2005

Annual report

Management report (extract)
Balance sheet
Income statement

Sparkasse Saarbrücken's complete annual financial statements have been published in Bundesanzeiger and issued with an unqualified certification of approval by the auditing office of the Saarland Savings Bank Association.

Sparkasse
Saarbrücken

Contents

Management report for fiscal 2005 (extract)

1 Underlying conditions

Sparkasse Saarbrücken is a legal entity organised according to public law and domiciled in Saarbrücken. We engage in all standard banking transactions permitted by the Savings Bank Act of the State of Saarland, the rules issued under this Act and the Bank's bylaws. The Bank's shareholder is Sparkassenzweckverband Saarbrücken. As a legally independent business entity, Sparkasse Saarbrücken pursues the aim of strengthening competition primarily in its home territory and providing the private and public sector with lending and banking services in the light of market and competition requirements. To this end, we maintain 70 branches in our home market, the city association and state capital, Saarbrücken.

Sparkasse Saarbrücken's management bodies comprise the Supervisory Board, the Credit Committee and the Management Board. The Supervisory Board issues instructions to the Credit Committee and the Management Board and monitors their activities. It comprises a total of 19 members. The Credit Committee, which comprises the chairman and six members, passes resolutions approving the grant of loans in accordance with the instructions issued. The Supervisory Board passes resolutions approving the grant of loans extended by the Bank to its own officers as defined in Article 15 of the German Banking Act. The Management Board manages the Bank at its own discretion. It represents the Bank and conducts its business.

As a member of the Savings Bank Support Fund of the Saar Savings Bank Association, our Bank is affiliated with the guarantee system of the German Savings Bank Organisation. This ensure that all savings deposited by our customers are guaranteed in full.

Economic development

In 2005, the German economic remained as muted as it had been in the previous year, with real gross domestic profit rising by 0.9 percent and thus falling short of potential growth for the fifth consecutive year. Given the continued sharp expansion in the global economy, this performance was, if anything, disappointing.

The German economy was fuelled almost solely by exports (up 6.2% over 2004) and capital spending on machinery and equipment (up 4.0%). Thus, the pattern typical of the German economy is now emerging, albeit with some delay, with expansionary foreign impetus ultimately feeding through to domestic demand. That said, this effect has so far been confined to machinery and equipment spending. All told, gross plant spending contracted again slightly on account of persistently muted construction activity (down 3.6%). What is more, consumer spending, which remained flat in real terms, placed a heavy damper on the economy. There were diverse reasons for the sustained restraint on the part of German consumers: muted wage and salary growth, rising energy prices and uncertainty surrounding future employment prospects as well as the added future burden of social security payments doubtless played a role.

As in the previous year, the Saarland economy outperformed the German national average in 2005, achieving real growth of a respectable 2.5%, which placed it at the top of all German states. The expansionary impetus which had given the Saarland economy above-average real growth of 3.6% in 2004 was sustained in 2005 as well. It particularly came from domestic industry - primarily steel, automotive production and mechanical engineering. This goes to show once more that Saarland as a region with an above-average export orientation particularly benefits from a strong global economy. The number of employees subject to compulsory social security changed only marginally in the course of 2005. Whereas jobs were shed in the manufacturing sector in particular, the number of employees subject to compulsory social security in the services sector remained almost stable.

2 Report on economic situation

2.1 Business performance

2.1.1 Total assets and volume of business

Total assets and volume of business

	Existing 31. 12. 2005 EUR mn	Changes 2005 EUR mn	2005 %	2004 %
Business volume[1)]	5,997.7	12.7	0.2	1.2
Total assets	5,941.6	15.3	0.3	1.2

1) Total shareholders' equity and liabilities plus contingent liabilities

There were only immaterial changes in the volume of business and total assets in 2005. What was conspicuous was the shift in the structure in loans to banks (down EUR 165.7 million) in favour of loans to customers (up EUR 166.0 million).

2.1.2 Lending business
(including off-balance-sheet (Item 1) liabilities)

	Existing 31. 12. 2005 EUR mn	Changes 2005 EUR mn	2005 %	2004 %
Volume of loans to customers	3,155.9	166.8	5.6	-1.0
Of which: Loans to public sector	867.0	187.4	27.5	10.3
Mortgage loans	1,006.1	-38,5	-3.7	-3.1
Loans to banks	1,063.4	-165.7	-13.5	14.9
Investments in securities	1,472.6	17.0	1.2	-2.7

Volume of loans to customers

Sparkasse Saarbrücken granted new loans totaling EUR 311.6 million in 2005 (EUR 236.3 million in the previous year). At 5.6 %, the percentage increase in the volume of loans to customers was up on the previous year and also higher than the average for the savings banks which operate in the area covered by our Saarland Savings Bank Association. This growth was primarily underpinned by lending to the public sector. Despite ongoing favourable conditions, demand for building finance remained muted.

Although loans to private individuals and companies contracted slightly, there was a distinct improvement in the overall trend over the previous year.

Loans to banks

The generally satisfactory state of non-bank business overshadowed lending to banks to a small extent. This was joined by the usual fluctuation in interbank business, as a result of which outstanding receivables dropped by EUR 165.7 million or 13.5% over the previous year to EUR 1,063.4 million.

Investments in securities

There was a further increase in investments in securities on a par with earlier years. Securities are primarily assigned to the liquidity reserve and particularly comprise fixed-income securities issued by investment-grade counterparties. Part of our securities are held in several special-purpose funds. It is our intention to achieve value growth with assets managed by third parties giving due consideration to risk and return profiles.

