

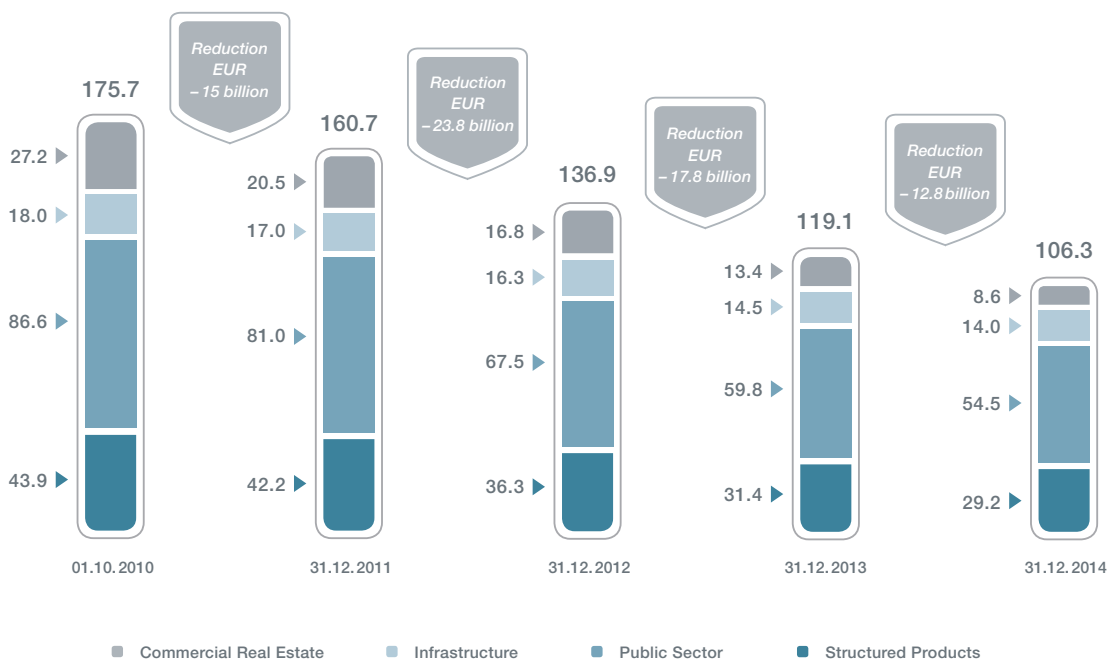


# FMS Wertmanagement AöR

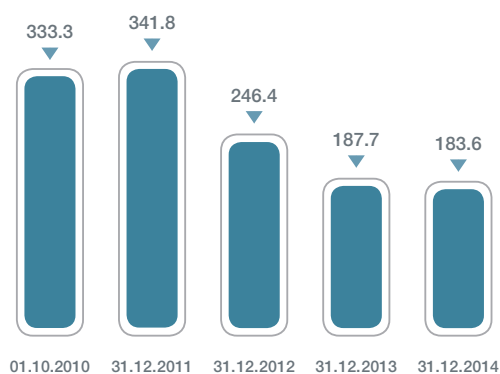
Annual Report 2014

# FMS Wertmanagement at a glance

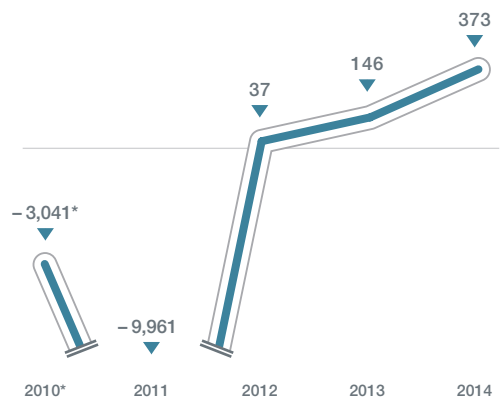
## DEVELOPMENT OF THE PORTFOLIO OF FMS WERTMANAGEMENT — IN EUR BILLION —



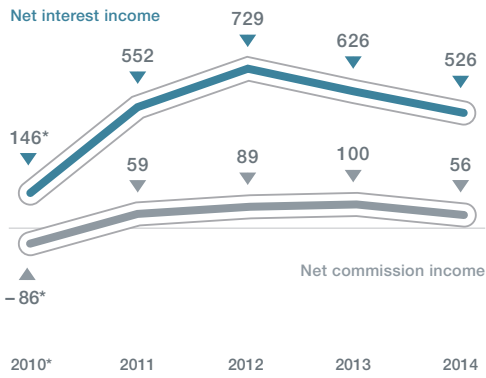
## TOTAL ASSETS — IN EUR BILLION —



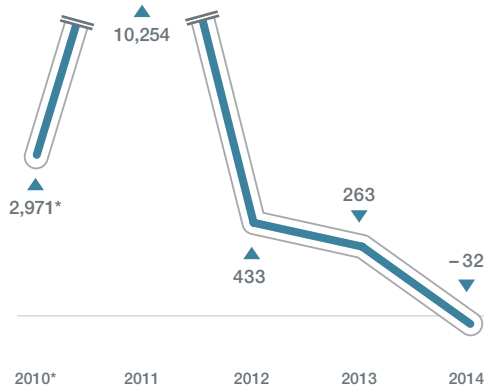
## RESULT FROM ORDINARY ACTIVITIES — IN EUR MILLION —



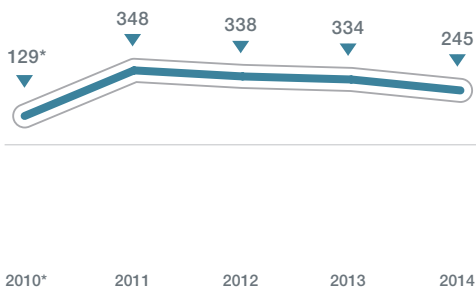
### NET INTEREST INCOME AND NET COMMISSION INCOME — IN EUR MILLION —



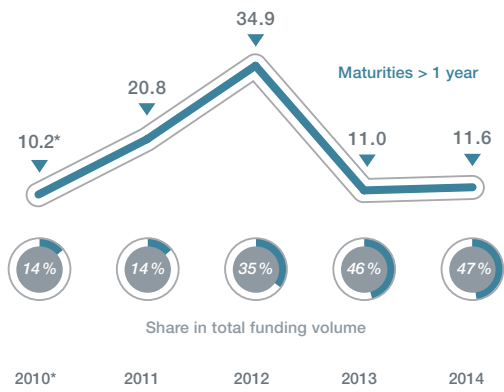
### RISK PROVISIONS (INCL. NET INCOME FROM INVESTMENTS) — IN EUR MILLION —



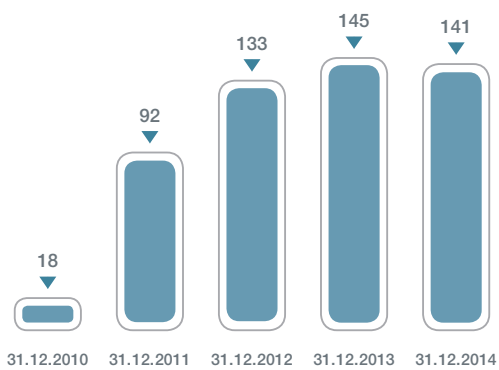
### GENERAL AND ADMINISTRATIVE EXPENSES — IN EUR MILLION —



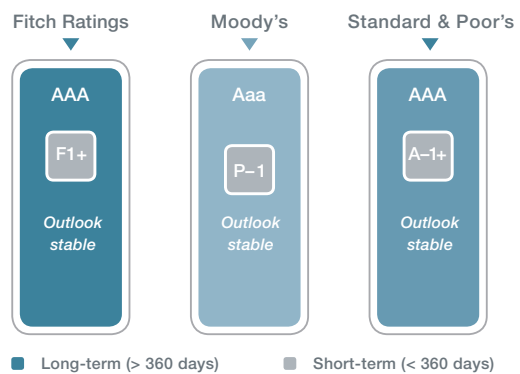
### CAPITAL MARKET FUNDING — IN EUR BILLION —



### EMPLOYEES — NUMBER —



### TOP RATINGS FOR FMS WERTMANAGEMENT



\* Short fiscal year from 08.07. — 31.12.2010

# FMS Wertmanagement in brief

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FMS Wertmanagement has been winding up assets and derivatives transferred to the company from the HRE Group since 1 October 2010 and develops and implements wind-up strategies for this purpose. FMS Wertmanagement refinances itself independently in the money and capital markets. The Executive Board and all employees of FMS Wertmanagement are committed to their task of actively and successfully managing and winding up the portfolio in the interests of the German taxpayer.

## 2014 fiscal year

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### **Portfolio**

The nominal value of the portfolio decreased by 11 % or EUR 12.8 billion in 2014 to EUR 106.3 billion at the end of the year.

### **Total assets**

Total assets fell by 2.2 % to EUR 183.6 billion. The small decline relative to the portfolio wind-up is mainly attributable to countervailing currency effects and higher collateral to be furnished in connection with derivatives.

### **Result for the year**

The result from ordinary activities is EUR 373 million, driven by net interest income of EUR 526 million and a reversal of risk provisions (including net income from investments) of EUR 32 million.

### **Funding**

FMS Wertmanagement was once again able to make use of the favourable funding conditions and continue its success in the money and capital markets, raising funds of EUR 11.6 billion in 2014 through the placement of medium- to long-term issues.

### **New task**

FMS Wertmanagement was commissioned in 2014 to take over Dublin-based DEPFA BANK plc and all related subsidiaries from the HRE Group and unwind them.



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# Foreword of the Executive Board

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*From the left: Ernst-Albrecht Brockhaus, Dr. Christian Bluhm, Frank Hellwig*

## **Ladies and Gentlemen,**

We are pleased to submit to you the fifth annual report of FMS Wertmanagement. It gives us the opportunity not only to present you with the figures for the 2014 fiscal year, but also to look back on what we have achieved since FMS Wertmanagement was established as a winding-up institution for Hypo Real Estate's non-strategic and high-risk assets.

Favourable market conditions and the special efforts made by our portfolio managers enabled us to achieve a portfolio wind-up in 2014 that was once again substantial and more extensive than planned, allowing us to present an exceedingly positive result that is significantly higher than in the previous year. At the same time, we need to tackle a new important task with which we were entrusted last year: winding up the Dublin-based DEPFA BANK Group as well as various overseas locations. We view this assignment as confirmation of the trust placed in us, which we intend to justify by increasing our efforts and continuing to improve what is already an efficient, flexible organisation.



We reduced the portfolio transferred to us by 11 % or EUR 12.8 billion in 2014. The share of active sales remains significant at around EUR 5.9 billion in 2014. Since the portfolio was transferred on 1 October 2010, its nominal value of EUR 175.7 billion has been lowered by 39 % to EUR 106.3 billion as at the end of 2014. The number of individual exposures fell from more than 7,100 to 3,226. At the same time, we succeeded in significantly reducing the complexity of the portfolio and restructuring a large number of exposures. In some cases, this increased the margins and improved the prospects for a later sale.

In 2014, however, the portfolio's nominal value in euros did not fall as steeply as in previous years, mainly due to countervailing currency effects. After adjusting for currency effects the portfolio has contracted by EUR 18.1 billion in 2014. The euro's decline against many other currencies during 2014 contributed to the fact that in nominal terms many of the remaining foreign currency exposures have higher book values in euros than in the previous year.

This effect also had an impact on total assets, which edged down just 2.2 % year on year to EUR 183.6 billion. In addition to the currency effects, the sharp drop in interest rates on the capital markets played a role here. The fall in interest rates led to higher negative fair values of derivative positions, which at FMS Wertmanagement serve to hedge interest rate risk in accordance with its business policy. Under the terms of the agreement, this requires higher collateral to be furnished, which likewise increased total assets in 2014. The overall effect came to approximately EUR 13.4 billion in 2014.

Still, currency effects and the furnishing of collateral barely contributed to the result from ordinary activities, which at EUR 373 million was once again substantially higher than in the previous year (EUR 146 million).

Net interest income, at EUR 526 million, remains an important driving force behind the positive result. It is roughly 16.0 % lower than in the previous year (EUR 626 million). The decrease, which is in line with expectations, is attributable to the contraction in the portfolio caused by unwinding measures and redemptions and hence to the reference volume of the interest-bearing assets. Financing obtained under favourable terms and conditions enabled this portfolio-based decrease in net interest income to be offset in part.

FMS Wertmanagement benefited on the one hand from the generally low interest rates, but on the other hand the yield spreads to issuers with a comparable risk profile were reduced further. The strategic goal — which is important from the aspect of risk — of achieving a balanced mix of short-term (money market) funding and long-term (capital market) funding was also reached in the fiscal year ended.



The fact that risk provisions including net income from investments made a positive contribution of EUR 32 million for the first time also boosted the result in 2014. In the previous year, risk provisions including net income from investments had had a negative effect of EUR –263 million on the income statement.

Administrative costs decreased considerably by 26.6% to EUR 245 million. As in previous years, these are significantly lower than the sum of net interest and commission income and therefore show that the portfolio in its present constellation is able to generate more than the running costs associated with its management and unwinding.

Through the recovery of prices on many markets, we are able to report that since the transfer of the portfolio in autumn 2010 the hidden losses in the securities — the difference between the book values and the market values of the securities — have also been substantially reduced. Amounting to EUR 24.4 billion in the first balance sheet as at the end of 2010, these fell to EUR 3.5 billion as at the end of 2014. Simultaneously, the hidden assets in the securities rose from EUR 0.8 billion at the end of 2010 to EUR 5.9 billion at the end of 2014. The balance (and thus a risk of further losses in the wind-up of the remaining portfolio), which was once EUR –23.6 billion, has moved into positive territory at EUR +2.4 billion. At the same time, however, the net fair value of the derivatives held by FMS Wertmanagement has fallen further from EUR –21.8 billion to EUR –35.6 billion, mainly on account of the sustained interest rate cuts on the capital markets.

The healthy figures aside, last year also brought some bad news for FMS Wertmanagement. In late summer, a press report alleged that three years ago FMS Wertmanagement had squandered billions in tax money in the restructuring of Greek government bonds. Complaints lodged by individual citizens led the Munich Public Prosecutor's Office to open an investigation into the Executive Board. We immediately expressed our readiness to cooperate fully with the Public Prosecutor's Office and subsequently supplied extensive documentation showing how our strategy relating to the capitalisation measures for Greece had been weighed up carefully taking into account economic aspects in the highly uncertain market environment. At the end of the year, the Munich Public Prosecutor's Office notified us that the investigation into FMS Wertmanagement's Executive Board had been discontinued as there were no longer grounds for suspicion.



We received another important assignment for FMS Wertmanagement to take over and wind up DEPFA BANK plc in Dublin following a decision by the inter-ministerial steering committee of the Federal Agency for Financial Market Stabilisation in May. The transaction was successfully completed on 19 December 2014 and ownership of DEPFA BANK was transferred to FMS Wertmanagement. Before the end of the year, after protracted negotiations, FMS Wertmanagement succeeded in signing contractual arrangements with a number of US investors which enabled us to lay the foundations for implementing one of the main value levers in the wind-up of DEPFA. The implementation of further value levers, particularly on the funding and cost side, is being tackled as a priority this year by DEPFA's newly formed management team.

An important task for us in the coming years in addition to the portfolio wind-up will be to align the structures of FMS Wertmanagement and the other units entrusted to us with the continued unwinding of the portfolio. Going forward, we intend to continue to rigorously and consistently pursue our dual strategy of an accelerated wind-up wherever possible and — where unwinding is currently not possible — pressing ahead with the restructuring of exposures to improve their marketability or yield for the years to come. Our aim is to employ creative solutions to manage the increasing concentration of risks that inevitably result from the portfolio wind-up. We are confident that we will be able to achieve good results here again in the future in the interests of the German taxpayer.

Munich, 27 March 2015

The Executive Board

A handwritten signature in blue ink, appearing to be 'Bluhm'.

Dr. Christian Bluhm  
Spokesman of the  
Executive Board

A handwritten signature in blue ink, appearing to be 'Brockhaus'.

Ernst-Albrecht Brockhaus  
Executive Board member

A handwritten signature in blue ink, appearing to be 'Hellwig'.

Frank Hellwig  
Executive Board member



# Report of the Supervisory Board

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The Supervisory Board fulfils its task as the corporate body of FMS Wertmanagement charged with supervising the organisation in accordance with applicable laws and FMS Wertmanagement's Charter. It also advises the company's Executive Board on matters of particular strategic importance. Employees of the Federal Agency for Financial Market Stabilisation (FMSA) not entitled to vote participate in the meetings of the Supervisory Board in their capacity as the representatives of the legal regulator and as the statutory agents of the owner (Financial Market Stabilisation Fund). In fiscal 2014 a total of six Supervisory Board meetings requiring personal attendance and six conference calls took place.

Since FMS Wertmanagement was founded, the Supervisory Board has closely overseen and monitored the unwinding of the assets transferred to the company. The Supervisory Board has advised the Executive Board of FMS Wertmanagement in all strategic, risk-related and business decisions and monitored the implementation of such decisions.

The Supervisory Board carries out some of its responsibilities through two committees, the Risk Committee and the Audit Committee. The Risk Committee makes recommendations and decisions regarding transactions in accordance with the set of rules allocating authority and regarding actions, strategies and targets related to individual exposures in respect of the portfolio's wind-up. The Risk Committee also obtains regular information from the Executive Board regarding the implementation and monitoring of relevant portfolio decisions. At its meetings it regularly deals with market and credit risks, operational risks, liquidity risks and issues related to the risk strategy. Furthermore, the Risk Committee makes recommendations to the full Supervisory Board in the context of topics relevant to risks. In fiscal 2014, the Risk Committee held a total of 26 meetings.

The audit committee in contrast concerns itself with the financial statements of FMS Wertmanagement as well as with both internal and external audits. Among other things, it advises and monitors the Executive Board in respect of all matters related to accounting. It had six regular meetings during the reporting year and held several discussions. The Chairman of the Audit Committee also received regular reports on the status of the audit results and the processing of the audit findings in bilateral discussions with the head of FMS Wertmanagement's internal audit department.



In the past year, FMS Wertmanagement again made significant strides in winding up the portfolio, the mission set out for it in its Charter. The assets transferred on 1 October 2010 were reduced by 39 % overall as at the reporting date of 31 December 2014. The Executive Board regularly reported to the Supervisory Board about the risk provisions recognised for the transferred risk positions and confirmed their appropriateness.

The Supervisory Board questioned FMS Wertmanagement's compliance officer on the methodology used for the compliance function at FMS Wertmanagement and asked to see the compliance reports. The Supervisory Board was particularly concerned with, among other things, the strategy adopted by the compliance function for preventing money laundering and terrorist financing.

Since 1 October 2013, FMS Wertmanagement Service GmbH as a wholly owned subsidiary has performed portfolio services for FMS Wertmanagement. These encompass all of the principal tasks relating to portfolio management, such as credit analysis, processing of business transactions, funds transfers, risk controlling and reporting. On 19 April 2014, as part of an EU tender, FMS Wertmanagement announced its intention to privatise FMS Wertmanagement Service GmbH. The Supervisory Board received regularly progress reports from the Executive Board on this venture, which is expected to be finalised in 2015.

On 13 May 2014, the inter-ministerial steering committee of the Federal Agency for Financial Market Stabilisation and the General Meeting of Hypo Real Estate Holding (HRE) decided that Dublin-based DEPFA BANK plc would be transferred to FMS Wertmanagement and wound up. The Supervisory Board received regular reports on the subsequent project, which prepared the takeover of DEPFA. The transfer of ownership from HRE to FMS Wertmanagement took place on 19 December 2014. DEPFA continues to exist under FMS Wertmanagement as an independent banking group that is to be wound up. During the initial months, with the Supervisory Board's approval, FMS Wertmanagement and DEPFA's new management team were able to put in place the basis for transactions at DEPFA that are designed to preserve value, including the announced buy-back of hybrid capital.



Following a press report on alleged irregularities in connection with FMS Wertmanagement's participation in the Greek haircut in spring 2012, the Supervisory Board, some of whom were not members in 2012, requested a detailed presentation of the decisions taken at the time. The Supervisory Board was satisfied that all decisions on the issues concerned are comprehensively documented and that FMS Wertmanagement and its bodies pursued and implemented an appropriate risk-minimising strategy at the time. The Executive Board notified the Supervisory Board that an investigation launched by the Munich Public Prosecutor's Office against the Executive Board of FMS Wertmanagement had been terminated before the end of 2014.

With effect from the beginning of 2015, the Supervisory Board approved a new organisational structure for FMS Wertmanagement. The division of the Chief Risk Officer (CRO) / Chief Financial Officer (CFO) and Spokesman of the Executive Board remains unchanged. The previously independent CRE (Commercial Real Estate) division was assigned to the Treasury, Markets & CRE division. Norbert Kickum, who was responsible for CRE, left FMS Wertmanagement effective 30 November 2014. The division of the Chief Operating Officer (COO) was set as the third Executive Board division. The previous General Manager and COO Frank Hellwig was appointed as Executive Board member with responsibility for this division.

The Supervisory Board appointed PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft (PwC) the statutory auditor for the 2014 fiscal year of FMS Wertmanagement. PwC audited the annual financial statements as at 31 December 2014, the management report, the cash flow statement and the statement of changes in equity for the 2014 fiscal year and issued an unqualified auditor's report. Both the Audit Committee of the Supervisory Board and the full Supervisory Board discussed PwC's audit report and did not raise any objections. At its meeting on 13 April 2015, the Supervisory Board approved the annual financial statements as prepared by the Executive Board.



In the 2014 fiscal year, the long-time Deputy Chairman of the Supervisory Board, Dr. Christopher Pleister, and the long-time Chairman of the Supervisory Board's Audit Committee, Dr. Harald Wiedmann, left the Supervisory Board. Jan Bettink, a new member of the Supervisory Board, took over as Chairman at the beginning of 2014. Klemens Breuer and Dr. Axel Berger were also newly appointed to the Supervisory Board. Klemens Breuer assumed the role of Deputy Chairman and Dr. Axel Berger took over as Chairman of the Audit Committee. At the end of 2014, Rita Geyermann succeeded Dr. Andreas Ricker as Chairman of the Supervisory Board's Risk Committee. Furthermore, Dr. Herbert Walter, Chairman of the Steering Committee of the Federal Agency for Financial Market Stabilisation, was appointed to the Supervisory Board in January 2015.

Munich, 13 April 2015

Jan Bettink  
*Chairman of the Supervisory Board*



# The task

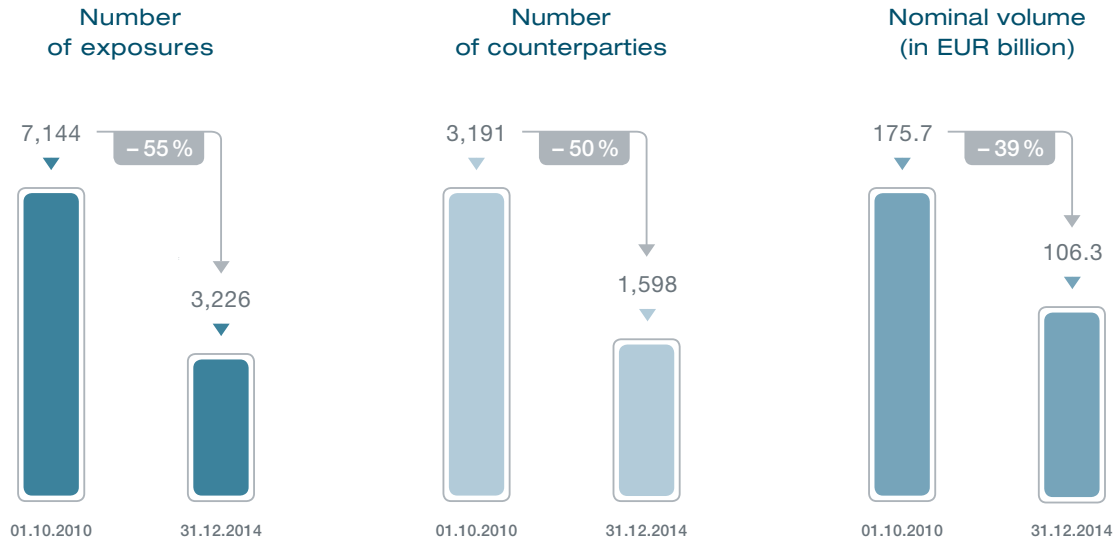
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## — Unwinding the portfolio —

In 2014, FMS Wertmanagement again made significant progress with its core task — unwinding the portfolio in a manner that maximises its value. Since the portfolio was transferred from the HRE Group on 1 October 2010, its original nominal value of EUR 175.7 billion has been reduced to EUR 106.3 billion as at the end of 2014. This corresponds to a cumulative reduction of 39%. In 2014, EUR 12.8 billion or 11% of the portfolio was wound up, reducing its volume from EUR 119.1 billion at the end of 2013 to EUR 106.3 billion at year-end 2014. Of the portfolio wind-up in 2014, active sales make up EUR 5.9 billion, whilst contractual and extraordinary redemptions account for the approximately EUR 6.9 billion remaining.



## DEVELOPMENT OF THE OVERALL PORTFOLIO



Adjusted for currency effects, the portfolio wind-up in 2014 would add up to EUR 18.1 billion. The individual exposures are located in 61 countries and denominated in 16 currencies (see chart on page 12/13). In individual countries and regions, for example in the United Kingdom and CIS, the portfolio's nominal value translated into euros actually increased despite the unwinding. This is attributable to the weaker euro. In 2014, the US dollar gained 12% against the euro and the pound sterling recorded gains of 7% against the single currency. The changes of the exchange rate had an overall effect of EUR 5.3 billion on the portfolio's nominal value in 2014. The total number of counterparties declined by 14% in 2014 to 1,598.

The portfolio is highly complex and diverse and has a particularly high proportion of illiquid exposures with extremely long maturities. In addition to actively reducing the portfolio volume, an important goal pursued during wind-up is the improvement of the quality of the portfolio's structure. This can be achieved with the

restructuring of loan exposures, securities holdings and derivative positions. In 2014, FMS Wertmanagement used appropriate restructuring measures to once again make substantial improvements to the medium-to long-term prospects for the realisation of numerous exposures and reduce the remaining portfolio's complexity and risk.

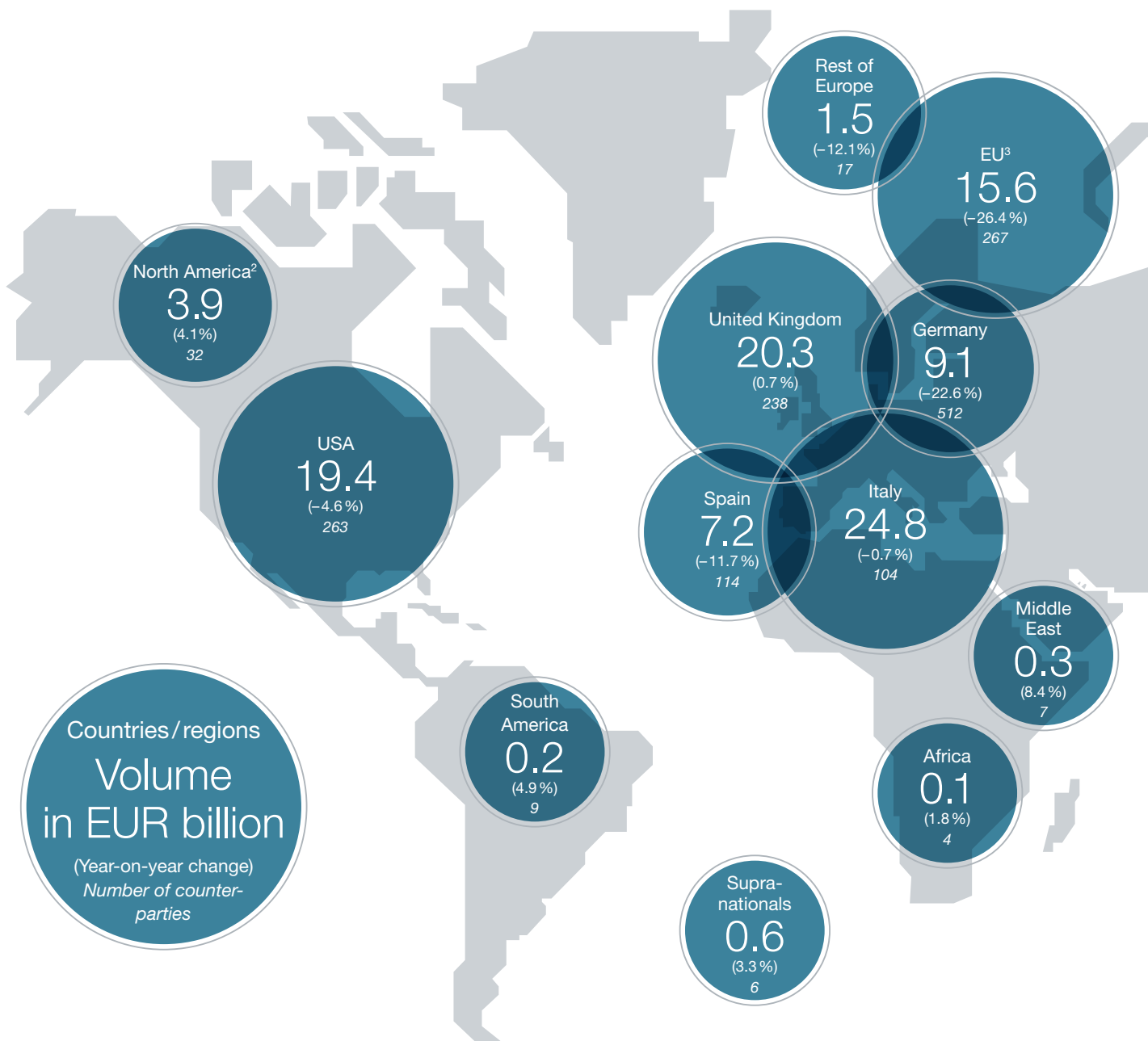
The portfolio of FMS Wertmanagement still contains significant concentration risks, including those in sovereign debt exposures. At EUR 24.8 billion, the share of Italian borrowers — mainly government bonds and instruments issued by other public borrowers — now accounts for just under one quarter of the total nominal volume, which in Italy is also spread amongst a relatively small number of just 104 counterparties.

In 2014, FMS Wertmanagement again was successful in unwinding individual positions and in restructuring exposures across all four portfolio segments.



