

## Report of the Supervisory Board of Aareal Bank AG, Wiesbaden

Dear shareholders,

Aareal Bank once again succeeded in posting positive results for all quarters of the financial year under review – and hence, also for the 2010 financial year as a whole. This means that Aareal Bank AG has generated positive quarterly results on each occasion since the outbreak of the international crisis affecting financial markets and the economy back in 2008.

The bank posted a marked increase in operating profit compared with the previous year. From the Supervisory Board's perspective, this positive performance of Aareal Bank AG is a resounding confirmation for the viability of the Group's business model.

Bearing in mind that the environment on property markets was difficult throughout the year, and also given the significant nervousness and volatility on financial markets, the results are very satisfactory. Since the second quarter of 2010, developments on financial markets were seriously influenced by the sovereign debt crisis which affected certain European countries. As such, the ongoing discussions concerning budget deficits meant that sovereign credit spreads for some European countries remained high until the end of the year. The environment for the property sector continued to be challenging throughout the year, even though signs for bottom-building were evident in numerous markets.

Thanks to careful and forward-looking management, Aareal Bank AG continued to have sufficient liquidity at all times during the 2010 financial year, together with a sound funding base. The positive business development permitted Aareal Bank AG to repay a first tranche of the silent participation by SoFFin. At the same time, to be prepared for further market uncertainty, the bank drew on the unutilised portion of the guarantee facility provided by SoFFin to issue a € 2 billion guaranteed bond, which the bank took on its own books.

During the financial year under review, the Supervisory Board continually advised, monitored, and supervised the management of the company. The Management Board informed the Supervisory Board regularly, without delay and comprehensively, both orally and in writing, of all issues important to the Group with regard to its situation, business development, key financial indicators, and market developments. In addition, detailed reports and explanations were given to the Supervisory Board regarding the current liquidity status and liquidity management measures taken, the prevailing risk situation, and on risk control and risk management measures taken within the Group. The Supervisory

Board also received comprehensive reports on the development of business segments, and on operative and strategic planning. The Supervisory Board was informed about, and involved in, all important decisions. All material events were discussed and examined in detail; where a Supervisory Board resolution was required, the decision proposals were submitted to the Supervisory Board and a decision taken. In cases where resolutions needed to be passed in between Supervisory Board meetings, such resolutions were passed by way of circulation.

Furthermore, between the meetings of the Supervisory Board, the Chairman of the Management Board kept the Chairman of the Supervisory Board informed, on a continuous and regular basis, both orally and in writing, on all material developments of the company. The Chairman of the Management Board maintained close contact with the Chairman of the Supervisory Board, in order to discuss key issues and important decisions personally.

### Activities of the Supervisory Board

Twelve plenary meetings of the Supervisory Board took place during the financial year under review, of which five were scheduled meetings. Four of the extraordinary meetings were held by way of a conference call. During the meetings, the members of the Supervisory Board received reports and explanations by the members of the Management Board, and discussed these in detail. Proceedings and reports during all scheduled meetings focused on the way the bank dealt with the challenges posed by the sovereign debt crisis affecting individual European countries, and with the impact of continued high levels of financial market nervousness and volatility on the bank's business environment.

The plenary meetings of the Supervisory Board also discussed the partial repayment of SoFFin's silent participation, and the utilisation of the remaining guarantee facility. These measures were coordinated with the Supervisory Board, and approved them.

In its discussions, the Supervisory Board also concerned itself with changes to the regulatory framework, in great detail. During the year under review, such changes included resolutions adopted by the G 20 countries and financial markets regulators regarding the new capital requirements for banks (commonly referred to as "Basel III"), the resolutions to establish a European financial markets regulatory authority, the repeated revision to the Minimum Requirements for Risk Management in Banks (MaRisk), and the amendments to the German Corporate Governance Code.

Throughout the financial year, in the course of all meetings as well as during the periods between meetings, the Management Board informed the Supervisory Board about economic and market developments and their potential impact on Aareal Bank Group, in a timely, complete and comprehensible manner. This included detailed explanations of the appropriate measures taken in response to the challenges arising from the sovereign debt crisis affecting certain European countries, and from other market developments.

During the scheduled plenary meetings of the Supervisory Board, the Management Board reported to the Supervisory Board, regularly and comprehensively; these reports also covered the development of the Structured Property Financing and Consulting/Services segments, focusing on current economic developments. Within regular intervals, the Supervisory Board was informed of the bank's liquidity status and the related steps taken by the bank's Treasury. In addition, the Supervisory Board was informed about business development of the entire Aareal Bank Group, on the basis of actual figures and projections. The Management Board also reported regularly on the quality of the property financing portfolio, against the background of general market trends and expected changes on the various property markets.