2.1.3 Deposit-taking business

	Existing 31. 12. 2005 EUR mn	Changes 2005 EUR mn	2005 %	2004 %
Funds deposited by customers	4,180.1	49.5	1.2	1.4
Of which: Savings deposits	1,996.4	29.6	1.5	0.5
Non-certificated liabilities	1,937-6	33.9	1.8	4.6
Certificated liabilities	175.9	-8.7	-4.7	-4.4
Subordinated liabilities and profit-sharing rights	70.2	-5.2	-6.9	-9.2
Liabilities to banks	1,423.5	-42.6	-2.9	-0.7

Funds deposited by customers

Funds deposited by customers (including certificated liabilities) were satisfactory, with growth largely underpinned by savings deposits and uncertificated liabilities. This trend was impeded by persistently low interest rates as our savings products compete closely with attractive opportunities for investments in securities.

In the case of savings deposits, the higher-yielding products particularly contributed to the positive trend.

Liabilities to customers

There was a further reduction in liabilities to banks, reflecting our efforts to increasingly use customer business as a source of funding.

2.1.4 Services

Large parts of our range of services are handled via S-Pro-Finanz GmbH. A wholly owned subsidiary of Sparkasse Saarbrücken, it advises our customers on all matters relating to real estate and insurance.

The planned abolition of tax allowances for home buyers resulted in a sharp increase in net commission income from real estate business towards the end of the year. In fact, the second best figure for any year since the commencement of these business activities was reported.

In insurance business, the boom seen in 2004 in life insurance faded as expected on account of the reduction of the tax privileges on this product at the end of 2004/beginning of 2005. This was exacerbated by uncertainty on the part of customers concerning pension-savings. Sales of "Riester" insurance products were encouraging due, among other things, to the introduction of unisex rates for this product at the beginning of 2006. Almost 6,700 property, life and pension insurance policies accounting for total premiums of over EUR 42 million were arranged. However, this was less than in the previous year.

As in earlier years, sales activities with respect to investment business continued to focus on fund-related asset management (saarINVEST) in the year under review. Structured bonds and certificates both with and without capital guarantees proved particularly popular with investors in 2005.The substantial decline in selling (down 14.5 %) on the part of customers in tandem with a slight increase in buying (up 4.2%) points to rekindled interest in securities investments. Total trading volumes contracted marginally (down 5.2 %).

In combined business with LBS, we achieved very pleasing results, with mortgage savings business rising by 57.3 % over the previous year. At the same time, the ratio of first-time contracts was particularly high compared with earlier years.

In the year under review, a total of more than 3,800 building savings contracts with an average volume of EUR 21,000 were transacted, resulting in a total volume of over EUR 81 million.

Turning to foreign business, there was a greater shift towards standard EU transfers in payment operations. Of a total of 44,033 outgoing payments accounting for a total volume of EUR 188.834 million, around 35,700 transactions alone with a volume of EUR 77.5 million were to payees in the European Union or the European Economic Region.

Trends in US exchange rates (31 December 2004: EUR/USD 1.3639 / 31 December 2005: EUR/USD 1.1835) resulted in a heightened volume of currency forwards in the course of the year as many importers made use of the favourable exchange rates for hedging their exposure. However, with 124 forward transactions involving a volume of EUR 15.909 million, it was not possible to repeat the previous year's very strong performance.

There was a sharp rise in L/C business, particularly on the export side. The bulk of the total volume of EUR 6.22 million related to China.

Foreign notes and coins and traveller's cheque business generated stable earnings on a par with the previous years.

2.1.5 Own trading

The extension to average maturities in our Custodian Account A initiated in earlier years has paid off. Trading volumes – buying, selling and maturities – came to a total of EUR 534.6 million. Sparkasse Saarbrücken is a non-trading book institute as defined in the German Banking Act.

2.2 Assets

	EUR mn	EUR mn	Percentage of business volume	
	31. 12. 2005	31. 12. 2004	31. 12. 2005	31. 12. 2004
Volume of loans to customers	3,155.9	2,989.9	52.6	49.9
of which: Loans to public sector	867.0	679.6	14.5	11.3
Loans to banks	1,063.4	1,229.1	17.7	20.5
Investments in securities	1,472.6	1,455.6	24.6	24.3
Fixed assets	73.9	72.3	1.2	1.2
Other assets	231.8	239.0	3.9	4.0
Funds deposited by customers	4,180.1	4,130.6	69.7	69.0
of which: Savings deposits	1,996.4	1,966.8	33.3	32.9
Liabilities to banks	1,423.5	1,466.1	23.7	24.5
Other liabilities (including contingent liabilities and reserves)	140.2	145.4	2.3	2.4
Shareholders' equity	253.9	242.9	4.2	4.1

Compared with the association average, Sparkasse Saarbrücken's asset structure is characterised by a smaller share of loans to customers. On the liabilities side, the proportion of liabilities to customers continued to widen and has now almost reached the average for Saarland savings banks.

Among other things, the reform to the Saarland Savings Bank Act, which is currently being debated in the Saarland State Parliament, will result in amendments to the provisions governing the distribution of profits. Accordingly, at this stage it is not possible to disclose any details of the allocation of profit. In addition to safety reserves, Sparkasse Saarbrücken has further extensive lower-tier equity resources. At 11.7 %, the ratio of equity capital, measured according to Section 10 of the German Banking Act in relation to the sum of risk-weighted assets and market risk positions as at 31 December 2005 substantially exceeds the minimum statutory requirement of 8 %.

This strong equity basis provides the foundations for further efforts to expand business so that Sparkasse Saarbrücken is able to achieve its targets.

Undisclosed reserves are included in the assets carried on the balance sheet, particularly real estate and equity interests. As well as this, we have taken additional precautions pursuant to Section 340f of the German Banking Act to avert banking-related risks. The fund formed for general banking risks in accordance with Section 340g of the German Commercial Code is valued at EUR 35 million.

2.3 Financial position

Sparkasse Saarbrücken's solvency was guaranteed at all times in the year under review thanks to the well-pla nned, balanced liquidity provisions it had set aside. Short and medium-term financial plans, which contain details of maturities by month for cash invested and raised as well as forecasts on customer business derived using statistical methods from historical data, are used to monitor our liquidity. If necessary, forecasts are backed up by historical and target figures in a further step. Major deviations are analysed in monthly comparisons of target/actual figures and incorporated together with more recent data and information in the regular financial plans (forecast horizon).

