

GROUP MANAGEMENT REPORT

Risk Management

THE FOCUS OF RISK AND EARNINGS MANAGEMENT IN THE SAL. OPPENHEIM GROUP IS ON STABILISING earnings power, thus making a significant contribution to maintaining stability and continuity. Risk strategies, process organisation, and risk measurement and monitoring mechanisms apply to all of Sal. Oppenheim's business divisions. Our risk management analysis focuses on the Sal. Oppenheim Group and the two group units Sal. Oppenheim and BHF-BANK.

RISK STRATEGIES

The group business strategy is determined by the group management and revised annually. The group risk strategy, which defines the framework for the Group's risk management, is derived from it. Additional partial risk strategies serve to flesh out the general risk strategy and are geared at continuously recording, measuring and controlling all existing and potential risks using adequate procedures and methods. The risk strategies are determined by the group management and revised annually.

REGULATORY REQUIREMENTS

The Sal. Oppenheim Group continues the path taken, thus remaining with the standardised approach to credit risk in accordance with the options for measuring capital offered under Basel II. The instruments used for internal management are based on the IRB foundation approach.

COREP supervisory reporting based on IFRS was adopted as at 1 January 2008 (implementation of the Basel II requirements).

For financial year 2008, disclosure at Sal. Oppenheim jr. & Cie. S.C.A. was made for the first time in Luxembourg in accordance with the rules of the Basel Accord (International Convergence of Capital Measurement and Capital Standards – A Revised Framework Comprehensive Version, June 2006).

-> ICAAP

Internal processes have been implemented group-wide to identify, measure, manage and report risks the Sal. Oppenheim Group is exposed to or can be potentially exposed to as part of the Internal Capital Adequacy Assessment Process (ICAAP). Moreover, a second internal process is in place to plan and manage internal capital. Both processes are subject to regular review and continuously developed in order to ensure that risk-coverage potential and risks taken are appropriately balanced at all times.

RISK-BEARING CAPACITY

The basis and main parameter for determining risk-bearing capacity is the risk coverage potential, which is the maximum amount of capital that can be made available for the risks the Sal. Oppenheim Group has assumed and potential risks it faces. This is mainly comprised of equity, unrealised reserves and the expected net income. Part of the risk coverage potential is made available to group companies as aggregate risk cover.

The amount of aggregate risk cover made available is a strategic decision, which sets the framework for seizing business opportunities. As such it is taken by management, reassessed each year and approved by the supervisory body.

On the basis of the business strategy and the planning in each business area, the risk limits required to achieve projected results and which must be backed by the aggregate risk cover made available by the Group, are allotted in an iterative process. Clearly defined limits have been set group-wide for the types of risk to the Group which are considered important, i.e. equity investment, market, credit and business risk, as well as operational risk, and ongoing checks and monitoring are performed to ensure compliance.

Group management is responsible for ensuring that the risks taken in the Sal. Oppenheim Group are backed by the available aggregate risk cover at all times. To this end, aggregate risk cover and utilisation of all risk limits are subject to routine comparison. The result of the risk-bearing capacity analysis is a component of the management's monthly reporting. Escalation processes are established for any adjustment measures that may be necessary.

The Sal. Oppenheim Group addressed the extraordinary requirements of financial year 2008 by a reduction in risk exposure as well as a capital increase to strengthen its equity and thus aggregate risk cover. Sal. Oppenheim maintained sufficient risk-bearing capacity at all times in 2008.

The risk-bearing capacity concept is to be adapted to the economic environment for financial year 2009. The portion of risk coverage potential not allotted as aggregate risk cover is considered a buffer, which ensures that both simulated stress scenarios as well as non-quantifiable risks are covered.

RISK MANAGEMENT STRUCTURE

Group Risk Management coordinates risk management across the Group and is responsible for the aggregation of the group units' risk information. BHF-BANK AG operates as a legally separate bank in daily operating business, independent of the other group companies. The group companies are responsible for managing and controlling risks that they have taken themselves, by means of a structured process subject to uniform requirements for all group companies. This process is based on strategies and guidelines adopted by group management.

—> GROUP CHIEF RISK OFFICER

The Group Chief Risk Officer (GCRO) is a personally liable partner of Sal. Oppenheim jr. & Cie. S.C.A. and responsible for risk management activities.

—> GROUP RISK MANAGEMENT

This function is responsible for identifying, measuring, and monitoring risks resulting from the Sal. Oppenheim Group's business activities, in particular for the Group Chief Risk Officer (GCRO), but also for the group management in general, as well as for the supervisory body. GRM conducts risk analyses on the basis of the aggregated risk information from group companies, derives alternative plans of action if necessary and initiates their implementation.

—> RISK CONTROL

The risk control units of the respective group companies are responsible for quantifying the risks taken. The methods used are aligned and further developed in line with Sal. Oppenheim Group specifications.

—> RISK REPORTING

The group companies report on risk exposures in accordance with the information requirements defined by GRM. On this basis, GRM regularly prepares a group risk report which provides the group management and the supervisory body with an overview of the group's entire risk situation.

MARKET RISKS

Market risk constitutes the risk of loss from own risk positions entered into, due to changes in market prices. Traditional price risks (interest rate, equity, currency and commodity risk), option-specific risks (delta, gamma, vega, theta and rho risk) and other market price risks (spread risk and basis risk) have to be taken into account here.

