the probability of default for an individual transaction. The retail lending

management function in VR Control is used to price the discrete transaction. The "DB III" contribution margin calculation includes all the significant earnings components (conditions contribution, commission result, risk premium and standard unit costs). Comparing this with the defined return requirement makes it possible to evaluate the profitability of the individual transaction relative to a specific customer or a customer group, to product groups or profit centres, right up to an overall view of customer results. The earnings components of the DB III contribution margin calculation are essential for operatively accurate pre- and post-calculation of customer business. The evaluation of all individual transactions using the contribution margin calculation forms the basis of portfolio-oriented management for the local cooperative banks.

Credit risk

In the portfolio model of VR Control, the credit risk of the bank overall and the individual sub-portfolios is determined and measured using the value-at-risk approach. The value-at-risk designates the potential risk of loss (maximum change in value) in a sub-portfolio, which, with a certain degree of probability (confidence level) will not be exceeded for a defined period of time (holding period).

With the VR CreditPortfolioManager (VR CPM), VR Control provides an efficient module for the analysis of the loan portfolios of local cooperative banks. The core elements of this approach include

- the expected present-value calls and the unsecured parts of the loans in the case of a default,
 - the probability of default determined for the period under analysis using the BVR II rating,
 - structural information regarding branch membership of the individual borrowers, and
-

- information on the inclusion in a risk-relevant unit of the borrower

With the aid of the centrally determined current yield curve and portfolio model parameters, the probability of default of the loan commitment is determined on the basis of default time series which are typical for the branch. The central model of VR CPM thus calculates the probability distribution of the credit portfolio losses of a credit cooperative. Based on this probability distribution, both the expected loss as well as the unexpected loss can be derived from the credit portfolio as a difference of an extreme loss scenario minus the credit or conditional value-at-risk covered by the risk premium. In addition to the aggregate credit risk, VR CPM also identifies the risk driven by individual borrowers and individual borrower groups (such as branch groups or rating groups). This transparency and quantifiability across the entire portfolio risk represent on the one hand the prerequisite for active trading of credit risks in the sense of active portfolio management, and on the other provide the opportunity to formulate adequate risk limits and to determine economic capital requirements and thus a more efficient allocation of risk capital.

Market risk

The market risk consists of the interest rate change risk, the currency risk and the share price risk as well as the risks derived from these. The risk strategy pursued by the bank is reflected in the interest book and the trading book as part of the portfolio analysis of VR Control. The management of the market risk includes the already completed customer transactions as well as the proprietary trading activities in the inventory: in accordance with the principle of dual management, the sales department is obligated to

conclude customer transactions with a positive contribution margin. Upon conclusion of the transaction, the sales department is positioned so that it is free of market risk and credit risk thanks to the concept of structurally congruent countertransactions and the calculation of the risk premiums. The ensuing management of the market risk takes place as part of the central structure management by the responsible dealer, who makes the decision whether to close the open market risk item or to leave the item open in view of his own analysis of the market. The value-at-risk approach is the method used to measure market risks.

In VR Control, the determination of the value at risk for the partial portfolio is accomplished using historical simulation. Backtesting is performed in order to check the forecast quality of the value-at-risk approach. To do this, the daily profits and losses are compared with the value-at-risk figures calculated using the risk model. Stress tests are also performed in order to take extreme market fluctuations into account. The crisis scenarios include the simulation of large fluctuations in the risk factors and are used to indicate potential losses that are not calculated using the value at risk. As part of the stress test, both extreme market fluctuations that actually occurred in the past as well as crisis scenarios are assumed, which are judged to be economically relevant regardless of the market data history. Based on the value losses simulated in the stress test, the adequacy of the internal limits imposed is continuously reviewed.