Partial use was made of the credit facilities granted by Deutsche Bundesbank and Landesbank Saar. Appropriate assets were maintained at the responsible central bank in order to comply with minimum reserve requirements. With effect as of the end of the fiscal year, a liquidity rating of 1.36 was calculated in maturity band I based on Principle II, which is used by the banking regulatory authorities to assess banks' liquidity position, such that the liquidity level can be considered adequate both on the balance sheet date and for 2005 as a whole.

Similarly, the key figures to be calculated for further periods of observation (maturity bands of up to twelve months) do not give any indication of potential liquidity problems.

2.4 Earnings

Income statement:	2004 EUR mn	2005 EUR mn
Net interest income (including items 3 and 4 of the income statement)	118.2	120.7
Net commission income	19.1	18.6
Administrative expenses a) Personnel costs	67.9	66.1
b) Non-personnel costs	27.2	27.1
Sub-total	**42.2**	**46.1**
Net income from financial transactions	0.1	0.4
Net other operating income/expenses	- 9.5	- 23.1
Result before provisioning	32.8	23.4
Net provisioning result	- 8.4	- 8.6
Result after provisioning	**24.4**	**14.8**
Taxes	12.5	5.6
Net income and unappropriated surplus	**11.9**	**9.2**

Net interest income, which was down in the year under review, remains the most important source of income from our business activities. In particular, the narrowing interest spreads between the money and the capital markets together with strong pressure on margins exerted pressure on net interest income. Current income from parts of the securities portfolio and equity interests was up on the previous year. The increase in **net commission income** is mainly due to the rise in commission income from securities business with customers. **Net income from financial business**, which comprises trading in securities, foreign notes and coins, foreign exchange and derivatives, contracted and once again played only a subordinate role in the year under review. **Personnel costs** rose by 2.7 % to EUR 67.9 million as a result of increases in pay scales, the re-allocation of staff to higher pay scale groups as well as provisions for pre-retirement reduced working hour contracts. The cost of materials increased only marginally by 0.4%. The **result before provisioning** was up on the previous year.

After the completion of all necessary provisioning, the **result after provisions** was substantially improved over the previous year.

The **net income reported for the year** was sufficient to cover Sparkasse Saarbrücken's equity requirements and to distribute a reasonable dividend to the shareholder.

For the purpose of analysing our earnings, we use what is known as the „Operations comparison" developed by the Savings Bank Organisation. In further analyses, we additionally track the earnings components broken down using the mark-to-market method as well as counterparty and market price risks for which provisions are set aside.

2.5 Non-financial performance indicators

Employees

The total number of employees dropped in 2005. At the end of the year, Sparkasse Saarbrücken employed a total of 1,277 people. Of these, 858 were full-time and 337 part-time employees and 82 trainees.

We have developed numerous models allowing employees to combine families and careers. There are various part-time models. In addition to the statutory parental leave, employees are able to apply for leave of up to four years with a guaranteed right to return to the Bank.

The declared aim of our site safety policy is to protect and, where possible, improve our staff's health and to ensure that they are able to work to the best their abilities with maximum job satisfaction.

Ongoing further training is in the interests of both the employer and the employee. With this in mind, we offer internal and external (e.g. at Saarländische Sparkassenakademie) vocational education programs oriented to specific aspects of our business and helping staff to plan their careers. Given the constant changes in savings bank business as well as new technological developments, target-oriented training and vocational education for employees continued to play a crucial role in personnel development activities last year.

Top priority is given to training school-leavers at all sites. 18 trainees who successfully completed their courses were offered permanent positions at Sparkasse Saarbrücken. The ratio of trainees to the total number of employees stood at 6.4%.

Customer relations

We place our customers' interests at the heart of our activities and systematically align our internal benchmarks to their needs, expectations and wishes. For Sparkasse Saarbrücken, economic success over the next few years will hinge decisively on its ability to unlock new potential and extend existing business opportunities. This involves detecting new customer needs at an early stage and developing the right answers for these.

For this reason, our complaints management plays a central role in ensuring customer satisfaction: By specifically recording and evaluating complaints, we are able to gain a good idea of customers' basic expectations.

Social responsibility

We have always considered social responsibility in all areas in which Sparkasse Saarbrücken is active to constitute a corner piece of our corporate culture. We support the region's development and its appeal in the form of donations, sponsoring activities and the payment of dividends to our shareholder. This also includes assisting charities as well as cultural and sports activities.

2.6 Summary and assessment

Sparkasse Saarbrücken's performance as well as its net assets, financial condition and results of operations can be considered satisfactory in the light of general economic conditions as well as the state of the banking sector. Taking account of general economic conditions, borrowing demand has generally grown compared with the previous year and also the Saarland savings banks as a whole. In the income statement, the interest margin remains under pressure in line with expectations. However, we managed to post higher net income for the year thanks to an increase in other operating profit and a further reduction in write-down expense.

As a result, we will be able to further increase our Tier 1 capital, something which is necessary for our continued growth.

3 Risk report

3.1 Risk management

The conscious acceptance, active management and specific transformation of risks are core functions of banks. Due to the nature of our business, we are primarily exposed to counterparty risks, liquidity risks, market price risks (interest, exchange rate risks) and operational risks.

The measurement and close monitoring of all risks constitute a key basis for the controlled acceptance of risk as part of our business strategy. We meet these requirements by enhancing our risk management systems on an ongoing basis. In order to achieve our strategic goals of risk and return-optimised employment of our capital, our risk management system must detect risks at an early stage and provide the responsible persons with all the information required to avert them with minimum delay.

The Management Board defines maximum potential risk in the light of the Bank's risk resistance.

The principles underlying the risk management and monitoring system, the types of risks identified as well as the instruments used are documented in Sparkasse Saarbrücken's risk manual. This additionally includes information on responsibilities as well as the cycles for reporting to the Management Board and other decision makers as well as planned enhancements.