For new business activities, a concept must be worked out including an analysis of the risk associated with these activities. Trading is only permitted in products and on markets which have been approved as part of the product launch process.

—> MARKET RISK ORGANISATION

The structure and organisation of operations comprises the risk management and control processes for all market risks. The processes are clearly established, communicated and documented at group level and throughout the group companies in accordance with the supervisory requirements.

The structure and organisation of operations is subject to regular checks and assessments by the Group's internal audit department and by the group companies.

→ MEASUREMENT AND ASSESSMENT OF MARKET RISKS

The trading book positions entailing market risks are assessed on a daily basis. The banking book positions entailing market risks are assessed on a regular basis, both daily and monthly, depending on relevance. The following minimum requirements apply to group monitoring:

- Value at Risk (VaR): confidence level of 99%, minimum holding period of one day, 250-day historical observation period.
- Daily calculation of a clean P/L (assessment of a day's positions under the market conditions of the next day).
- Worst-case/stress scenarios: Scenarios are defined on the basis of specific changes to the risk parameters or historically derived market movements.

For purposes of utilisation of aggregate risk cover for market risks, VaR calculation is based on longer holding periods and additional multipliers.

The market risk quantification methodology used by each group company takes account of its respective business focus. At Sal. Oppenheim, Monte Carlo simulations are used for equity-related transactions. Historical simulations are used in the interest rate and currency asset classes. At BHF-BANK, market risks in all asset classes are determined using a risk model authorised by the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht* – BaFin).

Different stress tests depending on the type of transaction are performed daily at Sal. Oppenheim jr. & Cie. KGaA. For equity portfolios, for example, an instantaneous shock of prices and volatilities is performed simultaneously, in order to measure the effects on the income statement. Daily stress scenarios to determine general market risk are used in BHF-BANK market risk control. In addition to basic risk factors (exchange rates, share prices, yield curves, credit spreads), change in volatility is also simulated as a risk factor and a full valuation performed under every stress scenario.

An instantaneous rate shock is simulated as a parallel shift in the yield curve by 200 basis points both upwards as well as downwards to measure interest rate risks of the banking book from the maturity transformation.

The suitability and reliability of the methods and processes are subject to regular review in the group companies in accordance with group market risk strategy requirements. This encompasses in particular appropriate backtesting procedures. Group Market Risk Controlling (GMRC) performs daily backtesting at a consolidated and aggregated level. This did not result in any outliers for business year 2008 due to diversification effects at the full trading and banking book portfolio level as well as to the conservative addition of VaR contributions of the individual group companies.

Product area	2008	2007*
	€ M	€ M
Interest-related transactions	2.3	2.7
Currency-related transactions	0.9	1.9
Equity-related transactions	4.0	8.2
Total	7.2	12.8

* During the reporting year, further consolidation of subsidiaries occurred as well as a reclassification of exposures from the trading into the banking book, which resulted in deviations compared to the presentation in the 2007 annual report for the values recalculated on this basis for 2007 for purposes of comparison.

VALUE AT RISK FOR THE TRADING BOOK AS AT 31 DECEMBER 2008

THE VALUE AT RISK FIGURE IS CALCULATED USING THE FOLLOWING PARAMETERS:

HOLDING PERIOD OF ONE DAY, CONFIDENCE LEVEL OF 99%, HISTORICAL OBSERVATION PERIOD OF ONE YEAR.

The VaR for equity-related trading book transactions was significantly reduced in 2008 through a lower issue volume for equity derivatives.

Product area	2008	2007*
	€ M	€ M
Interest-related transactions	9.9	6.1
Currency-related transactions	1.3	0.6
Equity-related transactions	15.8	9.9
Total	27.0	16.6

* During the reporting year, further consolidation of subsidiaries occurred as well as a reclassification of exposures from the trading into the banking book, which resulted in deviations compared to the presentation in the 2007 annual report for the values recalculated on this basis for 2007 for purposes of comparison.

VALUE AT RISK FOR THE BANKING BOOK AS AT 31 DECEMBER 2008

THE VALUE AT RISK FIGURE IS CALCULATED USING THE FOLLOWING PARAMETERS:

CONFIDENCE LEVEL OF 99% , HISTORICAL OBSERVATION PERIOD OF ONE YEAR.

The increase in VaR for equity and interest-related transactions in the Group's banking book is primarily due to increased share price risks in the funds with interest-bearing securities and equity positions in the banking book as well as the inclusion of Sal. Oppenheim jr. & Cie. (Schweiz) AG's banking book as a result of the consolidation process.

	VaR Max	VaR Min	VaR Median*
	€ M	€ M	€ M
Trading book	22.2	7.0	12.4
Banking book	29.9	11.9	18.2

*The median is the value which separates the higher half of values observed from the lower half.

SITUATION PARAMETER VALUE AT RISK 2008

THE VALUE AT RISK FIGURE IS CALCULATED USING THE FOLLOWING PARAMETERS:

TRADING BOOK: HOLDING PERIOD OF ONE DAY, CONFIDENCE LEVEL OF 99% , HISTORICAL OBSERVATION PERIOD OF ONE YEAR.