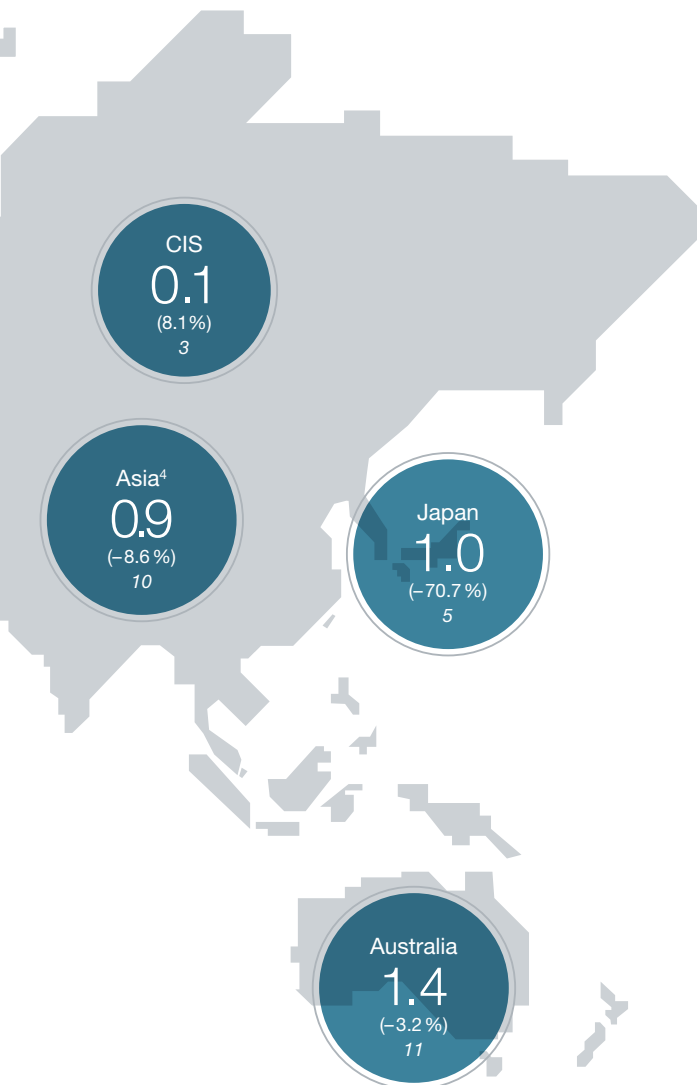
— The portfolio —

1,598 counterparties, nominal value of EUR 106.3 billion and 61 countries<sup>1</sup>  
as at 31 December 2014



Countries / regions  
**Volume  
in EUR billion**  
(Year-on-year change)  
Number of counter-  
parties

<sup>1</sup> Supranationals are counted as one country  
<sup>2</sup> Excluding the USA  
<sup>3</sup> Excluding Germany, the United Kingdom, Italy and Spain  
<sup>4</sup> Excluding Japan



### Worldwide exposures in the portfolio

#### Africa

Morocco  
South Africa  
Tunisia

#### Asia

India  
Japan  
Malaysia  
Philippines  
Singapore  
South Korea  
Vietnam

#### Australia

#### European Union

Austria  
Belgium  
Bulgaria  
Croatia  
Cyprus  
Czech Republic  
Denmark  
Estonia  
Finland  
France  
Germany  
Greece  
Hungary  
Ireland  
Italy  
Latvia  
Lithuania  
Luxembourg  
Malta  
The Netherlands  
Poland  
Portugal  
Romania  
Slovakia  
Slovenia  
Spain  
United Kingdom

#### Rest of Europe

Iceland  
Jersey  
Macedonia  
Norway  
Switzerland  
Turkey

#### CIS countries

Azerbaijan  
Ukraine

#### Middle East

Bahrain  
Egypt  
Kuwait  
Qatar  
United Arab Emirates

#### The Americas

Barbados  
Brazil  
British Virgin Islands  
Canada  
Cayman Islands  
Chile  
Mexico  
Peru  
USA



### Successful unwindings and restructurings

At the transfer date, the portfolio encompassed more than 7,100 individual exposures. By the end of 2014, this figure had been reduced to 3,226 exposures with 1,598 borrowers or debtors and a nominal value of EUR 106.3 billion.

### Public Sector

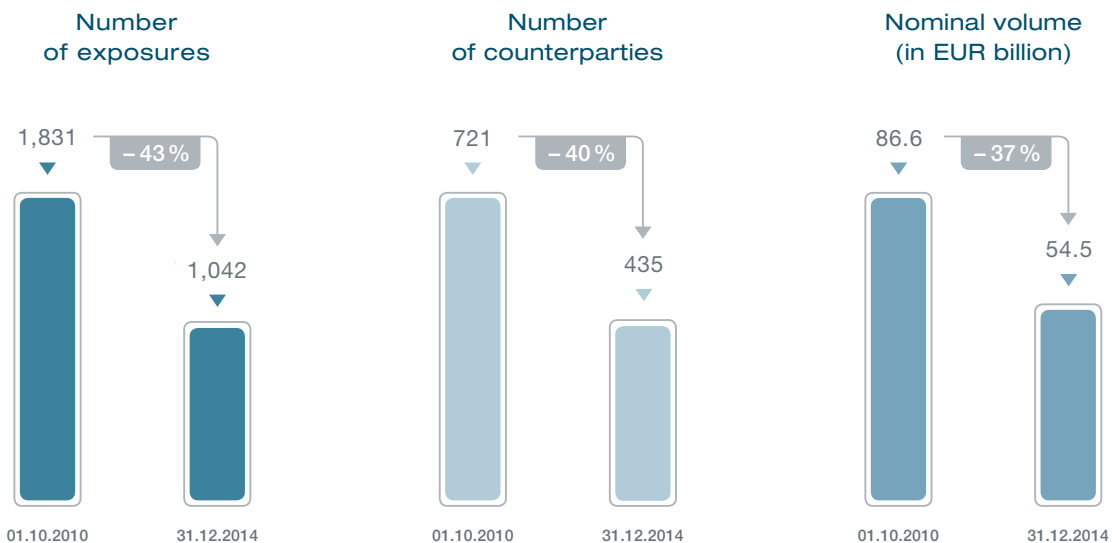
At the end of 2014, the Public Sector segment comprised a total of 1,042 exposures related to loans and securities, with an outstanding volume of EUR 54.5 billion. The borrowers and issuers of the securities are state and regional governments, municipalities, public law entities and semi-public companies. European Union member states account for the majority of the portfolio. Around 77 % of the segment is made up of bonds, with loans accounting for the remaining 23 %. Around 52 % of the exposures mature after 2030.

A particular success in the Public Sector segment is the accelerated wind-up in Japan, where the outstanding nominal volume was reduced by 69 % in 2014, from EUR 3.3 billion to around EUR 1.0 billion.

In a number of cases, there are legal disputes with municipalities and towns or cities regarding public sector financing. Most of these legal proceedings essentially arise from local/regional authorities considering themselves disadvantaged by the contracts concluded prior to the financial crisis or contending that they were not adequately informed about the economic effects of these contracts before signing them. Some of these legal disputes were terminated in 2014 by mutual agreement — in some cases following lengthy negotiations with the municipalities. This significantly reduced the legal and economic risks.

For instance, an out-of-court settlement was reached with a French town in mediation proceedings, leading to the conversion of a complex structured interest rate

## DEVELOPMENT OF THE PUBLIC SECTOR PORTFOLIO





swap into a fixed-interest obligation. At the same time, the municipality waived its right to assert claims under other transactions with FMS Wertmanagement. FMS Wertmanagement waived part of its claim in return. The pending legal proceedings were discontinued.

In Italy, FMS Wertmanagement prevailed against a municipality in key points of a legal battle that had lasted several years. This led to a reversal of a provision recognised for this case, which generated extraordinary income.

In Spain, FMS Wertmanagement succeeded in collecting past-due interest from a municipality through direct access to licence payments of a utility company.

In Iceland, a loan to a municipality that had not been serviced since 2011 was restructured after protracted negotiations. Here, the town in question initially pledged available plots of land to FMS Wertmanagement as collateral. Finally, a local bank was found to

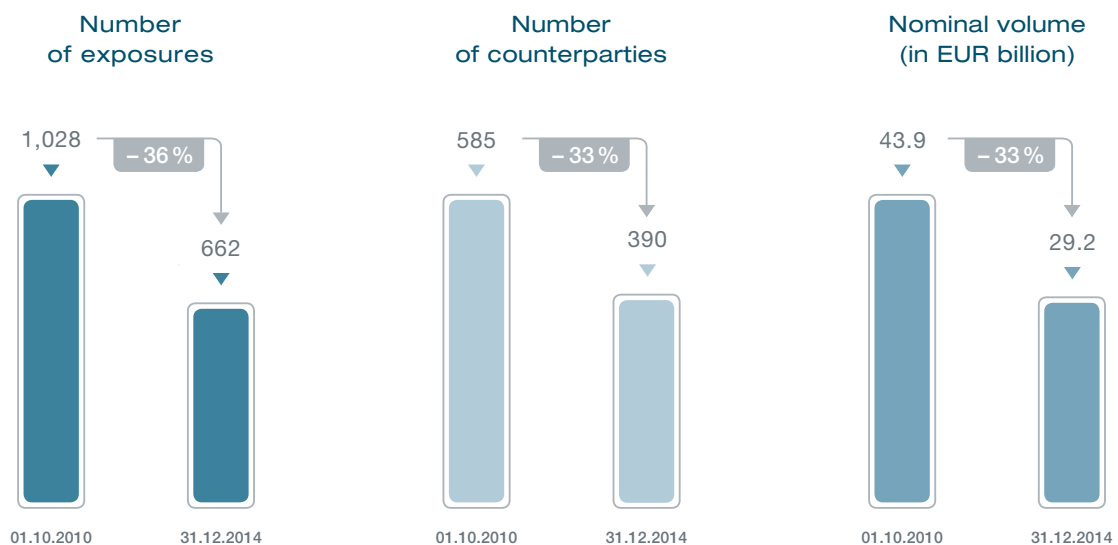
provide funding. In the end, FMS Wertmanagement secured early redemption of a significant portion of the loan and a commitment from the Icelandic bank to repay the remainder at maturity.

In Portugal, a complex structured interest rate swap worth around EUR 1.0 billion was unwound approximately four years before its final maturity.

### Structured Products

The Structured Products segment contracted to EUR 29.2 billion in 2014, a reduction of EUR 2.2 billion or 7% year on year. These structured products cover the spectrum of structured credit instruments and include asset-backed securities (ABS), commercial and residential mortgage-backed securities (CMBS and RMBS) and collateralised debt obligations (CDO). One regional focus of the underlying loans and securities is the United States. Most of the structured products are

## DEVELOPMENT OF THE STRUCTURED PRODUCTS PORTFOLIO





highly illiquid securities with long maturities and are as such rarely traded on the market. A hold strategy is often the best option for preventing losses on sales. In some cases, restructuring the transactions increased their value or improved their tradability.

The objective of the portfolio managers is to improve or — where possible — even unwind complex structures that are disadvantageous from FMS Wertmanagement's perspective. The following example shows that in many cases particularly sophisticated strategies need to be applied:

In a Benelux country, FMS Wertmanagement held 100 % of a securitisation of mortgage loans from 2006. The structure's credit risk was negligible because the underlying loans were guaranteed by the state. However, in economic terms FMS Wertmanagement's exposure led to losses on account of a small margin, in spite of a remaining term of around 20 years. A detailed legal analysis of the contracts resulted in the following option for action: FMS Wertmanagement was able to announce that it was buying the mortgage portfolio itself. This move would have allowed FMS Wertmanagement to wind up the entire securitisation and become a direct shareholder of the mortgage portfolio, which in turn would have widened the margin substantially and reduced the losses or eliminated them altogether. In this case, the Dutch bank that had established this structure in 2006 would have been forced to notify each individual mortgagor that their creditor was now FMS Wertmanagement. The Bank backed off, preferring to exercise its right of first refusal for the mortgage portfolio. As a consequence, the structure had to be wound up and FMS Wertmanagement received a full repayment of around EUR 1.6 billion.

## Corporate & Asset Finance

### *Infrastructure*

At the end of 2014, the Infrastructure sub-portfolio comprised 392 individual exposures with a nominal volume of EUR 14.0 billion. Compared with the previous year, the portfolio's nominal value was reduced by 3 % or 91 exposures. The portfolio is spread across all five continents and is dominated by bilateral loans and syndicated loans. The geographical focus is the United Kingdom. Around 47 % of the portfolio's nominal volume will mature after 2040. The exposures include corporate loans and securities, project financing, acquisition funding and a smaller portion of asset-based loans. The financed properties include ports, airports, toll roads, multi-storey car parks, schools, hospitals and projects from the energy supply, transport, water supply and waste disposal sectors, as well as telecommunications. To unwind the portfolio in a manner that maximises its value, FMS Wertmanagement is focusing its activities on restructuring individual transactions with the aim of reducing the transactions' risk whilst improving their profitability so as to ultimately achieve (partial) repayment by the borrower or a sale to third parties.

In 2014, the portfolio managers from the Infrastructure segment were particularly successful in the United States. Below is a selection of key transactions:

A full repayment of a loan in the triple-digit millions to a US multi-storey car park operator ahead of time was negotiated. FMS Wertmanagement used a contractually prescribed obligation of the equity provider to reduce the debt-equity ratio in this exposure as leverage.

The loan to an operator of container terminals on the East Coast of the United States was wound up. The port operator had experienced great difficulty obtaining funding because its income level had fallen significantly short of expectations, leading to a drop in the valuation of the port facilities. The complex contractual documentation enforced by legally questionable regulations

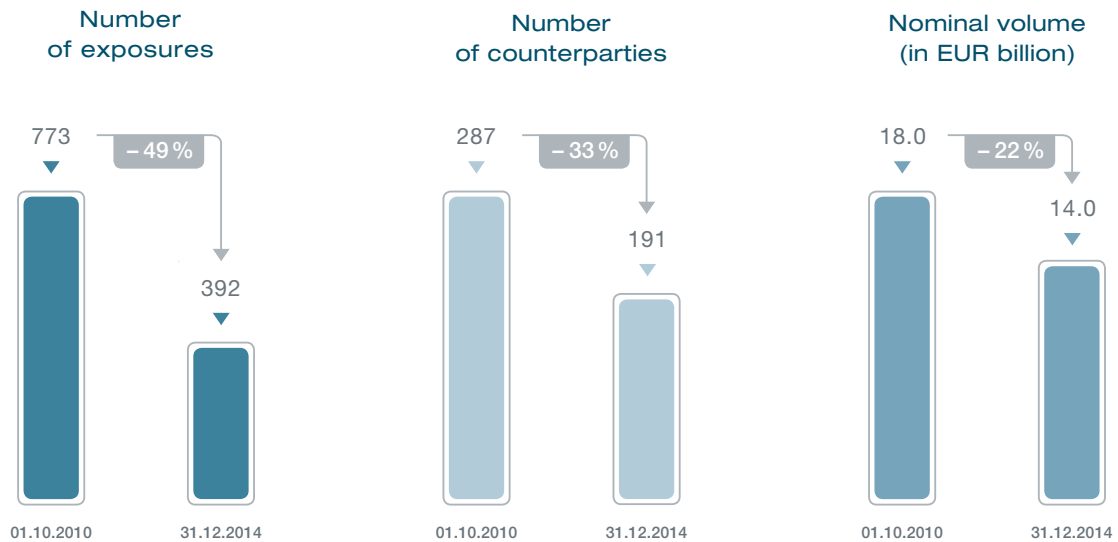


were used as leverage against the owner and initiator of the financing structure, a major international bank. The weaknesses identified by FMS Wertmanagement in its examination were sufficient to put the bank under such pressure that it repaid the full amount of the outstanding loan to FMS Wertmanagement after some negotiations.

FMS Wertmanagement's involvement in financing for a toll road in the Mid West was its largest exposure in the Infrastructure segment in the United States. Including the attached interest rate swaps, the exposure came to slightly over half a billion US dollars. Due to the fact that the volume of traffic was much lower than projected, a threat of bankruptcy and subsequent

insolvency proceedings arose as early as late June 2014. On account of the growing influence of aggressive hedge funds which had bought into the structure, it was also virtually impossible to reconcile the lenders' broad spectrum of interests. FMS Wertmanagement had rejected a proposal by the borrower in spring 2014 to restructure the debt because it contained too many elements that favoured the borrower and equity provider at the lender's expense. In view of positive developments in the market, falling costs for the unwinding of the attached swaps and rising prices on the secondary market, FMS Wertmanagement instead attempted to sell the whole package itself. The purchase price achieved was significantly higher than the book value of the exposure.

### DEVELOPMENT OF THE INFRASTRUCTURE PORTFOLIO





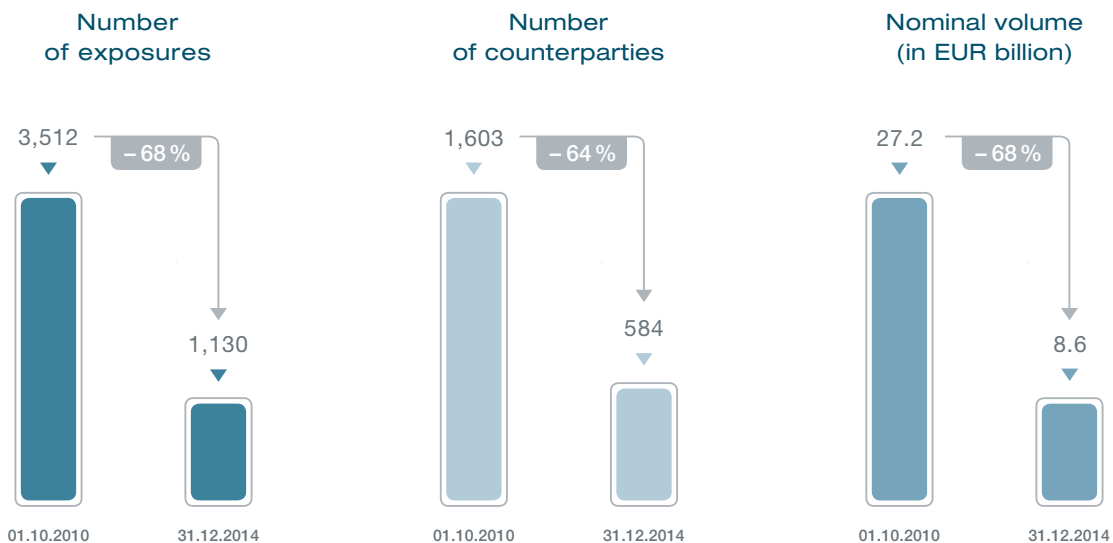
**Commercial Real Estate,**

At the end of the 2014 fiscal year, the Commercial Real Estate portfolio still comprised 1,130 exposures with a nominal volume of EUR 8.6 billion. The volume has thus been reduced by 68% since the portfolio was transferred to FMS Wertmanagement, making Commercial Real Estate the fastest-shrinking segment of the portfolio. The properties financed include residential properties, office buildings and shopping centres, as well as hotels and hospitals. Some of the successful winding-up operations and restructuring measures in 2014 are summarised below: With the assistance of FMS Wertmanagement Service GmbH, FMS Wertmanagement took advantage of the encouraging trend in the US market and disposed of a portfolio comprising 15 commercial property financing or partial financing arrangements with a nominal value of around USD 1.2 billion. These included office buildings, shopping centres and hotels in various US metropolitan areas. The sale took the form of a highly competitive bidding process and generated proceeds

that substantially exceeded the book values. In the Netherlands, FMS Wertmanagement participated in the development of a conversion concept for a hotel that significantly increased the price of the property and broadened the group of potential investors, ultimately leading to a profitable sale.

In a suburb of Munich, FMS Wertmanagement was heavily involved in extending the main tenant's lease for an office building. This step helped to stabilise the value and ultimately facilitated a value-maximising sale of the loan. In Berlin, FMS Wertmanagement sold a commercial property in a prime location to an investor at a price that far exceeded the original expectations. For several years this property had been the subject of legal disputes with the main tenant, all of which were now resolved. FMS Wertmanagement also succeeded in concluding a new lease with the main tenant that facilitated the sale to a third party. In Japan, FMS Wertmanagement gradually sold the entire remaining portfolio of five real estate loans, generating significant extraordinary income.

**DEVELOPMENT OF THE COMMERCIAL REAL ESTATE PORTFOLIO**





### **The Sales Process**

*How FMS Wertmanagement ensures that it obtains the highest possible prices in asset sales*

*The internal Instruction Sales Processes require all employees of FMS Wertmanagement AöR and the service provider FMS Wertmanagement Service GmbH to comply with clearly defined specifications when selling assets. As a public-law agency, FMS Wertmanagement is subject to the special provisions of budgetary law and hence the provisions on economy, sound financial management and transparency. Sales processes must be documented comprehensively.*

*The responsible portfolio managers and the portfolio servicer regularly examine the portfolio they manage for sales opportunities. Based on continuous monitoring of the markets in the relevant segments, the portfolio servicer and/or the portfolio manager then draw up sales proposals for the sales candidates identified. These proposals are analysed by the portfolio servicer using predefined calculation models and valuation rules. If these calculations in keeping with the Decision Logic and compared with the estimated selling prices show a contribution to a value-maximising portfolio wind-up, the next step is to submit an application for sale to the responsible authorised party at FMS Wertmanagement, with a review and validation of the calculations by FMS Wertmanagement. Depending on the volume of the transaction and the associated economic effects, sales decisions are made at different competency levels within FMS Wertmanagement as well as – if required for reasons of legal competence – with the involvement of the Supervisory Board's Risk Committee, the full Supervisory Board and FMSA.*

*In most cases, the first step in this process is a market analysis aimed at identifying possible buyers for the assets in question. After this, a sales strategy is defined setting out the concrete procedure – for example, the organisation of an auction – which must likewise be approved by the competent bodies. This strategy may already include a binding minimum sales price. Once the strategy has been approved, the actual sales*

*process is initiated, generally also by the portfolio servicer. If new essential knowledge comes to light at any stage during the sales process, the strategy decision must be updated.*

*A list with potential buyers is prepared with the goal of having the broadest possible group of interested parties participate in the selling process – normally at least three. Ideally, an intensive bidding contest will develop for the assets on offer. FMS Wertmanagement may engage external specialists, such as brokers or debt service agents, to conduct such bidding processes. These must be appointed via a tendering process.*

*The bidding process must be transparent and must not discriminate against any of the bidders. All bidders must receive the same data, information and documents simultaneously. For this purpose, a data room is generally set up to which the bidders are given access.*

*In exceptional cases in which an adequate number of bidders cannot be found for an intended sale, special provisions apply to the documentation of the sales process. For example, documentation must be furnished showing which potential investors were approached and when, which data was made available to them and why they decided not to participate in the bidding contest. Existing valuations and indicative market values must also be documented.*

*In 2014, the corporate bodies at FMS Wertmanagement made over 100 sales decisions. Some of these related to individual assets, while others entailed the sale of entire portfolios with numerous loans for different properties, such as in a large auction of financing for commercial properties in the United States.*



# Funding

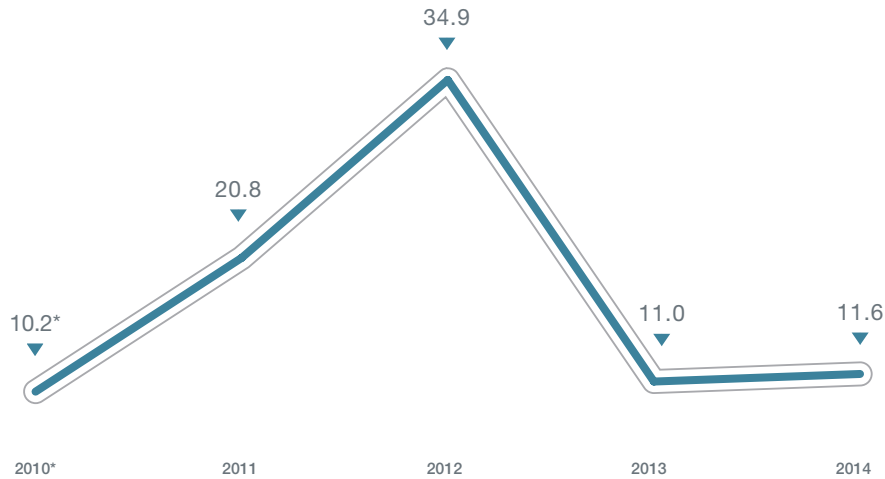
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— Triple-A rating and  
favourable funding options facilitate  
the portfolio wind-up —

In 2014, FMS Wertmanagement continued to benefit from the low interest rates on the money and capital markets. The favourable funding is and remains one of the key drivers of the success of the winding-up institution and was a major contributor to the net interest income figure of EUR 526 million. The decrease in net interest income compared with the previous year (EUR 626 million) is due primarily to the portfolio wind-up, which has been implemented as desired. FMS Wertmanagement's top AAA/A-1+ (Standard & Poor's), Aaa/P-1 (Moody's) and AAA/F1+ (Fitch) ratings remained unchanged in the 2014 fiscal year.



**CAPITAL MARKET FUNDING WITH MATURITIES  
OF MORE THAN ONE YEAR (IN EUR BILLION)**



\* Short fiscal year from 08.07. – 31.12.2010

FMS Wertmanagement's Charter stipulates that as a public-law entity (Anstalt öffentlichen Rechts), it must obtain funding on the money and capital markets independently. Article 2 (2) reads as follows: "The business activities of the winding-up institution cover all assets and liabilities transferred." By establishing and expanding diversified access to the money and capital markets, FMS Wertmanagement has ensured a sustainable, cost-effective, flexible funding structure.

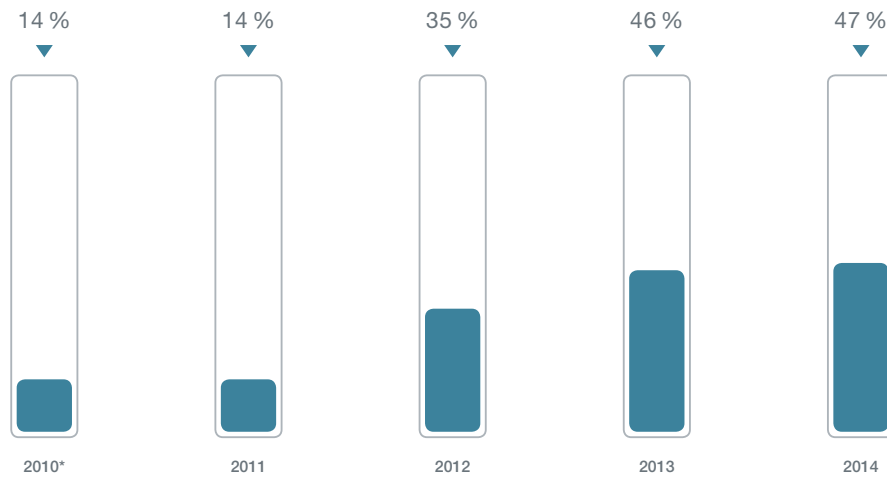
In fiscal year 2014, the target funding structure of 50 % money market to 50 % capital market funding was nearly achieved. At the end of 2014, the share of capital market funding with a maturity of more than one year was 47 % (previous year: 46 %). In total, EUR 11.6 billion (previous year: EUR 11.0 billion) was funded via the capital markets and EUR 70.1 billion (previous year: EUR 71.2 billion) was raised on the money markets in 2014. The 2014 issues have an average remaining maturity of around 3.5 years. Approximately half of

the issuing volume is made up of EUR issues; one quarter comprises issues in USD (US dollars) and the other quarter comprises issues in GBP (pounds sterling). The total long-term capital market funding volume issued since the establishment of FMS Wertmanagement is around EUR 78 billion. After deducting the share already repaid, the outstanding issuance volume is now approximately EUR 63 billion with an average original maturity of around five years. The major share of the issuance volume is in EUR, followed by USD and GBP.

High-volume public capital market issues in 2014 were again focused on USD-denominated bonds because a large share of FMS Wertmanagement's wind-up portfolio is still denominated in USD and the strategic goal of striking a balance between short- and long-term funding across all currencies is being pursued. The current funding structure creates a balanced mix of appropriate costs and stability as well as desired flexibility.



SHARE OF CAPITAL MARKET ISSUES IN  
TOTAL FUNDING VOLUME (IN %)



\* Short fiscal year from 08.07. – 31.12.2010

In late summer 2013, the Bundestag and Bundesrat resolved to grant FMS Wertmanagement a direct guarantee by the Financial Market Stabilisation Fund (SoFFin) from 1 January 2014 in connection with the introduction of Basel III rules. This explicit guarantee by SoFFin in addition to the existing loss compensation obligation became necessary to ensure that bonds issued by FMS Wertmanagement can also be set off by investors with a regulatory risk weighting of 0% even under a European regulatory framework.

From the regulatory perspective, the explicit guarantee underpins the fact that FMS Wertmanagement is an issuer on an equal footing with the Federal Republic of Germany. This led to renewed demand for debt instruments issued by FMS Wertmanagement and to a further substantial reduction in the yield spreads to issuers with a comparable risk profile.

In the course of 2014, FMS Wertmanagement almost completely opened up the potential investor base for securities of comparable issuers.

The established money market programmes supplement the capital market issues and continue to contribute to FMS Wertmanagement's stable, sustainable funding structure. Institutional investors' interest in the ECP/CD (European Commercial Paper/Certificates of Deposit) programme of FMS Wertmanagement, which totalled roughly EUR 36.3 billion (previous year: EUR 29.1 billion) at the end of 2014, remained high. London's Capital Market Daily (CMD), a network of money market participants offering services to fixed-income investors, issuers, dealers and brokers worldwide, once again recognised FMS Wertmanagement with the "Winner Best Overall ECP Issuer 2014" award.



Institutional investors' interest in FMS Wertmanagement's money market programmes and capital market issues remained high in 2014. During the second half of the year, FMS Wertmanagement increasingly entered into money market transactions at negative interest rates. The money market funding outstanding at the end of 2014 with a total volume of around EUR 70.1 billion (53% of overall funding) is broken down among the programmes/instruments as follows:

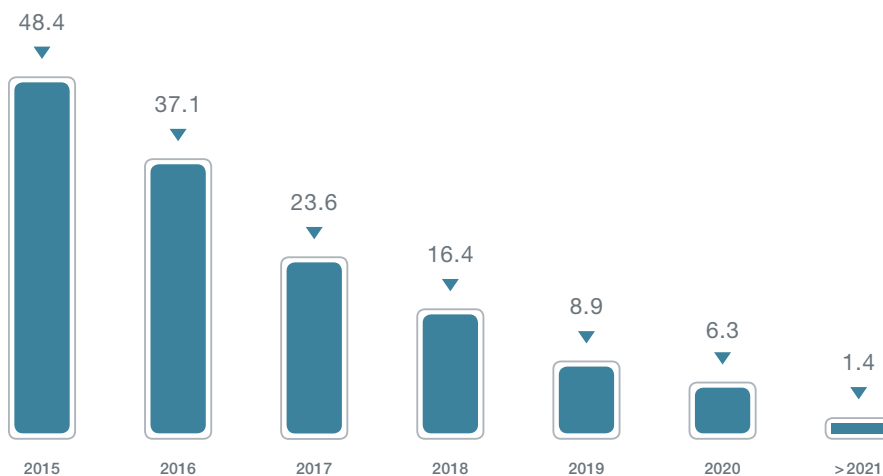
- ▶ ECP Programme: 27 %
- ▶ US ABCP Programme: 10 %
- ▶ Bilateral, tri-party and Eurex repos: 12 %
- ▶ Deposits from institutional investors: 4 %  
(capital market funding: 47 %)

While the further sharp drop in interest rates on the money and capital markets, especially in the second half of the year, provided FMS Wertmanagement with

favourable funding options, it also had negative effects. For instance, the negative fair values of derivatives increased substantially. On the basis of the contractual agreements entered into with the counterparties for these hedging instruments (banks), FMS Wertmanagement is required to furnish collateral for these derivatives in line with the market movements. The volume of collateral to be furnished rose in 2014 from around EUR 24 billion to over EUR 36 billion. In addition to the currency effects, this item, which increased the balance sheet, is the main factor contributing to the only moderate decrease in total assets over the previous year.

Under these changed market conditions, FMS Wertmanagement maintains its target funding structure of 50% capital market to 50% money market funding because this ratio has proven to be the right strategy in achieving a balanced mix of costs, security and flexibility.

### MATURITY PROFILE OF OUTSTANDING CAPITAL MARKET FUNDING (IN EUR BILLION AS AT 31 DECEMBER)





# New task

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## — Wind-up of DEPFA BANK plc —

On 13 May 2014, the inter-ministerial steering committee, which decides on measures to be adopted by the Financial Market Stabilisation Fund (SoFFin), and the General Meeting of Hypo Real Estate Holding (HRE) determined, after carefully weighing up all the options, to mandate FMS Wertmanagement to wind up DEPFA BANK plc (DEPFA). The transfer to FMS Wertmanagement was to be carried out at the conditions that HRE had previously negotiated for DEPFA with an external bidder.



**H**RE had acquired DEPFA in 2007. When the existence of the HRE Group was threatened in 2008 during the international financial crisis, the Federal Republic of Germany had stabilised the group with liquidity guarantees and capital and taken it over completely. On 1 October 2010, non-performing and non-strategic assets of DEPFA with a nominal volume of around EUR 131 billion were transferred to FMS Wertmanagement. In accordance with a European Commission requirement, HRE had to either privatise DEPFA by the end of 2014 or arrange for it to be wound up.

Immediately after the inter-ministerial steering committee decided to have DEPFA wound up by FMS Wertmanagement, preparations for the execution of this decision began as part of "Project Green". The strategic cornerstones of DEPFA's new business plan were laid in June, followed by intensive discussions with the regulators in Ireland, Germany and the United States in July and August to clarify regulatory issues. DEPFA's new Board of Directors was determined in September and the applications for the appointment of the new Board members were submitted to the regulatory authorities. The Irish regulator approved the composition of DEPFA's Board of Directors at the end of

October. In November, the new governance concept for DEPFA was passed, which particularly regulates the relationship to FMS Wertmanagement. Also in November, the final tasks necessary to separate DEPFA's IT systems from those of the HRE Group were completed. The Irish regulator gave its final approval of the transaction on 16 December 2014 and the transfer of ownership from HRE to FMS Wertmanagement took place on 19 December 2014.