As part of a project commenced in the year under review, a risk resistance model is being developed at the integrated bank level. This model comprises both value-oriented and periodic views and additionally takes account of regulatory requirements. A further key aspect of the project involves fine-tuning the periodic simulations as well as the reconciliation and integration of the value-oriented view within the periodic view.

In regular reviews, we determine the risk capital available to Sparkasse Saarbrücken for covering losses as an indication of the extent to which it can accept risk as part of its business strategy.

As part of its monitoring duties, the internal auditing department, which is not integrated in the risk management processes, assists the Management Board on the basis of a risk-oriented audit schedule, which has been approved by the Management Board and which the internal auditing department uses as a basis for examining and evaluating operating and business processes. This includes auditing risk management and monitoring, internal reporting as well as compliance with internal and external rules and regulations. In this connection, the focus is on processes and methods in the light of the principles of security, propriety as well as economic efficiency and appropriateness. No findings of any significance impacting the Bank's asset, financial position or results of operations were made in 2005. As a matter of principle, any improvements suggested by Internal Auditing are implemented.

3.2 Risk monitoring and management

3.2.1 Counterparty risks

Counterparty risk is defined as the risk of partial or full default on the part of business partners in the performance of their contractual obligations towards the Bank. Our counterparty risk exposure in lending business is managed with particular consideration being given to size class structure, the sectors, the collateral provided and the risk of the commitment concerned. Details are defined in the credit risk strategy.

The Management Board attaches crucial importance to risk limitation in the Bank's customer lending activities. This is reflected in the fact that the credit risk strategy continues to focus on quality, i.e. the risk-sensitive granting of loans. Major risks are only accepted with the approval of Sparkasse Saarbrücken's Credit Committee.

Assessment of credit rating

The credit rating is of crucial importance for assessing counterparty risks in lending business. To this end, Sparkasse Saarbrücken uses the rating method developed by the savings bank organisation which includes all corporate customers. With this system, the quantitative assessment involves a system-based analysis of the annual financial statements in connection with a mathematical/statistical rating model.

The results are supplemented with an assessment of business performance, the ability to service loans as well as the quality and date of the figures furnished. In addition, qualitative factors such as management, market position, the range of products and services as well as the outlook for the sector are considered. The systems developed by the savings bank organisation (e.g. EBIL-Plus for analysing individual balance sheets) are particularly used to assess borrowers' credit rating. Credit ratings are assessed by experienced credit analysts and corporate customer relationship managers. In addition to an assessment of the customer's credit rating as such, risk classification in customer lending business also takes account of the collateral provided. In the case of private individuals, credit ratings are determined on the basis of their income and assets as well as their ability to repay loans on the basis of these findings.

Potential credit risks are addressed at an early stage by intensive management in the front office. Non-performing loans or those requiring restructuring are managed in back-office departments.

The Management Board has defined a credit risk strategy on the basis of a risk analysis. It receives a quarterly report on the state of the credit portfolio and compliance with the strategy. The credit risk report breaks down the portfolio by credit rating class or rating indicators, sectors, size classes and risk-exposed volumes. Together with the other systems used, this report forms the basis for decision-making processes in lending business and enables the credit portfolio to be evaluated and managed. The risk premiums on risk-adjusted lending terms are calculated on the basis of internal ratings. The use of derivative instruments to manage credit risks is being prepared.

At the moment, there is no evidence of any exceptional risk exposure in our credit portfolio on account of its structure and diversification. We assume that risk provisioning requirements for lending business will remain at the previous year's level.

Trading business

These risks are limited thanks to the careful selection of our contractual partners based on the rules for determining credit ratings as well as volume limits per counterparty in the trading area. In addition, the counterparty risk from trading business is capped at the overall portfolio level by means of a risk limit. At the end of 2005, 45 % of the limit of EUR 1 million was in use, testifying to Sparkasse Saarbrücken's favourable risk situation not only on the balance sheet date but also throughout all of 2005.

3.2.2 Market price risks

Market price risks are defined as potential losses of income as a result of changes in the market prices of securities and foreign exchange, fluctuations in interest rates and prices as well as any resultant changes in the market value of derivatives. Additional market price risks occur in connection with items for which there is only a limited market. Market price risks are managed with the aim of making use of earnings opportunities without placing undue strain on financial resources.

Risks from trading business

Market price risks arising from trading business are calculated daily in accordance with current market prices and potential changes in market price (loss potential) and added to the defined risk limit. The loss and risk limit system is implemented in the light of Sparkasse Saarbrücken's net assets and results of operations. Trading transactions are measured and monitored on each stock market day on the basis of a value-at-risk model. Potential loss for the portfolio as a whole is forecast using a variance/covariance approach based on a retention period of 10 days and a confidence level of 95 %.

In 2005, market price risks moved within the limit defined by the Management Board at all times. At the end of 2005, 48 % (EUR 15.9 million; previous year EUR 15.5 million) of the risk limit for trading business of EUR 33 million (previous year EUR 33 million) was in use, indicative of Sparkasse Saarbrücken's favourable risk situation. The system and its validity are reviewed and enhanced by means of backtesting twice a year.

The Management Board is kept briefed on market price risks on each stock market day in accordance with the statutory requirements for engaging in trading business.

Interest risk

The Bank's overall exposure to interest margin risks is monitored periodically with the assistance of simulations in the Asset/Liability Management planning model, with reports submitted to the Management Board three times a year.

In addition, interest risk as a subset of market price risk is monitored regularly at the level of the overall interest book with the aid of risk analyses in accordance with the present value model. The findings are reported to the Management Board on a monthly basis. The interest risk is determined by applying a value-at-risk method based on a historic simulation with a retention period of 63 trading days, a confidence level of 95 % and a historic observation period of 12 years.

On the basis of the average for the savings bank association, we consider the value-oriented interest risk measured to be average.