Overall bank management

In all areas of bank management, the measurement of the homonymous and thus comparable risk and profit factors is undertaken. The aggregation of all risks at the overall bank management level facilitates the realistic assessment

of a bank's ability to handle risks. The controlling perspective of VR-Control splits profit contributions between customer business and risk management. On the one hand, this facilitates differentiation in the terms of business offered to customers via contribution costing. On the other hand, it also enables optimisation of the bank's portfolio structure in terms of returns and risks. The present-value-based management approach functions as an early warning system with regard to the impact of transactions on the profit and loss statement. Risk management solely on the basis of profit and loss management often results in adverse effects being recognised far too late.

VR Control's individual modules are mapped in a standard software tool used throughout the financial network. This has substantially minimised the Cooperative Financial Services Network's IT engineering costs. The regional cooperative associations ensure that local implementation of VR Control is tailored to the needs of those who will be using it and provide their member banks with appropriate package offers. It is their responsibility to create and refine an adequate structure for the systematic roll-out of VR Control.

VR Control outsourcing model

The expert implementation team at BVR has undertaken the task of developing a coordinated plan for an outsourcing model as part of VR Control. The aim was to create a service package that would relieve banks of the administrative expense involved in reporting in the area of bank management. This approach focuses particularly on small banks. The design of a basic package as well as possible optional components are the main elements of a corresponding template which can be adapted specifically to suit the needs of each region. Already existing packages

have been included in this development. In practice, the utilisation of the outsourcing option is determined primarily by the regularity of reporting required, accelerated implementation, the transfer of expertise involved and the quality assurance method used. The reports generated provide the basis for the management decisions of the bank's management board. Our analyses of banks that are already using the outsourcing services have revealed that they are already achieving increases in net interest income as well as higher operating results. Larger banks can make use of a comprehensive range of services offered by the cooperative associations and the central banks. The German financial services regulator BaFin has singled out this outsourcing model as a praiseworthy support for banks.

BVR's protection scheme

2005 was the second full fiscal year following the Cooperative Financial Services Network's implementation of all the extensive amendments to the statute governing BVR's protection scheme that had been initiated in previous years. The preventive and restructuring activities based on these changes produced very satisfactory results in 2005 as well.

Legal basis

BVR maintains a protection scheme in accordance with Section 4 of the by-laws of the National Association of German Cooperative Banks. This is explicitly identified as an institutional protection system (i.e., one that ensures the continued survival of a member bank) in Section 12 of the law implementing the EC deposit protection and investor compensation directive (Gesetz zur Umsetzung der EG-Einlagensicherungs- und Anlegerentschädigungsrichtlinie). Thus, since August 1, 1998, the BVR protection

scheme has been subject to supervision by the German financial services regulator BaFin (Section 12 (1) in conjunction with Section 7 (3) of the above-named law); this exempts it from the requirement to be part of a statutory compensation scheme and means it offers a higher level of depositor protection than the legally required minimum standard.

The purpose of the protection scheme is to pre-empt or remedy imminent or actual financial difficulties involving the affiliated banks and to prevent impairment of the public's trust in the cooperative banks. To help it perform the necessary rescue and restructuring tasks, the protection scheme has at its disposal a guarantee fund and a guarantee group.

As of December 31, 2005, a total of 1,298 (2004: 1,343) members of the Cooperative Financial Services Network were affiliated with BVR's protection scheme.

The BVR protection scheme performed the role defined in its statute to the full extent in 2005. With regard to the protection scheme, the course of the 2005 fiscal year was determined by the ongoing restructuring and preventive measures as well as the application of the classification process and the work towards establishing a network rating. The contributions to the guarantee fund are determined on the basis of member banks' classifications using the network's internal classification method. The results of this (early warning) system are also used in initiating preventive management.

Classification process

The system of contributions to the BVR protection scheme based on the financial standing of the banks as determined by BVR's classification process took effect on January

1, 2004. The annually determined contributions to the guarantee fund can now be reduced or increased within a range between 90 and 140 percent, depending on the financial standing of the individual member bank. As in 2004, all member banks in principal must pay their guarantee fund contributions for 2005 based on their individual classifications.