As an independent bank under FMS Wertmanagement, DEPFA will wind up its remaining portfolio. It will continue not to underwrite any new business.

DEPFA published its business figures for the 2014 annual financial statements on 1 April 2015. It is reporting a loss before taxes of EUR 185 million for 2014. Total assets at the end of 2014 amounted to EUR 48.5 billion. The volume of DEPFA's portfolio at the 31 December 2014 reporting date was EUR 30.4 billion (EaD). Around 99 % of this comprised investment grade assets; 40 % of the portfolio has a triple-A rating. Only around 0.3 % of the portfolio falls into the non-performing loans category. DEPFA is reporting equity of EUR 2.0 billion.

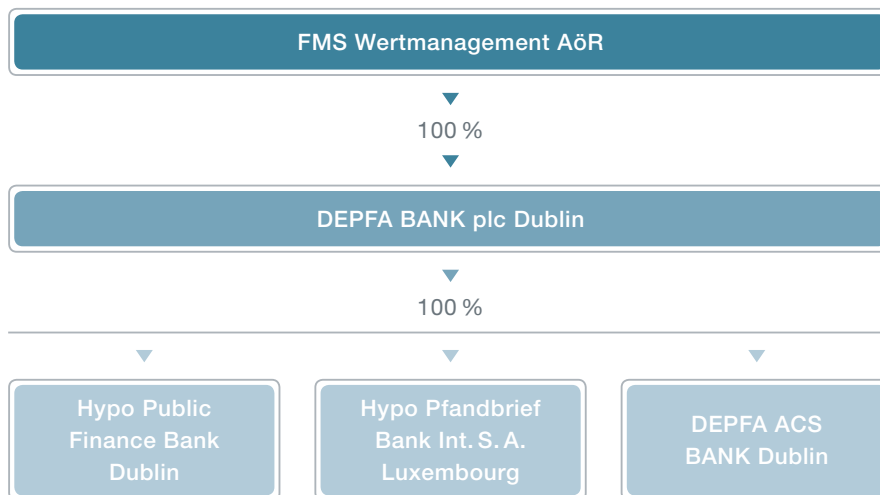


DEPFA's newly formed management team has been charged with developing and implementing a new strategy for DEPFA and its subsidiaries that ensures an orderly wind-up of DEPFA in a manner that maximises its value. The three cornerstones of this strategy are:

- ▶ Greatest possible conservation of the remaining equity whilst winding up the portfolio;
- ▶ Optimisation of the funding structure with FMS Wertmanagement's assistance;
- ▶ Simplification and streamlining of the organisational structure.

A number of measures were already implemented before or during the initial months following the transfer of ownership to FMS Wertmanagement. On 14 January 2015, DEPFA disclosed in an ad hoc announcement addressed to several stock exchanges that FMS Wertmanagement intended to submit a buy-back offer to the holders of three of the hybrid bonds issued by DEPFA. This announcement also stated that FMS Wertmanagement had already entered into contractual arrangements with specific holders of these bonds about a tender. Scheduled for spring 2015, this transaction will help to implement one of the main value levers for the wind-up of DEPFA ahead of time.

#### SHARE HELD BY FMS WERTMANAGEMENT IN DEPFA BANK PLC AND ITS MATERIAL SUBSIDIARIES





Alongside the announced buy-back of the hybrid capital with a total nominal value of EUR 1.2 billion, DEPFA and FMS Wertmanagement agreed on initial measures on the funding side aimed at reducing DEPFA's funding costs in the medium term.

Furthermore, FMS Wertmanagement granted DEPFA, or rather one of its subsidiaries, a guarantee on a security in order to avoid infringement of a regulatory large exposure limit. Without this guarantee, DEPFA would have been forced to sell this security — or at least parts of it — at a loss.

In connection with the efforts to simplify DEPFA's organisational structures and adapt them to the new task of effecting an orderly wind-up, initial workforce reduction

measures were also announced at the end of March. These will trim DEPFA's current headcount in Dublin from approximately 140 at the end of 2014 by almost 20 % in the coming months. In addition, DEPFA's Rome branch was closed this year. The branch in London is also expected to be shut down by the end of the year. The branches of DEPFA in New York and Tokyo are to be shut and wound up by the end of 2016 at the latest.

The aim of this package of measures is to get DEPFA out of making losses as quickly as possible, thereby halting the erosion of its equity. The projected losses for 2014 and subsequent years were already known at the time the decision to wind up DEPFA was made. They will be more than compensated over the entire wind-up period by DEPFA's significant overcapitalisation.



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# Management report

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## FUNDAMENTAL INFORMATION ABOUT FMS WERTMANAGEMENT

### Business and operating conditions

Upon application by Hypo Real Estate Holding AG, Munich (HRE), the Federal Agency for Financial Market Stabilisation, Frankfurt am Main (Bundesanstalt für Finanzmarktstabilisierung – FMSA), established FMS Wertmanagement AöR, Munich (FMS Wertmanagement), on 8 July 2010 in accordance with Section 8a of the German Financial Market Stabilisation Fund Act (Finanzmarktstabilisierungsfondsgesetz – FMStFG). FMS Wertmanagement is an organisationally and financially independent winding-up institution under public law with partial legal capacity that acts in its own name when transacting business. It is regulated and supervised by FMSA and the Federal Financial Supervisory Authority, Bonn and Frankfurt am Main (BaFin). The Financial Market Stabilisation Fund (SoFFin) as the owner is obligated by law and the Charter of FMS Wertmanagement to compensate the latter's losses. FMS Wertmanagement is not deemed a credit or financial services institution as defined in the German Banking Act (Kreditwesengesetz), a securities firm as defined in the German Securities Trading Act (Wertpapierhandelsgesetz) or an insurance company as defined in the German Insurance Supervision Act (Versicherungsaufsichtsgesetz), nor does it engage in any transactions requiring a licence pursuant to Directive 2006/48/EC of the European Parliament and of the Council dated 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (OJ EC L 177 dated 30 June 2006, p. 1) or Directive 2004/39/EC of the European Parliament and of the Council dated 21 April 2004 on markets in financial instruments, amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJ EC L 145 dated 30 April 2004, p. 1.)

Under agreements dated 29 and 30 September 2010, risk positions and non-strategic operations of HRE Group companies with a nominal value of around EUR 175.7 billion – excluding derivatives – were transferred to FMS Wertmanagement effective 1 October 2010. To this end both FMSA – acting as necessary for SoFFin, HRE, Deutsche Pfandbriefbank AG, Munich (pbb), DEPFA BANK plc, Dublin (DEPA BANK plc), and other HRE Group companies – and FMS Wertmanagement entered into a number of agreements pursuant to which certain risk positions and non-strategic operations of HRE Group companies were transferred to FMS Wertmanagement in accordance with Section 8a FMStFG.

The transferors, pbb and HRE, transferred risk positions and non-strategic operations to FMS Wertmanagement, partly by way of a spin-off for absorption, in accordance with Section 8a (1) and (8) FMStFG in conjunction with Section 123 (2) No. 1 and Section 131 of the German Reorganisation and Transformation Act (Umwandlungsgesetz – UmwG). The risk positions and non-strategic operations that were not transferred by way of the spin-off were transferred



to FMS Wertmanagement by way of a subparticipation, assignment, novation or guarantee (“transfer via guarantee”). Which approach was chosen depended on the different legal, regulatory and tax requirements of the respective countries governing the respective transaction. What is common to all means of transfer however, is that FMS Wertmanagement assumed the economic risk of the risk positions and non-strategic operations. The spin-offs were recorded in the respective German Commercial Register for HRE and pbb as well as for FMS Wertmanagement on 2 December 2010.

The contracts signed on 29 and 30 September 2010 also included the internal group “concentration agreements” between HRE on the one hand and pbb, DEPFA BANK plc and other companies of the HRE Group on the other. These concentration agreements established that HRE had claims and obligations from the transfer of the risk positions and non-strategic operations by the HRE Group companies. HRE spun off its contractual position and its claims under the concentration agreements to FMS Wertmanagement as part of the aforementioned spin-off. The concentration agreements were executed directly between the respective HRE Group company and FMS Wertmanagement by way of the aforementioned subparticipations, assignments, novations or guarantees.

Until FMS Wertmanagement is liquidated, SoFFin has the obligation under Article 7 (1) of the Charter of FMS Wertmanagement (i) to pay, on first demand by the Executive Board of FMS Wertmanagement, all amounts required in the Executive Board’s due assessment for ensuring that the winding-up institution can pay all its liabilities at any time when due and in full and (ii) to cover all losses of FMS Wertmanagement. Losses in this sense comprise all amounts that are payable to FMS Wertmanagement so that it can discharge its liabilities — as set out above — and that need not be repaid to SoFFin under the conditions set out in Article 7 (2) of the Charter.

FMS Wertmanagement has defined the following four strategic goals in connection with the transfer, realisation and wind-up of the risk positions and non-strategic operations that were moved to it from HRE Group companies:

▶ *Acceptance of non-strategic and at-risk assets, liabilities and derivatives from HRE Group companies:*

The risk assets were transferred effective 1 October 2010.

▶ *Profit-oriented wind-up of the risk assets, operational implementation and refining of adequate wind-up strategies for the entire transferred portfolio:*

The risk assets are unwound in a manner aimed at generating a profit subject to defined wind-up and risk strategies that are adjusted on a continuous basis. The so-called wind-up plan — which must be deemed the key strategic management tool of FMS Wertmanagement — serves as the basis for the operational implementation of these strategies.



► *Cost-effective servicing and management of the risk assets:*

The wind-up of the risk assets is carried out in part by FMS Wertmanagement itself and in part by service providers (until 30 September 2013 pbb and from 1 October 2013 FMS Wertmanagement Servicegesellschaft) on the basis of service level agreements. Sole responsibility for the profit-oriented wind-up and the cost-effective servicing and management of the portfolio, however, rests with FMS Wertmanagement alone.

► *Cost-effective funding and separate market access for the Treasury/Markets division of FMS Wertmanagement:*

FMS Wertmanagement shall ensure cost-effective funding for the purpose of carrying out its task. Given both regulatory and statutory parameters, FMS Wertmanagement can realise funding cost advantages that are not available to HRE Group companies. These are achieved through Treasury/Markets' separate market access and SoFFin's loss compensation obligation.

To carry out its task FMS Wertmanagement may engage in all kinds of banking and financial services transactions as well as operate all other kinds of businesses serving, directly or indirectly, to unwind the transferred portfolio; however FMS Wertmanagement may not engage in any transactions requiring a license pursuant to Directive 2006/48/EC or Directive 2004/39/EC. The business activities of the winding-up institution cover all assets and liabilities transferred.

The wind-up plan generally does not permit FMS Wertmanagement to engage in new business activities. Funding and hedging transactions by the Treasury/Markets division, as well as select new business aimed at reducing risks arising from existing commitments in a cost-efficient manner or making them manageable (required extensions as well as select restructuring measures), are exceptions to the above rule.

In 2012, FMS Wertmanagement established its own service entity (FMS Wertmanagement Service GmbH), which assumed responsibility for portfolio servicing and the provision of all associated services effective 1 October 2013. FMS Wertmanagement retains final decision-making powers and ultimate responsibility for the risk assets under management. The master agreement governing the outsourcing of business processes and services also grants FMS Wertmanagement extensive rights to obtain information and perform inspections, enabling the latter to monitor and control the servicing of the risk assets by FMS Wertmanagement Service GmbH, Munich (FMS Wertmanagement Servicegesellschaft). Effective 1 April 2015, FMS Wertmanagement Servicegesellschaft also assumes material portions of the accounting function of FMS Wertmanagement, which had been outsourced to capco Wirtschaftsprüfungsgesellschaft GmbH, Eschborn (capco), since 1 October 2013. FMS Wertmanagement Servicegesellschaft maintains a total of four offices, in Unterschleißheim, London, Dublin and New York.

IBM Deutschland GmbH (Ehningen) and other companies have also been hired to provide necessary IT services.



Under an agreement dated 15 May 2014, the wholly-owned subsidiary of FMS Wertmanagement, Hypo Real Estate Capital Corporation, New York (HRECC), sold US Commercial Real Estate (US CRE) loan receivables with a nominal value of USD 1.2 billion, of which FMS Wertmanagement had beneficial ownership of loans in a nominal amount of USD 0.4 billion. The property was transferred to the purchaser effective 2 June 2014.

Effective 19 December 2014, FMS Wertmanagement acquired all shares in DEPFA BANK plc at a purchase price of EUR 320 million (excl. incidental acquisition expenses). With this action, FMS Wertmanagement implemented the decision of 13 May 2014 by the inter-ministerial steering committee, which, after considering all options, decided to wind up DEPFA BANK plc and its subsidiaries via FMS Wertmanagement. DEPFA BANK plc is managed as an independent equity investment. FMS Wertmanagement appoints two members of the Executive Board and a unit head as “non-executive members” to the Board of Directors of DEPFA BANK plc.

The portfolio of DEPFA BANK plc consists mostly of positions with good issuer ratings (investment grade). As at 30 June 2014, the consolidated financial statements of DEPFA BANK plc show total assets of EUR 46.5 billion.

Effective 22 December 2014, FMS Wertmanagement reached agreement with certain holders of the DEPFA Funding II, III and IV LP hybrid bonds to acquire the bonds under specified terms and conditions. As per the ad hoc announcement by DEPFA BANK plc dated 15 January 2015, there is a plan for FMS Wertmanagement to issue a purchase offer to the remaining holders of the hybrid bonds. The implementation of the transaction is subject to approval by the relevant supervisory authority.

### Organisational structure

The organisational structure of FMS Wertmanagement is defined by its Charter; it provides for a Supervisory Board and an Executive Board as its corporate bodies.

The Supervisory Board has six members who are appointed by FMSA. It is tasked with advising the Executive Board of FMS Wertmanagement and monitoring its management activities. It is also responsible for

- ▶ decisions pertaining to the wind-up plan and deviations therefrom,
- ▶ the resolution on the annual wind-up report,
- ▶ appointing and dismissing the members of the Executive Board,
- ▶ issuing the Rules of Procedure for the Executive Board,
- ▶ approving the annual financial statements and appointing the auditor,
- ▶ appropriation of net retained profits and
- ▶ approving the final accounts.



Furthermore in matters of particular significance under the Executive Board's purview, the Supervisory Board may assume decision-making authority for itself on a case-by-case basis or in general. This shall not affect the authority of the Executive Board to represent FMS Wertmanagement externally to legal effect.

The members of the Executive Board are appointed by the Supervisory Board with FMSA's approval for terms of no more than four years; they may be reappointed however. The Executive Board manages the business of FMS Wertmanagement and represents it both in and out of court. In fiscal year 2014, the Executive Board comprised Dr. Christian Bluhm (Spokesman of the Executive Board), Ernst-Albrecht Brockhaus and Norbert Kickum (until 30 November 2014).

Dr. Christian Bluhm is responsible for the *Risk & Finance* function of the Executive Board, which is tasked with credit and securities operations for the business transferred to the company in the "structured products", "corporate & asset finance", "sovereign & public finance" and "financial institutions" asset classes, and is also in charge of the wind-up strategy and wind-up planning for the entire transferred portfolio. This Executive Board function also handles risk controlling, accounting, controlling, reporting and human resources, as well as internal and external communications for FMS Wertmanagement. In the 2014 fiscal year, Dr. Bluhm's purview also included responsibilities as regards legal matters, compliance, project management, IT, sourcing (including central service provider management) and operations. Compliance monitors compliance with all relevant requirements and internal guidelines of FMS Wertmanagement, for instance in matters related to the prevention of insider trading, money laundering and the code of conduct.

Until 30 November 2014 Norbert Kickum was responsible for the *Commercial Real Estate* function of the Executive Board. From 1 December 2014 to 31 December 2014, Ernst-Albrecht Brockhaus temporarily assumed responsibility for this area. The main responsibility of Commercial Real Estate is to prepare, evaluate and execute real estate financing decisions, which are typically complex, in order to minimise risk in the portfolio, and to enable portfolio wind-up in line with the set of rules allocating authority and in compliance with the wind-up plan. The majority of the portfolio comprises receivables from mortgage-backed commercial real estate loans. The primary objective is to unwind the portfolio at a profit while considering the exit opportunities available in view of the prevailing market conditions.

The key tasks assigned to the *Treasury/Markets* Executive Board function led by Ernst-Albrecht Brockhaus are tactical and strategic liquidity management, asset/liability management and analytical support for FMS Wertmanagement's portfolio of derivatives. By ensuring solvency at all times and obtaining sustainable, cost-effective funding, this function makes a substantial contribution to fulfilling the mission of profitably winding up the portfolio. These efforts are based on the funding strategy and funding plan, which takes into account the portfolio wind-up. Continuous contact is maintained on the market side with investors, commercial banks and rating agencies. This secures FMS Wertmanagement's position as a popular issuer and counterparty. This function is also responsible for managing and hedging market risks



(interest rate and currency risks), as well as supporting the portfolio managers when derivatives-specific issues arise during restructuring and sales activities in the various asset classes.

The *Audit* department, which is part of the Risk & Finance Executive Board function, reports directly to the Executive Board spokesman. Information is regularly exchanged by the head of Audit and the chair of FMS Wertmanagement's Supervisory Board Audit Committee. In carrying out its duties, the Audit department also receives support from an external auditing firm. In particular, the Audit department is responsible for conducting risk-based audits of all activities and processes, including outsourced activities, as well as providing support for key projects at FMS Wertmanagement and FMS Wertmanagement Servicegesellschaft, monitoring outsourced auditing activities at service providers, conducting special audits within FMS Wertmanagement, FMS Wertmanagement Servicegesellschaft and at service providers, and providing consulting services (while preserving the autonomy of internal auditing).

#### ***Organisational structure from 1 January 2015***

On 1 January 2015, the following changes were made on the Executive Board:

- ▶ Executive Board spokesman Dr. Christian Bluhm is responsible for the *CRO/CFO* function. In future this will include the units Risk Controlling, Finance & Portfolio Steering, Structured Products, Infrastructure & Asset Finance, Sovereign and Public Finance, Financial Institutions, Communications and Audit.
- ▶ In addition to his current duties, Ernst-Albrecht Brockhaus assumes responsibility for Commercial Real Estate. In future, this Executive Board function will be named *Treasury, Markets & CRE* and will include the units Treasury, Capital Markets Funding, Derivatives & Markets Advisory and Commercial Real Estate.
- ▶ Frank Hellwig was appointed to the Executive Board on 1 January 2015. The *COO* Executive Board function that reports to him includes the units Human Resources, Legal & Compliance, Operations Management and IT, Sourcing & Services Steering.



### Internal management systems

The control systems of FMS Wertmanagement are based on the strategic objectives described in the chapter “Business and operating conditions”.

#### *Profit-oriented unwinding of the transferred portfolio*

The risk assets (hereinafter also referred to as the “portfolio”) transferred from HRE Group companies consist of loan receivables, securities, derivative financial instruments, rights and duties under loan commitments, guarantees and equity investments, in each case along with the respective collateral.

The management of the portfolio and presentation in the wind-up report and the risk report is based on four segments:

- ▶ Commercial Real Estate
- ▶ Infrastructure
- ▶ Public Sector
- ▶ Structured Products

At the transfer date, the portfolio encompassed risk positions related to more than 60 countries, with a strong focus on the United States, Western Europe and Japan and relatively few larger individual exposures in emerging markets. A significant portion of the portfolio has maturities beyond 2020.

Pursuant to its Charter FMS Wertmanagement submits a monthly wind-up report to FMSA. The wind-up report contains information on the process of realising and unwinding the portfolio as well as on implementing the wind-up plan.

FMS Wertmanagement has updated its wind-up plan according to schedule and submitted it to its decision-making bodies for approval under the existing governance framework. The wind-up plan was revised further and takes into account updated assumptions concerning the portfolio wind-up in the individual segments, funding costs, expected losses and planned administrative expenses.

FMS Wertmanagement’s wind-up strategy is based on a basic division of the portfolio into actively managed and more passively managed sub-portfolios. Assets are assigned to the sub-portfolios using defined criteria approved by the Supervisory Board. Such assignments are reviewed regularly and adjusted as necessary. One particular focus of active management is accelerated redemption or the sale of positions: both steps are taken if necessary after any restructuring. Efficient management, including monitoring to identify risk or selling signals, is the focus for the more passively managed sub-portfolios.



The measures to unwind the portfolio are continually monitored by Controlling. Reports on the current situation are presented regularly to the Executive Board Portfolio Steering Committee and the Supervisory Board Risk Committee.

To implement the wind-up strategy, the wind-up plan provides for three approaches:

- ▶ Hold, e. g. if risks and earnings are acceptable
- ▶ Sell, e. g. reducing exposures with a higher risk profile and if the market offers opportunities and
- ▶ Restructure (also includes workout, wind-up and reorganisation measures), especially in Infrastructure and Commercial Real Estate

Within these approaches, the risk strategy and organisational structure of FMS Wertmanagement in the loan and workout activities jointly determine the next steps that drive the profit-oriented wind-up of the portfolio.

As defined by FMS Wertmanagement, the “hold” approach entails actively managing loans and securities with the aim of full repayment of all amounts outstanding. A large portion of the loans and securities are unwound by holding and managing them until maturity.

FMS Wertmanagement defines the “sell” approach as entailing the sale of individual assets or sub-portfolios where economically feasible. Selling decisions are made based on quantitative and qualitative criteria that, alongside economic value maximisation, also factor in accounting effects and other parameters such as the operational complexity of the servicing. Even if decision-making criteria are fulfilled, this does not automatically result in a sale. The decision is made on a case-by-case basis according to the set of rules allocating authority.

Activities serving to adjust and optimise the contractual framework of loans and securities, where economically necessary, as well as activities serving to restructure and unwind non-performing financial instruments, are integral to the “restructuring” approach. For every restructuring measure, the aim is to ensure a profit-oriented winding up of the respective financial instrument (whether performing or non-performing), including risk reduction measures.

The development of the portfolio in the 2014 fiscal year is shown in the chapter entitled “Course of business – Wind-up report”.

### ***Cost-effective servicing and management***

FMS Wertmanagement has the strategic objective of cost effectively servicing and managing its risk assets. Controlling this objective is based on budget planning and budget responsibility relating to FMS Wertmanagement and FMS Wertmanagement Servicegesellschaft.



The Controlling & Reporting department monitors the development of costs and compliance with the budget requirements. The Executive Board is informed of these developments as part of the cost reporting process.

In addition, FMS Wertmanagement controls and monitors outsourced activities using a standardised service provider management process carried out by the individual departments. This includes both the activities outsourced to FMS Wertmanagement Servicegesellschaft and activities outsourced to other service providers.

### ***Cost-effective funding***

FMS Wertmanagement ensures cost-effective funding in order to carry out its mandate. In determining funding requirements, the total assets recognised in cash and their scheduled maturity form the basis of the annual funding plan. This is supplemented for the planning period with the expected liquidity requirements from the cash collateral position. Expected asset sales of EUR 2 billion are taken into account for each year until 2020. In accordance with the funding strategy planning, half of the future funding requirement resulting from this is met in the money markets and half via capital market issues.

Funding activities are regularly presented and discussed in the Asset and Liability Committee, which has responsibility for this.

The development of funding activities is described in the chapter "Financial position".

## **Non-financial performance indicators**

### ***Social mission and reputation***

FMS Wertmanagement is aware that, in addition to the interests of its clients, it also has a key responsibility to protect the interests of the general public, the Federal Republic of Germany and German taxpayers. The resulting goal for FMS Wertmanagement is therefore to ensure the greatest possible level of public acceptance for its decisions and actions, while taking into account the benefits for its several stakeholders. FMS Wertmanagement is also committed to handling the resources provided as carefully as possible.



### ***Employees***

As at 31 December 2014, FMS Wertmanagement had 141 employees (31 December 2013: 145 employees). In some areas, employees are still being recruited as part of the plan approved by the corporate bodies. This mostly involves fixed-term contracts in order to take into account the ongoing unwinding of the portfolio. The target figure has been adjusted accordingly from 170 to 159 employees. The trend in employee numbers — and thus the balance between the target figure and the actual number of employees — is reviewed annually in cooperation with Controlling & Reporting as part of the wind-up planning process and adjusted to current conditions as necessary.

For FMS Wertmanagement, it is important that employees are able to optimally contribute their individual skills and experience to the company, and are always given opportunities for personal development. Key elements of staff development efforts include regular employee appraisals, continual feedback on performance, as well as systematic and needs-based continuing professional development planning. These activities are founded on elements that include the corporate values of trust, transparency, respect, fairness and commitment to our mission. FMS Wertmanagement aims to integrate these values into its HR processes, such as performance reviews, so as to make them tangible and bring them to life.

### ***Expertise***

With the unwinding of the portfolio, FMS Wertmanagement has assumed a complex task and committed itself to a high degree of professionalism. FMS Wertmanagement therefore places very high demands on all of its employees. FMS Wertmanagement considers it very important to ensure the availability of the necessary technical expertise for the tasks it faces throughout the winding-up period. A key challenge is to make sure that sufficient expertise is retained, despite employee turnover.



## **Locations**

FMS Wertmanagement is domiciled in Munich.

## ***Branches***

FMS Wertmanagement has maintained an office in Rome, Italy, since 2013, which commenced operations in February 2014.

FMS Wertmanagement has acquired part of the operations of the Rome branch of DEPFA BANK plc (“cessione di ramo d’azienda”) in a transaction that took legal and economic effect on 3 February 2014. These partial operations, which will be continued by the Rome branch of FMS Wertmanagement established in 2013, almost exclusively comprise assets (as well as the funding of these assets) whose risk positions were initially taken over from DEPFA BANK plc via guarantee with effect from 1 October 2010. The funding transferred was subsequently replaced by funding via FMS Wertmanagement. The partial transfer of operations reduced the contingent liabilities by EUR 2.0 billion in the first quarter of 2014. Loans and advances to customers increased by the same amount.

The branch in Rome consists of three full-time employees who were taken on in the context of the partial transfer of operations of DEPFA BANK plc and a branch manager appointed by FMS Wertmanagement. This branch serves public-sector customers and customers seeking infrastructure financing in Italy.

In the fourth quarter of 2014, the branch took over further loans from Italian borrowers of pbb whose risk positions were initially taken over via guarantee effective 1 October 2010.

The transfer of pbb's remaining, thus far only guaranteed, receivables from public sector customers in Italy to FMS Wertmanagement's branch in Rome and the simultaneous reversal of the guarantee granted to pbb is expected in the first half of 2015.



## REPORT ON ECONOMIC POSITION

### Macroeconomic and portfolio-specific developments

The global growth environment failed to meet expectations in 2014. In addition, economic developments both within and between the regions have drifted further apart, and increasingly reflect structural rather than economic factors. In the USA, the cold winter had a negative impact on the economy at the beginning of the year, while turbulences on the financial markets and the crisis in Ukraine had a negative influence mainly on various emerging economies. Growth in the USA accelerated in the spring, triggered by the normalisation of the weather, and China stabilised. However, after the value added tax increase in April, Japan dropped into another recession. In the euro zone, the economy saw only modest growth for the year as a whole. In the autumn, commodity prices began falling significantly against the backdrop of lower growth in demand, increasing supply and a stronger US dollar. As a result, oil prices recorded an especially sharp drop, falling by about 50.0 % from their mid-year high. This in turn led to turmoil in the markets of commodity producers — especially in Russia, which was already weakened by sanctions — and reinforced the trend of disinflation in the developed economies. Coupled with the pronounced disinflation and further monetary easing steps on the part of the ECB and the BoJ, the subdued economic environment led to another significant decline in global government bond yields and narrower secondary market spreads on bonds of peripheral euro zone states.

According to ECB estimates, growth in the euro zone was a moderate 0.8 % in 2014. Unemployment fell slightly to 11.5 % in November, but remained near its record high. Inflation in the euro zone fell from 0.8 % in December 2013 to -0.2 % at the end of 2014. Disappointing growth and declining inflation prompted the ECB to cut prime rates in June and to lower its deposit facility rate into the negative range. From September, the European Central Bank also offered new long-term financing operations to promote lending. In addition, in autumn 2014 the ECB began to buy covered bonds and asset-backed securities. These measures contributed to the easing of tensions in the euro zone financial markets, which began in the summer of 2012, and led to a further narrowing of credit spreads.

In the first quarter of 2014, the German economy grew by 0.7 % against the previous quarter, fuelled mainly by domestic consumption, with the mild winter providing additional support for economic growth. However, a weak spring revival following a dynamic winter, as well as foreign trade were a drag on the economy later in the year and the economy grew by only 1.5 % for the full year 2014 according to IMF estimates. The Spanish economy continued to recover and the IMF estimates 2014 growth at 1.4 %. The Italian economy, in contrast, again dropped into a slight recession. In the United Kingdom, the economy grew by 2.6 % in 2014 (IMF expectation), and unemployment also declined significantly. Annualised inflation fell from 2.0 % at the end 2013 to a historic low of 0.5 % at the end of the 2014.



In the first quarter of 2014, the US economy was hampered by the extremely cold winter and a considerably slower increase in inventories by businesses, and GDP contracted by 2.1 % on an annualised basis. After the weather normalised in the spring, growth recovered strongly and rose to more than 4.0 % on an annualised basis in the second and third quarters. Private consumption, investment and net exports all contributed to growth. The IMF expects GDP growth of 2.4 % for the full year 2014. Unemployment fell significantly from 6.7 % to 5.6 % during the year. The annual inflation rate rose from 1.5 % to 2.1 % in the first half of 2014, but then fell to 0.8 % at the end of the year due to falling oil prices and a resurgent US dollar. At its meeting, the Fed reduced its monthly bond purchases by USD 10.0 billion and ended its bond purchases entirely after its October meeting.

Most of the Asian economies lost momentum in the first quarter, mainly as a result of a decline in credit growth. A recovery then began, especially in China, triggered by growth-supporting measures. In Japan, the increase in value added tax in April led to higher consumer demand in the first quarter. Thereafter, however, the economy dropped into recession. Due to the VAT increase, the annual inflation rate rose to a 23-year high of 3.7 % in May, before dropping to 2.4 % in November.

### ***Real estate markets***

Developments in the real estate markets in which FMS Wertmanagement's real estate collateral is located presented a varied picture in 2014. The sale of most of the real estate loans in the USA changed the geographic focus of the real estate collateral portfolio. The focus of this portfolio now includes German, British and Spanish loans.

In Germany, FMS Wertmanagement's loan portfolio is secured mainly by office, residential, commercial and retail properties. Overall, the German real estate market developed positively in 2014, although there were clear differences between regions and usage types. The trend of movement to cities continued in 2014; this has resulted in even greater pressure than in previous years on both rents and purchase prices in rural regions and regions considered to be unattractive.

In addition to Germany, the United Kingdom was one of the most popular real estate markets in Europe in 2014. Nearly all types of properties enjoyed great popularity among investors. Nevertheless, the performance in the United Kingdom varied significantly by region. In particular, major metropolitan areas benefited much more than smaller cities.

The real estate market in Spain has recovered. But here, too, there were significant differences between regions and property types. In 2014, investor interest in the Spanish market increased greatly, especially in urban centres.



### ***Infrastructure markets***

At approximately USD 407.8 billion, global project finance volume (bond, loan and equity market) was about 7.0 % lower in 2014 than in the previous-year period.

The market share of syndicated loans for project financing was 10.0 %, 2.0 % higher than in 2013. Despite rising global demand for infrastructure investments, investors were reluctant to finance new infrastructure, as rising valuations and increasing competition for established projects are having a negative impact on the expected rate of return.

The recovery in the euro zone came to a halt in 2014. Gross domestic product rose by 0.8 %, weaker than forecast. The global economy grew by 3.3 %, less than expected. This was due to the unfavourable financing conditions for the emerging markets, an economic downturn in Japan and weather-related declines in the USA. The political situation in crisis areas such as Ukraine, Russia, Syria and Libya is increasingly curtailing investment behaviour and the risk appetite of investors. Consequently, the project financing volume in Western Europe was about 14.0 % lower than in the previous-year period. The retroactive changes to the statutory feed-in tariffs for solar power plants in Spain and Italy also dampened the investment climate in Europe.

### ***Financial institutions and covered bonds***

The results of the stress test and the ECB's covered bond purchase programme had a positive impact on the performance of the bonds issued by financial institutions. Bonds issued by banks in the euro periphery countries were particular beneficiaries.