As part of integrated bank management, derivative financial instruments in the form of interest swaps and bond futures alongside on-balance-sheet instruments are used to hedge interest risks.

Exchange rate risks are of only subordinate importance for Sparkasse Saarbrücken. Open positions are generally matched by counter transactions or currency forwards.

3.2.3 Liquidity risk

The risk of not being able to enter into contracts on the expected terms in the event of insufficient market liquidity for individual products is also addressed by risk management and monitoring. The liquidity risk is averted by ensuring that sufficient liquidity is available and that assets and liabilities are structured responsibly. The liquidity status is used as a basis for planning and managing Sparkasse Saarbrücken's liquidity. The current liquidity status is analysed by the trading departments each day and used to manage daily liquidity. Liquidity is fine-tuned monthly using historical data. Sparkasse Saarbrücken is able to determine both current and future liquidity requirements or surpluses by observing the maturity lists for all interest and payment flows. In addition to this, it applies the Principle II requirements to measure and limit the longer-term liquidity reserve. As reflected in the liquidity principle indicator in the section on the Bank's financial position, Sparkasse Saarbrücken generally has a strong liquidity position thanks to its holdings of highly liquid securities.

3.2.4 Operational risks

Sparkasse Saarbrücken defines operational risks as the possibility of unexpected losses occurring as a result of shortcomings in processes and monitoring activities, technological and human failure, natural disasters or external factors. The Bank's organisation department is currently responsible for selecting the methods and determining the appropriateness of the methods and processes deployed. In addition, this department is implementing the regulatory and statutory requirements relating to managing and monitoring operational risks.

Sparkasse Saarbrücken identifies and documents operational risks once a year in its risk manual. The rules and processes installed for managing operational risks particularly include the internal controlling system, written rules governing the Bank's structure and main processes, the use of qualified personnel as well as ongoing further development of methods and improvements to technical processes. Operational risks in the IT field or due to organisational or processing errors are minimised by agreements with an external IT centre, precautions for emergency situations, growing automation and ongoing supervision carried out by qualified staff, and are covered in part by insurance. Legal risks are averted by means of careful examination of contracts and the use of standard template contracts. Risks arising in connection with equity interests are addressed by means of periodic supervision and reporting in this area.

The responsible department briefs the Management Board on the Bank’s risk situation and operational risks when and as required. The implementation of regular reporting on operational risks to the Management Board is planned.

The scope of operational risks is considered to be minimal.

3.3 Overall risk assessment

Our Bank has established a risk management, monitoring and control system in accordance with Section 25a of the German Banking Act (KWG) that is appropriate in the light of the nature and scope of its business activities. The risk management and monitoring system enables risks to be identified at an early stage, information forwarded to the responsible decision-makers and risks averted. The risk resistance analyses show that there is sufficient risk resistance in all scenarios.

There is no evidence of any risks to Sparkasse Saarbrücken’s status as a going concern or risks in excess of normal business levels. Similarly, no risk liable to exert a material effect on Sparkasse Saarbrücken's net assets, financial condition and results of operations have been identified. Given its existing risk management system, Sparkasse Saarbrücken sees itself well positioned to handle existing business and to master the challenges of the future.

4 Material events occurring after the balance sheet date

No events of material importance have occurred since the end of the fiscal year.

5 Outlook

Our foremost strategic aim is to retain the leadership of our core market. Only by ensuring reasonable profitability will we have sufficient financial scope for future business growth. Accordingly, we are seeking to steadily boost profitability on the basis of equity resources meeting the statutory requirements. Among other things, we are working towards this by entering into management-by-objectives agreements with executives and staff.

We are committed to operating economically, making appropriate precautions to cover any risks and generating funds which we can plough back into our business without losing sight of our public mission. Growth targets for balance-sheet items on the one hand and expense and income goals on the other have been defined to achieve reasonable profits to safeguard Sparkasse Saarbrücken's risk resistance. Target achievement is monitored on an ongoing basis by means of a comparison of actual and required figures.

The forecast covering Sparkasse Saarbrücken's performance over the next two years constitutes our view of what is the likeliest outcome on the basis of the information available to us on the date on which we prepared this management report. As forecasts invariably involve uncertainty or may be rendered void by changes in the underlying assumptions, it should be noted that actual events may differ from those projected at this stage if the underlying assumptions fail to eventuate.

Expected business performance in 2006 and 2007

The outlook for the German economy in 2006 is favourable, with gross domestic product generally expected to grow by a real 1.4 - 2 percent. The continued sharp global expansion should underpin the German economy as it will fuel strong demand for exports. This will be joined by an appreciable recovery in capital spending, particularly replacement and rationalisation capex. Consumer spending looks set to generate weaker impetus, although there was some cause for muted optimism in the first few months of 2006. Still, assuming that there is an appreciable improvement in the uncertain situation in the labour market in 2006, there is a chance of a pleasant surprise on this front. Regardless of this, efforts to avoid the sharp increase in value added tax planned for 2007 by bringing forward big-ticket purchases could also spur consumer spending in the second half of 2006.

The outlook for 2007 is less favourable on account of the planned increase in the rate of value added tax referred to above. Judging by current indications, it seems reasonable to assume that the economy will lose steam again in 2007.

The most important economic risks in 2006 are to be found in global factors. The oil market remains susceptible to geopolitical strain. If, for example, the dispute over the Iranian nuclear program intensifies, an even higher oil price will result, with all the familiar growth-impeding ramifications. It is also not possible to rule out the risk of the US economy and, along with it, the global economy cooling off to a greater extent than expected in response, for example, to a correction in what is partially already an overheated US real estate market. Indeed, there is preliminary evidence of this. Such a trend would presumably exert strong downside pressure on the US dollar, something which many experts already consider to be inevitable on account of the large current account deficit in the United States. This would almost certainly trigger turbulence in the global financial markets and take its toll on European exports as a result of higher exchange-rate-induced prices with a corresponding effect on growth. That said, however, there is still a reasonable chance of a pleasant economic surprise. Thus, the cyclical momentum of economic upswings regularly tends to be underestimated. After years of consolidation, many companies now appear to be more willing to act on opportunities for new investments and growth. It is also conceivable that political progress in the Near and Middle East could cause oil prices to weaken.