During the March, September and December meetings, various remuneration issues were presented in the context of the new German Ordinance on Remuneration in Financial Institutions, as well as other regulatory requirements. This included a

detailed inventory of remuneration systems throughout Aareal Bank Group, as well as issues concerning Management Board remuneration which were raised by the new regulations.

The focal points of the various Supervisory Board meetings are presented below:

During three meetings in January and February, the Supervisory Board discussed in detail the strategic options available to Aareal Bank Group in a changed market environment.

In its March meeting, the Supervisory Board concerned itself in detail with the financial statements and consolidated financial statements presented for the 2009 financial year, and with the auditors' report. The relevant facts were presented in the Supervisory Board report for the previous year. The meeting also discussed the proposal for the appointment of external auditors to be submitted to the Annual General Meeting, as well as the details of the subsequent instructions to be given to them, including the contents and focal points for the audit during the 2010 financial year, as specified by the Supervisory Board.

Further topics discussed during the March meeting included preparing the Annual General Meeting held in May 2010, as well as the annual reports submitted by Internal Audit and the Compliance Officer. In accordance with the German Act on the Modernisation of the Accounting and Reporting Laws (Bilanzrechtsmodernisierungsgesetz – "BilMoG"), the plenary meeting also received a presentation of the internal control system used to manage Group subsidiaries, together with measures planned in this context.

In April, another Supervisory Board meeting was held to discuss strategic issues, following up on topics for which further work had been instructed during the meetings at the beginning of the year.

The May meeting of the Supervisory Board was held after the Annual General Meeting of Aareal Bank AG; this was the constituting meeting of the newly-elected Supervisory Board and its com-

mittees. During this meeting, the Supervisory Board also followed up on the Annual General Meeting. Certain aspects of the credit risk strategy were discussed and adopted, and a final report provided on the merger of Aareal Bank France S.A. into the parent company Aareal Bank AG, which had necessitated the early re-election of the Supervisory Board.

The topics of the subsequent extraordinary meetings included discussions and the passing of resolutions regarding the first partial repayment of the silent participation by SoFFin, and the drawdown of the remaining guarantee facility, to guarantee a bond issue.

During the September meeting, the 2010 amendments to the German Corporate Governance Code were presented and discussed, alongside other regulatory changes. Certain aspects of lending approval management were reviewed, and corresponding resolutions passed.

The two meetings in October and November focused on the personnel changes in the Management Board of Aareal Bank AG; specifically, the retirement of Mr Norbert Kickum and the appointment of Mr Dirk Große Wördemann.

During the December meeting, the Management Board reported on the Group's business plan, which it submitted to the Supervisory Board and gave detailed explanations. Corporate governance issues were discussed as well: in this context, the Supervisory Board adopted the Declaration of Compliance, pursuant to section 161 of the AktG, for the year 2010, which was subsequently published on the bank's website. Another key aspect was to bring Aareal Bank AG's rules and regulations in line with the modified corporate governance framework.

In accordance with good corporate governance practice, the Supervisory Board also regularly examines the efficiency of its activities in order to identify any areas requiring improvement. The results of the examination of efficiency conducted during the 2010 financial year were acknowledged

by the members of the Supervisory Board, and were discussed in detail. Measures were discussed and initiated in order to realise the minor improvements identified.

Strategy documents were regularly submitted to, and discussed by the Supervisory Board, in accordance with the Minimum Requirements for Risk Management in Banks (MaRisk).

The Chairmen of Supervisory Board committees regularly gave account of the work in the committees to the plenary meeting, answering all related questions by the plenary meeting in detail.

Any Supervisory Board decisions which were taken by way of circulation were discussed at the subsequent meeting, to ensure that the members were able to reconcile the implementation of such decisions.

As part of preparing Supervisory Board decisions, a routine examination is carried out as to whether there are any conflicts of interest. Against this background, during the financial year under review a lending decision was taken by the Committee for Urgent Decisions without the participation of the Chairman of the Supervisory Board, in order to prevent a potential conflict of interest.

Beyond this, the members of the Supervisory Board did not give notice of any conflicts of interest (pursuant to section 5.5.3 of the German Corporate Governance Code) during 2010.