The classification system assigns member banks to one of eight credit classes which reflect their financial standing (A+, A, A-, B+, B, B-, C and D) based on eight key figures relating to their assets, earnings and risks. The internal classification method relies on quantitative ratios taken primarily from the banks' audited annual financial statements and audit reports. This data is automatically supplied in electronic form to the protection scheme by the regional audit associations responsible for the respective member banks.

As a rule, the classification method described above applies to all of the banks affiliated with the protection scheme. However, under the BVR's by-laws, cooperative sector institutions that have a credit rating from an external rating agency are exempt from internal classification schemes. This includes in particular the two cooperative central banks, the mortgage banks and the building society Bausparkasse Schwäbisch Hall AG.

The results of the annual internal classification process provide an early warning indicator which the protection scheme uses as part of its support for banks, specifically for its preventive work. This process is a powerful, precisely discriminating tool for identifying those banks that may represent a higher exposure to risk for the protection scheme. The banks given an A+ rating demonstrate the lowest probability of requiring a rescue whilst those given a D rating have the highest.

In 2005, the shift in the distribution of credit ratings towards the better classes which was observed in the two preceding years continued; this is a major indicator of the sustained trend towards fewer cases which require restructuring.

Preventive management

The results of BVR's internal classification process also constitute the basis for systematic preventive management of the protection scheme. Based on their classifications, additional information and supplementary discussions with local management, agreements are made with the banks affected to implement adequate measures designed to stabilise and improve their business development. During 2005, the protection scheme therefore approached the banks that were given a B- classification or worse based on their year-end financial statements as per December 31, 2004 for the first time or attracted attention based on other information.

Following the analysis of further documentation submitted by the banks detailing their current business development, their management and controlling processes as well as their audit reports, these banks are assigned to one of three categories. Assignment takes place regardless of their internal classification score; the relevant categories in this case are "monitored bank", "actively supported bank" and "bank requiring reorganisation". The primary assignment criterion is the degree of risk they present for a potential restructuring. All preventive management interventions take place in close consultation with the regional audit associations.

Since the procedure was introduced, almost half of all the member banks covered by the preventive management scheme have already successfully completed the pro-

gram and received satisfactory classifications: Either these banks' financial situation had improved significantly due to the actions taken, or they have merged with other banks to form new institutions. Eight banks subjected to preventive measures had to implement restructuring measures in 2005 because they could no longer generate the funds needed to remedy their risk situation from their own resources. Otherwise, and in the vast majority of the cases requiring support, the preventive procedures designed in 2003 and applied universally since 2004 proved to be compatible with banks' ordinary operations and thus far more acceptable - especially to the banks concerned. In many specific instances, the necessary remedial activities or measures were agreed on an individual basis and are already in progress or have even been completed by the affected banks.

One of the key objectives of our preventive management effort is to return the guarantee fund contribution to the base levy rate within the next few years.

Restructuring management

The work of the protection scheme with regard to the restructuring of member banks focuses on making the banks healthy businesses again and ensuring that their annual accounts are eligible for an audit certificate. The protection scheme's activities are based on uniform standards for the treatment and support of banks adopted in 2003 throughout the network that make use of the facilities of the guarantee fund. These standards were compiled in a "Manual for Banks Undergoing Restructuring", which defines mandatory procedures for affiliated banks in this situation.

In 2005, the total restructuring volume as well as the number of banks affected were again noticeably re-

duced. This repeated reduction in the number of banks requiring restructuring is a strong indication that our preventive activities are working.

Moreover, numerous banks undergoing restructuring in accordance with the new uniform standards of the protection scheme for the network have made gratifying progress and are returning relatively quickly to the earnings trajectory outlined in their business plan for the restoration of their underlying profitability.