BANKING BOOK: CONFIDENCE LEVEL OF 99% , HISTORICAL OBSERVATION PERIOD OF ONE YEAR.

—> MARKET RISK LIMITS AND OPERATIONAL MANAGEMENT

Risk management is based on a multi-tier limit system. Limits (i.e. largely VaR limits, sensitivity limits and stop-loss limits) are approved at least once a year. When limits are exceeded, established escalation procedures come into play, which ensure that steps are taken quickly to reduce risk.

Risks are monitored once a day (end-of-day process), several times a day (separate limits are approved for intraday monitoring by responsible partners and/or Executive Board members), or for longer observation periods.

—> MARKET RISK REPORTING

Comprehensive and transparent risk reporting serves to appropriately communicate risks.

Reporting is adjusted in line with changes in requirements on a continual basis. The figures calculated by the individual group companies are aggregated daily by the Group's risk control department and made available to group management. A report covering the current risk position and operating results of the respective group company is also discussed by management on a monthly basis.

The management information system was expanded across the Group in financial year 2008 to include the results of measurement of interest rate risks in the banking book in accordance with the Basel II requirement. Utilisation of the group's regulatory capital is contained in the monthly risk reporting to group management.

GMRC will also arrange for the incorporation of group-wide liquidity and concentration risk figures in financial year 2009.

LIQUIDITY RISKS

Liquidity risk in its narrow sense means the risk that the Bank may not have sufficient funds to fulfil its payment obligations. Such payment obligations result from deposits being called, trading transactions being settled, interest payments and loan granting, among other reasons. Liquidity risks in a broader sense include:

- inability to source sufficient liquidity at the expected conditions when required (refinancing risk), and
- inability to liquidate or close transactions at all, or only with losses, due to inadequate market depth or market disruptions (market liquidity risk).

→ LIQUIDITY RISK MANAGEMENT STRUCTURE

Liquidity risk management in the Sal. Oppenheim Group has a decentralised structure, which means the respective group companies, in particular Sal. Oppenheim jr. & Cie. KGaA and BHF-BANK AG, are responsible for managing the risks they have taken themselves. This includes responsibility for implementing regulatory requirements. Liquidity risk management is centralised at Sal. Oppenheim jr. & Cie. KGaA for the relevant group companies. In particular, this includes Sal. Oppenheim jr. & Cie. (Schweiz) AG as well as Sal. Oppenheim jr. & Cie. S.C.A.

This encompasses critical recognition of illiquidity risk, refinancing risk and market liquidity risk using appropriate indicators, such as stress values for market price development of significant positions on the assets side, as well as liquidity coefficients of relevant cash flow maturities in the short, medium and long-term maturity ranges.

Liquidity risks are adequately addressed in the risk management and control processes of the group companies and conservatively controlled, ensuring solvency of the Sal. Oppenheim Group at any time. A working group was formed at Sal. Oppenheim Group management level as a reaction to the turbulence on the financial markets.

→ LIQUIDITY RISK MEASUREMENT

The German Liquidity Regulation (*Liquiditätsverordnung* – LiqV) with the liquidity coefficient as central assessment criterion forms the basis for liquidity risk determination from a supervisory point of view taking

into account the liquidity risk management structure. In addition, liquidity requirement (surplus), liquidity status, liquidity projection and capital commitment balance are determined on a regular basis (once/several times a day); liquidity requirement may not exceed the available refinancing funds.

The liquidity situation is also analysed through simulated crisis scenarios which examine various risk situations. Refinancing risk is taken into consideration here in that some extreme crisis situations without the possibility of refinancing are analysed. The results of these simulations, which are a component of quarterly reporting at group unit level, show that the established procedures also address at any time the increased requirements caused by the financial market crisis.

—> LIQUIDITY MANAGEMENT

The core responsibility of liquidity management is to ensure group solvency at all times. Liquidity is determined on an ongoing basis, with surplus liquidity placed on the market or short-term refinancing needs covered at market conditions.

The majority of liquidity is controlled through traditional money-market trading and repo transactions, as well as via client deposits and own issues of structured bonds and borrower's notes. Unforeseen liquidity restraints can also be countered in the form of a portfolio of securities eligible as collateral with Deutsche Bundesbank.

In view of the worsening crisis, new instruments for secured money-market trading as well as procedures for efficient utilisation of collateral received as a result were used to extend the scope of action.

The liquidity risk of traded products (market liquidity risk) is monitored and duly considered in the context of market risk control.

Even under the effects of the financial market crisis, the recently introduced as well as the established procedures and the instruments and processes used proved appropriate for adequate management of liquidity risk. The sustained high level of deposits during the crisis highlighted the considerable trust private and institutional clients placed in the Bank.

Liquidity risks will also require special attention in 2009. For this reason, secured transactions (repo transactions) will continue to be more relevant than unsecured money market transactions. In this context, a stronger focus will be placed on collateral management. Moreover, for inter-bank business, the Group will concentrate on banks with top credit ratings.

—> LIQUIDITY RISK REPORTING

The management of the group units and the Sal. Oppenheim Group receive daily reports on the Group's liquidity and refinancing situation based on key figures. The daily reporting also includes an outlook for the next few business days. Reports are also issued on a monthly and quarterly basis.