In addition to its regular meetings, the Supervisory Board convened for a separate meeting during which auditors PricewaterhouseCoopers provided information on current changes and deliberations in the regulatory and legal framework. This meeting provided the opportunity for a more detailed analysis and discussion of key topics, outside the regular work of the Supervisory Board.

## Activities of Supervisory Board committees

The Supervisory Board has established five committees in order to perform its supervisory duties in an efficient manner: the Executive Committee, the Risk Committee (previously: Credit and Market Risk Committee), the Committee for Urgent Decisions, the Accounts and Audit Committee, and the Nomination Committee.

The Executive Committee held five meetings, including two extraordinary meetings, one of which was convened as a conference call. The Executive Committee has prepared the plenary meetings of the Supervisory Board, together with proposed resolutions. In its meeting in March 2010, the Executive Committee discussed the merger of Aareal Bank France S.A. into the parent company, and the re-election of the Supervisory Board which became necessary as a result. Discussions also concerned strategic issues related to the SoFFin support measures. The extraordinary meetings focused on the personnel changes to the Management Board, and all issues involved.

The Risk Committee held three meetings during the year under review. The Management Board submitted detailed reports to the committee, covering all markets in which the bank is active in the property financing business, as well as supplementary reports regarding the bank's investments in securities portfolios. The committee members discussed these reports and market views in detail. The committee also regularly dealt with loans requiring approval and transactions subject to reporting requirements. The committee discussed individual exposures of material importance to the bank, which were presented and explained by the Management Board. Also, detailed reports were given regarding the bank's liquidity status and funding.

The committee regularly discussed reports on the bank's risk situation, which were submitted and explained by the Management Board. Having discussed the contents with the Management Board, these were duly noted and approved by the mem-

bers of the committee. Besides credit and country risks, the committee concerned itself with market risks, liquidity risks, and operational risks. The committee also decided on any other transactions requiring the Supervisory Board's approval pursuant to the company's Memorandum and Articles of Association, or the Managing Board's internal rules of procedure.

The Committee for Urgent Decisions is a sub-committee of the Risk Committee. As the committee approves loans subject to approval requirements by way of circulation, it did not convene any meeting. Any decisions which were taken between meetings of the Risk Committee were discussed at the subsequent meeting.

The Accounts and Audit Committee held six meetings during the year under review. During its meeting in March 2010, the Accounts and Audit Committee received the external auditors' report on the 2009 financial year and discussed the results with the auditors in detail. The committee members read the audit reports provided; they formed their own judgement of the audit results on the basis of these reports, and by way of extensive discussions with the external auditors. In accordance with its duties under the Memorandum and Articles of Association, the Accounts and Audit Committee also discussed the instruction of external auditors and the focal aspects of the audit for 2010 during the same meeting.

Proceedings at the meetings in August and November included information regarding the progress of audit activities for the 2010 financial year; follow-up questions were also discussed. In addition to a further updated report on the audit progress, the updated Group planning was presented and explained to the committee during its December meeting. The committee also received reports submitted by Internal Audit, and by the Compliance Officer, requesting and receiving detailed explanations.

Furthermore, during the committee meetings in February, May, August and November 2010, the Management Board presented the quarterly

results for the financial year, as well as the preliminary full-year results for 2009 prior to publication, in accordance with the German Corporate Governance Code; the committee members discussed the reports with the Management Board. As in the financial year under review, the preliminary results for 2010 were discussed at a meeting in February 2011.

In its meeting on 24 March 2011, the Accounts and Audit Committee received the external auditors' detailed report on the audit and audit results for the 2010 financial year, and extensively discussed these results with the auditors and the Management Board.

The Nomination Committee, which was established during the year under review, met for one meeting during 2010. The task of the committee is to coordinate and carry out the search for new shareholder representatives on the Supervisory Board, if a member representing shareholders retires from the Supervisory Board. All members of the Supervisory Board had to be re-elected during the financial year under review, due to the merger of the French subsidiary Aareal Bank France S.A. into the parent company. Fulfilling their duties in this context, during their meeting on 30 March 2010, the members of the Nomination Committee resolved to propose to the Supervisory Board that all existing shareholder representatives be nominated for re-election by the Annual General Meeting for the next term of office. This proposal was accepted by the plenary meeting of the Supervisory Board. The shareholder representatives on the Supervisory Board were re-elected for a further term of office by the Annual General Meeting held on 19 May 2010.

Where members of the Supervisory Board were unable to attend a meeting, they had announced their absence in advance, giving reasons. If material decisions were on the agenda, these Supervisory Board members submitted written instructions for the casting of their votes, or cast their votes afterwards, in writing.