The collapse and subsequent restructuring of the largest Portuguese financial group, Banco Espirito Santo, had no effect on FMS Wertmanagement, as there was no exposure to this group.

### ***Public sector***

The major factors in 2014 were geopolitical tensions in areas such as Ukraine and the Middle East, continued weak growth and the associated measures taken by central banks, especially the ECB, and the sharp decline in oil prices (energy prices) in the second half of the year.

Continued weak growth and emerging deflationary tendencies prompted the ECB to considerably expand its monetary policy measures during the year. The general level of yields in the euro zone declined significantly last year and bond spreads of the euro periphery countries fell sharply. Yields on 10-year Bunds fell sharply, from 1.9 % at the start of 2014, to record lows around 0.5 % at the end of December 2014. Yields on Spanish and Italian 10-year government bonds fell even more significantly, with each dropping from about 4.0 % at the beginning of 2014 to around 1.5 % at the end of 2014. Yields on 10-year Greek government bonds also fell during 2014, from around 8.0 % at the beginning of the year to below 6.0 %. In the fourth



quarter of 2014, Greek yields rose to well over 10.0 % due to uncertainty about the outcome of the political crisis and the new elections this triggered. Despite a sustained very strong economic performance, yields on 10-year British government bonds fell from about 3.0 % to 1.8 % during 2014, due to the elimination of the uncertainties surrounding the ultimately unsuccessful Scottish independence referendum and significantly reduced inflation expectations.

Despite massive measures by the Japanese government and the Bank of Japan, the Japanese economy recorded a drop in GDP for 2014 after starting off the year with two slightly positive quarters. This was due to the value added tax increases introduced in order to finance the economic stimulus programme. Despite this negative environment, FMS Wertmanagement, in part by taking advantage of the central bank's buy-back programme, continued selling Japanese government securities in 2014 and in the first weeks of 2015.

In the US, both public-sector securities and US government bonds recorded positive performances in 2014. The high-yield sector led the way with an approximately 15.0 % improvement in total return/yield. The economic situation in respect of employment, GDP growth and tax revenues of the individual states and counties has improved significantly and created good conditions for capital expenditure. After the completion of the bankruptcy proceedings of the City of Detroit and the economic problems of Puerto Rico, a certain level of calm has now returned to the US municipal market.

### ***ABS markets***

The recovery in the global ABS markets, which began in 2013, continued in 2014. The European ABS markets recorded an especially significant narrowing of risk premiums, driven mainly by the intervention of the ECB and the introduction of the ECB's ABS purchase programme. The US ABS market also recorded growth in new issues in 2014 and exceeded the threshold of USD 200 billion. European ABS new issues stagnated in contrast and, at EUR 156 billion, remained at approximately the previous year's level. Most of the securities were issued for purposes of ECB repos.



In 2014, the performance of US CMBSs reflected the continued positive developments in the residential and commercial real estate markets. Risk premiums continued to narrow and new issues rose in comparison with the previous year.

Economic fundamentals from the US were mostly positive and indicate a stable asset performance in the ABS and MBS markets. Europe, however, recorded mixed fundamentals. Unemployment in the euro periphery countries remained high in 2014, making it necessary to continue monitoring the ABS markets very closely.

### **Course of business**

#### ***Business performance***

The business activities and annual financial statements of FMS Wertmanagement as at 31 December 2014 are shaped by the ongoing portfolio wind-up, the company's own issuing activities and the sustained effects of the European sovereign debt crisis.

FMS Wertmanagement posted a positive result from ordinary activities of EUR 373 million (previous year: EUR 146 million) for the 2014 fiscal year. Deducting the tax expense of EUR 60 million (previous year: EUR 29 million) gives net income for the fiscal year of EUR 313 million (previous year: EUR 117 million). This confirms the statement made in the outlook for the 2014 fiscal year that a positive result was expected.

As net interest income and net commission income combined surpassed general and administrative expenses, current income from the portfolio offset expenses from operating activities.

FMS Wertmanagement had sufficient liquidity at all times. As regards issuance activities at FMS Wertmanagement, the total issuance volume of all capital market instruments amounted to EUR 11.6 billion in 2014 and was thus approximately EUR 2.0 billion higher than the issuance volume of EUR 10.0 billion forecast in the outlook for the 2014 fiscal year. This was largely a result of higher liquidity requirements on account of providing collateral for the derivatives business. The additional liquidity requirements were funded pro rata via the capital markets in order to maintain the desired funding structure (50.0 % via capital market issues compared to 50.0 % in the money market).



### *Wind-up report*

The following table shows the cumulative portfolio wind-up from the transfer date (1 October 2010) until 31 December 2014<sup>1</sup>:

<b>Development of the wind-up portfolio Cumulative</b>	<b>in € billion</b>
Wind-up portfolio commitment as at 01.10.2010	175.7
- Cumulative portfolio wind-up	-73.5
+ Currency effects	+4.1
<b>Wind-up portfolio commitment as at 31.12.2014</b>	<b>106.3</b>

<sup>1</sup> Translated at exchange rates as at 31 December 2014

The table below shows the portfolio wind-up in the 2014 fiscal year and the reconciliation of the commitment of the wind-up portfolio to total assets as at 31 December 2014<sup>1</sup>:

<b>Development of the wind-up portfolio 2014 fiscal year</b>	<b>in € billion</b>
Wind-up portfolio commitment as at 31.12.2013	119.1
- Portfolio wind-up, fiscal year	-18.1
+ Currency effects	+5.3
<b>Wind-up portfolio commitment as at 31.12.2014</b>	<b>106.3</b>
- Undrawn credit lines and guarantees	-0.6
+ Portfolio of own issues (nominal)	+29.2
+ Other receivables incl. portions thereof/other	+48.7
<b>Total assets as at 31.12.2014</b>	<b>183.6</b>

<sup>1</sup> Translated at exchange rates as at 31 December 2014

The item heading "Other receivables incl. portions thereof/Other" mainly contains cash collateral for derivatives, the amortised cost of derivatives taken over, receivables from the utilisation of liquidity facilities issued, current credit balances and accrued interest.



Until the end of the past fiscal year, portfolio performance was as follows, based on nominal values and broken down by segment:

Segment/commitment Cumulative	01.10.2010 in € billion	Portfolio wind-up in € billion	Currency effects in € billion	31.12.2014 in € billion
Commercial Real Estate	27.2	-18.8	+0.2	8.6
Infrastructure	18.0	-4.8	+0.8	14.0
Public Sector	86.6	-32.6	+0.5	54.5
Structured Products	43.9	-17.3	+2.6	29.2
<b>Total</b>	<b>175.7</b>	<b>-73.5</b>	<b>+4.1</b>	<b>106.3</b>

Segment/commitment 2014 fiscal year	31.12.2013 in € billion	Portfolio wind-up in € billion	Currency effects in € billion	31.12.2014 in € billion
Commercial Real Estate	13.4	-5.0	+0.2	8.6
Infrastructure	14.5	-1.3	+0.8	14.0
Public Sector	59.8	-6.8	+1.5	54.5
Structured Products	31.4	-5.0	+2.8	29.2
<b>Total</b>	<b>119.1</b>	<b>-18.1</b>	<b>+5.3</b>	<b>106.3</b>

Overall, the transferred portfolio was reduced to EUR 106.3 billion as at 31 December 2014. Not including countervailing currency effects, this corresponds to a reduction of EUR 73.5 billion. The reduction was brought about through scheduled and unscheduled redemptions as well as sales.

With an actual portfolio wind-up (before currency effects) totalling EUR 18.1 billion, FMS Wertmanagement exceeded the wind-up amount of approximately EUR 12.0 billion anticipated in the 2014 outlook. The faster wind-up is attributable in particular to extraordinary repayments in the Commercial Real Estate and Structured Products units as well as sales in the Public Sector unit.

## Net assets, financial position and results of operations of FMS Wertmanagement

### Net assets

The asset transfer from HRE Group as at 1 October 2010 continues to have a major impact on the net assets of FMS Wertmanagement as at 31 December 2014. FMS Wertmanagement took over assets, liabilities, provisions, accrued and deferred items, derivative financial instruments as well as other executory contracts from the transferring legal entities for accounting purposes as at that date.



Taking contingent liabilities and other obligations into account, FMS Wertmanagement posted a transaction volume of EUR 191,123 million as at 31 December 2014 (31 December 2013: EUR 201,732 million). The enumeration below provides an overview of the amount and composition of the transaction volume of FMS Wertmanagement as at 31 December 2014 (explanations may contain rounding differences):

<b>Assets</b>	<b>31.12.2014 in € million</b>	<b>31.12.2013 in € million</b>
Cash reserve	88	383
Loans and advances to banks	36,515	23,609
Loans and advances to customers	22,397	28,359
Debt instruments	119,750	130,918
Other long-term equity investments	7	7
Shares in affiliated companies	807	386
Intangible and tangible fixed assets	2	11
Other assets	791	51
Prepaid expenses	3,272	3,940
<b>Total assets</b>	<b>183,629</b>	<b>187,664</b>

<b>Equity and liabilities</b>	<b>31.12.2014 in € million</b>	<b>31.12.2013 in € million</b>
Liabilities to banks	20,276	21,837
Liabilities to customers	17,575	26,367
Securitised liabilities	127,493	121,189
Other liabilities	530	373
Deferred income	16,316	16,559
Provisions	1,007	1,220
Equity	432	119
<b>Total assets</b>	<b>183,629</b>	<b>187,664</b>
Contingent liabilities	3,641	8,115
Other obligations	3,853	5,953
<b>Transaction volume</b>	<b>191,123</b>	<b>201,732</b>

The reduction of total assets does not reflect the unwinding of the portfolio in the fiscal year. The unwinding of the portfolio (EUR 18.1 billion) and the reduction of own bonds bought back (EUR 6.4 billion) are contrasted with increases in cash collateral to be provided (EUR 13.5 billion) and currency effects (EUR 6.3 billion, of which EUR 5.3 billion relate to the wind-up portfolio commitment).



### *Lending business*

The transferred risk positions that arise from the underlying lending business encompass receivables, disbursement obligations under irrevocable loan commitments and guarantees. Some of the contingent liabilities stem from guarantees for certain assets that are being held by HRE Group companies and could not be transferred to FMS Wertmanagement.

The lending business has a volume of EUR 63,149 million and is broken down into the following balance sheet and off-balance-sheet items:

	<b>31.12.2014</b> in € million	<b>31.12.2013</b> in € million
Loans and advances to banks	36,515	23,609
Loans and advances to customers	22,397	28,359
Contingent liabilities (excluding CDS)	384	3,313
Other obligations	3,853	5,953
<b>Lending business</b>	<b>63,149</b>	<b>61,234</b>

The development of the lending business was influenced by the increase in loans and advances to banks, which is mainly due to increased holdings of cash collateral. The position of collateral in the context of derivative contracts increased by approximately EUR 13.4 billion.

Since the reporting year, receivables from repo transactions amounting to EUR 3.0 billion with EUREX Clearing AG, Frankfurt am Main (hereinafter: EUREX), have been recognised under loans and advances to banks, while in the previous year (31 December 2013: EUR 2.5 billion) they were included in loans and advances to customers.

The partial transfer of operations of the Rome branch of DEPFA BANK plc in February 2014 resulted in a decrease of EUR 2.0 billion in contingent liabilities at the time of the transfer and an equivalent increase in loans and advances to customers. With this transfer, FMS Wertmanagement assumed legal ownership of the so-called Italy portfolio ("asset upgrade"), which was transferred to FMS Wertmanagement via guarantee.

The decrease in other obligations as at 31 December 2014 is mainly due to the end of a liquidity facility made available to DEPFA BANK plc and the reduction of a liquidity facility in respect of pbb.



In the 2014 fiscal year, there were also significant effects from currency translation, especially the US dollar, whose main impact was the increase in loans and advances to customers.

These effects more than compensated for the decline in the lending business in fiscal year 2014, which resulted from the unwinding of the portfolio.

#### *Holdings of securities*

Holdings of securities in the amount of EUR 119,750 million were recognised as at 31 December 2014 (31 December 2013: EUR 130,918 million). The own issues bought back including accrued interest in the amount of EUR 29,220 million (31 December 2013: EUR 35,660 million) are allocated to the liquidity reserve and partly pledged as collateral. The additional holdings solely concern marketable bonds and other fixed-income securities, which are classified as holdings of financial investments. The holdings of securities are hedged against interest rate and foreign exchange risks by means of derivatives.

In fiscal year 2014, the portfolio was increased by currency effects of approximately EUR 4.6 billion, which partially compensated for the unwinding of the portfolio.

#### *Shares in affiliated companies and other long-term equity investments*

The book value shown for shares in affiliated companies and other long-term equity investments was EUR 814 million as at 31 December 2014 (31 December 2013: EUR 393 million). The changes in the 2014 fiscal year resulted mainly from the acquisition of DEPFA BANK plc of EUR 320 million (excl. incidental acquisition expenses) and from the payments into the capital reserves of FMS Wertmanagement Servicegesellschaft of EUR 50 million. In addition, currency translation effects increased the portfolio by EUR 41 million.

#### *Liabilities*

Issuing own bonds and engaging in repos in accordance with the funding strategy of FMS Wertmanagement has a significant impact on the following balance sheet items: Liabilities to banks, Liabilities to customers and Securitised liabilities.

FMS Wertmanagement recognised liabilities to banks of EUR 20,276 million as at 31 December 2014 (31 December 2013: EUR 21,837 million). As at 31 December 2014, this item primarily comprised repo transactions of (a nominal) EUR 16,033 million (31 December 2013: EUR 16,764 million).



Liabilities to customers totalled EUR 17,575 million (31 December 2013: EUR 26,367 million) and mainly included repo transactions of (nominal) EUR 12,158 million (31 December 2013: EUR 21,747 million).

Since the reporting year, liabilities from repo transactions with EUREX have been recognised under liabilities to banks (EUR 6.6 billion), while in the previous year they were included in liabilities to customers (EUR 6.4 billion).

In addition, FMS Wertmanagement recognised securitised liabilities of EUR 127,493 million as at 31 December 2014 (31 December 2013: EUR 121,189 million). Of this item, the holdings of FMS Wertmanagement's own debt issues, including pro rata interest, as at 31 December 2014 were EUR 91,242 million (31 December 2013: EUR 92,139 million). This item also includes EUR 36,251 million (31 December 2013: EUR 29,050 million) in commercial paper from the Euro CP/CD Programme launched in fiscal year 2011. The increase in securitised liabilities in fiscal year 2014 is mainly due to the increased need for the provision of collateral in the context of derivatives transactions and the corresponding funding.

#### *Prepaid expenses and deferred income*

Prepaid expenses in the total amount of EUR 3,272 million (31 December 2013: EUR 3,940 million) include EUR 1,739 million (31 December 2013: EUR 2,541 million) of derivatives costs that have not yet been amortised, as well as EUR 1,433 million (31 December 2013: EUR 1,281 million) in accruals from the lending business attributable to payments made by FMS Wertmanagement in 2010 for the hedge adjustments of the hedged items (receivables) taken over from the HRE Group companies. The increase in prepaid expenses from the lending business in fiscal year 2014 is due to the transfer of the partial operations of the Rome branch of DEPFA BANK plc. In addition, currency effects also had an increasing effect.

The deferred income of EUR 16,316 million (31 December 2013: EUR 16,559 million) includes EUR 16,154 million (31 December 2013: EUR 16,380 million) of payments not yet amortised, received in connection with the derivatives (which were mainly taken over as at 1 October 2010) from the transferring HRE Group companies. The book values of these financial instruments at the transfer date arise in particular from the negative fair values of the financial instruments used to hedge interest rate risks. The slight decrease in unamortised payments received for derivatives taken over in fiscal year 2014 resulted primarily from payments for negative fair values of swap transactions, which were transferred to FMS Wertmanagement with the transfer of the partial operations of the Rome branch of DEPFA BANK plc and which had an increasing effect. In addition, currency effects also increased holdings, so these effects largely compensated for the decrease in the amortisation of deferred income.



### *Equity and loss compensation claim*

The capital base of FMS Wertmanagement is structured as follows:

HRE and pbb each made an equity contribution of EUR 1 million to FMS Wertmanagement in connection with the spin-off pursuant to Section 8a (1) and (8) FMStFG in conjunction with Sections 123 (2) No. 1 and 131 UmwG.

FMS Wertmanagement recognised net retained profits of EUR 313 million as at 31 December 2014 (31 December 2013: EUR 117 million).

Net retained profits from the 2013 fiscal year were transferred to retained earnings by decision of 11 April 2014.

In accordance with the law and the Charter of FMS Wertmanagement, SoFFin is under an obligation to compensate all losses. Accordingly, until FMS Wertmanagement is liquidated, SoFFin has the obligation to pay, on first demand by the Executive Board of FMS Wertmanagement, all amounts required in the Executive Board's due assessment for ensuring that the winding-up institution can pay all its liabilities at any time when due and in full and to cover all losses of FMS Wertmanagement.

As in the previous year, there was no loss compensation claim against SoFFin as at 31 December 2014.

### *Financial position*

The transfer of assets and liabilities from the HRE Group also included funding items. Some of these holdings were repaid in connection with the restructuring of the funding and replaced by new FMS Wertmanagement issues. Securitised liabilities totalling EUR 127,493 million were recognised as at 31 December 2014 in connection with FMS Wertmanagement's own debt issues, the Euro CP/CD Programme and accrued interest (31 December 2013: EUR 121,189 million). As at 31 December 2014, FMS Wertmanagement had issued EUR 91,242 million in own debt instruments including pro rata interest (31 December 2013: EUR 92,139 million); of this amount, EUR 29,220 million (31 December 2013: EUR 35,660 million) including pro rata interest had been bought back and reported as an asset in the balance sheet under the "Debt instruments" item. The increase in securitised liabilities in fiscal year 2014 of EUR 6,304 million is mainly due to the increased need for the provision of collateral in the context of derivatives transactions and the corresponding funding.



### *Issuing activity and funding*

In the reporting year, FMS Wertmanagement met its targets for its funding debt investor strategy. The overriding aim here is to ensure the solvency of FMS Wertmanagement at all times. This is accomplished by means of a broadly diversified funding structure, which is characterised by product diversity and a broad, international investor base.

In the money market, the product range comprises the following instruments:

- ▶ Euro CP/CD Programme
- ▶ USD Asset Backed CP Programme (via an issuance vehicle in the USA)
- ▶ Repos (bilateral, tri-party and Eurex repos)
- ▶ Deposits from institutional investors

Capital market funding is based on strategic benchmark issues, publicly offered issues and private placements. These three instruments primarily differ in issuance volume. FMS Wertmanagement still does not issue structured products but it can issue in different currencies – USD and GBP besides the euro.

The total 2014 issuance volume of all capital market instruments amounts to EUR 11.6 billion, with issuance in EUR dominating the funding activities. The successful issuance of two strategic USD benchmark bonds to a broad range of investors and regions is of particular relevance in connection with the USD capital market issues. Furthermore, GBP benchmark issues were placed with international investors.

FMS Wertmanagement plans to keep the proportion of long-term capital market financing in the overall funding volume stable at 50.0 %.

### *Results of operations*

The results of operations were shaped mainly by the current income and expenses of risk positions transferred from the HRE Group and the valuation decisions made. At EUR 335 million, current income and expenses (net interest and commission income less administrative expenses and depreciation/amortisation of intangible and tangible fixed assets) was significantly positive in the 2014 fiscal year. At EUR 32 million, the balance from the risk provisions and net income from investments items that were shaped by valuation decisions and sales results was also positive in the 2014 fiscal year.



In the 2014 fiscal year, there was a positive result of EUR 373 million (previous year: EUR 146 million) from ordinary activities (after deducting the balance of other operating income and expenses as well as the cost of loss absorption). After deducting the tax expense of EUR 60 million (previous year: EUR 29 million) the net income for the fiscal year is EUR 313 million (previous year: EUR 117 million).

The enumeration below provides an overview of the structure of the result from ordinary activities based on the items of the income statement.

*Income statement  
of FMS Wertmanagement for the period from 1 January until 31 December 2014*

	01.01. – 31.12.2014 in € million	01.01. – 31.12.2013 in € million
Net interest income	526	626
Income from profit transfer	7	0
Net commission income	56	100
Other operating income/loss, net	–1	25
General and administrative expenses	–245	–334
Depreciation and amortisation	–2	–3
Risk provisions for the lending business	109	–440
Net income from investments in the securities business	–77	177
Expenses from loss absorption	0	–5
<b>Result from ordinary activities</b>	<b>373</b>	<b>146</b>
Taxes (incl. other taxes)	–60	–29
<b>Net income for the year</b>	<b>313</b>	<b>117</b>
Retained profits/accumulated losses brought forward	0	0
<b>Net retained profits</b>	<b>313</b>	<b>117</b>

*Net interest income*

Net interest income in fiscal year 2014 amounts to EUR 526 million (previous year: EUR 626 million). This decrease is mainly attributable to the reduction in the portfolio volume stemming from the portfolio wind-up. FMS Wertmanagement's funding advantages were also affected adversely by the EUR money market interest rates, which had fallen to historical lows.



### *Net commission income*

Net commission income primarily comprises commission income from the lending and derivatives business. Commission expenses mainly contain premium payments for loan hedging derivatives.

The decline in net commission income is attributable in part to lower commission income from credit default swaps with HRECC after the sale of the US CRE portfolio. Another contributing factor was the lower current income generated from the “transfer via guarantee” due to asset upgrades from the Italian portfolio.

In addition, net commission income in the fiscal year was influenced to a lesser degree by positive one-off effects from additional payments by pbb/DEPFA BANK plc for assets transferred via guarantee (fiscal year 2014: EUR 3 million; fiscal year 2013: EUR 14 million).

### *Other operating income/loss, net*

Other operating expenses of EUR 18 million (previous year: EUR 26 million) mainly result from currency translation. Other operating income of EUR 17 million (previous year: EUR 51 million) stems from the reversal of provisions and from cost reimbursements for servicing expenses from prior years, among others.

### *General and administrative expenses*

General and administrative expenses decreased by EUR 89 million (–26.6 %) to EUR 245 million (previous year: EUR 334 million) in fiscal year 2014.

The decrease in administrative expenses is due primarily to a lower level of expenses incurred in the context of service outsourcing (servicing of the portfolio assets, administrative and back office activities, IT services, accounting services).

Including all active service providers, servicing expenses totalled EUR 155 million for the 2014 fiscal year, EUR 39 million (–20.1 %) below the comparable expenses for servicing the portfolio in the previous year (EUR 194 million).



Expenses in the previous year were largely incurred in respect of pbb, as major parts of the operating activities of FMS Wertmanagement had been managed by the HRE Group companies under the cooperation agreement with pbb until 30 September 2013. For the period from 1 January 2013 to 30 September 2013, expenses of EUR 159 million were incurred for the tasks assigned to pbb. Since 1 October 2013, key components of activities outsourced to the HRE Group until then have been performed by FMS Wertmanagement Servicegesellschaft. In addition, other service providers have been working for FMS Wertmanagement in defined capacities such as IT services (IBM Deutschland GmbH, Ehningen) or key areas of accounting (capco). Expenses of EUR 35 million were incurred for tasks transferred to FMS Wertmanagement Servicegesellschaft and other service providers for the period from 1 October 2013 to 31 December 2013.

In addition to the decline in expenses for servicing the portfolio, the elimination of one-time charges related to IT transition costs was mainly responsible for the reduction in general and administrative expenses in the 2013 fiscal year.

Personnel expenses for the staff of FMS Wertmanagement in 2014 were EUR 26 million (previous year: EUR 25 million).

#### *Risk provisions and net income from securities*

The result from risk provisions (write-downs of and valuation allowances on receivables and certain securities, additions to loan loss provisions / Income from reversals of write-downs of receivables and certain securities and from the reversal of loan loss provisions) improved to EUR 109 million (previous year: EUR –440 million) primarily as a result of the reversal of specific and general loan loss provisions.

Net income from investments (write-downs of and valuation allowances on shares in affiliated companies, other long-term equity investments and securities classified as fixed assets as well as income from reversals of write-downs of shares in affiliated companies) amounted to EUR –77 million (previous year: EUR 177 million). The negative result in the reporting year is mainly due to additions to specific loan loss provisions and provisions which were partly offset by profits from disposals.



### ***Overall appraisal***

On the whole, business developed very positively for FMS Wertmanagement in 2014. The favourable conditions in many market segments were used to speed up the unwinding of the transferred portfolio. The commitment of the wind-up portfolio was reduced before currency effects to the amount of EUR 102.2 billion, corresponding to an unwinding of EUR 18.1 billion (15.0 %) compared to 31 December 2013 and EUR 73.5 billion (41.8 %) compared to 1 October 2010. The wind-up of approximately EUR 12 billion projected in the outlook for the 2014 fiscal year was therefore exceeded.

The results of operations also developed positively, confirming the statement made in the outlook for the 2014 fiscal year that a positive result was expected. FMS Wertmanagement recognised net income of EUR 313 million for the 2014 fiscal year (previous year: EUR 117 million).

The aggregate of net interest income and net commission income surpassed general and administrative expenses plus depreciation and amortisation of intangible and tangible fixed assets by a substantial EUR 335 million (previous year: EUR 389 million). As a result, income from the portfolio more than offset expenses from operating activities. At EUR 32 million (previous year: EUR –263 million), the balance from items shaped by valuation measures (risk provisions and net income from investments) was also positive in the 2014 fiscal year, with FMS Wertmanagement benefiting from the favourable market developments.

As regards issuance activities at FMS Wertmanagement, the total issuance volume of all capital market instruments amounted to EUR 11.6 billion in 2014 and was thus approximately EUR 2 billion higher than the issuance volume of EUR 10 billion forecasted in the outlook for the 2014 fiscal year. This was largely a result of higher liquidity requirements on account of providing collateral for derivatives transactions.



## FORECAST REPORT

### Macroeconomic developments

#### *Overall economy*

The global economy should be able to gradually recover in the next few quarters, although the recovery will likely remain moderate. Reduced negative effects of fiscal policy, a continued accommodative monetary policy, improved labour market conditions and a slow increase in demand are expected to be the main drivers. Various emerging markets are also likely to recover slightly. The medium-term outlook for growth is, however, adversely affected by a combination of accumulated economic imbalances, structural obstacles, political and economic uncertainties and — in several countries — more restrictive financing conditions. The IMF expects the global economy to grow by 3.5 % in 2015 after an estimated 3.3 % in 2014. Inflationary pressures should remain mild and inflation rates may decline even further in the short term due to the fall in oil prices.

Against the background of weakening negative effects on growth from fiscal tightening and increasing monetary easing, the gradual recovery in growth in the euro zone is likely to continue. In addition, rising net exports in the countries of the euro zone periphery and increased purchasing power due to low oil prices are contributing to stabilisation. However, demand remains generally weak because of the low availability of credit in many places, high debt and sluggish investment activity. In Germany, the loose monetary policy environment and a robust labour market supported domestic demand. The IMF expects growth in the euro zone to be 1.2 % and 1.4 % in 2015 and 2016, with growth in Germany at 1.3 % and 1.5 % respectively. This means that a significant underutilisation of the economy of the euro zone can be expected to persist and that inflationary pressures will remain minimal for an extended period.

In the US, a continued loose monetary environment, the recovery in the real estate market and rising household wealth should create a favourable climate for growth. The IMF expects real gross domestic product to rise by 3.6 % in 2015 and 3.3 % in 2016. There are upside risks in the developed economies. If falling oil prices stimulate growth more than is assumed, the pent-up demand for durable goods and capital investment could be greater than expected in the USA in particular.

The divergence of the monetary policies of the various economic areas is likely to increase. For example, the ECB decided in January to launch a large-scale government bond purchase programme (QE), while the SNB dropped the minimum exchange rate of the euro to the Swiss franc that had been in place since 2011. In the USA, however, the Fed is expected to raise interest rates.



Risks for macroeconomic developments could arise from the following factors. In the report on opportunities and expected developments, FMS Wertmanagement does not currently expect any repercussions from these risks.

- ▶ The downside risks to the global economy could continue to predominate as the risk of deflation in the euro zone has risen and traditional monetary policy is nearing its limit. If banks do not adequately pass on improved financing conditions to households and to small- and medium-sized companies, the recovery of growth could be at risk. Declining government bond yields, in turn, could reduce the pressure to forge ahead with structural reforms to increase potential growth.
- ▶ In the USA, a significant increase in bond yields and the appreciation of the US dollar resulting from the Fed's pursuit of the normalisation of monetary policy could have a negative effect on growth and — reinforced by the volatility in commodity prices — lead to distortions in the global markets and capital outflows from the emerging markets.
- ▶ In addition, geopolitical risks, especially in Ukraine and Russia and the Middle East, have increased.

### ***Real estate markets***

The European real estate market is expected to continue to improve in 2015. However, current developments in Greece and global conflicts could lead to uncertainties, which could have a negative impact on the real estate markets. As a result, rising prices are expected in 2015, which will have the effect of reducing returns. The anticipated positive trend in the Southern European countries is likely to continue. Spain in particular is projected to see further recovery.

In Germany, price increases are expected to slow down, especially in the housing market. Further moderate increases are expected in the office market in 2015, although a widespread reduction in vacancy rates for office properties is not foreseeable. In the retail sector, the forecast calls for continued movement into city centres with rents at a constant level.

For the United Kingdom, developments in real estate are expected to be largely positive. However, there are uncertainties associated with changes in the monetary policy of the Bank of England.

In Spain, a supply shortage in very good locations and in very good properties could shift demand to 1b locations and non-core properties in 1a locations. The outlook for the investment climate in 2015 is positive.



### ***Infrastructure financing***

The outlook for 2015 in Europe and the USA shows a positive development in respect of traffic in motorway projects, container ports or airports, as a rebound in GDP is expected in the euro zone (+ 1.0 % to 2.0 %) and in the US economy. Rates are anticipated to stagnate due to low inflation in the euro zone. The main risks for the euro zone in 2015, as in 2014, are uncertainties about the development of the Greek economy and the conflict in Ukraine. New escalations could set the euro zone recovery back for an extended period and thus contribute to a reluctance to make capital investments.

On the other hand, investors have huge sums available and there is significant investment pressure as the required target returns are difficult to achieve in the current interest rate environment. The relatively low number of new greenfield projects is therefore increasingly forcing investors to open positions in the secondary market, although there is mounting pressure on the price markdowns being demanded.

### ***Financial institutions and covered bonds***

The wind-up of the portfolio will be dominated by principal payments in 2015. The ECB's purchase programme for covered bonds and government bonds will have a positive effect on yield spreads on financials and generate sales opportunities.

### ***Public sector***

The euro zone will continue to benefit strongly from the ECB's highly supportive monetary policy next year. This should result in the continued narrowing of spreads in the peripheral euro countries, although at a less dynamic pace. The weaker euro and significantly lower energy costs should also have a positive impact in 2015.

The Greek government that took office shortly after the new year made statements on its future approach to debt restructuring and dealing with lenders that created uncertainty in the markets. It is not possible at this time to make valid predictions about future developments.

In the United Kingdom the uncertainty regarding a possible change in central bank monetary policy will remain as the decline in inflation leaves the Bank of England scope to keep interest rates low for some time to come, despite the ongoing economic recovery.

In the USA, the positive economic conditions in the public sector have created good conditions for new investments, with new issue volumes of well over USD 300 billion expected.



In Japan, the outlook remains clouded. The extreme policies of the government and the Bank of Japan boosted the Japanese economy into growth in the first quarter of 2014, but the economy slipped back into recession thereafter. The problems of high debt and demographic trends continue to gain relevance.

### ***ABS markets***

The ABS purchase programme introduced in Europe by the ECB in the fourth quarter of 2014 has given a boost to the ABS markets in Europe and will also have a positive effect on the market in 2015. Although purchasing volumes were fairly modest in the first two months of the programme, risk premiums have narrowed significantly and market players expect them to narrow further in 2015.

ABSs with risks in the countries peripheral to the euro zone continue to face the challenging environment of weak economic performance, although a significant increase in liquidity can be seen. Sales are expected to remain high in the secondary market in 2015. In the primary market, the first new issues from Italy and Spain were seen in 2014. The ECB is expected to give a significant boost to the primary market in 2015.

The regulatory framework will remain a dominant theme in the European securitisation markets in 2015. Market players continue to view the revised proposals from regulators with scepticism and believe their risk weightings are generally too high. How this issue develops will have a significant impact on the ABS markets in Europe.