Group Risk Controlling provides regular reports to the Sal. Oppenheim Group management, at least monthly, on significant consolidated results relating to the Group's liquidity risk situation and also initiates escalation processes if necessary and/or proposes measures to manage liquidity risk.

CREDIT RISKS

In the Sal. Oppenheim Group, the term credit risk is understood as counterparty risk. In addition to traditional credit risk in the lending business, this includes counterparty risk in trading transactions, issuer risk in securities transactions as well as country risk. Traditional credit risk quantifies potential losses in the lending business as a result of the borrower not fulfilling his contractual obligations. Counterparty risk arises from potential counterparty default in trading activities. A general distinction is made between replacement risks and settlement risks. Issuer risk results from the Bank's proprietary positions in securities or synthetic security positions (e.g. credit derivatives) upon default of the issuer or the reference borrower/the underlying. Country risks arise in cross-border lending (political and/or economic risk).

—> CREDIT RISK STRATEGY AND ORGANISATION

Credit risk strategy defines risk identification, risk measurement and risk management procedures, as well as limitation and escalation mechanisms. The product launch procedure applies to business activities in new products or markets in the same manner as for market risks.

The group lending procedures in place ensure that credit risks are assessed for each individual borrower. The credit assessment results in a rating. In accordance with the internal competence structures, the responsible decision-makers in the group companies and at group level for amounts that exceed pre-determined limits authorise credit lines. Group Credit Risk Management (GCRM) assumes additional monitoring responsibilities for exposures that are of major significance to the Sal. Oppenheim Group.

—> RATING SYSTEMS

The Sal. Oppenheim Group has internally developed rating procedures for all the main types of credit risk in the Asset Management, Corporates and Banks areas. The regulatory framework was taken into account in developing these rating systems. Existing rating methods were further developed in 2008.

Using these rating models, the respective client rating is calculated on the basis of quantitative and qualitative information. The processes used ensure that the ratings are reviewed at least once a year. Events that influence credit rating trigger an ad-hoc reassessment.

A new accounting analysis and evaluation tool BARS (*Bilanzanalyse- und Reportingsystem*) was acquired in 2008 and modified to meet the requirements of Sal. Oppenheim Group. It is to be gradually introduced in the group companies starting 2009.

—> COLLATERAL

Acceptance and valuation of collateral is uniformly performed across the Sal. Oppenheim Group.

Collateral Management, which is part of the Risk Management department, is responsible for managing and monitoring standardised collateral agreements for OTC trading transactions. Corresponding netting agreements are concluded and taken into consideration.

—>PORTFOLIO STRUCTURE

In credit risk assessment, the Sal. Oppenheim Group's total exposure, which aggregates the risks of individual counterparties or borrower entities, is evaluated. Loan commitments and bank guarantees are also included in the total exposure with a credit conversion factor.

The following table shows the gross exposure for the Sal. Oppenheim Group by sub-portfolios. The values recorded as at 31 December 2007 for BHF-BANK and the group companies Bank Sal. Oppenheim jr. & Cie. (Österreich) AG and Bank Sal. Oppenheim jr. & Cie. (Schweiz) AG were recalculated on the basis of a further standardisation for the sake of comparability with financial year 2008. Liquidity management in the Group is centralised in Sal. Oppenheim jr. & Cie. KGaA; no special presentation is therefore made here of intra-group receivables in the bank portfolio.

Portfolio	Group		of which KGaA		of which BHF		of which L, A, CH*	
	2008	2007	2008	2007	2008	2007	2008	2007
	€ M	€ M	€ M	€ M	€ M	€ M	€ M	€ M
Asset Management	3,447	3,418	3,149	3,090	278	313	20	15
Corporates	7,567	6,002	2,870	2,092	4,564	3,884	**133	26
Banks	11,608	9,992	2,652	4,554	8,352	5,142	604	296
Eligible as collateral for borrowings from								
Bundesbank	534	852	132	350	179	161	223	341
Other	36	21	36	21	0	0	0	0
Intensified loan management	335	237	276	207	59	30	0	0
Total	23,527	20,522	9,115	10,314	13,432	9,530	980	678

* This item aggregates gross exposure by sub-portfolios for group companies Sal. Oppenheim jr. & Cie. S.C.A. as an operating entity, Bank Sal. Oppenheim jr. & Cie. (Österreich) AG and Bank Sal. Oppenheim jr. & Cie. (Schweiz) AG.

** Increase resulting from intra-group loans of Sal. Oppenheim jr. & Cie. S.C.A. to consolidated companies.

The increase in volume at BHF-BANK results from setting up a covered bond portfolio for the BHF-BANK AG subsidiary BHF Asset Servicing GmbH and from reclassification of bonds from the trading to the banking book.

GROSS EXPOSURE BY SUB-PORTFOLIO AS AT 31 DECEMBER 2008

Overall, the Sal. Oppenheim Group's lending portfolio from lending and trading business has a diversified structure. As regards subprime risks, the existing exposures were analysed, Subprime exposure is limited

to an indirect investment via a fund in the amount of € 42 million as at 31 December 2008; 98% of the securities comprising the fund portfolio have an investment grade rating. The majority of the transactions were issued in 2004 and earlier. Overall, no particularly high risks are currently recognisable as resulting from this investment. Moreover, additional indirect investments exist in European (non-subprime) ABSs via two funds with a volume of € 266 million as at the end of 2008 and a rating structure of 98% in the investment grade area as well as a money market fund in the amount of € 37 million. At least 75% of the individual shares contained in each of the funds have a rating of A or better. Originator or sponsor positions in subprime ABS portfolios were not entered into. The Sal. Oppenheim Group has no hedging transactions with monolines.