The upbeat sentiment amongst Saarland companies at the beginning of 2006 justifies hopes of a continuation of favourable economic conditions this year, with the recovery possibly gaining a broader footing across different sectors. By the same token, the aforementioned depreciation in the value of the dollar would exert particular strain on the Saarland economy. The upbeat sentiment amongst Saarland companies at the beginning of 2006 justifies hopes of a continuation of favourable economic conditions this year, with the recovery possibly gaining a broader footing across different sectors.

Sparkasse Saarbrücken faces the challenge of responding to dynamic competitive conditions. This includes the continued intensification of competition amongst banks as well as customers' rising expectations. The Bank already has a broad range of acknowledged financial products covering a large part of the regional market. Our product strategy aims at achieving a reasonable presence in all economically viable market segments.

Given the muted forecast for the economy as a whole, we project only marginal growth in total assets in 2006 and 2007. This growth is likely to be primarily underpinned by lending to customers as well as deposit-taking from customers.

In 2006, we expect to see moderate growth in commercial lending business, spurred for the most part by companies seeking to finance their replacement capex budgets. Turning to households, the main focus will be on financing homes and consumer spending. Despite the low interest rates, we project only moderate growth here on account of the high unemployment and resultant uncertainty on the part of customers. All told, we expect only minor expansion in our lending business in 2006, something which has been indicated by trends emerging in the past few months. Assuming that the economy picks up, we project small growth in lending business in 2007.

We anticipate a slight increase in funds received from customers and therefore expect a generally moderate increase in business activity.

The interest environment exerts the greatest influence on our net interest income. Although we expect interest rates to be slightly up over the previous year throughout much of 2006, they will remain at their historically low levels, meaning that interest margins will continue to be squeezed in tandem with intensifying competition in the banking sector. Net interest income will decline again.

By implementing systematic cost management, Sparkasse Saarbrücken will attempt to keep the forecast increase in operating expense in check to remain as close as possible to the favourable level achieved last year.

As personnel expenses will tend to rise on account of moderate wage and salary settlements, Sparkasse Saarbrücken plans to minimise these effects via strict personnel management. That said, we are also planning to spend on information technologies and products offering potential for the future as a basis for widening our share of the market. This is because, looking ahead over the next few years, we consider the key tasks facing us to involve enhancing our existing management instruments towards implementing integrating bank management, the risk-adjusted pricing of transactions as well as extensions to Internet access by our customers in the interests of heightened security and ease of use. The end-to-end integration of distribution channels such as telephone banking and the Internet, on the one hand, and over-the-counter branch-based distribution, on the other, will help us to serve our customers in the line with their requirements and offer them what they are specifically seeking.

Risk provisioning in lending business will be materially impacted by macroeconomic trends as well as the state of the regional economy. At this stage, we assume that provisioning requirements for this year will be unchanged over 2005. Depending on trends in the interest environment, we may also need to remeasure the value of our securities holdings.

Looking ahead to next year, we expect net profit to be down on the previous year. As far as we can forecast at this stage, we expect steady performance for 2007, with net profit for the year remaining at a comparable level provided that the economy continues to recover. Accordingly, Sparkasse Saarbrücken will be able to earn the Tier 1 capital which it requires itself. The Bank's resources of liable equity will remain satisfactory.

On the basis of our anticipatory financial projections, we assume that we will remain solvent at all times during the forecast period.

Our branch network

The Management Board

in 2005

Dieter Klepper
Chairman

Uwe Kuntz
Deputy Chairman

Dr. Harald Langenfeld
Board member

Hans-Werner Sander
Board member

The Supervisory Board of Sparkasse Saarbrücken

Chairperson

Charlotte Britz
Mayor
Until 30 April 2005

Michael Burkert
President of the City Association
As of 1 May 2005

Deputy Chairman

Michael Burkert
President of the City Association
Until 30 April 2005

Charlotte Britz
Mayor
As of 1 May 2005

Further members:
Bertold Bahner, Dr. Gerhard Bauer, Roland Bentz, Karin Bernhard, Herbert Bonenberger, Annemie Christoph, Manfred Hayo, Martin Karren, Günther Karcher (as 02.12.2005), Ralf Latz, Manfred Maurer, Klaus Meiser, Christian Schmidt, Walter Schneider (until 26.04.2005), Frank Schuler, Gerhard Sendel, Friedel Trouvain, Karlheinz Wiesen, Klaus Winter

Legal form

Sparkasse Saarbrücken is a member of the Sparkassenverband Saar (Saarland Savings Banks Association) and as such is affiliated with the Deutscher Sparkassen und Giroverband E.V., Berlin/Bonn.
The shareholder is Sparkassenzweckverband Saarbrücken, of which Saarbrücken City Association and the City of Saarbrücken are members.