In the US, we expect positive developments in the new issues markets. For CMBS the supply of new issues is expected to exceed maturing bonds in 2015. The US ABS market is stable and new issue volumes are expected to be at the level of the previous year. Spreads in the ABS segment have little opportunity to narrow further. CMBS risk premiums, however, could narrow further during 2015.

## **Development of FMS Wertmanagement**

### ***Portfolio***

The portfolio is expected to be further unwound by an estimated EUR 11 billion in 2015, especially in the Public Sector, Commercial Real Estate and Structured Products segments. The forecast is based on the contractual terms of the wind-up portfolio, factoring in assumptions about the economic repayment profile for structured products and assumptions by FMS Wertmanagement portfolio managers about required compulsory extensions and restructuring measures.



In the Commercial Real Estate segment in particular, the anticipated portfolio wind-up hinges on the prevailing market environment. Compulsory extensions for maturing loans can be avoided if follow-up financing is obtained from other lenders or if borrowers repay their loans. Alongside the execution of planned measures, FMS Wertmanagement's wind-up strategy is also based on the exploitation of opportunities as these arise, identified by continual monitoring of the portfolio and market conditions.

In the first three months of the 2015 fiscal year, there were no developments that contradicted this forecast.

For the individual segments, successful unwinding is expected to proceed in the coming years, thus achieving a corresponding reduction in the nominal value.

On 15 January 2015, the Swiss National Bank announced that it would abolish the minimum exchange rate against the euro. As a result, the Swiss franc appreciated significantly against other currencies. Regardless of the fact that foreign currency positions are hedged, the risk positions in the portfolio of FMS Wertmanagement increase, all other things being equal, when the Swiss franc appreciates against other major currencies (euro, US dollar).

### ***Results of operations***

To the extent that the developments in the core markets materialise as described above (namely: gradual economic recovery in the euro zone and a favourable growth environment in the USA, a stable environment for real estate markets, infrastructure financing, financial markets, covered bonds, the public sector and the ABS markets) and no unforeseen events trigger other critical developments affecting the portfolio of FMS Wertmanagement, results are expected to remain positive in the years to come. The result from ordinary activities is mainly dependent on risk provisions and net income from investment – volatile positions which are heavily influenced by valuations. Due to the high concentration risks in individual counterparties and in some individual markets, valuation parameters may lead to corresponding positive and negative deviations from projected results in this position.

FMS Wertmanagement anticipates net interest income to follow the trend seen during the reporting year, and thus shrink further in the 2015 fiscal year due to the portfolio wind-up. Net commission income is also likely to decrease slightly on account of the portfolio wind-up.

Administrative expenses should develop positively with the progressive wind-up of the portfolio. However, according to current planning, FMS Wertmanagement assumes that current income will decline more quickly than administrative expenses.



Based on the above assumptions, FMS Wertmanagement's 2015 forecast predicts to break even in terms of its result from ordinary activities, because it expects the positive balance from current income less administrative expenses to equal a possible negative balance of the risk provisions and net income from investments items influenced by valuations and the proceeds of sales. In the first three months of the 2015 fiscal year, there were no developments that contradicted this forecast.

Given the aforementioned indicators, any longer-term earnings forecast for the coming fiscal years is fraught with uncertainty and thus not particularly reliable.

### ***Funding***

FMS Wertmanagement assumes that it will be able to raise funds as planned for 2015. FMS Wertmanagement is aiming for capital market issues with a total equivalent value of EUR 8.0 to 10.0 billion in 2015.

### ***Opportunities arising from strategic projects and other opportunities***

The opportunities listed below also involve risks that could arise when taking advantage of these opportunities and projects.

FMS Wertmanagement is planning key strategic projects for 2015, including optimising and privatising FMS Wertmanagement Servicegesellschaft and finalising the project for the integration of the activities outsourced to capco (material aspects of accounting).

FMS Wertmanagement intends to privatise its subsidiary, FMS Wertmanagement Servicegesellschaft, which has been a major service provider to FMS Wertmanagement since 1 October 2013, thus releasing it from the indirect ownership of the Federal Republic of Germany. This will also be in accordance with the owner's maxim of keeping the winding-up institution as lean as possible. The privatisation of FMS Wertmanagement Servicegesellschaft also offers good career prospects for employees acquired from the HRE Group, because it means that FMS Wertmanagement Servicegesellschaft is preparing to do business on the market with other clients. FMS Wertmanagement believes that this significantly reduces the risk of key personnel leaving FMS Wertmanagement Servicegesellschaft. However, privatisation is also associated with risks, especially those arising from the fact that after privatisation FMS Wertmanagement Servicegesellschaft will no longer be owned by FMS Wertmanagement and management of the service provider could become more complex after privatisation.

The activities outsourced to capco will be integrated into FMS Wertmanagement Servicegesellschaft by 31 March 2015. Employee recruitment for the finance function in FMS Wertmanagement Servicegesellschaft is largely completed, and the trial run was successfully concluded in the context of preparing the annual financial statements dated 31 December 2014.



The goal of integration is to reduce the number of external service providers thereby reducing both the interface risks and the associated administration overhead. This will also make internal coordination within FMS Wertmanagement easier.

If FMS Wertmanagement Servicegesellschaft is able to exploit the resulting process optimisation potential, this could in turn have a positive impact on the sales process introduced by FMS Wertmanagement Servicegesellschaft. However, there are associated process risks that the existing implicit or explicit knowledge of the previous service provider and, in particular, of the key personnel of the service provider is not fully transferred.

A positive economic trend in the European and US markets offers FMS Wertmanagement a number of opportunities.

The positive outlook for the development of the European real estate markets may result in increased rental income and indirectly in improved earnings for borrowers in the Commercial Real Estate segment. This would in turn have a positive impact on the number and volume of loan defaults caused by a lack of creditworthiness. Increasing demand for properties and a corresponding rise in real estate prices in the markets relevant for FMS Wertmanagement could have a positive effect for FMS Wertmanagement on collateral in the form of mortgage liens. This in turn could increase proceeds from disposal in the event of an asset sale.

In other segments, positive macroeconomic developments in the relevant markets, such as an easing of the debt crisis, declining risk premiums or the successful implementation of reforms by states peripheral to the euro zone, could generate additional sales opportunities and therefore result in an accelerated portfolio wind-up. Such developments could also affect the credit quality of the risk positions and thus positively impact income statement items affected by valuations.

## REPORT ON POST-BALANCE SHEET DATE EVENTS

### Change in the composition of the Supervisory Board

Effective 21 January 2015, the FMSA appointed Dr. Herbert Walter, Chairman of the Steering Committee of the Federal Agency for Financial Market Stabilisation, as a new member of the Supervisory Board of FMS Wertmanagement.



### **Changes in the organisational structure**

As at 1 January 2015, the Supervisory Board appointed Frank Hellwig, previously General Manager, as an additional member of the Executive Board of FMS Wertmanagement. Frank Hellwig is responsible for the areas previously assigned to the Risk & Finance function on the Executive Board: Legal & Compliance, IT, Sourcing & Servicer Steering, Operations Management and Human Resources.

Effective 1 January 2015, the Executive Board function Commercial Real Estate will be headed by Ernst-Albrecht Brockhaus, a member of the Executive Board who is already in charge of Treasury, Capital Markets Funding and Derivatives & Markets Advisory.

### **Reduction of the liquidity facility of pbb**

Pursuant to an agreement dated 19 November 2014, the liquidity facility provided to pbb in connection with the acquisition of the economic risk of risk positions was reduced by a further EUR 600 million to EUR 540 million effective 17 January 2015.

### **Payment moratorium on the debt securities of HETA ASSET RESOLUTION AG**

The FMA, in its capacity as the winding-up institution of the Republic of Austria pursuant to Section 3 (1) of the Austrian Federal Law on the reorganisation and unwinding of banks (Federal Gazette I no. 98/2014, published on 29 December 2014, "BaSAG"), in its ruling on 1 March 2015 ordered a payment moratorium with immediate effect for HETA ASSET RESOLUTION AG, Klagenfurt, (HETA), pursuant to Section 50 (1) no. 2 in conjunction with Section 58 (1) BaSAG, and for all creditors of the eligible liabilities of HETA listed in the decision. For the affected debt securities, due dates for repayment and interest payments pursuant to Section 58 (1) no. 10 BaSAG shall be amended with immediate effect so that they are postponed until the end of 31 May 2016, if payments would otherwise be due earlier.

FMS Wertmanagement holds debt securities affected by the moratorium with a nominal value of EUR 295 million. As at 31 December 2014, FMS Wertmanagement had a risk provision appropriate for this exposure.

## **RISK REPORT**

The risk report has been prepared in accordance with the requirements of the German Commercial Code (Handelsgesetzbuch — HGB) applicable to large corporations and the supplementary provisions applicable to banks.

The disclosures in the risk report take all risk positions into account, to the extent that FMS Wertmanagement has beneficial ownership of them and thus bears the value at risk. This also encompasses subsidiaries' risk positions where FMS Wertmanagement has assumed all



credit risks — whether direct or indirect — arising from these subsidiaries' funding activities. Besides risk positions, this also encompasses properties that were taken over in connection with the disposal of collateral. In addition, the risk report also shows exposures where the risks were not transferred directly for a variety of reasons but instead by means of guarantees for instance. These disclosures do not distinguish between on-balance sheet transactions (receivables, securities) and off-balance transactions (guarantees, loan commitments, derivatives).

FMS Wertmanagement holds risk positions from DEPFA BANK plc, which was taken over as at 19 December 2014, totalling the book value, the intragroup receivables reported separately from the wind-up portfolio and the receivables relating to the wind-up portfolio. Since FMS Wertmanagement has no obligation to assume the losses of DEPFA BANK plc, the risk positions of DEPFA BANK plc are not reported in FMS Wertmanagement's risk report.

### **Basics of risk management**

Risk management is based on the wind-up plan and the risk strategy and is documented in the Risk Manual. The key risk management functions and instruments were further refined in 2014. Aside from the sets of tools used to steer and monitor risk, this also includes reviewing and adjusting, as necessary, approaches to management, limit setting and reporting, given the special nature of FMS Wertmanagement.

The risk strategy takes into account the requirements of Section 25a (1) KWG, Article 2 (4) of the Charter and the relevant rules and regulations of the German Minimum Requirements for Risk Management (MaRisk). Even though FMS Wertmanagement is not a bank or a financial services institution as defined in the German Banking Act, to the extent advisable, required or stipulated in the Charter it complies with all relevant rules, regulations and standards because its operations establish commonalities with such institutions. Extensive exploratory talks were conducted between FMS Wertmanagement and FMSA, its legal regulator, prior to foundation in respect of the applicable MaRisk rules and regulations.

Changes of the legal framework in the banking sector are reviewed for their relevance to FMS Wertmanagement and applied insofar as necessary.

The risk strategy defines long-term, general and consistent frameworks and principles for FMS Wertmanagement's risk management to the extent that this is advisable and required in substantive terms. It provides the basis for managing and controlling different types of risk and establishes fundamental risk targets that govern all business decisions.

The current risk strategy is derived directly from the aims of FMS Wertmanagement as set out in its Charter. FMS Wertmanagement follows a strategy of unwinding the portfolio in a way that maximises its value. The efficiency and operational feasibility of all risk steering activities constitute additional requirements for reducing risk. The risk tolerance of FMS Wertmanagement is described in the wind-up plan, which reflects the business strategy. The risk strategy derived from it is documented in the Risk Manual.



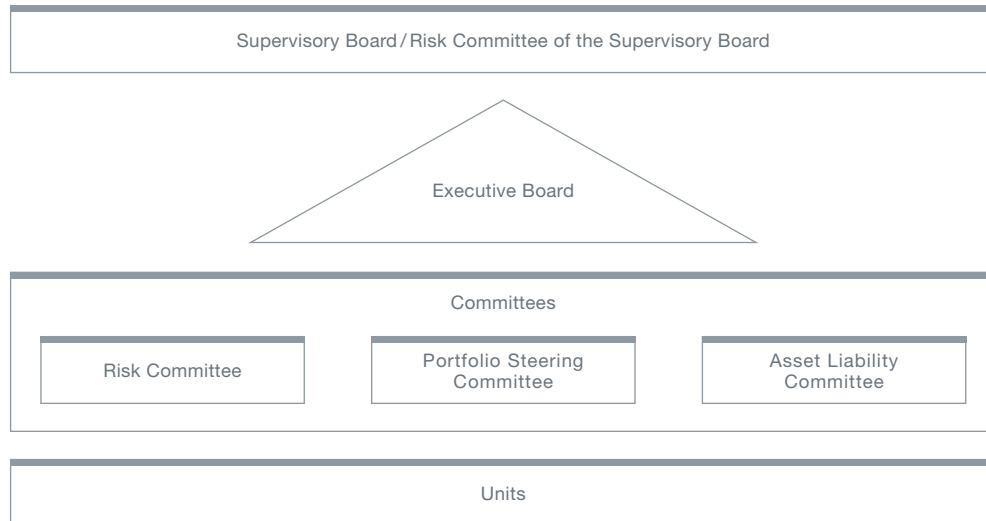
To refine its risk management FMS Wertmanagement also adopts specific strategies for five relevant risk categories: credit risk, market risk, liquidity risk, operational risk and other risks.

Because the capital adequacy requirements of the German Banking Act do not apply to FMS Wertmanagement, the absence of any obligation to prepare an internal capital adequacy assessment process to manage its business based on economic capital pursuant to MaRisk standards result in reduced requirements on FMS Wertmanagement's reporting system compared to other financial institutions. FMS Wertmanagement's approach to risk management is designed in particular to avoid seeking recourse with SoFFin under the latter's obligation to compensate losses.

The wind-up plan and the risk strategy including the underlying assumptions are reviewed on a regular basis (at least annually) and updated as necessary. Deviations from plan that are identified in the wind-up report also determine the need for updates.

### Organisational structure of risk management

Responsibility for risk management rests with the Executive Board of FMS Wertmanagement, in particular the CRO/CFO. The chart below shows the organisational structure of risk management:





### ***Supervisory Board / Risk Committee of the Supervisory Board***

The Supervisory Board monitors the Executive Board within the meaning of the Charter of FMS Wertmanagement and has delegated risk-relevant topics to the Risk Committee of the Supervisory Board. As far as loan and portfolio management are concerned, the Risk Committee of the Supervisory Board serves as the latter's approval body tasked especially with making decisions on a case-by-case basis that are particularly relevant to risk, have major effects on FMS Wertmanagement's financial results or possess major strategic significance. It reviews and approves transactions and activities, strategies and targets related to individual exposures in connection with unwinding the portfolio and monitors relevant loan decisions. All members delegated for this purpose by the Supervisory Board are entitled to vote.

### ***Committees***

The following committees, which generally meet weekly or monthly and can be convened at short notice, have been established at FMS Wertmanagement to support and advise the Executive Board as well as to make certain decisions:

- ▶ The *Risk Committee* is the corporate body for operational lending decisions at the management level of FMS Wertmanagement; it makes loan decisions on individual loans for all asset classes that fall within the scope of the Committee.
- ▶ The *Portfolio Steering Committee* is a strategic management and information committee at Executive Board level whose duties include preparing decisions on adjustments to the wind-up plan and making decisions on methodological changes in risk controlling and concerning overall risk steering.
- ▶ The *Asset Liability Committee* (ALCO) serves as the Executive Board's key body tasked with information gathering, monitoring and management activities in connection with strategic decisions on issues related to the structure of the balance sheet, liquidity and market risk positions, funding and hedging strategies, limits as well as methodological requirements for market and liquidity risks.

### ***Units***

The units listed below are mainly responsible for risk management at FMS Wertmanagement.

The Risk Controlling department within the Risk Controlling, Finance & Portfolio Steering unit is responsible for carrying out all risk controlling activities in accordance with MaRisk for all risk types. This includes identification, analysis, assessment, monitoring and reporting of the risks. The Risk Controlling, Finance & Portfolio Steering unit is also responsible for carrying out the annual review of FMS Wertmanagement's wind-up plan and for preparing the monthly wind-up report, which is the centralised reporting tool for all risk types.



The task of reviewing the adequacy of the models used to determine credit risk and model-based market price valuation is assigned to the Quantitative Analytics department, which was part of the Structured Products & Quantitative Analytics unit until 2014. Since the start of 2015, this department has been assigned to the Risk Controlling, Finance & Portfolio Steering unit.

Managing credit risk is one of FMS Wertmanagement's central tasks. The main tasks of the portfolio management units entail making decisions on loans and securities at both the individual and the portfolio level. This is where the decisions of the committees whether or not to hold risk positions to maturity or sell or restructure them are prepared and carried out. Credit Portfolio Management comprises the following four units and departments whose responsibilities in the reporting year — essentially as in the previous year — were oriented to the segments or product groups below:

- ▶ The Structured Products department within the Structured Products & Quantitative Analytics unit manages the structured products.
- ▶ The Sovereign & Public Finance, Financial Institutions unit is responsible for government bonds and the Public Sector and Financial Institutions portfolio segment.
- ▶ The Corporate & Asset Finance unit is mainly responsible for infrastructure financing.
- ▶ The Commercial Real Estate I unit handles exposures that are mostly performing. The Commercial Real Estate II unit handles exposures that are generally being restructured or require workout activities.

Due to the diminishing portfolio size, Commercial Real Estate I and II were consolidated into a single unit at the beginning of 2015. The Corporate & Asset Finance unit was split, and responsibility for infrastructure financing was assigned to the newly named Structured Products, Infrastructure & Asset Finance unit.

The Treasury unit is assigned responsibility for operational management of interest rate, foreign exchange and counterparty risks as well as for tactical liquidity management.

The Capital Markets Funding unit handles long-term funding via capital market issues and manages strategic liquidity risk.

In the reporting year, the Audit unit in the Risk & Finance division performed risk-based and process-independent audits relating to the efficacy and adequacy of risk management at FMS Wertmanagement and FMS Wertmanagement Servicegesellschaft.



The Sourcing & Corporate Services department in the IT, Sourcing & Servicer Steering unit is tasked with service provider management and thus managing outsourcing risks.

Moreover, each individual department at FMS Wertmanagement must also manage the operational risks falling within their own scope of responsibility. For example, ensuring adequate rules of representation and carrying out measures to prevent losses are decentralised responsibilities.

### **Process organisation of risk management**

Risk management comprises the

- ▶ identification,
- ▶ analysis / assessment,
- ▶ steering and
- ▶ monitoring / reporting

of risks.

The material types of risks associated with the business model of FMS Wertmanagement are:

- ▶ Credit risks
- ▶ Market risks
- ▶ Liquidity risks
- ▶ Operational risks and
- ▶ Other risks

An annual risk inventory is conducted to identify and review risks classified as material. Due to the size and complexity of the portfolio transferred, credit risk in the form of borrower and issuer risk is the most important type of risk for FMS Wertmanagement. In addition, FMS Wertmanagement is subject to considerable operational risk as a result of the extensive outsourcing of processes.

Risk management also entails limiting, monitoring and actively steering the following risks in particular: counterparty, market and liquidity risks. In addition to risk type-specific stress tests, integrated (cross-risk type) stress scenarios are run and reported on a quarterly basis. Borrower and issuer risks are monitored and managed as part of the wind-up strategies for specific wind-up clusters within the segments. Counterparty, market, liquidity, operational and other risks are managed at the total portfolio level.



FMS Wertmanagement is fully liable for managing and monitoring each individual risk type. FMS Wertmanagement has outsourced major operating duties and activities to FMS Wertmanagement Servicegesellschaft by way of a framework agreement. The scope of services provided is set out in detailed service level agreements.

Moreover, a framework agreement was signed to outsource key areas of IT operations to IBM Deutschland GmbH (Ehningen). Extensive service level agreements are intended to safeguard day-to-day IT system functionality and to provide for future adaptation of the systems to the special needs of FMS Wertmanagement by means of change requests.

## **Credit risk**

### ***Definition***

The credit risk of FMS Wertmanagement mainly comprises borrower and issuer risk, counterparty risk as well as country risk.

- ▶ Borrower and issuer risk comprises the risk that a contracting party, or a reference entity in the case of credit derivatives, does not fulfil the payment obligations resulting from loan agreements or securities issues in full and in a timely manner or that a credit event defined in derivative contracts occurs. The borrower and issuer risk is further classified into default and migration risk.
  - Default risk: The risk that a borrower cannot fulfil payment obligations in full or on time or that a defined credit event occurs and that FMS Wertmanagement suffers a financial disadvantage as a result. In many cases, FMS Wertmanagement is in possession of marketable collateral. Recoveries from the liquidation of collateral can mitigate part of the default losses, but they are also subject to uncertainties.
  - Migration risk: Risk that a borrower's or issuer's creditworthiness might deteriorate over time. Such deterioration in creditworthiness does not immediately result in direct losses, but it increases the risk of incurring such losses. Irrespective of the treatment for accounting purposes, a deteriorated credit profile is usually associated with declining market values.
  
- ▶ Counterparty risk is the risk that a contracting party's default makes it impossible to fully collect unrealised profits from derivatives and executory contracts. It encompasses replacement and settlement risk.
  - Replacement risk: If a derivative counterparty defaults, a contract must be replaced at conditions that are less favourable than the ones applicable when the contract was initially made.
  - Settlement risk: FMS Wertmanagement delivers an asset that it has sold to a counterparty or makes a payment but does not receive the stipulated monetary amount or asset.



- ▶ Country risk comprises credit or counterparty risks arising from the dependence of the contracting party on the actions of foreign states or political or economic developments. In particular, this includes the risk that a debtor cannot service its liabilities because
  - the government or central bank of the debtor's country cannot or will not make available the foreign currency required for such repayment or
  - prohibits such repayment (transfer risk),
  - or because the currency of the debtor's country can no longer be converted due to a serious deterioration of the country's economic or political situation (conversion risk).

Collective country valuation allowances are recognised for borrowers in countries with discernible country risks.

### ***Risk strategy***

FMS Wertmanagement's credit risk strategy entails to minimise losses by holding assets to maturity or winding them up as profitably as possible. Taking on new business for other purposes than hedging risks is not permitted by the risk strategy and is not stipulated in the wind up plan. In individual cases, new business in the sense of prolongations, acquisitions of collateral and stabilisation measures is allowed to cost-effectively reduce risks from existing positions.

### ***Risk identification***

A catalogue of early warning indicators, which is coordinated with FMS Wertmanagement Servicegesellschaft, is used to continuously monitor loan exposures so as to ensure early identification of problem assets. The latter are then classified into Facilities in Focus, Watchlist, Restructuring and Workout – in that order – if certain indications are present. Exposures are subject to increasingly intensified monitoring – in that order – to ensure that risks are detected and steps aimed at reducing risk can be initiated as soon as possible.

The guidelines agreed with FMS Wertmanagement Servicegesellschaft for credit processes determine the requisite steps for performing risk reviews and risk assessments as part of regular monitoring. Early warning indicators as well as the credit processes are reviewed on a regular basis but at least annually by FMS Wertmanagement Servicegesellschaft and coordinated with the responsible units within FMS Wertmanagement.



### ***Risk analysis and assessment***

Credit risk is measured using internal models that calculate the

- ▶ probability of default (PD) of receivables,
- ▶ expected amount of the receivable at the time of default (exposure at default, or EaD), and
- ▶ potential loss given default (LGD)

The models for determining these parameters are reviewed annually by FMS Wertmanagement. The aforementioned parameters are in turn used to calculate the expected loss (EL) for a one-year horizon. The expected loss is calculated on a per-transaction basis and then aggregated by segment and across the overall portfolio.

In addition, the cumulative expected loss for a longer planning horizon and for the entire term of the positions in the wind-up portfolio is calculated as a risk reference value for use in managing the portfolio. Stress tests are conducted at both portfolio and segment level, and the unexpected loss is quantified with the help of a credit portfolio model. In sensitivity analyses and both historical and hypothetical scenario analyses, stress situations are modelled for the key risk parameters PD and LGD, and their effects are measured on the cumulative EL.

### ***Risk steering***

The credit portfolio management units and departments listed in section “Organisational structure of risk management” are responsible for steering credit risks. Restructuring and selling receivables are the two most important tools that are available to FMS Wertmanagement for steering credit risks.

In managing the portfolio, FMS Wertmanagement generally bases its decisions on the long-term value of an exposure (intrinsic value) in order to decouple decision-making from short-term fluctuations in market values. Changes in market values, however, are considered within internal credit rating analyses because they can provide timely and independent indications of creditworthiness. Additional analyses regarding borrower and issuer risk and potential write-down requirements are also performed in the event of material market value changes.

Counterparty risks are managed by means of suitable limits and application of the “gross future exposure” measure, which does not only take current market values of derivative contracts into account, but also their potential future changes. Both replacement and settlement risks are managed by FMS Wertmanagement. As a rule, transactions entailing a counterparty risk may not be made without a sufficient borrower-specific limit. The extent to which the limit has been utilised must be verified before any new transaction takes place (“pre-deal limit check”). All transactions are charged to the respective borrower-specific limits immediately.



Two dimensions are analysed in connection with the limiting of counterparty risks and active management of the related exposures.

- ▶ *Counterparty risks involving customers in the wind-up portfolio:* The transferred risk positions also encompass derivatives with customers in lending and securities transactions. The counterparty risks arising from these derivatives are limited for the purpose of monitoring any potential increases in risk resulting from changed market conditions. Increases are possible only in exceptional cases, for example with the aim of stabilising the overall exposure. In accordance with the governance framework set out in the Charter, limit increases of this nature must be decided and approved according to the respective lending authority provisions.
- ▶ *Counterparty risks involving capital market partners:* The Treasury and Capital Markets Funding units enter into money market transactions, derivatives and repos to manage the risk and liquidity positions of FMS Wertmanagement. Managing these business activities requires limits that give both units enough flexibility while enabling Risk controlling to carry out its monitoring duties. The activities are restricted to a defined pool of counterparties (white list) and are subject to an independent limit monitoring and escalation process by the Risk Controlling department.

### ***Risk monitoring and reporting***

Primarily at the portfolio level, borrower and issuer risks are monitored pursuant to the current wind-up plan and described in the wind-up report that is to be prepared monthly for the Executive Board and the Supervisory Board. Furthermore, a detailed credit risk and stress test report for the Executive Board evaluates credit-risk specific as well as integrated stress test scenarios.

At the level of individual exposures, FMS Wertmanagement Servicegesellschaft monitors credit risk via approved processes. The migration of the ratings of the largest exposures is reported to the Executive Board in the wind-up report. In addition, FMS Wertmanagement Servicegesellschaft reports monthly on the development of the watchlist and problem assets to the responsible portfolio managers at FMS Wertmanagement. Based on the data delivered and their own analyses, the portfolio managers monitor the individual exposures for their segments with regard to the decisions required in the interest of economic value maximisation.

Counterparty limits and their utilisation at transaction level are also recorded in the daily counterparty risk report, monitored and reported to the Executive Board as well as to the Treasury unit. An escalation process ensures timely reaction and communication to the Executive Board if limits are exceeded.



### *Risk position*

The credit portfolio of FMS Wertmanagement is managed through the Commercial Real Estate, Public Sector, Structured Products and Infrastructure segments. An exposure at default (EaD) is determined for all portfolio segments based on uniform specifications. The EaD shows the potential amount of the claim against the borrower irrespective of the latter's credit rating and any risk provisions already set up in that connection. Besides the current drawdown, the EaD also takes into account the pro rata interest payments in relation to which a borrower may default before an exposure is defined as having defaulted (maximum 90 days) as well as those loan commitments which a borrower will still be able to draw on in future despite a significant deterioration in creditworthiness. The EaD of derivatives is defined as the sum of the current market value (after accounting for collateral) and the prescribed regulatory add-ons, which constitute a cushion for possible future market value increases.

The expected loss (EL) as an additional important short-term parameter for managing the credit portfolio is determined for the entire portfolio for a period of one year. The only risk positions exempted from the determination of the expected loss are those for which a specific loss provision was already recognised or for which a specific loss provision was transferred within the takeover of the portfolio.

The disclosures below correspond to the presentation of internal risk reporting in the wind-up report.

#### *Breakdown of the EaD and the EL of the credit portfolio*

Breakdown of the EaD and the EL of the credit portfolio by segment:

EaD and EL in € billion	Commercial Real Estate		Public Sector		Structured Products		Infrastructure		Total (excluding derivatives)		Derivatives	
	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013
31.12.												
EaD	8.8	13.6	66.1	72.0	30.4	32.5	18.7	18.3	124.0	136.4	7.8	15.1
EL	0.24	0.25	0.14	0.06	0.12	0.16	0.05	0.12	0.55	0.59	0.04	0.17

As at 31 December 2014, the EaD of the risk positions reported in the wind-up report (excluding derivatives) was EUR 124.0 billion – a decline of EUR 12.4 billion (9%) compared to 31 December 2013. The decrease was mainly a result of scheduled and unscheduled redemptions (EUR –9.5 billion) and sales (EUR –6.1 billion). As in the previous year, sales primarily involved the exposure to Japan (EUR –2.3 billion). In addition, nearly equal shares of Polish, Greek and Portuguese government bonds totalling EUR –0.85 billion were sold, along with EUR –0.9 billion in US commercial real estate loans.



In contrast to the previous year, exchange rate movements had the net effect of increasing FMS Wertmanagement's EaD by EUR 5.4 billion as at 31 December 2014. Some two-thirds of this risk-amplifying effect was due to the increase in the value of the US dollar (14 % gain) and one-third of it was the result of the appreciation of the British pound (7 % gain). Other foreign currencies are much less important for FMS Wertmanagement's portfolio and, for the most part, were also less affected by revaluations.

The change in exposure can be broken down as follows: Commercial Real Estate segment EUR -4.8 billion (-35 %), Public Sector EUR -5.9 billion (-8 %), Structured Products EUR -2.1 billion (-6 %) and Infrastructure EUR +0.3 billion (+2 %). Adjusted for foreign currency effects, i. e. assuming exchange rates had remained unchanged from 31 December 2013, the exposure in all segments had decreased.

While the exposure of the wind-up portfolio (not including derivatives) declined by 9 % year-on-year, the one-year expected loss (EL) declined by approximately 6 % to EUR 0.55 billion as at 31 December 2014. In relation to the EUR 113.0 billion of exposure from loans and securities for which specific loan loss provisions have not yet been recognised (internal rating classes 1 to 28), this corresponds to a one-year expected loss rate of 0.49 %. The EUR 0.03 billion decline in the EL is largely the result of the portfolio wind-up (EUR -0.18 billion), especially the wind-up of risky exposures in the Commercial Real Estate segment. However, exchange rate effects, rating downgrades (also mainly in the Commercial Real Estate segment) and EL increases resulting from a single transaction in the Public Sector segment mostly offset EL-decreasing effects from the portfolio wind-up.

The overall derivative position had a total EaD of EUR 7.8 billion based on the wind-up report as at 31 December 2014 and was therefore a net EUR 7.3 billion lower (-49 %) than the figure as at 31 December 2013. EUR 6.0 billion of the decline is mostly due to a change in methodology. When calculating EaD, the generalised haircuts applied to date to collateral in the form of securities and cash furnished and received for OTC transactions will now be calculated in a more granular way and will more accurately reflect risk for purposes of risk reporting. The expected loss (EL) from derivatives for one year fell by EUR 0.13 billion (-78 %). This decrease is partly attributable to the aforementioned change in methodology which reduced the EaD and partly also to one-off effects – more than half of the EL from derivatives in the previous year was accounted for by a single customer derivative relating to a real estate exposure that has been mostly wound up in the meanwhile.

Not included in the wind-up portfolio are FMS Wertmanagement's receivables from its own investees (DEPFA BANK plc and FMS Wertmanagement Servicegesellschaft) with an EaD totalling EUR 0.6 billion and liquidity facilities (as part of irrevocable loan commitments and the agreed "Ersatzdeckungslösung" (substitute cover solution)) of Deutsche Pfandbriefbank AG in the amount of EUR 3.7 billion. Based on the current risk parameters, the one-year EL for the aforementioned items amounts to less than EUR 1.0 million.