In contrast to the previous gross exposure tables, the table below shows total credit risk exposures including Sal. Oppenheim jr. & Cie. KGaA and BHF-BANK nostro securities.

Equivalent S&P rating	Cash loans and advances and bank guarantees		OTC derivatives		Securities portfolios, repos, reverse repos and securities lending		Total	
	2008	2007	2008	2007	2008	2007	2008	2007
	€ M	€ M	€ M	€ M	€ M	€ M	€ M	€ M
AAA	1,609	1,299	196	33	6,166	5,362	7,971	6,694
AA	3,155	6,482	1,181	791	4,323	4,143	8,659	11,416
A	3,974	4,992	1,370	842	2,942	2,637	8,286	8,471
BBB	2,612	3,013	491	58	616	1,026	3,719	4,097
Non Investment Grade	2,377	1,413	52	20	479	147	2,908	1,580
Other*	235	164	115	0	358	1,298	708	1,462
Total	13,962	17,363	3,405	1,744	14,884	14,613	32,251	33,720

* Other consists mainly of nostro exposures (equities, fixed-income securities and covered bonds) the credit ratings of which lie in the upper investment grade range.

CREDIT RISK EXPOSURES INCLUDING NOSTRO SECURITIES ACCORDING TO CREDIT RATING
AND PRODUCT AS AT 31 DECEMBER 2008

As at 31 December 2008, 88.8% of total exposure was attributable to investment grade paper (previous year: 91.0%); 77.3% had a rating of A or better (previous year: 78.8%).

In order to address risk concentration, existing processes ensure that portfolio diversification is already taken into account when lending decisions are made.

Size range (in € M)	Exposure	
	2008	2007
	€ M	€ M
0 – 5	1,816	1,452
5 – 15	2,530	2,055
15 – 25	1,702	1,673
25 – 50	3,679	3,549
50 – 100	5,281	5,377
100 – 200	2,974	3,834
> 200	5,545	2,087
Other*	-	495
Total	23,527	20,522

* Recording gross exposure values by size range for Bank Sal. Oppenheim jr. & Cie. (Schweiz) AG and Bank Sal. Oppenheim jr. & Cie. (Österreich) AG was implemented in financial year 2008; the corresponding values were recorded under *Other* as at 31 December 2007.

As part of the continuous improvement process of group reporting, recording by size range was further optimised in that deviations appear in the distribution by size range shown as at 31 December 2007 compared to the previous presentation.

GROSS EXPOSURE BY SIZE RANGE AS AT 31 DECEMBER 2008

The increase in exposures in the > € 200 million size category is primarily the result of covered bonds and bonds with public guarantee obligation (*Gewährträgerhaftung*); the general increase in volume results from setting up a covered bond portfolio for the subsidiary BHF Asset Servicing GmbH of BHF-BANK AG and from reclassification of bonds from the trading to the banking book.

—> LOAN PORTFOLIO MANAGEMENT

The Sal. Oppenheim Group performs the internal management of the loan portfolio based on a loan portfolio model, which is used to calculate a Credit Value at Risk (CVaR) of the Group's total loan portfolio. With a confidence level of 99.95%, CVaR represents the maximum risk of loss for a period of one year. As at 31 December 2008, this totalled € 427 million (previous year: € 341 million). Additionally, the group companies perform stress tests to analyse risks by simulating the downgrade of the entire portfolio by one notch. This combined PD/LGD stress test is performed at least once a quarter to determine expected loss. As of 2009, this testing including CVaR is to be performed on a monthly basis.

GCRM analyses the detailed results calculated in order to actively steer processes and to develop recommendations for handling credit risks.

Portfolio	Group	
	2008	2007
	€ M	€ M
Asset Management	90.8	71.6
Corporates	240.3	188.8
Banks	76.9	69.6
Eligible as collateral for borrowings from Bundesbank	0.0	1.3
Other	1.1	0.4
Intensified loan management	17.8	9.5
Total	426.9	341.2

In 2008, the assignment to sub-portfolios was further improved and enhanced, which resulted in deviations compared to the presentation in the 2007 annual report for the values recalculated on this basis for 2007.

CREDIT VALUE AT RISK BY SUB-PORTFOLIO AS AT 31 DECEMBER 2008

—> DERIVATIVES

In the case of derivative instruments, exposures included in credit risk measurement are calculated according to the mark-to-market method. This method is based on current market prices. For BHF-BANK, potential future fluctuations in value are also taken into account. At rates of 94.8% (previous year 98.9%) for Sal. Oppenheim jr. & Cie. KGaA and 96.6% (previous year 98.5%) for BHF-BANK AG, the derivatives portfolio focuses on counterparties with investment-grade ratings.