## Transactions of particular importance during 2010

In its meeting on 23 June 2010, the Supervisory Board approved the proposal submitted by the Management Board for a partial repayment in the amount of € 150 million on the silent participation by SoFFin, and to simultaneously utilise the remaining € 2 billion guarantee facility. The € 2 billion SoFFin guarantee was used to issue a new unsecured bond in the same amount, with a maximum term of 36 months, which the bank took on its own books.

The remaining framework guarantee was utilised for purely precautionary reasons; it was designed to retain Aareal Bank AG's ability to react quickly and flexibly to potential market distortions over a medium-term horizon – at any time, and even during a turbulent phase. No decision has been taken to date on the repayment of the remaining SoFFin silent participation.

The process of merging Aareal Bank France S.A. into the parent company Aareal Bank AG was completed during the financial year under review. This measure was a further step in the continuous process to simplify the structure of the Group, and to enhance the efficiency of credit processes. The term of office of the Supervisory Board ended prematurely as a result of this merger, and the necessary election was held. Henceforth, Aareal Bank AG's presence in Paris is a branch office. This organisational change had no effect upon Aareal Bank AG's clients.

## Financial statements and consolidated financial statements

The Supervisory Board instructed PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Frankfurt/Main, who were elected as auditors by the Annual General Meeting 2010, with the audit of the financial statements. The external auditors appointed submitted a statement regarding their independence to the Supervisory Board, who duly noted it. The Supervisory Board

has no reason to doubt the accuracy of this statement of independence. Fulfilling their duties as commissioned by the Supervisory Board, PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft audited the financial statements prepared in accordance with the German Commercial Code (HGB) and the consolidated financial statements prepared in accordance with IFRSs, as well as the Management Report and the Group Management Report. Based on the results of their audit, PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft issued an unqualified audit opinion for the financial statements and consolidated financial statements.

All members of the Supervisory Board received the audit reports regarding the financial statements and the consolidated financial statements, including all annexes thereto, in good time before the meeting during which the audit results were discussed. Having examined the documents provided, the Supervisory Board members formed their own judgement of audit results. The representatives of the external auditors, PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, attended the Supervisory Board meeting during which the financial statements were discussed, giving a detailed account of the results of their audit and were available to answer further questions, and to provide additional information. All questions were answered to the full satisfaction of the Supervisory Board.

No objections were raised following the detailed examination of the financial statements and Management Report of Aareal Bank AG, prepared in accordance with the HGB; the consolidated financial statements and the Group Management Report prepared in accordance with IFRSs; the proposal of the Management Board regarding the appropriation of profit; and of the audit report. In its meeting on 24 March 2011, the Supervisory Board approved the results of the audit. The Supervisory Board approved the financial statements and Management Report of Aareal Bank AG, prepared in accordance with the HGB, together with the consolidated financial statements and the Group Management Report prepared in accordance with

IFRSs, which are thus confirmed. Having examined and discussed it with the Management Board, the Supervisory Board has endorsed the proposal for the appropriation of profit submitted by the Management Board.

Mr Norbert Kickum, who, as a member of the Management Board, was responsible for Aareal Bank AG's property financing business on international markets, left the bank with effect from 31 October 2010. His departure was for purely personal reasons, by amicable and mutual consent. The Supervisory Board would like to thank Mr Kickum for his contribution during the challenging past years. Mr Dirk Große Wördemann was appointed to the Management Board of Aareal Bank AG with effect from 1 November 2010. The Supervisory Board looks forward to working with Mr Große Wördemann, and wishes him every success in his new office.

Due to the merger of Aareal Bank France S.A. into the parent company, the term of office of all Supervisory Board members ended prematurely, necessitating a re-election. Given the re-election of employee representatives to the Supervisory Board, the office of Ms Tamara Birke was terminated at the end of the Annual General Meeting of Aareal Bank AG on 19 May 2010. The Supervisory Board would like to thank Ms Birke for her trusting and constructive cooperation over many years. The employees elected Mr Dieter Kirsch to succeed Ms Birke as employee representative to the Supervisory Board. The Supervisory Board wishes Mr Kirsch every success in his new function.

In conclusion, the Supervisory Board would like to thank the Management Board and all of the company's employees for their strong commitment and successful work during the eventful 2010 financial year. Once again, it was thanks to the motivation and contribution of Aareal Bank Group staff that enabled the Company to successfully master the challenges of recent months.

**Kronberg, March 2011**

**For the Supervisory Board**



**Hans W. Reich (Chairman)**