*Breakdown of credit portfolio by rating classes\**

Breakdown of credit portfolio by internal rating classes (IR)\*\*

EaD in € billion	Commercial Real Estate		Public Sector		Structured Products		Infrastructure		Total (excluding derivatives)	
	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013
31.12.										
IR 1 – 7	0.0	0.0	25.9	27.3	15.9	17.6	1.3	0.2	43.1	45.1
IR 8 – 10	0.0	0.4	33.4	36.3	12.0	10.4	10.1	9.7	55.5	56.8
IR 11 – 13	0.8	1.7	4.3	6.4	1.1	2.2	1.8	2.5	8.0	12.8
IR 14 – 22	2.4	4.5	0.4	0.2	0.5	0.8	1.7	1.4	5.0	6.9
IR 23 – 27	0.2	0.4	0.0	0.0	0.6	0.7	0.0	0.4	0.8	1.5
IR 28 – 30	5.4	6.6	2.1	1.8	0.3	0.8	3.8	4.1	11.6	13.3
<b>Total</b>	<b>8.8</b>	<b>13.6</b>	<b>66.1</b>	<b>72.0</b>	<b>30.4</b>	<b>32.5</b>	<b>18.7</b>	<b>18.3</b>	<b>124.0</b>	<b>136.4</b>

\* Excluding derivatives with an EaD of EUR 7.8 billion

\*\* In the previous year, a breakdown of the credit portfolio by internal rating classes (IR) was shown mapped to an S&P rating scale. The groups based on internal rating classes used in the current report correspond to the groups used last year.

During 2014, the portfolio's rating profile improved slightly. Year-on-year, assets with an EaD of EUR 16.0 billion experienced rating improvements (according to the internal rating assessment), while assets with an EaD of EUR 7.7 billion were downgraded. More than half of the rating improvements were attributable to the Public Sector segment (particularly to Spain, Portugal and Poland). One-third of all rating downgrades related to loans in the Commercial Real Estate segment.

*Breakdown of credit portfolio by countries and regions\**

EaD in € billion	Commercial Real Estate		Public Sector		Structured Products		Infrastructure		Total	
	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013
31.12.										
PIIGS	1.0	1.2	36.8	38.6	3.5	4.1	0.9	1.0	42.2	44.9
Of which Italy	0.3	0.3	28.3	28.6	1.5	1.6	0.5	0.5	30.6	31.0
Of which Spain	0.7	0.8	5.4	5.7	1.4	1.9	0.2	0.3	7.7	8.7
Of which Greece	0.0	0.0	1.2	1.6	0.0	0.0	0.0	0.0	1.2	1.6
Of which Ireland	0.0	0.0	0.3	0.7	0.5	0.5	0.1	0.1	0.9	1.3
Of which Portugal	0.0	0.1	1.6	2.0	0.1	0.1	0.1	0.1	1.8	2.3
United Kingdom	1.4	1.7	10.4	10.0	3.8	4.1	12.3	11.2	27.9	27.0
Germany	3.9	6.0	4.0	4.4	1.3	1.6	0.2	0.1	9.4	12.1
Rest of Europe	1.6	2.7	11.7	13.3	0.6	2.5	1.0	1.1	14.9	19.6
USA	0.7	1.8	0.0	0.1	18.7	17.8	0.8	1.4	20.2	21.1
Japan	0.0	0.2	1.2	3.5	0.0	0.0	0.0	0.0	1.2	3.7
Asia (excl. Japan)	0.1	0.0	1.0	1.1	0.0	0.0	0.2	0.2	1.3	1.3
Rest of world	0.1	0.0	1.0	1.0	2.5	2.4	3.3	3.3	6.9	6.7
<b>Total</b>	<b>8.8</b>	<b>13.6</b>	<b>66.1</b>	<b>72.0</b>	<b>30.4</b>	<b>32.5</b>	<b>18.7</b>	<b>18.3</b>	<b>124.0</b>	<b>136.4</b>

\* Excluding derivatives with an EaD of EUR 7.8 billion Allocation by country of the economic risk



As in the previous year, the breakdown of the credit portfolio by countries and regions continues to show a high percentage of European borrowers (76 %). The shares of the portfolio accounted for by the three largest country concentrations increased compared with the prior year due to disproportionately high repayments or sales and/or due to exchange rate effects. The largest country-specific shares of the portfolio are attributable to Italy at 25 % (up 2 percentage points from last year), the UK at 23 % (up 3 percentage points) and the USA at 16 % (up 1 percentage point).

Within the Commercial Real Estate segment the largest country-specific exposures relate to Germany (EUR 3.9 billion) and the UK (EUR 1.4 billion). The largest exposures in the “Rest of Europe” category comprise loans in the Netherlands (EUR 0.5 billion) and France (EUR 0.3 billion). The volume of US real estate loans was reduced to less than half of the volume held at the prior-year reporting date due to portfolio sales in particular.

The Public Sector segment comprises a financing portfolio with municipal, sovereign or other public-sector issuers as well as banks with an EaD of EUR 66.1 billion. A sum amounting to EUR 36.8 billion EaD is attributable to the states especially affected by the European debt crisis, known as the PIIGS countries, and more than three fourths of this to Italy. Already partly reduced in the previous years, receivables in respect of Greece were further rolled back in 2014 through selective sales. The largest exposures in the “Rest of Europe” region comprise government bonds and loans in France (EUR 1.9 billion), Poland (EUR 1.8 billion), the Netherlands (EUR 1.5 billion), and Austria and Hungary (EUR 1.2 billion each). The exposure to Japanese counterparties decreased by EUR 2.3 billion (–66 %) year-on-year partly due to exchange rate effects and principal repayments, but mostly as a result of sales.

With an EaD of EUR 30.4 billion, the Structured Products segment comprises all of FMS Wertmanagement’s securitisation transactions and other structured products. Of this amount, EUR 18.7 billion — more than 60 % — is attributable to the United States, with EUR 9.2 billion comprising FFELP (Federal Family Education Loan Program) student loan securities and EUR 6.0 billion accounted for by securitised receivables with municipal borrowers. It also includes risk positions totalling EUR 3.5 billion in respect of the PIIGS countries (mostly Italy and Spain), EUR 3.8 billion with the United Kingdom, EUR 2.2 billion in respect of Canada and EUR 1.3 billion vis-à-vis Germany. The exposure to borrowers in the Netherlands was reduced by EUR 1.9 billion (–89 %) from the previous year, mainly due to the early repayment of a single large exposure.

In the Infrastructure segment, the regional focus is on the United Kingdom, to which EUR 12.3 billion, or nearly two thirds of the total exposure of EUR 18.7 billion, is attributable. Other regions with large infrastructure financings are Canada (EUR 1.5 billion) and Australia (EUR 1.4 billion). Despite contrary exchange rate effects, the US infrastructure financing portfolio was reduced by nearly half from the previous year and now amounts to EUR 0.8 billion.



*Breakdown of credit portfolio by remaining maturities\**

EaD in € billion	Commercial Real Estate		Public Sector		Structured Products		Infrastructure		Total	
	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013
31.12.										
Due	2.9	3.2	0.0	0.0	0.0	0.0	0.0	0.0	2.9	3.2
Until 2015	2.9	7.5	4.7	6.2	0.2	0.5	0.2	1.5	8.0	15.7
2016–2020	2.5	2.3	11.3	15.0	4.5	4.7	1.8	1.1	20.1	23.1
2021–2030	0.5	0.4	12.7	12.7	8.0	8.0	2.6	2.6	23.8	23.7
2031–2040	0.0	0.0	25.8	26.7	9.9	8.9	3.4	3.2	39.1	38.8
After 2040	0.0	0.2	11.6	11.4	7.8	10.4	10.7	9.9	30.1	31.9
<b>Total</b>	<b>8.8</b>	<b>13.6</b>	<b>66.1</b>	<b>72.0</b>	<b>30.4</b>	<b>32.5</b>	<b>18.7</b>	<b>18.3</b>	<b>124.0</b>	<b>136.4</b>

\* Excluding derivatives with an EaD of EUR 7.8 billion

Remaining maturities (calendar year in which the next adjustment of terms will be made)

The remaining maturities of receivables differ greatly depending on the segment. The receivables held in the Commercial Real Estate portfolio are usually due in less than five years. Around one-third of the receivables (EUR 2.9 billion) relate to called loans, while another third will come due in the current year (EUR 2.9 billion).

In contrast, 57 % (EUR 10.7 billion) of infrastructure financing have a maturity beyond 2040. Often, these are inflation-indexed bonds issued by UK utility companies.

EUR 54.4 billion (82 %) and EUR 22.6 billion (74 %) in receivables from borrowers in the Public Sector and Structured Products segments, respectively, will mature by 2040.

*Watchlist and Problem Assets*

EaD in € billion	Commercial Real Estate		Public Sector		Structured Products		Infrastructure		Total	
	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013
31.12.										
Watchlist assets	0.2	0.8	0.0	0.1	0.6	0.7	0.5	0.6	1.3	2.2
Problem Assets	5.3	7.1	2.1	2.8	0.5	1.0	3.8	4.2	11.7	15.1
Restructuring Assets	4.5	6.2	2.1	2.8	0.5	1.0	3.8	4.2	10.9	14.2
Workout assets	0.8	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.8	0.9
<b>Total</b>	<b>5.5</b>	<b>7.9</b>	<b>2.1</b>	<b>2.9</b>	<b>1.1</b>	<b>1.7</b>	<b>4.3</b>	<b>4.8</b>	<b>13.0</b>	<b>17.3</b>

Risk positions are classified as “Watchlist Assets” if the payment is delayed for more than 60 days or if another specified criterion triggers intensified monitoring of the given risk position.



The “Restructuring Assets” category contains exposures for which specific loan loss provisions were recognised as well as exposures that have defaulted according to the Basel II criteria (e. g. payment past due > 90 days).

“Workout Assets” comprise risk positions where a restructuring seems unfeasible, where legal action has been initiated and where a valuation allowance has been recognised.

“Restructuring” and “Workout Assets” are combined in the “Problem Assets” category.

The early warning system is designed to identify and closely monitor borrowers of FMS Wertmanagement whose credit or collateral quality might deteriorate. Non-performing risk positions where payment arrears exceed 90 days are assigned to the non-performing loan management (i. e. Restructuring, Workout). This involves testing for impairment at regular intervals and upon occurrence of certain predefined events (“trigger events”) to determine the need for write-downs. If this is the case, a proposal for specific loan loss provisions is prepared that is approved by the Risk Committee of FMS Wertmanagement.

The amount of the general loan loss provisions is determined by considering the probability of default (PD) and the loss given default (LGD).

### ***Major challenges arising from credit risks***

The transferred portfolio imposes major risks on FMS Wertmanagement which can lead to further recourse to the Federal Republic of Germany’s loss compensation obligation and therefore to additional burdens on Germany’s federal budget. The most important of these risks are:

- ▶ ***Portfolio concentration:*** The “expected loss” (EL) of a credit portfolio shows the expected value of the credit losses occurring within a specific forecast horizon as the result of the default risks to which the portfolio is exposed to. However, actual portfolio losses can be smaller or considerably larger. The greater the concentrations in the portfolio, the greater the danger that actual losses will differ significantly from the average losses expected. The portfolio exhibits strong concentrations especially in the Public Sector segment, among other things with respect to what are known as the PIIGS countries, particularly vis-à-vis Italy. Adverse effects on income that may substantially surpass the determined EL are conceivable if a widening of the European sovereign debt crisis leads to further defaults.



- ▶ *Long maturities:* In 75 % of the risk positions, the contractually agreed or forecast maturities of the loans and securities assumed exceed the end of FMS Wertmanagement's original planning horizon of 2020. One-third of these positions do not mature until after 2040, and many of these in turn are inflation-indexed securities for which the exposure is expected to grow significantly over time.
- ▶ *Risks of hedging transactions:* FMS Wertmanagement's risk strategy stipulates broad hedging of the credit portfolio against market risks, such as interest rate risk or foreign exchange risk. In the event of default of the underlying credit risk positions, substantial additional losses can arise from the premature termination of the associated market risk hedging transactions.
- ▶ *Restructuring risks:* In many cases FMS Wertmanagement took over syndicated loans; occasionally it holds junior positions making it difficult to control or influence the structure. This in turn may trigger restructuring risks.
- ▶ *Financing structures:* The financial and economic crisis has fundamentally changed the credit and capital markets. A significant number of FMS Wertmanagement's risk positions comprise exposures that were liquid originally but have turned out to be illiquid since the crisis. To make matters worse, in some market segments overall positive earnings contributions for FMS Wertmanagement are hardly realistic any longer, even in view of the currently extremely favourable funding options, since the credit margins agreed at the time of entry into the agreement no longer correspond to today's expectations of default for the risk positions.

The implementation of the requirements imposed by the German Commercial Code regarding the recognition of "adequate risk provisions" is proving challenging in view of the aforementioned risks. As a rule, FMS Wertmanagement recognises specific loan loss provisions only on exposures that are either already non-performing or where full repayment at maturity is no longer to be expected from today's vantage point. The adequate amount of the specific loan loss provisions for risk positions where FMS Wertmanagement expects to liquidate the provided collateral is determined by discounting the expected proceeds from collateral disposal using a risk-free interest rate. General loan loss provisions are recognised for potential default risks based on the EL for a one-year forecast horizon. Furthermore, country risk provisions are recognised as generalised specific loan loss provisions for selected countries to address transfer and conversion risks.



## Market risks

### *Definition*

Any impairment of the value of the risk positions due to changed market conditions and market price factors gives rise to market risks. The following types of market risks are relevant to FMS Wertmanagement:

- ▶ *Interest rate risk*: This risk concerns the change in the present value of risk positions due to changes in the respective market interest rates.
- ▶ *Foreign exchange risk* (FX risk): This risk results from a change in foreign exchange rates and indicates how the given change will affect the value in euros of an FX exposure.
- ▶ *Credit spread risk*: This risk concerns the change in the present value in the event of changes in the underlying CDS or credit spread curve.
- ▶ Other market risks mainly encompass
  - *Basis risk*: Basis risk, such as foreign exchange or interest rate basis risk, can arise when transactions are financed with mismatches in currencies and/or terms and when reference interest rates for variable-rate transactions differ.
  - *Inflation risk*: Inflation risks arise when interest or principal payments for some products in the portfolio are linked to changes in certain national or regional or supranational consumer price indices (inflation rates).

According to the current risk profile, the key market risk factors for FMS Wertmanagement are interest rate risk and foreign exchange risk.

As previously, FMS Wertmanagement is not exposed to equity and commodity risks. Market liquidity risk is not considered material as fire sales at unacceptable prices can be largely ruled out. This is due to the funding opportunities available and the commitment made by SoFFin to supply FMS Wertmanagement with liquidity in a crisis situation.

### *Risk strategy*

FMS Wertmanagement's market risk strategy serves to limit fluctuations in the value of the portfolio that arise from factors affecting market risks and their impact on parameters that are relevant to earnings. This concerns both the risks from the transferred portfolio and new market risks from Treasury activities. The ratio of the expenditure required for hedging purposes to the realisable benefits must be commercially reasonable. The goal is to unwind the existing risk positions and avoid new ones.



To support the wind-up strategy and if requested by portfolio management, hedging derivatives can be unwound at a point in time unrelated to the sale of the risk position, so as to increase the flexibility of planned short- to medium-term restructuring and wind-up activities. In a way identical to that used for the rest of the portfolio, the interest rate risks of the risk exposures from approved wind-up strategies are identified, measured, limited strictly and separately, and reported daily as a separate item. The approved wind-up strategies are monitored by the responsible portfolio managers and reported on regularly (at least quarterly) to the Executive Board.

Whilst the Treasury and Capital Markets Funding units operate on the principle that FMS Wertmanagement will not open positions solely for the purpose of making gains, the Treasury unit has discretion to act within predetermined limits. Responsibility for the operational management of open positions lies with the market departments of the two units; Risk Controlling is in charge of monitoring; and the Asset and Liability Committee is in charge of setting limits and establishing principles in connection with risk steering.

### ***Risk identification***

Market risks exist because of the structure of the portfolio, particularly in the form of interest rate and foreign exchange (FX) risks. The risks arising from changes in credit spreads are monitored in current reporting, but due to the general intention to hold the positions until final maturity, they are not actively limited. Recognition of all third-party securities using the moderate lower-of-cost-or-market principle prevents an increase in credit spreads from having a direct impact on profit or loss as long as an impairment is not permanent and FMS Wertmanagement holds the given securities to maturity.

The daily data deliveries of FMS Wertmanagement Servicegesellschaft as well as the information available in the IT systems along with current market data serve as the basis for identifying the market risks.

### ***Risk analysis and assessment***

Interest rate risks are measured using sensitivity analyses, i. e. the effects of a shift in interest rate curves by a basis point, at the net present value of the portfolio. Separate analyses by maturity ranges enable FMS Wertmanagement to perform more extensive analyses of interest rate risks besides their sensitivity to a parallel shift, e. g. when the curve turns. Besides the detailed analysis by maturity range, separate assessments by currency are also performed to take into account that every currency has a different interest rate curve.

With the aim of keeping fluctuations in parameters relevant to income to a minimum, the on-balance sheet foreign currency position is determined, analysed and controlled on a monthly basis. In addition, foreign exchange risks are analysed based on sensitivities via a change in the net present value (NPV) in case of changes in exchange rates by 1 % relative to the euro.



Credit spread risks are determined using a current spread view, i. e. cash flows are discounted based on the current credit spreads. The parameter used in this case is the change in the NPV for credit spread changes by one basis point.

Suitable monthly stress tests based on hypothetical but plausible and historic interest rate, foreign exchange and credit spread scenarios complement risk measurement and analysis based on sensitivities. These stress scenarios encompass, among others, the scenario specifications of Deutsche Bundesbank with respect to the interest rate, foreign exchange and credit spread risks that are rated as relevant internally. Aside from these scenarios arising from changes in each type of market risk, FMS Wertmanagement also analyses the extent of the change in the net present value of the portfolio if extreme historical or hypothetical market shifts were to occur simultaneously for all types of market risk.

### ***Risk steering***

The Treasury unit opens risk positions only to a limited extent and subject to the existing limits for purposes of risk steering. This is particularly necessary for short-term liquidity management, which can expose FMS Wertmanagement to short-term interest rate risks. The management of interest rate and foreign exchange risks may give rise furthermore to a limited amount of open risk positions subject to the existing limits. For reasons of efficiency, risk positions are not effectively hedged unless they reach certain transaction volumes in order to avoid price surcharges due to smaller transaction volumes or short-term market distortions. In steering market risks, appropriate write-downs are recognised for risk positions.

The credit portfolio management units and Treasury may only utilise approved financial instruments for hedging the risk positions.

Interest rate risks are managed using a limit system for interest rate sensitivities per primary currency and maturity range, including an escalation process for limit breaches.

For interest rate risks from risk positions whose hedging derivatives were unwound pursuant to a wind-up strategy at a point in time unrelated to the sale of the risk position, separate limits are determined on submission of the wind-up strategy for the relevant portfolio. Risk Controlling monitors these strict limits within the approved range. Reviews of the wind-up strategies are conducted at least quarterly and include the management of interest rate risks. Management is handled by Treasury in accordance with the stipulations from the wind-up strategies.

The approach to managing the foreign-currency position is based on managing the on-balance sheet FX position calculated monthly such that the effects of fluctuations from changes in FX rates on income are as low as possible. To this end, limits are defined per primary currency along with an escalation process. The limits are monitored based on the previous month's



on-balance sheet foreign-currency position as well as postings of FX transactions that are relevant to the balance sheet and have occurred in the interim. FX sensitivities are additionally calculated on a daily basis and monitored using a trigger system. Any breach of the triggers initiates a root cause analysis in order to ensure that any foreign-currency position relevant to the balance sheet can be hedged if necessary in a timely manner.

The risks from changes in credit spreads are not limited, since the task is to unwind the portfolio taken over in a way that preserves its value. These risks are actively managed by Portfolio Management as part of portfolio wind-up.

### ***Risk monitoring and reporting***

Market risks may not exceed sensitivity limits in the daily risk management process. Limits are monitored based on the daily market risk report that is prepared by FMS Wertmanagement Servicegesellschaft and analysed by FMS Wertmanagement's Risk Controlling department. The report, which also includes the credit spread sensitivities, is made available to both the Executive Board and the Treasury unit on a daily basis. The defined review and escalation process applies whenever limits are exceeded. In the event of the approved limits for exposures from wind-up strategies being exceeded, the measures predefined for this event by the adopted strategies are triggered.

Additionally, the ALCO Report to the members of the Asset Liability Committee and the monthly wind-up report to both the Executive Board and the Supervisory Board discuss market risks in varying levels of detail.

### ***Risk position***

The main factors affecting interest rate sensitivities are exposures in assets and liabilities with fixed interest rates where the interest rate risks are hedged largely through interest rate derivatives. As determined based on the method applied, the interest rate sensitivity as at 31 December 2014 was EUR –0.15 million (31 December 2013: EUR –0.91 million). This means that the present value of the portfolio would decrease by EUR 0.15 million in case the interest rate curves of all currencies rise by one basis point simultaneously. Substantial interest rate sensitivity exposures concern the euro in the amount of EUR 0.16 million (31 December 2013: EUR –0.60 million), the US dollar in the amount of EUR –0.38 million (EUR –0.24 million) and the pound sterling in the amount of EUR 0.02 million (EUR –0.09 million). The change in interest rate sensitivity is largely due to positions in the short-term maturity range. A further EUR –0.24 million (31 December 2013: EUR –0.78 million) is due to exposures from approved wind-up strategies. The reduction in this sensitivity resulted from the wind-up of exposures from approved wind-up strategies.



On all trading days in the 2014 fiscal year, interest rate sensitivity lay within a bandwidth of EUR –0.98 million to EUR 0.11 million. The interest rate sensitivity of exposures from agreed wind-up strategies ranged from EUR –0.78 million to EUR –0.22 million.

Given the stress scenarios defined for interest rate risks, a parallel increase in all interest rate curves by 200 basis points would have the greatest negative impact (EUR –60 million) on the net present value as at the 31 December 2014 reporting date (31 December 2013: EUR –317 million in the case of a 200 basis point increase). The decline from the prior-year figure is mainly due to the reduction in the risk position in the short-term maturity range and the wind-up of exposures from agreed wind-up strategies.

Foreign exchange risks are managed based on the balance sheet position and the derivative hedging positions subject to compliance with the fixed limits. The open FX position based at 31 December 2014 amounted to EUR 16 million in aggregate for all currencies. The FX position shown in the balance sheet is closed to an extent that enables compliance with the approved limits. Stress scenarios are calculated comparable to the FX sensitivities that are determined on a daily basis. Given the defined FX stress scenarios, an increase by 15 % in the value of the euro against all other currencies would have the greatest negative impact – EUR –47 million (31 December 2013: EUR –98 million) – on the net present value.

Since interest rate exposure in the wind-up portfolio is largely closed, except for a few individual exposures from approved wind-up strategies, any future changes in interest rate curves will only minimally influence the present value of FMS Wertmanagement's portfolio.

Inflation risks – as an aspect of market risks – are still deemed to be minor. Most of them are hedged. Inflation sensitivities are low and remain relatively constant.

## Liquidity risks

### *Definition*

FMS Wertmanagement distinguishes between tactical and strategic liquidity risks:

- ▶ The *tactical liquidity risk* concerns the risk of not being able to generate sufficient cash on short notice such that present or future payment obligations may not be fulfilled at all or not in full when due under the contract.
- ▶ *Strategic liquidity risk* is the risk of being able to implement the necessary measures described in the funding strategy in the market only at greater expense. An unexpected rise in funding costs might result from general market distortions or idiosyncratic events, for instance.



### ***Risk strategy***

The tactical liquidity risk strategy aims to ensure at all times — even in stress conditions — that FMS Wertmanagement is solvent without having to seek recourse with the SoFFin. To that end FMS Wertmanagement maintains a sufficient liquidity reserve (securities eligible for ECB funding purposes to hedge against unexpected cash outflows) and diversifies its funding (in respect of lenders as well as the maturities and the instruments used). Both the funding strategy and the funding plan, which is revised annually as part of the wind-up plan, serve to ensure its strategic liquidity.

### ***Risk identification***

To identify the tactical liquidity risk, the liquidity maturity profile

- ▶ is analysed for each maturity range based on different scenarios and then compared to the liquidity cushion, and
- ▶ analysed by product group and compared to the internal control limits imposed by Treasury.

Strategic liquidity risks are identified by way of an analysis of the expected funding costs based on the long-term funding structure and the expected cash outflows in accordance with the assumptions under both the wind-up plan and the funding plan.

### ***Risk analysis and assessment***

Analysing the tactical liquidity risk requires determining the liquidity position by means of the maturity profile of all assets and liabilities (gap profile), which is based on the 24-month forecast for three components:

- ▶ Contractual cash inflows and outflows including nostro accounts
- ▶ Assumptions with respect to
  - extensions of available assets,
  - drawdowns from credit lines granted,
  - availability of the funding instruments and
  - liquidity effect of market scenarios (including interest rate, FX and credit spread scenarios)
- ▶ Liquidity reserve encompassing liquid, free securities eligible for ECB funding purposes



In terms of assumptions, FMS Wertmanagement uses two scenarios whose methodology reflects the special situation of FMS Wertmanagement. Both scenarios include the Normal Case as the basic assumption and a Global Financial Market Crisis as the stress scenario.

Monthly back-testing enables regular reviews of the adequacy of the assumptions in the scenarios. During this process, the projected liquidity position is compared with the actual liquidity position. In 2014, the assumptions for the normal case and the stress scenario remained the same as in the risk report in the management report included in the Annual Report for the year ended 31 December 2013.

The strategic liquidity risk is determined by analysing the deviation of the actual funding volume from the funding plan, the deviation of the funding costs from the funding plan as well as funding concentrations. Building on this, a quarterly analysis of the effects of an increase in FMS Wertmanagement's own funding cost rate on net interest income is introduced.

### ***Risk steering***

The tactical liquidity is managed by the Treasury unit, which is responsible for ensuring the availability of short-term liquidity at any time. Secured and unsecured money market instruments are available to this end based on the approved product catalogue.

Strategic liquidity is ensured by the Capital Markets Funding unit. This unit prepares the long-term funding strategy and its derived funding plan. The funding plan is implemented by using direct access to the capital market via issues with maturities of more than one year.

The one scenario that would significantly affect FMS Wertmanagement, given its funding structure, was selected among the defined stress scenarios for the purpose of limiting liquidity risk. The Global Financial Market Crisis scenario and a minimum survival period of 90 days were fixed as the limit based on the experience of recent years. Within this period, the liquidity position must be positive even under the premises of the defined scenario such that FMS Wertmanagement remains solvent at all times by realising its liquidity reserve.

The liquidity contingency plan fixes the actions that must be taken in the event of a liquidity shortfall.



### ***Risk monitoring and reporting***

The liquidity profile of FMS Wertmanagement is monitored daily and reported to both the Executive Board and the Treasury unit. The Risk Controlling department monitors compliance with the limit on a daily basis. The following escalation process is carried out in case of limit breaches:

- ▶ Treasury verifies the limit breach and gives its view of the expected duration of the breach and the actions required to cure it.
- ▶ Risk Controlling comments on these measures and monitors their implementation.
- ▶ The Executive Board is notified immediately of the limit breach.

As long as the limit breach has not been cured, the Executive Board and the Treasury unit are kept abreast daily of the degree to which agreed-upon steps have been implemented. The ALCO is also informed of the limit breach as part of the regular reporting. In addition, the liquidity position is reported monthly to the Executive Board and the Supervisory Board as part of the wind-up report.

### ***Risk position***

In 2014, FMS Wertmanagement's funding strategy was validated in the money and capital markets by a stable and broadly diversified investor base.

FMS Wertmanagement's issuing activity under the existing money market programmes, European Commercial Paper (ECP/CD) and the US vehicle, Kells Funding LLC, Delaware, USA (US ABCP), further contributed to a stable and sustainable funding structure for FMS Wertmanagement in 2014. The average remaining maturity of money market funding was kept constant.

FMS Wertmanagement established itself already in the last years as a regular and reliable issuer on international capital markets. As a result, capital market issues equivalent to EUR 11.6 billion were placed by FMS Wertmanagement in 2014, with capital market issues in EUR dominating the funding activities at EUR 5.7 billion.

As at 31 December 2014, FMS Wertmanagement's positive liquidity cushion is EUR 14.7 billion based on the assumptions of the stress scenario, Global Financial Market Crisis, and pursuant to the defined minimum survival period of 90 days (31 December 2013: EUR 17.0 billion).



## Operational risks

### *Definition*

FMS Wertmanagement distinguishes three kinds of operational risks: *outsourcing risk, project risk and other operational risks*.

- ▶ Outsourcing risk: Refers to potential losses from the outsourcing of services to third parties. Aside from the default of the service providers, this also includes the risk that services contracted for are not provided at all or not in the stipulated quality or within the stipulated time.
- ▶ Project risk: Refers to the risk that FMS Wertmanagement can not fulfil key functions and meet planned goals for major strategic projects, or fulfil or meet these adequately, owing to unsuccessful or late implementation, or implementation at higher than anticipated project costs.
- ▶ Other operational risks: This includes all risks of loss arising from the inadequacy or failure of internal processes, people or systems (e. g. defective data quality, process errors, fraud), or due to external events. This definition includes legal risks according CRR Article 1, no. 52 (particularly risks relating to the laws of obligations or property).

### *Risk strategy*

The strategy for operational risk management — which also includes the operational risks at FMS Wertmanagement Servicegesellschaft — is aimed at avoiding and reducing them through early detection, recording, analysis and monitoring. A timely reporting to the management about events and actions concerning operational risks as part of the wind-up report is in place. The aim is to ensure that sufficient data and analyses are available for minimising existing operational risks in targeted fashion.

### *Risk identification*

FMS Wertmanagement established a separate unit for managing and monitoring outsourcing given the substantial significance of the outsourcing risk. The relevant departments / units participate in identifying risks concerning the outsourced activities and processes.



Information about project risks arising from major strategic projects, the preparation for and optimisation of the privatisation of FMS Wertmanagement Servicegesellschaft and the acquisition of DEPFA BANK plc by FMS Wertmanagement decided in May 2014 by the German federal government's inter-ministerial steering committee, is being collected by a separate project group. The potential risks are identified with respect to the aims of the projects in a three-stage process that comprises risk reporting, risk categorisation and risk recording in a project risk database. The risks remaining when a project is completed are then added to the Operational Risk Self Assessment of the relevant units for monitoring.

Other operational risks, identified in the annual operational risk self-assessment, and risk events at FMS Wertmanagement and FMS Wertmanagement Servicegesellschaft are recorded in a Group-wide, computerised operational risk system. In addition, data is collected for developing risk-relevant early warning indicators, in order to identify potential risks within FMS Wertmanagement and FMS Wertmanagement Servicegesellschaft at an early stage.

### ***Risk analysis and assessment***

The Sourcing department analyses and assesses outsourcing risk as part of the risk analyses in conjunction with the affected departments / units and the Audit and Risk Controlling departments. In this context, the first step is to classify the outsourced activities according to materiality using a structured questionnaire with risk assessments. In the case of material outsourced activities, further risk analyses and assessments are conducted for the transition and for subsequent regular operations analogously to the operational risk self-assessment. These risk analyses are updated as necessary but at least once a year. If material risks are identified, the affected department is required to document the risk immediately in the operational risk IT System. Non-material risks are recorded in the course of the annual operational risk self-assessment.

For each individual project risk identified in the major strategic projects of 2014, qualitative estimates were made of the risk's probability of occurrence and its potential impact, using pre-defined five-stage scales. Combining the two parameters yielded an overall assessment that entails classifying each individual project risk into a risk matrix. Which combinations are classified as low, high or critical was defined for the matrix. The risk assessment was the responsibility of the Project Risk Office in conjunction with the programme and project managers.

Other operational risks at FMS Wertmanagement and at FMS Wertmanagement Servicegesellschaft are analysed and assessed

- ▶ ex post via the recording of relevant loss events in a Group-wide loss database within the operational risk IT system,



- ▶ ex ante during the standardised operational risk self-assessment conducted each year, by estimating the probability of occurrence and potential losses in a Group-wide operational risk IT system,
- ▶ and by analysing agreed early warning indicators.

### ***Risk steering***

Outsourcing risk is steered by agreeing qualitative performance indicators and by requesting regular assessment of the end products from the recipients of these deliverables.

The quality of the services rendered is evaluated on the basis of assessment criteria such as timeliness, formal accuracy, substantive completeness, substantive quality, degree to which the tasks and agreements have been implemented as well as internal or external audit comments. Service management software is used to document the assessments. The quality of performance is ensured by regular communication with the service providers and through measures that are coordinated with them and monitored by FMS Wertmanagement. Inadequate services are discussed in this connection, and work is to be carried out to bring about improvements. Escalation processes that start with the responsible staff member and end with the Executive Board have been defined for performance of the measures.