—> COUNTRY RISKS

Aggregate exposure to countries or debtors with an Institutional Investor Rating of less than 60 points after deductions of valuable collateral amounted to € 6.2 million (previous year: € 0.13 million) for Sal. Oppenheim jr. & Cie. KGaA and € 389 million (previous year: € 319 million) for BHF-BANK AG at the end of 2008. At BHF-BANK, country risks are managed using country limits, which serve to restrict transfer and conversion risk, as well as political and economic risk involved with transactions with borrowers from the respective countries. Limit monitoring, which is the back office's responsibility, involves comparison of the net risk of each country with that country's limit. In the event that a country's situation significantly deteriorates, the country limit is adjusted accordingly.

—> DEALING WITH DEFAULTED EXPOSURES AND WORKOUT

Within the respective credit department, the unit which has been entrusted with intensified loan management, is the specialised internal service area responsible for:

- > early identification of problem exposures (asset managers, corporates and banks) and
- > monitoring the intensified loan management exposures remaining under front-office management.

The aims of Intensified Loan Management are to reduce and qualitatively improve risk exposure of performing loans as well as to restructure and workout defaulted exposures in a manner that maximises recovery value and is time and cost-effective.

→ CREDIT RISK REPORTING

The group companies prepare a monthly credit risk report in line with group requirements as part of regular reporting to GCRM. On this basis, GCRM then prepares a group-level risk report which provides the group management and the supervisory body with an overview of the group's entire portfolio.

EQUITY INVESTMENT RISK

Equity investment risk means the risk of a loss due to negative performance in the Sal. Oppenheim Group equity investment portfolio. The term "equity investments" refers to all affiliated and associated companies (irrespective of consolidation) and other group holdings.

→ EQUITY INVESTMENT RISK STRATEGY AND ORGANISATION

An equity investment strategy and an equity investment risk strategy defining the framework have been implemented in the Sal. Oppenheim Group on the basis of the group business strategy.

The equity investment risks taken in line with the strategies and prescribed limits at Sal. Oppenheim and BHF-BANK are backed with capital on the basis of the risk-bearing capacity assessment.

Management of equity investment risk at Sal. Oppenheim jr. & Cie. KGaA is the responsibility of Strategic Equity Investments. Credit Portfolio Management at Sal. Oppenheim jr. & Cie. KGaA is responsible for selecting the methods and calculating Sal. Oppenheim's equity investment risks. The results are reported to Corporate Investments & Controlling at Sal. Oppenheim jr. & Cie. S.C.A. at fixed dates and are included in the group-level examination. Correspondingly, Corporate Investments & Controlling is responsible for the management of equity investment risk at Sal. Oppenheim jr. & Cie. S.C.A. both from a single entity and from a group perspective. It is BHF-BANK AG's responsibility to calculate and manage its own equity investments, including equity investment risk.

→ MEASUREMENT OF EQUITY INVESTMENT RISK

With the exception of banking and asset management subsidiaries, equity investment risk is quantified using the VaR method and compared to the risk limits derived using the risk-bearing capacity concept. This is an integrated market and credit risk model. The potential loss due to negative performance which will not be exceeded at portfolio level in a one-year period with a confidence level of 99% is used as a risk measure. In addition to the value fluctuations driven by market risk, defaults of equity investments are simulated on an integrated basis during an observation period for historical default probabilities (analogous to a credit risk default model). Stress scenarios are also calculated in addition to a VaR for a normal scenario. This involves evaluating the model sensitivity regarding individual parameters and parameter constellations which reflect different economic scenarios.

The portfolio of other equity investments at BHF-BANK is of subordinate importance because of its business model. It consists predominantly of strategic equity investments for the purpose of implementing

the bank's business model and performing internal services, and also includes various mandatory investments. For this reason, a simplified economic capital calculation is carried out on the basis of the carrying amount taking the associated risk into account. At the banking and asset management subsidiaries, risk is measured for each relevant type of risk.

The risk determination methods are reviewed and developed on a regular basis.

—> MONITORING AND MANAGEMENT OF EQUITY INVESTMENT RISK

Value-based equity investment management includes regular monitoring and management of the portfolio as a whole, with the aim of identifying economic risks early and reacting accordingly.

To this end, each investment is assigned to a cluster which determines the level of intensity of management. Cluster allocation is based on factors which ensure that both important strategic investments and those which represent high-risk positions due to their size or current economic situation are subject to intensive monitoring. One aspect of the monitoring involves defined value drivers which, using operations-related and market-oriented indicators, show the development of the equity investment. Another involves monitoring the achievement of objectives on the basis of planning data and also a risk assessment. In addition, a qualitative assessment of each equity investment's corporate development, strategy and market position is carried out.

The risk measurement results in an equity investment VaR in the Group of € 685.5 million. 70% of this is attributable to Strategic Equity Investments and around 30% to Alternative Investments. Broken down by sector, equity investment risk mainly relates to investments in the financial sector (51%), the real estate sector (33.7%) and the services sector (12.3%).

Spinning off select equity investments into an industrial holding company that is not affiliated with Sal. Oppenheim Group will result in significantly lower equity investment risk in future.

Stress scenarios will be calculated on a monthly basis for Sal. Oppenheim jr. & Cie. KGaA and Sal. Oppenheim jr. & Cie. S.C.A. (single entity) with effect from 2009. This will involve simulation of the sensitivity of equity investment risk to changes in the input parameters volatility, default probability, LGD and default correlation. BHF-BANK's equity investments which are not directly included in the risk calculation or tracked via the market risk model are less important and are thus recorded under equity investment risk with no explicit stress tests.