Additional risk management instruments

In addition to the risk management and risk hedging tools made available at the overall network level, the cooperative central banks have also developed further instruments to allow the local credit cooperatives to transfer risk on an individual basis. Risk transfer makes it possible for banks to transact additional new business without taking on significantly greater risk, even though the credit lines available to individual customers, sectors or risk groups have already been exhausted, and to invest in customer segments to which they previously had no or only limited access. Trading in credit risks can actually reduce unforeseen losses and thereby relieve the burden on the local cooperative banks' equity capital.

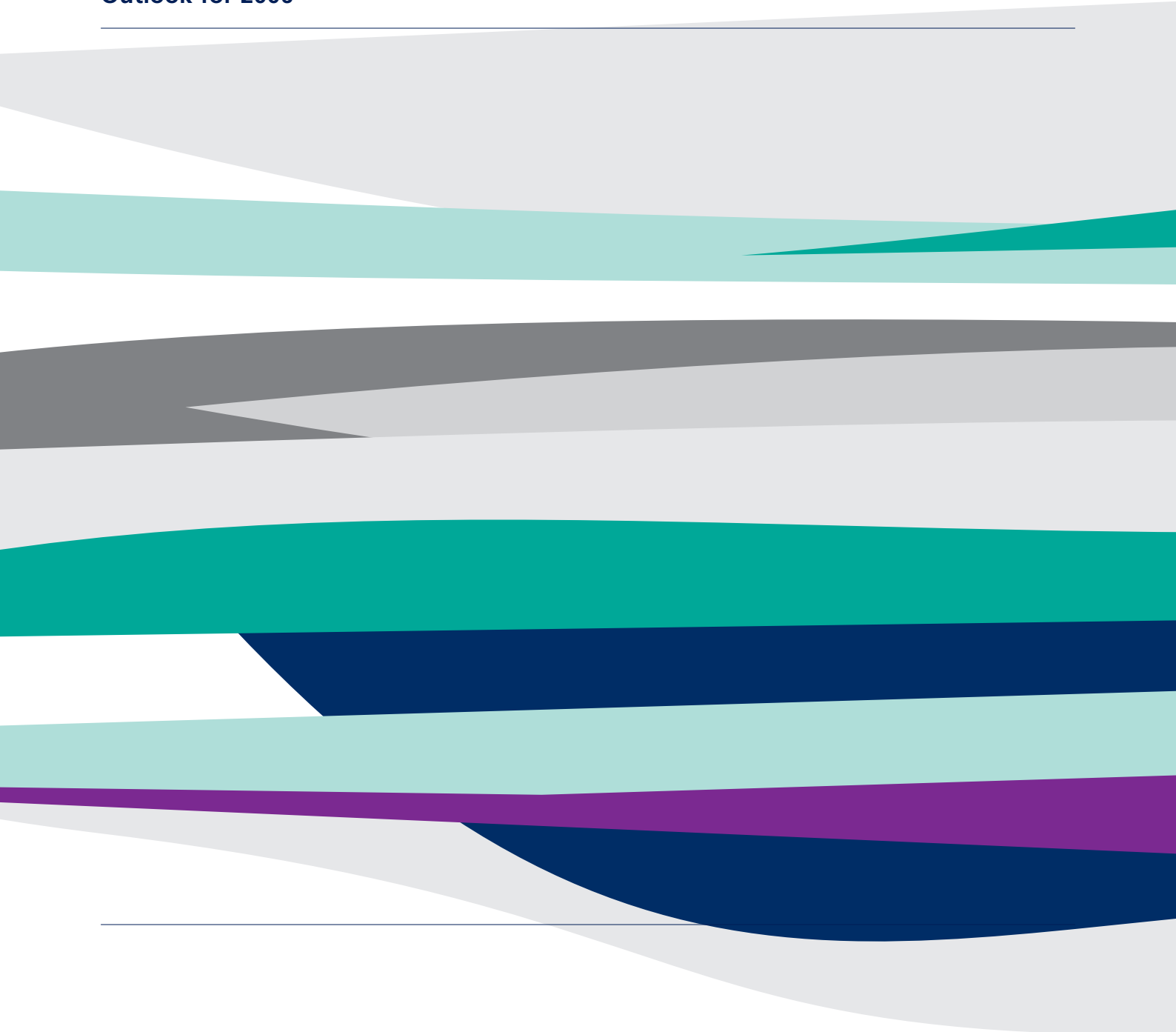
For many years, the members of the Cooperative Financial Services Network have been making use of traditional instruments such as loan syndication, loan insurance, guarantees and sureties as ways of transferring their lending risks to third parties. However, the spectrum of suitable products has been considerably extended in recent years. Credit derivatives are playing an increasingly important role in this process.