To manage material project risks for major strategic projects in 2014, suitable measures and “Plan B” scenarios were approved by programme management and the project group. The timely completion of the measures was tracked and reported jointly to the Executive Board by project management and the project group. After hand-over by the project management, steering of the remaining risks from the two major projects is handled by the responsible departments at FMS Wertmanagement, DEPFA BANK plc and FMS Wertmanagement Servicegesellschaft.

For other potential operational risks classified as critical in the operational risk self-assessment, action plans and measures must be agreed and implemented that serve to reduce the loss amount and/or the probability of occurrence. The measures are documented in the Group-wide operational risk IT system. These risks are managed by FMS Wertmanagement Servicegesellschaft or by the affected department of FMS Wertmanagement in accordance with assigned responsibilities. Potential steps serving to improve the at-risk situation include introducing the dual-control principle, personnel measures, IT precautions, operational rules and regulations, process documentation or the purchase of insurance policies. A contingency plan has been defined for all processes critical to operations with the aim of hedging



operational risks within FMS Wertmanagement. The new-product process serves to lower risks from operating new products or restructurings.

FMS Wertmanagement uses clearly defined governance structures and processes to manage legal risks. FMS Wertmanagement's close cooperation with FMS Wertmanagement Servicegesellschaft and supervisory bodies/regulators makes it possible to identify potential future risks early on and avoid them before they arise. External specialists are used as necessary in connection with legal matters.

The Legal department in the Legal & Compliance unit manages and reviews the work of FMS Wertmanagement Servicegesellschaft and monitors legal risks, which could arise for FMS Wertmanagement in its dealings with third parties.

In particular, FMS Wertmanagement counteracts the risk of internal and external fraud based on an internal control system and an Internal Audit unit, and by sharpening employees' consciousness of risk and the need for vigilance.

### ***Risk monitoring and reporting***

Monitoring outsourcing risk is the responsibility of the Sourcing department in conjunction with the Risk Controlling department. The performance of outsourcing partners is reported on in the monthly wind-up report, and in a detailed service provider management report provided to the Executive Board and project management.

For both major projects, the documented project risks along with the measures agreed were collected in a database and project risk reports were prepared. This report contained a detailed overview of all project risks classified as material, their possible causes and potential effects, the assessment of the risks pursuant to the risk matrix as well as recommended steps to manage them and the status thereof. The reports were made available regularly to the Executive Board, the respective programme management, FMSA and the Supervisory Board.

Other operational risks that concern the services are monitored directly at FMS Wertmanagement Servicegesellschaft. Losses incurred by FMS Wertmanagement Servicegesellschaft or by FMS Wertmanagement are reported to the Executive Board and Supervisory Board in the monthly wind-up report. The results of the operational risk self-assessments are reported to the Executive Board and Supervisory Board in the annual operational risk report, which also covers the loss events that occurred and the key risk indicators.



FMS Wertmanagement Servicegesellschaft publishes a quarterly report on certain relevant key risk indicators determined in cooperation with FMS Wertmanagement's Risk Controlling department; this report addresses potential operational risks at FMS Wertmanagement Servicegesellschaft and potential operational outsourcing risks of FMS Wertmanagement and is presented annually to the Executive Board.

The aforementioned reports provide the Executive Board with comprehensive reporting on operational risks, both at FMS Wertmanagement Servicegesellschaft and at FMS Wertmanagement.

### ***Risk position***

In 2014, further progress was made at FMS Wertmanagement and FMS Wertmanagement Servicegesellschaft in refining documented structures and processes that lower the risk of occurrence of other operational risks. The processes and procedures taken over by FMS Wertmanagement Servicegesellschaft from the HRE Group largely unchanged were also updated to minimise the other operational risks to which the material portfolio management services provided by FMS Wertmanagement Servicegesellschaft are subject. These arise from the heterogeneity of the IT platforms running the wind-up and monitoring systems, as well as the numerous manual processes for recording transactions and conducting data quality assurance. The significant reliance on the expertise possessed by the key personnel who transferred from the HRE Group to FMS Wertmanagement Servicegesellschaft as part of the transfer of operations was reduced by providing ongoing training to employees and through human resources management.

In 2014, a Group-wide expected loss (EL) of EUR 23 million (previous year: EUR 32 million) was estimated for FMS Wertmanagement during the annual Operational Risk Self Assessment (ORSA). The now established workflows and gradually improved processes that FMS Wertmanagement Servicegesellschaft took over in the prior year from the previous servicer, pbb, led to a EUR 9 million year-on-year decrease in the estimated expected loss. Of the total EL, 5.6 % is attributable to a risk classified as material (EL greater than EUR 1 million): the temporary unavailability of the IT service provider IBM. There were three risks classified as material in the previous year.

Out of the total of all identified risks, nearly all of them — some 95.8 % — have an EL of less than EUR 0.1 million, while 4.1 % amount to between EUR 0.1 million and EUR 0.4 million.

Furthermore, FMS Wertmanagement remains subject to substantial risks from the legal complexity of the transferred portfolio.



### **Other risks**

The following risk types are also material to FMS Wertmanagement above and beyond credit risk, market risk, liquidity risk and operational risk.

### ***Strategic risk***

Given the business model of FMS Wertmanagement, the risk of management's disadvantageous corporate decisions or of lack of reaction to changes in FMS Wertmanagement's business environment are particularly relevant to decisions on wind-up strategies and / or other strategic decisions. Carefully weighing all advantages and disadvantages of the available options can reduce the risk of making wrong decisions.

### ***Reputational risk***

Given the public's interest in FMS Wertmanagement, the reputational risk has a material and direct impact on the market presence of FMS Wertmanagement as well as on assessments by potential funding and hedging partners. Reputational risks are managed via coordinated and proactive external communication and the public relations work of the communications unit.

### ***Tax risk***

Tax risk arises from potential changes in tax legislation, potential changes in tax jurisdiction, possible errors in the application of tax laws or inadequate deliveries of data. FMS Wertmanagement uses clearly defined processes to analyse and manage tax risks. It turns to external advisers as necessary in connection with tax matters.

### ***Equity risk***

The greatest equity risk to which FMS Wertmanagement is exposed stems from the takeover of DEPFA BANK plc, which was acquired from the HRE Group at a purchase price of EUR 320 million on 19 December 2014, as instructed by the German federal government's inter-ministerial steering committee. The risk of a change in value from this acquisition as a potential negative deviation from the market value will be derived from scenarios in the wind-up plan, which must be updated each year.



In accordance with statutory and regulatory requirements, DEPFA BANK plc remains an independent entity. Specifically, FMS Wertmanagement will not intervene in DEPFA BANK plc's day-to-day business. Interactions between FMS Wertmanagement and DEPFA BANK plc are conducted within the specified legal parameters and, in future, will be specified in a framework agreement. In particular cases, transactions are conducted between FMS Wertmanagement and DEPFA BANK plc.

The risks arising from the equity investment in FMS Wertmanagement Servicegesellschaft are recorded, managed, monitored and reported in accordance with the inherent major risk — the operational risk — by applying the uniform, Group-wide risk management processes for operational risk.

In addition to the equity investments mentioned, FMS Wertmanagement also holds shares in property companies that hold real estate from rescue acquisitions. The real estate properties are exposed to risks from changes in their value that are measured, managed and reported as described below.

### ***Real estate risk***

The Commercial Real Estate unit currently manages the real estate portfolio that encompasses nothing but rescue acquisitions (takeover of real estate collateral from financing to limit losses in connection with foreclosures). This unit determines the properties' market values with the support of external experts and commissions repairs and upkeep to maintain the properties' value.

To date, the risk of a change in property value has been tracked collectively by fluctuations in suitable real estate indexes. At the end of 2014, the process for determining this risk was revised. Similarly to the LGD model in the Commercial Real Estate unit in which a weighted average of the "work-out", "restructuring" and "financial recovery" scenarios is calculated, real estate risk is determined using a method suitable for the type of real estate and location in question.

Due to the new calculation method, a higher level of risk overall is reported for the real estate holdings of FMS Wertmanagement, which are slightly diversified.

The associated risks are basically managed by selling such properties with the aim of unwinding the real estate portfolio in ways that maximise its value.



### Assessment of the overall risk exposure and outlook

The largest risks to which FMS Wertmanagement is exposed still are credit risk and operational risk, with operational risk including outsourcing and project risk in particular.

FMS Wertmanagement's credit risks arise from the portfolio transferred from the HRE Group. With the exception of a few cases related to forced extensions, restructurings and rescue acquisitions subject to strict limits, under its Charter FMS Wertmanagement may not engage in any new business that entails additional credit risks.

The portfolio comprises financing, with some instruments having very long maturities. Furthermore, the portfolio also carries high concentration risks which will further intensify over time due to the varying speed with which the portfolio can be wound up through principal repayment or sales. The greater the concentrations in the portfolio, the greater the danger that actual losses will differ significantly from the average losses expected at total portfolio level. Defaults in large positions in the portfolio could therefore put significant downward pressure on financial results. In keeping with its wind-up strategy which seeks to generate a profit, FMS Wertmanagement intends to reduce the credit risks incrementally pursuant to the guidance in the wind-up plan.

In the past fiscal year, sales proceeds were mainly generated from the Public Sector segment, especially Japanese government bonds. In addition, a portfolio of US commercial real estate financing in the Commercial Real Estate segment was sold. In fiscal year 2015, FMS Wertmanagement will continue to focus on a profitable wind-up of the assets transferred to FMS Wertmanagement from the HRE Group.

FMS Wertmanagement recognises risk provisions for at-risk and impaired risk positions by recognising specific loan loss provisions for loans or writing down securities. In addition general loan loss provisions are recognised for potential default risks in the portfolio. If necessary, country risk provisions are recognised for country risks.

Market and counterparty risks are subject to stringent limits and extensive monitoring. Changes in the interest rate, foreign exchange and counterparty risks to be monitored arise in particular from permitted and necessary funding and hedging activities. In the case of certain specific sales strategies, hedging instruments can be unwound at a point in time unrelated to the sale of a position. The resulting open market risk positions are monitored, subjected to limits and reported on separately. Reports are issued regularly on the course of the selling process, and when defined triggers are reached, the positions are hedged again.



With regard to operational risk and in particular to project and outsourcing risk, the following factors were significant in the 2014 fiscal year:

- ▶ Continual optimisation and efficiency increases in the servicing processes of FMS Wertmanagement Servicegesellschaft
- ▶ Stabilisation of the IT systems
- ▶ Preparation of the planned privatisation of FMS Wertmanagement Servicegesellschaft and the acquisition of DEPFA BANK plc decided on 13 May 2014 by the joint owner

In 2015, processes for monitoring outsourcing risk will be further refined and improved in connection with the planned privatisation of FMS Wertmanagement Servicegesellschaft to ensure the most complete monitoring and management of this risk possible.

The acquisition of DEPFA BANK plc on 19 December 2014 gave rise to additional equity risks in fiscal year 2014.

On 22 December 2014, FMS Wertmanagement reached agreement with certain holders of the DEPFA Funding II, III and IV LP hybrid bonds to acquire the bonds under specified terms and conditions. As per the ad hoc announcement by DEPFA BANK plc dated 15 January 2015, there is a plan in addition for FMS Wertmanagement to issue a purchase offer to the remaining holders of the hybrid bonds. The transaction is dependent on approval by the regulators responsible and will further increase the risks arising from the equity investment in DEPFA BANK plc.



## INTERNAL CONTROL / RISK MANAGEMENT SYSTEM RELEVANT TO THE FINANCIAL REPORTING PROCESS (ICS / RMS)

The internal control and risk management system relevant to the financial reporting process (ICS/RMS) of FMS Wertmanagement serves to ensure compliance with financial reporting standards and requirements and the reliability of the accounting.

Accounting (Finance department) is assigned to the Risk & Finance division and managed by the Head of Risk Controlling, Finance & Portfolio Steering.

Responsibility for the general ICS relevant to the financial reporting process rests with the central ICS body led by the Head of Operations Management (Financial Process Support department); this body is also assigned to the Risk & Finance division. Responsibility for the Operations Management unit was assigned to the COO as at 1 January 2015.

FMS Wertmanagement has outsourced material aspects of its accounting. In this regard, the subsidiary FMS Wertmanagement Servicegesellschaft handles asset management, including maintaining the subledgers, managing master data and conducting payment transactions. Other service providers take care of maintaining the general ledger, handling ongoing financial accounting and preparing the annual financial statements (financial services providers) as well as drafting regulatory notices.

In addition to services directly related to accounting, IT services were also outsourced; these are also relevant to the accounting-related ICS.

FMS Wertmanagement's departments manage and supervise these services by applying the criteria defined in service level agreements. FMS Wertmanagement's own employees in the Finance department manage outsourced activities related more specifically to accounting.

IT services are monitored by the Solution Definition department.

The Controlling department also aims to guarantee the correct representation of products not yet available at FMS Wertmanagement.

In addition, the Financial Process Support department conducts activities to ensure the quality of processes relevant to financial reporting.

An interdepartmental New Product Process (NPP) is managed by the Risk Controlling department. In addition to its responsibilities for monitoring and managing outsourced services, FMS Wertmanagement is also the ultimate authority for the following methods and decisions related to the financial reporting process:

- ▶ Making decisions on recognition, measurement and disclosure options
- ▶ Providing incoming invoices and posting instructions, e. g. for posting valuations, provisions and deferred taxes



The aforementioned service providers are also subject to the ICS relevant to the financial reporting process at FMS Wertmanagement pursuant to contractual provisions.

The basic task of FMS Wertmanagement's ICS is to fulfil the following important principles:

- ▶ Safeguarding the effectiveness and efficiency of operations
- ▶ Propriety and reliability of internal and external accounting
- ▶ Compliance with legal requirements with relevance for the entity

Based on the target levels of customary market standards (COSO framework), the principal objectives for the ICS at FMS Wertmanagement were specified as follows:

- ▶ Increase transparency and reliability of management-related information for effective and efficient management
- ▶ Protect the business assets by reducing the potential for fraud
- ▶ Increase process reliability and / or reduce the likelihood of errors in the processes
- ▶ Create the means to be able to point out opportunities and undesirable developments more quickly
- ▶ Ensure compliance with internal and external regulations

The planning and design of operational control procedures for the ICS takes into account FMS Wertmanagement's internal business policy objectives and principles. To this end, individual control objectives that are derived from the overall objectives are defined for the planned control procedures. These accounting-related control objectives relate to the statements and disclosures in the annual financial statements as to completeness, recognition, accuracy, measurement, rights and obligations, presentation and compliance with the accrual basis of accounting.

The ICS framework at FMS Wertmanagement governs the specifics of the principles of the ICS for FMS Wertmanagement and its service providers.

As part of the annual ICS standard procedures, structured surveys are conducted in the relevant departments to systematically determine the risks related to financial reporting. During the subsequent validation of the existing controls in the context of organisation-wide performance processes, any additional control requirements are identified and implemented accordingly by the departments.



The relevant unit heads are responsible for collecting information about risks, identifying the controls required and monitoring performance of the controls (control attestation). The identified control owner is responsible for defining and performing the relevant ICS controls.

The central ICS unit handles the centralised management of the ICS control database, the coordination of the standard ICS procedure, and the consolidation of the relevant risk assessments and ICS control confirmation into a high-level ICS report.

Overall responsibility for the FMS Wertmanagement Internal Control System lies with the FMS Wertmanagement Executive Board.

Process-independent audits are also utilised by Internal Auditing to assess the effectiveness and suitability of the FMS Wertmanagement ICS.

To ensure the effectiveness of the FMS Wertmanagement ICS, the standards and conventions applied are regularly reviewed and continuously updated. FMS Wertmanagement also takes steps to ensure that the system is integrated sustainably into its units and at service providers.

The structure of the ICS and proper performance of the controls were confirmed and regularly monitored in an ICS Control Attestation in 2014 by the relevant unit heads at FMS Wertmanagement, FMS Wertmanagement Servicegesellschaft and its managing directors, and the external financial service provider.

In the 2014 fiscal year, the ICS was approved with regard to the IT services by a report prepared pursuant to ISAE 3402. Furthermore, FMS Wertmanagement has performed additional IT controls relating to the IT services as needed. Further expansion and improvement of the material IT service provider's IT-based ICS was pursued further in the 2014 fiscal year.



# Annual financial statements

## Balance sheet

of FMS Wertmanagement as at 31 December 2014

Assets	in € thousand	in € thousand	31.12.2014 in € thousand	31.12.2013 in € thousand
<b>1. Cash reserve</b>				
a) Balances with central banks		87,915		382,955
Of which: with Deutsche Bundesbank € 87,915 thousand (previous year: € 382,955 thousand)			87,915	382,955
<b>2. Loans and advances to banks</b>				
a) Payable on demand		30,177,928		16,491,822
b) Other receivables		6,337,737		7,117,045
			36,515,665	23,608,867
<b>3. Loans and advances to customers</b>			22,397,150	28,358,888
Of which: secured by mortgages € 2,118,482 thousand (previous year: € 3,706,237 thousand) Public-sector loans € 7,987,456 thousand (previous year: € 6,898,253 thousand)				
<b>4. Debt instruments</b>				
a) Bonds and notes				
aa) Public-sector issuers	44,679,202			47,646,776
Of which: eligible as collateral for Deutsche Bundesbank advances € 30,783,893 thousand (previous year: € 31,978,256 thousand)				
ab) Other issuers	45,850,313			47,611,455
Of which: eligible as collateral for Deutsche Bundesbank advances € 9,422,429 thousand (previous year: € 11,141,109 thousand)		90,529,515		95,258,231
b) Own debt instruments		29,220,003		35,660,121
Principal amount € 29,211,316 thousand (previous year: € 35,646,674 thousand)			119,749,518	130,918,352
<b>5. Other long-term equity investments</b>			6,829	6,719
Of which: in banks € 0 thousand (previous year: € 0 thousand)				
Of which: in financial services institutions € 0 thousand (previous year: € 0 thousand)				
<b>6. Shares in affiliated companies</b>			807,566	385,766
Of which: in banks € 323,274 thousand (previous year: € 0 thousand)				
Of which: in financial services institutions € 345,698 thousand (previous year: € 304,702 thousand)				
<b>7. Fiduciary assets</b>			276	276
Of which: fiduciary loans € 276 thousand (previous year: € 276 thousand)				
<b>8. Intangible fixed assets</b>			1,050	10,770
Purchased concessions, industrial and similar rights and assets, and licences in such rights and assets				
<b>9. Tangible fixed assets</b>			617	753
<b>10. Other assets</b>			790,523	51,380
<b>11. Deferred income</b>			3,271,741	3,939,661
<b>Total assets</b>			<b>183,628,850</b>	<b>187,664,387</b>

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BALANCE SHEET



Equity and liabilities	in € thousand	in € thousand	31.12.2014 in € thousand	31.12.2013 in € thousand
<b>1. Liabilities to banks</b>				
a) Payable on demand		449,883		203,970
b) With agreed maturity or notice period		19,826,156		21,633,160
			20,276,039	21,837,130
<b>2. Liabilities to customers</b>				
Other liabilities				
a) Payable on demand		11,333		52,637
b) With agreed maturity or notice period		17,563,702		26,314,386
			17,575,035	26,367,023
<b>3. Securitised liabilities</b>				
Debt instruments issued			127,493,449	121,189,000
<b>4. Fiduciary liabilities</b>			276	276
Of which: fiduciary loans € 276 thousand (previous year: € 276 thousand)				
<b>5. Other liabilities</b>			529,556	373,020
<b>6. Deferred income</b>			16,315,822	16,559,398
<b>7. Provisions</b>				
a) Tax provision		2,432		33,508
b) Other provisions		1,004,193		1,186,386
			1,006,625	1,219,894
<b>8. Equity</b>				
a) Subscribed capital		200		200
b) Capital reserves		1,800		1,800
c) Retained earnings				
Other retained earnings		116,646		0
d) Net retained profits		313,402		116,646
			432,048	118,646
<b>Total equity and liabilities</b>			<b>183,628,850</b>	<b>187,664,387</b>
<b>1. Contingent liabilities</b>				
Contingent liabilities from guarantees and indemnity agreements			3,641,024	8,114,774
<b>2. Other obligations</b>				
Irrevocable loan commitments			3,853,038	5,952,561



## Income statement

of FMS Wertmanagement for the period from 1 January until 31 December 2014

Income statement	in € thousand	in € thousand	01.01. – 31.12.2014 in € thousand	01.01. – 31.12.2013 in € thousand
1. Interest income from				
a) Lending and money market transactions	5,289,230			6,038,831
b) Fixed-income securities and registered government debt	2,558,467			2,618,391
		7,847,697		8,657,222
2. Interest expenses		-7,321,397		-8,031,121
			526,300	626,101
3. Income from profit pooling, profit transfer or partial profit transfer agreements			6,570	0
4. Commission income		81,504		139,266
5. Commission expenses		-25,179		-39,037
			56,325	100,229
6. Other operating income			16,925	50,972
7. General and administrative expenses				
a) Personnel expenses				
aa) Wages and salaries	-23,324			-22,213
ab) Social security, post-employment and other employee benefit costs	-2,622			-2,896
Of which: in respect of post-employment benefits € 724 thousand (previous year: € 1,046 thousand)		-25,946		-25,109
b) other administrative expenses		-218,866		-308,938
			-244,812	-334,047
8. Depreciation, amortisation and write-downs of intangible and tangible fixed assets			-2,805	-2,659
9. Other operating expenses			-18,011	-25,660
10. Write-downs of and valuation allowances on receivables and certain securities, and additions to loan loss provisions		0		-440,051
11. Income from reversals of write-downs of receivables and certain securities and from reversals of loan loss provisions		109,205		0
			109,205	-440,051
12. Write-downs of and valuation allowances on shares in affiliated companies, other long-term equity investments and securities classified as fixed assets		-77,059		0
13. Income from reversals of write-downs of other equity investments, shares in affiliated companies and securities classified as fixed assets		0		176,587
			-77,059	176,587
14. Expenses from loss absorption			0	-5,351
15. Result from ordinary activities			372,638	146,121
16. Taxes on income			-72,755	-34,759
17. Other taxes not included in "Other operating expenses"			13,519	5,284
18. Net income for the fiscal year			313,402	116,646
19. Net retained profits			313,402	116,646



## Cash flow statement

of FMS Wertmanagement for the period from 1 January until 31 December 2014

Cash flow statement		01.01.– 31.12.2014 in € thousand	01.01.– 31.12.2013 in € thousand
1.	Profit/loss for the period	313,402	116,646
<b>Non-cash items included in net income/loss for the period and reconciliation to cash flow from operating activities</b>			
	Depreciation, amortisation and write-downs and valuation allowances on receivables and items of fixed assets/reversals of such write-downs and valuation allowances		
2.	+/-	-284,701	305,203
3.	+/-	-181,789	-174,618
4.	+/-	-48,976	13,637
5.	-/+	0	0
6.	-/+	0	-5,351
7.	-/+	-12,568,195	13,147,885
8.	-/+	6,145,299	-5,007,458
9.	-/+	4,815,648	9,222,356
10.	-/+	-31,046	1,001,309
11.	+/-	-1,561,092	-20,299,592
12.	+/-	-8,791,988	-11,032,122
13.	+/-	12,744,567	3,544,460
14.	+/-	-87,039	-1,305,910
15.	+/-	-526,300	-626,101
16.	+/-	0	0
17.	+/-	72,755	34,759
18.	+	7,847,697	8,657,222
19.	-	-7,321,397	-8,031,122
20.	+	0	0
21.	-	0	0
22.	-/+	-136,432	-1,618
23.	=	<b>400,413</b>	<b>-10,440,415</b>
24.	+	0	0
25.	-	-373,213	-20,043
26.	+	1	0
27.	-	-75	-10
28.	+	7,873	0
29.	-	-748	-11,748
30.	+/-	0	0
31.	+	0	0
32.	-	0	0
33.	=	<b>-366,162</b>	<b>-31,801</b>

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CASH FLOW STATEMENT



<b>Cash flow statement</b>			<b>01.01.– 31.12.2014 in € thousand</b>	<b>01.01.– 31.12.2013 in € thousand</b>
34.	+	Proceeds from capital contributions by the shareholder	0	0
35.	–	Cash payments to the shareholder from the redemption of shares	0	0
36.	+	Cash receipts from extraordinary items	0	0
37.	–	Cash payments for extraordinary items	0	0
38.	–	Dividends paid to the shareholder	0	0
39.	+/-	Change in cash funds relating to other capital (net)	0	7,283,045
40.	=	<b>Cash flows from financing activities</b>	<b>0</b>	<b>7,283,045</b>
41.		Net change in cash funds	34,251	–3,189,171
42.	+/-	Effect on cash funds of exchange rate movements and remeasurements	0	0
43.	+	Cash funds at beginning of period	892,416	4,081,587
44.	=	<b>Cash funds at end of period</b>	<b>926,667</b>	<b>892,416</b>

The cash flow statement was prepared using the indirect method in accordance with GAS 21. The cash funds reported comprise demand deposits with banks that are payable on demand and do not serve as collateral for financial derivatives, as well as balances with Deutsche Bundesbank.



## Statement of changes in equity

of FMS Wertmanagement for the period from 1 January until 31 December 2014

Statement of changes in equity	Balance at 01.01.2014 in € thousand	Appropriation of net income / loss in € thousand	Net income for the year in € thousand	Balance at 31.12.2014 in € thousand
Subscribed capital	200	0	0	200
Capital reserves	1,800	0	0	1,800
Other retained earnings	0	116,646	0	116,646
Net retained profits	116,646	- 116,646	313,402	313,402
Equity as defined by German commercial law	118,646	0	313,402	432,048

Net retained profits from the 2013 fiscal year were transferred to retained earnings by decision of 11 April 2014.

## Statement of changes in equity

of FMS Wertmanagement for the period from 1 January until 31 December 2013

Statement of changes in equity	Balance at 01.01.2013 in € thousand	Appropriation of net income / loss in € thousand	Net income for the year in € thousand	Balance at 31.12.2013 in € thousand
Subscribed capital	200	0	0	200
Capital reserves	1,800	0	0	1,800
Other retained earnings	0	0	0	0
Net retained profits	33,096	- 33,096	116,646	116,646
Equity as defined by German commercial law	35,096	- 33,096	116,646	118,646



## NOTES

### General information

#### *Legal framework*

FMS Wertmanagement AöR (hereafter: FMS Wertmanagement) was founded on 8 July 2010 and recorded in the Commercial Register of the Munich Local Court on 13 September 2010.

Under agreements dated 29 and 30 September 2010, a portfolio with a nominal value of around EUR 175.7 billion (excluding derivatives) was transferred to FMS Wertmanagement effective 1 October 2010. For this, the Federal Agency for Financial Market Stabilisation, Frankfurt am Main (Bundesanstalt für Finanzmarktstabilisierung – FMSA) – acting as necessary on behalf of the German Financial Market Stabilisation Fund (Finanzmarktstabilisierungsfonds – SoFFin), Hypo Real Estate Holding AG, Munich (HRE), Deutsche Pfandbriefbank AG, Munich (pbb), DEPFA BANK plc, Dublin (DEPFA BANK plc) and other companies of the former HRE Group as well as FMS Wertmanagement entered into a number of agreements pursuant to which certain risk positions and non-strategic operations of the HRE Group were to be transferred to FMS Wertmanagement in accordance with Section 8a of the German Law Establishing a Financial Market Stabilisation Fund (Gesetz zur Errichtung eines Finanzmarktstabilisierungsfonds – FMStFG).

The transferors, pbb and HRE, transferred risk positions and non-strategic operations to FMS Wertmanagement, partly by way of a spin-off for absorption, in accordance with Section 8a (1) and (8) FMStFG in conjunction with Section 123 (2) No. 1 and Section 131 of the German Reorganisation and Transformation Act (Umwandlungsgesetz – UmwG). The risk positions and non-strategic operations that were not transferred by way of the spin-off were transferred to FMS Wertmanagement by way of a subparticipation, assignment, novation or guarantee. Which approach was chosen depended on the different legal, regulatory and tax requirements of the respective countries governing the respective transaction. What is common to all means of transfer however, is that FMS Wertmanagement assumed the economic risk of the risk positions and non-strategic operations. The spin-offs from HRE and pbb were recorded in the respective German Commercial Register on 2 December 2010 for HRE and pbb as well as for FMS Wertmanagement.

The contracts signed on 29 and 30 September 2010 also included the intragroup “concentration agreements” between HRE on the one hand and pbb, DEPFA BANK plc and other companies of the former HRE Group on the other hand. These concentration agreements established that HRE had a claim to the transfer by the HRE Group companies of the risk positions and non-strategic operations. HRE spun off its contractual position and its claims and obligations under the concentration agreements to FMS Wertmanagement as part of the aforementioned spin-off. The concentration agreements were performed directly between the respective HRE Group company and FMS Wertmanagement by way of the aforementioned subparticipations, assignments, novations or guarantees.



FMS Wertmanagement is an organisationally and financially independent winding-up institution under public law with partial legal capacity that may engage in legal transactions in its own name, sue and be sued in court. It is regulated and supervised by FMSA and the Federal Financial Supervisory Authority (BaFin).

In accordance with the law and the Charter of FMS Wertmanagement, SoFFin is under an obligation to compensate all losses. Until FMS Wertmanagement is liquidated, SoFFin has the obligation under Article 7 (1) of the Charter of FMS Wertmanagement (i) to pay, on first demand by the Executive Board of FMS Wertmanagement, all amounts required in the Executive Board's due assessment for ensuring that the winding-up institution can pay all its liabilities at any time when due and in full and (ii) to cover all losses of FMS Wertmanagement. Losses in this sense comprise all amounts that are payable to FMS Wertmanagement so that it can discharge its liabilities — as set out above — and that need not be repaid to SoFFin under the conditions set out in Article 7 (2) of the Charter.

#### *Situation until 30 September 2013*

In accordance with its Charter, FMS Wertmanagement utilised a notarised cooperation agreement to outsource the servicing of the risk assets transferred to it by the HRE Group to pbb as the portfolio servicer until 30 September 2013. In order to fulfil its responsibilities, pbb further outsourced activities to other companies of the HRE Group or external third parties. FMS Wertmanagement's decision-making and auditing rights remained unaffected by the aforementioned. The work outsourced entailed many of the administrative activities connected with the portfolio taken over. The scope of this outsourcing was described in service level agreements concluded between FMS Wertmanagement and pbb. The agreement between FMS Wertmanagement and pbb ended effective 30 September 2013 on account of existing EU requirements.

#### *Situation from 1 October 2013 onward*

In 2012, FMS Wertmanagement established its own service entity (FMS Wertmanagement Service GmbH), which assumed responsibility for portfolio servicing and the provision of all material services associated with it effective 1 October 2013. FMS Wertmanagement retains final decision-making powers and ultimate responsibility for the risk assets under management. The master agreement governing the outsourcing of business processes and services also grants FMS Wertmanagement extensive rights to obtain information and perform inspections, enabling the latter to monitor and control the servicing of the risk assets by FMS Wertmanagement Service GmbH, Munich (FMS Wertmanagement Servicegesellschaft). FMS Wertmanagement Servicegesellschaft maintains a total of four offices, in Unterschleißheim, London, Dublin and New York.

IBM Deutschland GmbH (Ehningen) and other companies have also been hired to provide necessary IT services.



### ***Accounting principles***

These annual financial statements of FMS Wertmanagement were prepared in accordance with Section 8a (1) sentence 10 in conjunction with Section 3a (4) of the German Law Establishing a Financial Market Stabilisation Fund (Gesetz zur Errichtung eines Finanzmarktstabilisierungsfonds – FMStFG) and the supplementary provisions of its Charter pursuant to the provisions of the German Commercial Code for large corporations, the supplementary provisions of the German Commercial Code (Handelsgesetzbuch – HGB) for credit institutions and financial services institutions as well as the requirements of the German Accounting Directive for Banks and Financial Services Providers (Verordnung über die Rechnungslegung der Kreditinstitute und Finanzdienstleistungsinstitute – RechKredV).

Since FMS Wertmanagement is a capital market oriented organisation as defined by Section 264d HGB, it has expanded its annual financial statements to include a statement of changes in equity and a cash flow statement in accordance with Section 264 (1) Sentence 2 HGB. A management report has also been prepared.

### ***Accounting policies***

Assets, liabilities as well as prepaid expenses and deferred income are recognised in accordance with Section 246 ff. HGB. Assets, liabilities and executory contracts are measured based on the principles of Section 252 ff. HGB in conjunction with Section 340 ff. HGB. Pursuant to Section 2 (1) RechKredV, FMS Wertmanagement used Form 1 to structure the balance sheet and Form 3 (vertical presentation format) for the income statement.