—> REPORTING EQUITY INVESTMENT RISK

Corporate Investments & Controlling calculates and reports the level of the equity investment risk (VaR) in line with the risk-bearing capacity concept and in consultation with Finance/Controlling and Market and Group Credit Risk Management on a monthly basis and separately for Sal. Oppenheim jr. & Cie. S.C.A. and Sal. Oppenheim jr. & Cie. KGaA. If certain risk thresholds or concentrations are reached, different options for courses of action are available to management.

OPERATIONAL RISKS

According to the Basel Committee on Banking Supervision, operational risks are defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or external events.

The Sal. Oppenheim Group has assumed this definition from the Basel Committee on Banking Supervision; moreover, the definition includes legal and reputational risks for the Sal. Oppenheim Group, but excludes strategic risks.

—> OPERATIONAL RISK STRATEGY

The Sal. Oppenheim Group has implemented a risk strategy for the Group on the basis of the group business strategy. The group risk strategy defines the framework for risk management in the Group. The group risk strategy is defined in the group operational risk strategy through principles and methods specific to managing operational risks in the Group. All operational risks are guaranteed to be identified, assessed and reported on a continuous basis with suitable methods. These principles are implemented at group level through policies and guidelines applicable throughout the Group.

—> OPERATIONAL RISK ORGANISATION

The structure and organisation of operations comprise the organisation and design of risk management and control processes for all operational risks. The processes are clearly established, communicated and documented at group level and throughout the group companies.

Operational risk management has a decentralised structure. The group companies are individually responsible for managing operational risks as well as for meeting all relevant regulatory requirements.

The structure and organisation of operations are subject to regular checks and assessments by the Group's internal audit department and by the group companies.

—> MEASUREMENT AND ASSESSMENT OF OPERATIONAL RISKS

The Sal. Oppenheim Group applies the basic indicator approach to measuring the capital to be allocated to cover operational risks. With the basic indicator approach, capital must be available that is equal to the average amount over the past three years of a fixed percentage of the positive annual gross income.

—> RISK INVENTORY, DOCUMENTATION, REPORTING

The process for collecting data relating to losses has been implemented across the Group. A daily reporting process is in place throughout the Bank, which includes negative reports.

In 2008, on the basis of regulatory requirements and the Sound Practices for the Management and Supervision of Operational Risk, the focus of operational risk management was on the introduction and establishment of the uniform, group-wide "GORA" (Group Operational Risk Application) MIS infrastructure to support the processing, analysis, reporting and administration of all information relevant to operational risk in addition to the following already productive operational risk components:

- > Loss database (structural, Basel II-compliant, group-wide collection of loss data),
- > Risk inventory and documentation (Identification of risk potential with corresponding documentation, including risk avoidance and early identification measures, as well as emergency measures),
- > Key figures, risk indicators and reporting (continuous development of defined and established risk key figures/indicators and uniform group reporting).

COMPLIANCE RISKS

Compliance risk refers to the risk of damages which the Sal. Oppenheim Group may suffer if its activities are not carried out in conformance with the relevant rules and regulations. The Group's most important compliance risks include in particular:

- > the risk of non-compliance with statutory and supervisory requirements
- > sanction risk, i.e. the risk of penalty from a court, government agency or disciplinary action due to non-compliance with laws, regulations, standards or contractual agreements
- > reputational risk
- > the risk of a breach of ethical rules of conduct.

-> COMPLIANCE STRATEGY

The excellent reputation enjoyed by the Sal. Oppenheim Group as a whole and by its individual subsidiaries is a main pillar of the Bank's business success. A sound reputation forms the basis for client confidence in the services offered by the Sal. Oppenheim Group. This confidence goes hand in hand with confidence in the integrity and the specialised know-how of bank employees as well as in the high quality of our products. For this reason, key principles of compliance for the Sal. Oppenheim Group are ensuring employee integrity and maintaining service and product quality. Compliance is primarily aimed at maintaining and continuously improving the Bank's reputation.

Ensuring the Bank's integrity and that of its employees is accomplished by adhering to compliance-relevant legislation. It is also achieved by conveying adequate knowledge of the compliance legislation to be adhered to as well as by monitoring the resultant compliance guidelines and principles.

-> COMPLIANCE COMMITTEE

The Sal. Oppenheim Group has resolved to identify, analyse, aggregate and minimise compliance risk at group level in accordance with the comprehensive Luxembourg definition via the Compliance Committee. In accordance with Luxembourg law, the compliance unit can delegate compliance duties to other areas.

The purpose of the Compliance Committee is therefore to consolidate and take steps to minimise the specific compliance risks identified for the Group in the areas represented. Compliance issues and risks which may affect interfaces between the individual areas and which may require reallocation or redefinition of responsibilities are also addressed by the committee, and measures applied accordingly. This also prevents compliance risks occurring because they are at the interface between two areas and therefore occur due to unclearly defined responsibilities or a lack of appropriate measures applied.

-> COMPLIANCE STEERING COMMITTEE

The aim of the committee is to identify, analyse and control compliance risks in the narrower sense (prevention of money laundering and terrorist financing, securities compliance) at group level and to minimise them as far as possible.