For example, in fiscal year 2005 DZ BANK carried out two special loan securitisation transactions referred to

as "VR Circle 1 and 2". VR Circle is a closed-loop model for commercial customer loans and advances that was co-developed by the cooperative banks and tailored specifically to their needs. Thirty-three pilot banks participated in the first two securitisation transactions. With this model, the credit cooperatives can reduce risks arising from large loan commitments by putting the loans into a pool. The repurchase of a share in this widely distributed pool can considerably reduce the credit risk of the cooperative banks. Risk is transferred synthetically through credit-linked notes, so that the loans remain in the balance sheet of the cooperative bank and the relationship between the customer and the bank remains unaffected. The broad distribution and thus reduction of the risks and the expansion of room for manoeuvre in lending means that VR Circle significantly improves the protection of the entrepreneurial independence of the cooperative banks.

The WGZ LOOP risk transfer platform marketed by WGZ-Bank eG is another good example of the interaction between different partners in the Cooperative Financial Services Network in the context of risk transfer. WGZ LOOP also utilises a closed-loop model to optimise portfolio diversification through the transfer of risk on unsecured commercial loans. It enables participating banks to use credit default swaps to transfer credit risk without damaging the original customer relationship. Local cooperative banks take back the credit risks they have put into the system in widely diversified form. The prerequisite for this multi-seller transaction is that the uniform BVR II rating must provide the basis for evaluating the contributed risks. Participation in WGZ LOOP reduces cluster risks, thereby lowering the value at risk of the lending portfolio and permits more flexible credit line management.

Outlook for 2006





Outlook for 2006

In 2006, the German economy is gaining vitality. Germany will be able to achieve economic growth of two percent in real terms. Exports are growing strongly despite the high price of oil and the rising euro, while domestic demand is increasing as well. Private consumption is benefiting from the slight growth in the labour market, and is experiencing growth due to special effects such as the soccer world cup and pre-emptive effects arising from the pending increase in V.A.T. The companies are investing more once again, supported by improved depreciation terms, high profits and other favourable financing conditions.

In view of the business potentials, and taking into account the positive figures for business development in the first two quarters of 2006 combined with the improving economic environment, the result for the cooperative Financial Services Network for the current fiscal year is expected to be at least at the level of the previous year.

In the corporate customer business, DZ BANK Group and WGZ BANK Group will enable the cooperative banks (Volksbank and Raiffeisenbank) to increase their below-average market share in this sector through further standardisation of instruments and processes as well as targeted joint initiatives. This will likewise have a positive influence on the interest result, such as the promising instalment loan business of norisbank and its partner banks. Furthermore, successful cross-selling will significantly increase the income from the corporate customer business with interest rate and currency hedges. Together with their subsidiaries, DZ BANK and WGZ BANK will continue to develop their range of products and services for corporate customers.

In retailing, the comparatively strong market position of the local cooperative banks will be further developed by means of quality improvements across the entire

range of integrated financial services from a single source. These measures will also improve the net commission income on a sustained basis. A slight increase in the net gain from financial and investment banking transactions is expected; however, this part of the result depends to a large extent on the developments in the capital market. Based on the continuation of our risk-oriented business policy, we are optimistic about the future development of risk provisioning.