Commercial register

Saarbrücken, A 8590

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66104 Saarbrücken

Telephone
(06 81) 5 04-0

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(06 81) 5 04 - 21 99

Telex
4 421 343 sbrk d

SWIFT- Code
SAKS DE 55

eMail
service@sk-sb.de

Internet
http://www.spk-sb.de

Our A-class correspondent banks

Belgium	Ing Belgium SA/NV	Brussels	BBRU	BE	BB 010
	KBC Bank NV	Brussels	KRED	BE	BB
Denmark	Danske Bank Aktieselskab	Copenhagen	DABA	DK	KK
Finland	Nordea Bank Finland PLC	Helsinki	NDEA	FI	HH
France	Banque Fédérative du Credit Mutuel	Strasbourg	CMCI	FR	PA
	Banque Populaire de Lorraine Champagne	Metz	BPLM	FR	2M
	Caisse Nationale des Caisses d'Epargne et de Prevoyance (CNCEP)	Paris	CEPA	FR	PP
	Caisse d'Epargne et de Prevoyance de Lorraine	Metz	CEPA	FR	PP 575
Great Britain	Barclays Bank PLC	London	BARC	GB	22
	Standard Chartered Bank	London	SCBL	GB	2L
Italy	Banca Lombarda E Piemontese SpA	Brescia	BLOP	IT	22
Japan	Sumitomo Mitsui Banking Corporation	Tokyo	SMBC	JP	JT
Canada	Bank of Montreal	Montreal	BOFM	CA	M2
Luxembourg	Banque et Caisse d´Epargne de l´Etat, Luxembourg	Luxembourg	BCEE	LU	LL
	Banque Générale du Luxembourg	Luxembourg	BGLL	LU	LL
Norway	DnB NOR Bank ASA	Oslo	UBNO	NO	KK
Austria	Bank Austria Creditanstalt AG	Vienna	BKAU	AT	WW
	Dornbirner Sparkasse Bank AG	Dornbirn	DOSP	AT	2D
Sweden	Nordea Bank Sweden AB(publ.)	Stockholm	NDEA	SE	SS
Switzerland	Bank CIAL Schweiz AG	Basel	CIAL	CH	BB
United States	The Bank of New York	New York	IRVT	US	3N
	Wachovia Bank NA	New York	PNBP	US	3N NYC

Balance sheet as of 31 December 2005

Assets

		EUR	EUR	EUR	31. 12. 2004 TEUR
1. Cash reserve					
a) Cash on hand			36,568,070.10		38,144
b) Balances held with Deutsche Bundesbank			178,364,511.46		180,476
				214,932,581.56	218,620
2. Public-sector bonds and bills of exchange approved for funding with Deutsche Bundesbank					
a) Treasury bills and non-interest bearing treasury notes and similar public-sector bonds			0.00		0
			261,148.64		559
b) Bills of exchange				261,148.64	559
3. Loans to banks					
a) Due daily			14,373,900.31		25,753
b) Other loans			1,048,999,216.25		1,203,373
				1,063,373,116.56	1,229,126
4. Loans to customers				3,098,414,688.06	2,928,428
of which: secured with liens					
on real estate	EUR 1,006,100,696.13				(1,044,563)
Municipal loans	EUR 867,037,673.14				(679,589)
5. Bonds and other fixed-income securities					
a) Money market securities					
aa) From public issuers		0.00			0
of which: eligible as security for loans from Deutsche Bundesbank	EUR 0.00				(0)
ab) From other issuers		0.00			0
of which: eligible as security for loans from Deutsche Bundesbank	EUR 0.00				(0)
			0.00		0
b) Debentures and bonds					
ba) From public issuers		113,995,556.11			68,387
of which: eligible as security for loans from Deutsche Bundesbank	EUR 113,995,556.11				(68,387)
bb) From other issuers		970,575,423.05			1,037,034
of which: eligible as security for loans			1,084,570,979.16		1,105,421
from Deutsche Bundesbank	EUR 922,279,944.30				(799,672)
c) Own bonds			1,619,428.78		3,618
				1,086,190,407.94	1,109,039
Nominal amount	EUR 1,591,805.36				(3,536)
6. Shares and other non-fixed-income securities				386,399,634.35	346,533
7. Equity investments				36,572,053.43	32,358
of which:					
in banks	EUR 1.00				(0)
in financial services companies	EUR 0.00				(0)
8. Shares in affiliated companies				50,000.00	50
of which:					
in banks	EUR 0.00				(0)
in financial services companies	EUR 0.00				(0)
9. Trustee assets				1,133,405.15	1,324
of which: Trustee loans	EUR 1,133,405.15				(1,324)
10. Compensation claims from public-sector bodies bonds from their exchange				0.00	0
11. Intangible assets				841,317.00	790
12. Tangible assets				36,481,097.39	39,084
13. Other assets				14,345,384.20	17,811
14. Deferred income				2,571,802.61	2,558
Total assets				5,941,566,636.89	5,926,280

Equity and liabilities

		EUR	EUR	EUR	31. 12. 2004 TEUR
1. Liabilities to banks					
a) Due daily			202,969,467.20		200,592
b) With agreed term or notice period			1,168,542,784.40		1,228,676
				1,371,512,251.60	1,429,268
2. Liabilities to customers					
a) Savings deposits					
aa) With agreed period of notice of three months		1,751,649,633.55			1,581,721
ab) With agreed period of notice of more than three months		280,797,100.88			385,094
			1,996,446,734.43		1,966,815
b) Other liabilities					
ba) Due daily		721,844,594.15			703,277
bb) With agreed period of notice		1,215,783,634.29			1,200,459
			1,937,628,228.44		1,903,736
				3,934,074,962.87	3,870,551
3. Certificated liabilities					
a) Bonds issued			211,390,327.96		204,922
b) Other certificated liabilities			0.00		0
				211,390,327.96	204,922
of which:					
Money market securities	EUR 0.00				(0)
Own bills of acceptance and promissory notes outstanding	EUR 0.00				(0)
4. Trustee liabilities				1,133,405.15	1,325
of which: Trustee loans	EUR 1,133,405.15				(1,325)
5. Other liabilities				10,590,991.54	11,357
6. Deferred income				5,527,670.10	8,511
7. Provisions					
a) Provisions for pensions and similar commitments			8,187,755.00		8,759
b) Tax reserves			5,932,580.74		4,993
c) Other reserves			52,558,269.12		51,758
				66,678,604.86	65,510
8. Special tax-allowable reserve				0.00	0
9. Subordinated liabilities				71,445,549.85	76,581
10. Participatory capital				15,338,756.44	15,339
of which: due in less than two years	EUR 0.00				(0)
11. Fund for general banking risks				35,000,000.00	35,000
12. Equity capital					
a) Subscribed capital			0.00		0
b) Capital reserves			0.00		0
c) Profit reserves					
ca) Contingency reserve		206,995,562.33			198,717
cb) Other reserves		0.00			0
			206,995,562.33		198,717
d) Unappropriated surplus			11,878,554.19		9,199
				218,874,116.52	207,916
Total equity and liabilities				5,941,566,636.89	5,926,280
1. Contingent liabilities					
a) Contingent liabilities from rediscounted bills of exchange			0.00		0
b) Liabilities from sureties and guarantee contracts			56,058,516.86		58,735
c) Liability for assets pledged as collateral security for third parties			51,986.60		21
				56,110,503.46	58,756
2. Other obligations					
a) Return commitments for synthetic repo transactions			0.00		0
b) Placement and acceptance obligations			0.00		0
c) Irrevocable loan commitments			41,513,265.36		23,571
				41,513,265.36	23,571