—> MANAGEMENT AND MONITORING OF COMPLIANCE RISK

Compliance risk in the narrower sense is consolidated across the Group by Group Compliance. Group Compliance continuously analyses the Group's legal and business environment for early identification and minimisation of compliance risks that arise.

Compliance risk is assessed in each group company and these are then assigned to a risk class with the appropriate level of supervision. Supervision comprises inclusion in reports (ad-hoc, quarterly and annual reports), visits or analysis on site, analysis of risk identification sources (e.g. self assessment, audit reports) and summarising the results in the compliance risk management system.

—> UNIFORM GROUP LEVEL FRAMEWORK FOR ACTION

At group level, uniform understanding of the identification of compliance risks in the narrower sense, the specification of the respective degree of risk as well as the appropriate minimisation measures is necessary. A uniform action framework for identifying and controlling compliance risks in the narrower sense has been set up. This group-wide action framework contains guidelines and methodical procedures to ensure uniform understanding of individual compliance risks and how to manage them.

—> PREVENTION OF MONEY LAUNDERING AND TERRORIST FINANCING

Using the risk analyses in the individual group companies undertaken thus far as a basis, Compliance has established a uniform methodology of risk analysis to identify potential risks of the Bank being misused for money laundering or terrorist financing. The relevant units are required to identify and analyse their individual potential risks and implement the necessary minimisation measures for the risks determined, based on this methodology.

The Third EU Money Laundering Directive was implemented in business processes and workflows in due time across the Group to the extent legally required.

—> SECURITIES COMPLIANCE

Compliance has established a uniform method of risk analysis in securities compliance with a securities compliance risk management policy. The policy has been implemented as a pilot scheme at BHF-BANK. One by one, the relevant units will be required to identify and analyse their individual potential securities compliance risks and implement the necessary minimisation measures for the risks determined, based on this methodology. Introducing a uniform method at group level is a requirement for adequate risk control across the group.

—> REPORTING COMPLIANCE RISKS

Compliance risks in accordance with the comprehensive Luxembourg definition are reported and consolidated in the Compliance Committee. The areas represented report on the specific compliance risks they have identified, in the regular meetings, on an ad-hoc basis and via quarterly and annual reports to the compliance unit or the Group Chief Risk Officer.

As regards compliance risks in the narrower sense, the individual compliance units of each group company are required to prepare a risk-oriented annual report on the basis of compliance self assessments, and taking into consideration all available risk identification sources, such as internal and external audit reports, findings from operational risk reports or complaints management. This is then provided to local management and Group Compliance. Group Compliance uses these reports, also taking risk identification sources into consideration to prepare the group annual report and individual reports for each group company. The latter include planned measures for minimising risk, the implementation of which the group companies report on in their quarterly reports. These reports are supplemented by risk-oriented ad-hoc reporting. Group Compliance reports regularly to the group management about compliance risks in the monthly Compliance Committee meetings, and by way of ad-hoc, quarterly and annual reports.

The annual reports prepared by the various areas represented in the Compliance Committee are integrated into the compliance annual report.

OUTLOOK FOR 2009

The macroeconomic environment, which also determines the general conditions of business orientation for the near future for the Sal. Oppenheim Group, has been shaped by one of the sharpest downturns of the last decades. Market conditions will likely call for a phase of consolidation – following a sustained period of growth, in which the Sal. Oppenheim Group successfully garnered itself a leading position among independent private banks.

The focus of activities in financial year 2009 will thus continue to be on the further development of existing risk management procedures and processes, combined with the further expansion of the risk management functions. In this context, a basic review will be conducted of the risk profile of all business areas combined with a reduction in risk positions and the realignment of areas which have demonstrated weaknesses. Further risk reduction can thus also be accomplished in some areas by consciously waiving earnings.

Moreover, in the future, key industry holdings will be managed in a newly formed, independent holding structure that is not affiliated with the Sal. Oppenheim Group. Concentrating on the traditional banking business with a focus on the integrated asset management and investment banking business model will contribute to a reduction in volatility, thus serving to stabilise the risk profile.

Moreover, in financial year 2009, a number of additional measures to further develop the risk management processes will be implemented, including the following:

- Implementation of group-wide presentation of liquidity and concentration risks in market risk control.
- Coordination of activities in liquidity management via a management level working group.
- Further development of the MIS infrastructure GORA (Group Operational Risk Application) to process, analyse, manage and report all information relevant to operational risk.
- Further development of the stress tests to improve risk measurement. A project is already underway to develop a consistent stress plan covering the major types of risk.

- > To further develop the Internal Capital Adequacy Assessment Process (ICAAP), the calculation methods for the risk types: equity investment, market and credit risk are to be adjusted (e.g. including a credit spread VaR in the total VaR). In general, use of a confidence level of 99.93% in economic capital risk calculation is to be standardised for all risk types.
- > In the area of Compliance, the group-wide implementation of the risk analysis methods developed for the securities compliance area, the further development of methods to standardise risk analysis for the identification of money laundering risks at group level.
- > Establishing a compliance risk assessment review concept to monitor the implementation of group policy in local compliance units.

On the whole for 2009, we expect further risks or impairments. This could impact alternative investments, individual equity interests and securities. In loan loss provisioning, we assume an increase with provisioning remaining at an overall low level.