Income statement for 2005

	EUR	EUR	EUR	1.1. - 31. 12. 2004 TEUR
1. Interest income from				
a) Lending and money market business	209,178,858.48			207,859
b) Fixed-income securities and debt register claims	36,895,799.97			40,103
		246,074,658.45		247,962
2. Interest expenditure		143,762,099.16		142,053
			102,312,559.29	105,909
3. Current income from				
a) Shares and other non-fixed-interest securities		13,360,839.58		(12,113)
b) Equity investments		1,231,777.12		(1,053)
c) Shares in affiliated companies		0.00		(0)
			14,592,616.70	13,166
4. Income from profit pools and full or partial profit transfer agreements			1,302,951.50	1,609
5. Commission income		21,151,711.16		(20,561)
6. Commission expenditure		2,067,917.61		(1,990)
			19,083,793.55	18,571
7. Net income from financial transactions			130,398.18	397
8. Other operating income			4,781,358.77	5,968
9. Income from the release of the special tax-allowable reserve			0.00	0
			142,203,677.99	145,620
10. General administrative costs				
a) Personnel costs				
aa) Wages and salaries	52,032,750.90			(51,112)
ab) Social security levies and expenses for old age pensions and support	15,835,427.98			(14,975)
		67,868,178.88		(66,087)
of which: old age pensions EUR 4,954,689.11				(4,913)
b) Other administrative costs		27,230,621.02		(27,046)
			95,098,799.90	93,133
11. Depreciation and amortization			6,573,207.67	6,258
12. Other operating expenses			7,733,931.98	22,847
13. Value adjustments and write-downs on receivables and certain securities as well as allocations to provisions for lending business		7,791,145.25		(10,392)
13a. Allocations to the fund for general banking risks			0.00	0
14. Income from write-ups of receivables and certain securities as well as release of provisions for lending business		0.00		(0)
			7,791,145.25	10,392
14a. Withdrawals from the fund for general banking risks			0.00	0
15. Value adjustments and write-downs on equity interests, shares in affiliated companies and securities treated as fixed assets		580,000.00		(0)
16. Income from write-ups on equity interests, shares in affiliated companies and securities treated as fixed assets		0.00		(1,782)
			580,000.00	1,782
17. Loss-absorption expenses			0.00	0
18. Additions to special tax-allowable reserve			0.00	0
19. Profit on ordinary activities			24,426,593.19	14,772
20. Extraordinary income		0.00		(0)
21. Extraordinary expenses		0.00		(0)
22. Extraordinary net income/loss			0.00	0
23. Income taxes		12,337,059.23		(5,365)
24. Other taxes not included in Item 12		210,979.77		(208)
			12,548,039.00	5,573
25. Net income			11,878,554.19	9,199
26. Profit/loss carried forward from the previous year			0.00	0
			11,878,554.19	9,199
27. Withdrawals from revenue reserves				
a) From contingency reserve		0.00		(0)
b) From other reserves		0.00		(0)
			0.00	0
			11,878,554.19	9,199
28. Allocations to profit reserves				
a) To contingency reserve		0.00		(0)
b) To other reserves		0.00		(0)
			0.00	0
29. Unappropriated surplus			11,878,554.19	9,199

At a glance

Item	Existing 31.12. 2005 EUR mn	Existing 31. 12. 2004 EUR mn	2005 Changes EUR mn	%
Total assets	**5,941.6**	**5,926.3**	**15.3**	**0.3**
Funds deposited by customers	**4,180.1**	**4,130.6**	**49.5**	**1.2**
Of which: Savings deposits	1,996.4	1,966.8	29.6	1.5
Non-certificated liabilities	1,937.6	1,903.7	33.9	1.8
Certificated liabilities	175.9	184.7	-8.8	-4.8
Subordinated liabilities	54.9	60.1	-5.2	-8.7
Participatory capital	15.3	15.3	0.0	0.0
Liabilities to banks	**1,423.5**	**1,466.1**	**-42.6**	**-2.9**
of which: Subordinated liabilities	16.5	16.5	0.0	0.0
Other liabilities	**140.2**	**145.4**	**-5.2**	**-3.5**
(including contingent liabilities and provisions)				
Equity capital	**253.9**	**242.9**	**11.0**	**4.5**
(including fund for general banking risks)				
Volume of loans to customers	**3,155.9**	**2,989.0**	**166.9**	**5.6**
Of Which: Loans to customers	3,098.4	2,928.4	170.0	5.8
Obligations under bills of exchange	0.3	0.6	-0.3	-50.0
Trustee assets	1.1	1.3	-0.2	-15.4
Guarantee loans	56.1	58.7	-2.6	-4.4
Loans to banks	**1,063.4**	**1,229.1**	**-165.7**	**-13.5**
Investments in securities	**1,472.6**	**1,455.6**	**17.0**	**1.2**
Fixed assets	**73.9**	**72.3**	**1.6**	**2.3**
Other assets	**231.8**	**239.0**	**-7.2**	**-3.0**
Net income	**11.9**	**9.2**	**2.7**	**29.3**