FMS Wertmanagement took over assets, provisions, liabilities, prepaid expenses and deferred income as well as derivatives effective as at 1 October 2010 for accounting purposes. The transfer of assets is recognised in line with general principles; with respect of the assets taken over as part of the spin-off for absorption (Section 123 (2) No. 1 UmwG) recognition is based on Section 24 UmwG. FMS Wertmanagement made use of the option in Section 24 UmwG, which provides for a continuation of the transferring entity's book values.

Those book values were used if the assets were transferred to FMS Wertmanagement under the concentration agreements described in the chapter entitled "Legal framework". If the transferor prepares its accounting pursuant to the International Financial Reporting Standards (IFRS), the IFRS book value corresponds to FMS Wertmanagement's acquisition cost. The IFRS book value contains hedge adjustments for loans, advances and securities that were reported in micro hedges; the hedge adjustments related to securities are reported under the item "debt instruments" and those for loans under prepaid expenses and deferred income. The hedge adjustments for loans or securities are generally contrasted by the fair values of the hedging derivatives transferred. The payments that FMS Wertmanagement has received or made for the hedging derivatives are shown under prepaid expenses and deferred income. The hedge adjustments and the recognised items for accrued payments related to derivatives are amortised regularly over the remaining terms to maturity of the corresponding transactions.



Expenses and income from such amortisation are reported under interest expense or interest income. Both amortisations and current premium payments related to credit default swap (CDS) exposures are reported under the item headings "Commission income" or "Commission expenses".

The fact that the transferring entity's book value represents the transfer price was to be taken into account as part of the acquisition process. Consequently, the write-downs recognised by the transferring entity were to be taken into account in the determination of the transfer price. The transfer price in turn represented FMS Wertmanagement's cost.

*Loans and advances to banks and loans and advances to customers* are generally carried at their nominal value less "risk provision" in the form of specific and general loan loss provisions. Differences between the nominal value and the cost, which are similar in nature to interest, are accounted for in prepaid expenses and deferred income and recognised in profit or loss under net interest income over the term of the receivable using the straight-line method. The proportionate interest calculated at the reporting date is recognised together with the underlying receivable.

On the basis of proposals by the portfolio servicer, analyses by other expert third parties and analyses by FMS Wertmanagement itself, *specific loan loss provisions and other provisions* are recognised for individual risks that have arisen in the lending business. Expected future proceeds from the realisation of collateral were discounted over the realisation period as necessary using a market interest rate with matching maturities.

Latent risks in the lending business are covered by *general loan loss provisions* set up in line with the requirements of the IDW statement BFA 1/1990 on the recognition of general loan loss provisions. They are calculated based on the expected loss determined by the portfolio servicer, which is modelled for the case in question using several parameters: probability of default, amount of exposure in the event of a default and expected recovery rate in the event of a default. Estimating the calculation parameters of the anticipated loss is based on data of the portfolio servicer.

Collective country valuation allowances are also recognised for loans to borrowers in countries with discernible country risks. They are recognised in accordance with the methods required under German tax law. The countries to be included and the amount of the valuation allowances are determined on the basis of external country ratings that reflect current and expected economic data as well as the overall political situation in the countries in question.

*Debt instruments* are allocated to fixed assets (financial assets) because they are continuously used for operations. These are measured at amortised cost in accordance with Section 253 (1) and (3) HGB. If FMS Wertmanagement believes that the assets are permanently impaired, impairment losses are charged in accordance with Section 340e (1) Sentence 1 HGB. The existence of permanent impairment is determined in the case in question on the basis of information supplied by the portfolio servicer and commissioned expert third parties and obtained through FMS Wertmanagement's own investigations. The test of whether there is



permanent impairment is generally conducted similar to the test for impairment of loan receivables, except that market values representing an additional trigger in the test for impairment of wind-up clusters with a high percentage of securities traded on liquid markets are to be taken into account.

Furthermore, in certain, clearly defined cases, FMS Wertmanagement takes advantage of the option provided by Section 253 (3) sentence 4 of the German Commercial Code (Handelsgesetzbuch – HGB), which permits write-downs of financial assets according to the strict lower-of-cost-or-market principle even if the impairment is not expected to be permanent. In the 2014 reporting year, this approach was applied to securities classified as fixed assets with a book value of EUR 512 million.

Investment securities that are not permanently impaired and to which the option provided for in Section 253 (3) sentence 4 HGB is not applied are included in the measurement base for calculating the general loan loss provision. When the reasons for permanent impairment no longer apply, write-ups are charged in accordance with Section 253 (5) Sentence 1 HGB up to a maximum of the amortised cost.

Own bonds bought back are allocated to current assets (liquidity reserve). They are measured in accordance with the strict lower-of-cost-or-market principle in accordance with Section 253 (4) HGB.

The fair values of securities and derivatives are determined either based on external rate sources (e. g. via stock exchanges or other providers such as Reuters) or based on fair values derived from internal measurement models (mark to model). Fair values of securities are largely determined on the basis of securities prices obtained from external sources. The fair value of own issues bought back and allocated to current assets takes into account FMS Wertmanagement's own credit risk. Derivatives are largely measured using specific measurement models, whereby the counterparty risk in the case of unsecured OTC derivatives is taken into account when determining any provisions for expected losses for hedge inefficiencies or for stand-alone derivatives.

In the measurement of secured derivatives, future cash flows are discounted on the basis of EONIA swap curves.

Securities holdings are measured based on the following measurement hierarchy, which is oriented above all on the availability of plausible external market data:

- ▶ If an (indicative) market price (rate) is available for a liquid market, it is used.
- ▶ If a market price is not available or the market is not sufficiently liquid, the measurement is converted to a proxy measurement based on the available market prices for similar securities.



- ▶ If an appropriate proxy security cannot be identified, the measurement is carried out using the benchmark spreads or estimated spreads determined by the portfolio servicer's experts.
- ▶ Securities not measured based on market prices, proxies, or spreads, (e.g. structured inflation-linked bonds) are measured based on actuarial valuation models.

The parameters for internal measurement models (e.g. interest rate curves, volatilities, spreads) are derived from external sources and reviewed by Risk Controlling as to their plausibility and accuracy. The models used for measuring structured derivatives are initially calibrated on the basis of market data, with the subsequent measurement being based on the resulting model parameters.

Differences that stem from the reporting of securities classified as fixed assets above their fair value based on application of the moderate lower-of-cost-or-market principle are shown separately in the notes.

FMS Wertmanagement holds positions in asset-backed securities. These structured financial instruments are not required to be separated; they are carried as a uniform asset and in compliance with IDW AcP HFA 22.

*Securities repurchase agreements* (repos) are reported in accordance with the provisions of Section 340b HGB. The securities sold under genuine repurchase agreements are still reported in the balance sheet of FMS Wertmanagement. Depending on the transferee, the obligation to repurchase securities sold under repo agreements is presented under the balance sheet item, Liabilities to banks, or the balance sheet item, Liabilities to customers. If reverse repo transactions were entered into to place excess liquidity on the money market, the resulting receivables are recognised under the balance sheet item, Loans and advances to banks or the balance sheet item, Loans and advances to customers, depending on the transferor. The specific securities are not presented in FMS Wertmanagement's balance sheet due to the lack of beneficial ownership.

*Shares in affiliated companies and other long-term equity investments* are recognised at cost. If impairment is expected to be permanent, write-downs to the lower fair value are recognised.

*Tangible fixed assets* are recognised at cost less depreciation. The useful life is determined based on the expected wear and tear of the tangible fixed assets.

*Intangible assets* are recognised at cost less amortisation. The useful life is determined based on factors expected to limit the longevity of the intangible assets.



For the sake of simplicity and in compliance with the tax regulations, assets costing EUR 150.00 or less before VAT are written down in full in the year of acquisition. Assets costing between EUR 150.00 and EUR 1,000.00 before VAT are presented in an omnibus account that is written down over five fiscal years using the straight-line method.

As in the previous year, FMS Wertmanagement does not make use of the option to carry the excess of deferred tax assets in the balance sheet in accordance with Section 274 (1) Sentence 2 HGB. Deferred tax assets and deferred tax liabilities are initially calculated on temporary differences between the book values of the assets or liabilities and their tax base and measured at a tax rate of 30.28 %. The combined income tax rate comprises corporate income tax, trade tax and the solidarity surcharge. In a general overview, FMS Wertmanagement's deferred tax assets exceed its deferred tax liabilities. The surplus of deferred tax assets at 31 December 2014 stems from temporary differences, especially with respect to loans and advances to customers, debt instruments, shares in affiliated companies as well as provisions for expected losses and litigation costs. Tax loss carryforwards also exist.

Based on the existing control and profit-and-loss transfer agreement dated 16 October 2012, there is a consolidated VAT, corporate income tax and trade tax group with FMS Wertmanagement Servicegesellschaft. Consequently, the German tax obligations of FMS Wertmanagement Servicegesellschaft are disclosed in FMS Wertmanagement's financial statements.

*Prepaid expenses* include:

- ▶ Expenditures prior to the reporting date where these concern expenses in a certain period of time after the reporting date
- ▶ Deferrals (discounts) in connection with the issuing business
- ▶ Deferrals in connection with derivative products. This primarily concerns payments made for the derivatives taken over from HRE Group companies (positive fair values).
- ▶ Positive differences between the nominal value of receivables and the cost, which are similar in nature to interest, are included in the prepaid expenses. This basically concerns payments that FMS Wertmanagement has made for the hedge adjustments of the hedged items taken over from the HRE Group companies, provided the hedged items are loans. These hedged items were accounted for by the transferor in accordance with IFRSs, with the IFRS book value (including the IFRS hedge adjustment) constituting the transfer price.



As a rule, prepaid expenses are amortised on a pro rata basis. To the extent that prepaid expenses include payments in connection with the takeover of derivatives and there are serious doubts regarding the contracts' validity or the recoverability of the payments for the derivatives taken over that are recognised under prepaid expenses, these components of prepaid expenses are reversed through profit or loss.

*Liabilities* are carried at their settlement amount. Differences between the issue amount and the settlement amount of the liabilities are posted to deferred income or prepaid expenses and reversed through profit and loss on a pro rata basis.

*Provisions* for uncertain liabilities and provisions for expected losses from executory contracts are recognised at the settlement amount dictated by prudent business judgement. Provisions with a remaining maturity of more than one year are generally discounted in accordance with Section 253(2) HGB using the average market interest rate of the past seven fiscal years corresponding to their remaining maturity. The applicable interest rates are published by the Bundesbank. Provisions for expected losses from executory contracts (derivatives) were recognised in the amount of the existing excess of expected obligations over expected benefits.

Regardless of future developments, if a fixed excess obligation exists in the relevant market risk factors for a derivative, this is not recognised as a provision for expected losses but instead in other liabilities.

*Deferred income* includes:

- ▶ Proceeds received prior to the reporting date where these concern income in a certain period of time after the reporting date
- ▶ Deferrals (premiums) in connection with the issuing business
- ▶ Deferrals in connection with derivative products. This mainly concerns payments that FMS Wertmanagement received for the derivatives taken over from HRE Group companies (negative fair values).
- ▶ Deferrals in connection with the lending business (discounts on receivables). This basically concerns payments that FMS Wertmanagement has received for the hedge adjustments of the hedged items taken over from the HRE Group companies. These hedged items were accounted for by the transferor in accordance with IFRSs, with the IFRS book value (including the IFRS hedge adjustment) constituting the transfer price.

Deferred income is amortised on a pro rata basis.



*Derivative financial instruments* are entered into to hedge interest rate risk in individual hedged items, to manage general interest rate risk and to hedge inflation, counterparty and currency risks.

- ▶ Derivative financial instruments serving to *hedge the market risks (basically interest rate risks) of individual hedged items* are aggregated into micro hedges along with the hedged items in accordance with Section 254 HGB.
- ▶ Derivative financial instruments that are used to *manage the general interest rate risk* are aggregated into an offsetting item with the other transactions in the banking book (securities and loans) that are interest-based and regarded as non interest-induced as well as the issues floated for funding purposes. Prevailing opinion holds that this is not a hedge under Section 254 HGB but an accounting practice.
- ▶ Derivatives such as credit default swaps are used to *hedge counterparty risks*. As a rule, these derivatives are not aggregated with other hedged items in hedges and are measured in accordance with the general principles of commercial law (in accordance with IDW BFA 1).
- ▶ Derivative financial instruments such as currency and cross currency interest rate swaps serve to *fund or manage FMS Wertmanagement's liquidity in the individual foreign currencies*. They are used in connection with the management of foreign currency positions to close open risk positions.

Consistent with the specifications of risk management, documented hedging relationships are entered into at the transaction level (micro hedges) to hedge market risks. FMS Wertmanagement recognises these hedging relationships using the net hedge presentation method ("Einfrierungsmethode") in accordance with Section 254 HGB. Where the offsetting changes in value resulting from the hedged risk (especially interest rate risk) are compensated, the changes in value in the hedged item or in the hedging instrument were not recognised. Where the offsetting changes in value resulting from the hedged risk of the hedged item and the hedging instrument are not compensated, the general accounting policies are used for this ineffective portion. In an existing excess obligation, the ineffective portion of the hedge's hedged risk is recognised as an expense in accordance with the imparity principle pursuant to IDW RS HFA 35 through the recognition of a provision for expected losses. The ineffective portion is computed by comparing the change in value from the hedged risk of the hedged item with the change in value from the hedged risk of the hedging instrument. Excess obligations for unhedged risks are recognised in accordance with the imparity principle through the recognition of a provision for expected losses. Expenses from additions to provisions for expected losses are shown in the net revaluation gain/loss for the lending and securities business.



FMS Wertmanagement took over a portfolio consisting of synthetic US CMBS financial instruments. The totality of the instruments defined for this portfolio constitutes a hedge pursuant to Section 254 HGB which serves in particular to hedge the risks from US CMBS. Given their complex structures, the financial instruments contained in this portfolio are measured based on models. As at the end of the previous reporting period, FMS Wertmanagement performed a fundamental, model-based valuation of the financial instruments based on market data (especially ratings) because market liquidity remained insufficient during the reporting year.

All hedges were tested for effectiveness. The effectiveness of the hedges was examined primarily on the basis of linear regression.

In addition, FMS Wertmanagement holds credit derivatives (e. g. credit default swaps — CDS) where it is the guarantor. These credit derivatives are accounted for in accordance with IDW AcP BFA 1.

In addition to the necessary and recognised provisions for expected losses for hedges, the entire interest rate portfolio and/or banking book is evaluated for the existence of an excess obligation. All interest-based financial instruments (referred to in the German literature as a “Refinanzierungsverbund”) are included in this evaluation, including those that are designated as hedges under Section 254 HGB. Additional provisions for expected losses for the excess obligation are only recognised in accordance with the provisions under IDW AcP BFA 3 if an excess obligation existed in this offsetting item. SoFFin’s loss compensation obligation under Section 7 of FMS Wertmanagement’s Charter is included in the offsetting item.

For derivatives secured in hedges, the change in value resulting from the change in the measurement of secured derivatives (discounting of future cash flows on the basis of EONIA swap curves) was not considered a portion of the hedged risk and was recognised in connection with the determination of the overall excess obligation from the banking book.

*Contingent liabilities* are disclosed below the line at their nominal amount after deduction of any risk provisions.

Foreign currency items in the balance sheet are translated into the reporting currency (euros) in accordance with the provisions of Section 256a HGB in conjunction with Section 340a (1) and Section 340h HGB and pursuant to the provisions of IDW AcP BFA 4. FMS Wertmanagement translated its assets and liabilities at the average spot rate prevailing at 31 December 2014 Using the respective reference exchange rate of the European Central Bank. Expenses and income arising from the currency translation of on-balance sheet and off-balance sheet transactions denominated in foreign currencies with special coverage in the same currency are presented net in other operating expenses or other operating income. If excess assets result from the translation of off-balance sheet transactions denominated in foreign currencies within the context of special coverage according to Section 340h HGB, these are recognised



in other assets. If excess liabilities arise in this way, they are reported as other liabilities. If forward exchange transactions serve to hedge interest-bearing items, the forward rate is split into its two elements (spot rate and swap rate) in order to account for them separately for the purpose of determining the result. Until 31 December 2013 (inclusive), FMS Wertmanagement included the excess of receivables or obligations arising from derivatives featuring swap agreements with an exchange of principal in offsetting for the balancing item for translation of off-balance sheet transactions denominated in foreign currencies related to special coverage under Section 340h HGB.

To the extent that derivative financial instruments feature the exchange of principal (swap agreements with an exchange of principal), payments received or payments yet to be made are recognised in other liabilities. Payments made or payments yet to be received are reported in other assets.

Expenses and income were translated into euros at the exchange rate on the transaction date. Expenses and income arising from the currency translation are presented net under other operating expenses or other operating income.

Interest income and interest expense for swaps entered into are presented gross, i. e. not netted, in the income statement.

FMS Wertmanagement avails itself of the options under Section 340f (3) HGB. Accordingly, income and expenses from the measurement of loans, advances and securities allocated to the liquidity reserve may be shown in a single item after offsetting against income and expenses from the disposal of such transactions. This also includes additions to or reversals of loan loss provisions.

FMS Wertmanagement avails itself of the options under Section 340c (2) HGB. Accordingly, expenses from write-downs on long-term equity investments, shares in affiliated companies and securities classified as fixed assets may be offset against the income from additions to such assets and shown in a single expense and income item. Under Section 340c HGB, the expenses and income from transactions involving such assets may also be included. FMS Wertmanagement also reports the profit/loss from the sale of securities as well as the profit/loss from the termination of related derivatives transactions in this item.



## NOTES TO THE BALANCE SHEET

### Assets

#### *Cash reserve*

The cash reserve item shows a credit balance with Deutsche Bundesbank in the amount of EUR 88 million (31 December 2013: EUR 383 million).

#### *Loans and advances to banks*

	31.12.2014 in € million	31.12.2013 in € million
a) Payable on demand	30,178	16,492
b) Other receivables	6,337	7,117
<b>Total</b>	<b>36,515</b>	<b>23,609</b>
to affiliated companies	1,555	0
to other long-term equity investment	0	0

The increase in receivables payable on demand mainly results from a greater need for collateral provided in the form of cash for derivative positions. For the most part, the decline in other receivables was due to the repayment of liquidity facilities which had been drawn down by DEPFA BANK plc and which were terminated in the first half of 2014.

Loans and advances to affiliated companies include EUR 19 million in loans and advances to DEPFA ACS Bank and EUR 1,536 million in loans and advances to DEPFA BANK plc and relate mainly to receivables in connection with collateral to be provided in the form of cash for financial derivatives.

The remaining maturities of the other loans and advances to banks as at 31 December 2014 are as follows:

	31.12.2014 in € million	31.12.2013 in € million
Up to three months	3,584	161
More than three months and up to one year	1,960	2,107
More than one year and up to five years	201	849
More than five years	592	4,000
<b>Total</b>	<b>6,337</b>	<b>7,117</b>



The increase in receivables with a remaining maturity of up to three months is mainly due to receivables from EUREX (reverse) repos (31 December 2014: EUR 3.0 billion) reported starting with the year under review in loans and advances to banks. In the previous year (31 December 2013: EUR 2.5 billion) they had still been included in loans and advances to customers.

### *Loans and advances to customers*

	31.12.2014 in € million	31.12.2013 in € million
<b>Total</b>	<b>22,397</b>	<b>28,359</b>
Of which: to affiliated companies	169	886
Of which: to other long-term equity investments	7	7

The decline in loans and advances to customers was due the sale of the majority of the US Commercial Real Estate portfolio in addition to the steady wind-up of mortgage loans and other loans.

The partial transfer of operations of the Rome branch of DEPFA BANK plc in the first quarter of 2014 had the opposite effect. FMS Wertmanagement assumed legal and economic ownership of the so-called Italy portfolio ("asset upgrade") in the course of which risk positions have to date been transferred to FMS Wertmanagement via guarantee. The off-balance sheet items reported under contingent liabilities from guarantees and indemnity agreements up to 31 December 2013 have been included in loans and advances to customers since the first half of 2014. The loans assumed as a result amounted to a nominal EUR 1,978 million as of the transfer date (3 February 2014).

The remaining maturities of the loans and advances to customers as at 31 December 2014 are as follows:

	31.12.2014 in € million	31.12.2013 in € million
Payable on demand	259	476
Up to three months	2,499	4,814
More than three months and up to one year	2,962	4,187
More than one year and up to five years	3,932	6,414
More than five years	12,745	12,468
<b>Total</b>	<b>22,397</b>	<b>28,359</b>

As previously, there are no loans and advances with indefinite maturity.



### *Debt instruments*

The debt instruments item in the balance sheet is broken down as follows:

	31.12.2014 in € million	31.12.2013 in € million
Book value	119,750	130,918
Of which: public-sector issuers	44,679	47,647
Of which: other issuers	45,851	47,611
Of which: own debt instruments	29,220	35,660
Marketable securities	119,750	130,918
Of which: listed	103,072	112,865
Of which: not listed	16,678	18,053
Securities sold under repurchase agreements	22,329	36,858
Securities due in the following year	12,267	28,108

Of the marketable securities, securities totalling EUR 90,018 million (31 December 2013: EUR 95,258 million) are measured as fixed assets in accordance with the moderate lower-of-cost-or-market principle and EUR 512 million are measured in accordance with the strict lower-of-cost-or-market principle.

In addition, the marketable securities include own debt instruments and accrued interest totalling EUR 29,220 million (31 December 2013: EUR 35,660 million) which, because these are treated as current assets, are measured using the strict lower-of-cost-or-market principle. The issues of FMS Wertmanagement serve to provide additional collateral and manage liquidity.

The deferred write-downs on debt instruments total EUR 3,484 million based on their fair values as at 31 December 2014 (31 December 2013: EUR 9,883 million). With respect to the securities that carry hidden losses as at 31 December 2014, FMS Wertmanagement assumes, given its, in part, long-term wind-up strategy and the securities' expected performance, that their fair value will be less than the book value only temporarily. Corresponding write-downs were taken if there were any doubts as to collectability.

Especially in the case of PIIGS countries, write-downs were not recognised on the corresponding portfolio due to the measures taken by the EU in respect of the European rescue fund. The discount on the cost of debt instruments bearing lower-than-market interest added under the exchange programme for Greek government bonds was not unwound.



The “debt instruments” balance sheet item also includes the accrued but not yet amortised payments made by FMS Wertmanagement in 2010 for hedge adjustments on securities taken over from the HRE Group companies. As a result, the book values frequently exceed the nominal values. This has a corresponding effect on the hidden losses disclosed.

The book values and the fair values of the securities contained in the banking book, broken down by issuer group, follow from the overview below. Both the book values and the fair values contain deferred interest.

in € million	Other issuers			Total 31.12.2014	Total 31.12.2013
	Of which: public-sector issuers	Of which: banks	Of which: other issuers		
Book value	44,679	5,944	39,907	90,530	95,258
Fair value	45,925	6,244	40,826	92,995	87,741
Hidden reserves	2,567	390	2,992	5,949	2,366
Hidden losses (deferred write-downs)	-1,322	-90	-2,072	-3,484	-9,883
Of which:					
Hidden losses, ABS				1,046	1,593
Of which:					
Hidden losses, PIIGS countries*				1,637	6,379
Of which:					
Portugal				84	317
Ireland				62	71
Italy				1,351	5,369
Greece				0	0
Spain				140	622

\* Issuer's country of domicile

The hidden losses from ABS as at 31 December 2014 in the amount of EUR 373 million include those losses attributable to risks related to the PIIGS countries (31 December 2013: EUR 444 million).

The hidden losses and reserves from debt instruments are also exposed in some cases to countervailing effects on derivatives (particularly interest-based derivatives). For more information, see the explanation under “Derivative financial instruments”. Out of the above total of hidden losses and reserves, EUR –1.9 billion and EUR 5.0 billion, respectively, are attributable to securities in hedges.



### *Shares in affiliated companies and other long-term equity investments*

With the exception of the equity investment in DEPFA BANK plc, the long-term equity investments and shares in affiliated companies held by FMS Wertmanagement are not marketable.

	31.12.2014 in € million	31.12.2013 in € million
<b>Other long-term equity investments</b>		
Book value	7	7
Of which: other long-term equity investments in banks	0	0
Of which: other long-term equity investments in financial services institutions	0	0

	31.12.2014 in € million	31.12.2013 in € million
<b>Shares in affiliated companies</b>		
Book value	807	386
Of which: shares in affiliated companies (banks)	323	0
Of which: shares in affiliated companies (financial services institutions)	346	305

Shares in affiliated companies (banks) relate to DEPFA BANK plc, whereas shares in affiliated companies (financial services institutions) relate to Hypo Real Estate Capital Corp., New York, (HRECC) and Flint Nominees Ltd., London, (Flint).

### *Fiduciary assets*

	31.12.2014 in € million	31.12.2013 in € million
Loans and advances to customers	0.3	0.3
<b>Total</b>	<b>0.3</b>	<b>0.3</b>



### Changes in fixed assets

in € million	Cost 31.12.2013	Additions 2014	Disposals 2014	Depreciation/ amortisation			Book value 31.12.2014	Book value 31.12.2013
				Current year 2014	Disposal 2014	cumulative 31.12.2014		
Intangible fixed assets	14.2	0.7	12.9	2.6	5.1	1.0	1.0	10.7
Tangible fixed assets	1.3	0	0	0.2	0.0	0.7	0.6	0.7
Other long- term equity investments	7			0*			7	7
Shares in affiliated companies	386			421*			807	386
Securities classified as fixed assets	95,258			-4,728*			90,530	95,258

\* The option to combine items in accordance with Section 34 (3) RechKredV was used.

The intangible assets as at 31 December 2014 solely concern software licenses purchased for consideration. Disposals in the amount of EUR 13 million relate to software licences sold to FMS Wertmanagement Servicegesellschaft.

The tangible fixed assets as at 31 December 2014 solely comprise operating and office equipment.

### Other assets

Other assets include EUR 712 million for the balancing item for foreign currency translation of off-balance sheet transactions related to special coverage under Section 340h HGB (31 December 2013: EUR 198 million; this was reported in other liabilities in the amount of EUR 326 million taking into account the net obligations from derivatives featuring swap agreements with an exchange of principal; see also the explanation under "Other liabilities").



**Prepaid expenses**

Prepaid expenses are comprised of the following items:

	31.12.2014 in € million	31.12.2013 in € million
Unamortised cost of derivatives	1,739	2,541
Lending business (premium from receivables)	1,433	1,281
Issuing business/loans taken out	96	111
Other	4	7
<b>Total</b>	<b>3,272</b>	<b>3,940</b>

Payments that FMS Wertmanagement has made for the fair values of derivatives accounted for by the transferors as at the transfer date are amortised on a pro rata basis. The portion not yet amortised mainly represents the amount recognised under “Unamortised cost of derivatives”. The prepaid expenses from the lending business also include the deferred, unamortised payments that FMS Wertmanagement made for the hedge adjustments of the hedged items (loan receivables) that were transferred from HRE Group companies. These hedged items (receivables) were accounted for by the transferor in accordance with IFRSs, with the IFRS book value (including the IFRS hedge adjustment) constituting the transfer price.

The increase in premiums on receivables from the lending business in 2014 was mainly the result of the takeover of partial operations of the Rome branch of DEPFA BANK plc. In this context, FMS Wertmanagement assumed legal and economic ownership of the so-called Italy portfolio (“asset upgrade”) during which risk positions have to date been transferred to FMS Wertmanagement via guarantee. The hedge adjustments assumed in the amount of EUR 226 million at the time of transfer declined to EUR 200 million as at the reporting date.

The prepaid expenses are reversed proportionately over the remaining term of the respective underlying transactions.



### ***Subordinated assets***

The following items on the assets side of the balance sheet contain subordinated assets:

	31.12.2014 in € million	31.12.2013 in € million
Loans and advances to banks	510	510
Debt instruments	47	43
<b>Total</b>	<b>557</b>	<b>553</b>

### **Equity and liabilities**

#### ***Liabilities to banks***

	31.12.2014 in € million	31.12.2013 in € million
a) Payable on demand	450	204
b) With agreed maturity or notice period	19,826	21,633
<b>Total</b>	<b>20,276</b>	<b>21,837</b>
to affiliated companies	1,761	0
to other long-term equity investments	0	0

Liabilities from EUREX repo transactions are reported in liabilities to banks in the year under review (EUR 6.6 billion), whereas in the previous year they were recognised in liabilities to customers (EUR 6.4 billion).

Nonetheless, the repo transactions reported in liabilities to banks in the 2014 fiscal year decreased by EUR 0.8 billion from EUR 16.8 billion to EUR 16.0 billion.



The remaining maturities of the liabilities with agreed maturity or notice period as at 31 December 2014 are as follows:

	31.12.2014 in € million	31.12.2013 in € million
Up to three months	11,068	10,052
More than three months and up to one year	8,755	8,711
More than one year and up to five years	3	820
More than five years	0	2,050
<b>Total</b>	<b>19,826</b>	<b>21,633</b>

*Liabilities to customers*

	31.12.2014 in € million	31.12.2013 in € million
a) Payable on demand	11	53
b) With agreed maturity or notice period	17,564	26,314
<b>Total</b>	<b>17,575</b>	<b>26,367</b>
to affiliated companies	401	363
to other long-term equity investments	0	0

The decline in liabilities to customers is largely accounted for by the aforementioned reporting of EUREX repo transactions, which have been recognised in liabilities to banks since the year under review (EUR 6.6 billion). In the previous year they had been recognised in liabilities to customers (EUR 6.4 billion).

The remaining maturities of the liabilities with agreed maturity or notice period as at 31 December 2014 are as follows:

	31.12.2014 in € million	31.12.2013 in € million
Up to three months	8,093	13,063
More than three months and up to one year	8,062	11,848
More than one year and up to five years	52	46
More than five years	1,357	1,357
<b>Total</b>	<b>17,564</b>	<b>26,314</b>



### *Securitised liabilities*

	31.12.2014 in € million	31.12.2013 in € million
Book value	127,493	121,189
Of which: to affiliated companies	0	0
Of which: to other long-term equity investments	0	0
Amounts due in the following year	59,691	65,291

The securitised liabilities comprise EUR 91,242 million (31 December 2013: EUR 92,139 million) in debt instruments issued including accrued interest and EUR 36,251 million (31 December 2013: EUR 29,050 million) in issuing activities (European Commercial Paper and Certificates of Deposit).

Of the securitised liabilities issued, own debt instruments repurchased including accrued interest, amounted to EUR 29,220 million (31 December 2013: EUR 35,660 million).

### *Fiduciary liabilities*

	31.12.2014 in € million	31.12.2013 in € million
Liabilities to banks	0.3	0.3
<b>Total</b>	<b>0.3</b>	<b>0.3</b>

### *Other liabilities*

Other liabilities include EUR 487 million in liabilities from derivatives featuring swap agreements with an exchange of principal (31 December 2013: EUR 524 million; in the previous year this was reported in the amount of EUR 326 million and included off-balance sheet transactions denominated in foreign currencies related to the concept of special coverage).



### Deferred income

Deferred income is comprised of the following items:

	31.12.2014 in € million	31.12.2013 in € million
Unamortised payments received for derivatives	16,154	16,380
Lending business (discount on receivables)	46	54
Other	116	125
<b>Total</b>	<b>16,316</b>	<b>16,559</b>

Payments that FMS Wertmanagement has received for the fair values of derivatives accounted for by the transferors as at the transfer date are amortised on a pro rata basis. The portion not yet amortised mainly represents the amount recognised under “Unamortised payments received for derivatives”, with the continuous amortisation of the item offset by countervailing effects. In connection with the acquisition of legal or beneficial ownership (asset upgrade) of risk positions transferred via guarantee in the past, the related derivatives were also taken over in the reporting period. This increased the as yet unamortised payments received for derivatives.

Deferred income from the lending business also includes deferred payments received by FMS Wertmanagement for the hedge adjustments of the hedged items (receivables) taken over from HRE Group companies. These hedged items (receivables) were accounted for by the transferor in accordance with IFRSs, with the IFRS book value (including the IFRS hedge adjustment) constituting the transfer price.

### Provisions

in € million	Balance 31.12.2013	Addition	Reversal	FX effect/ Other	Utilisation	Balance 31.12.2014
Provision for taxes	34	2	2	0	31	3
Other	1,186	421	199	-98	306	1,004
Expected losses	1,143	358	198	-107	230	966
Non-personnel and personnel expenses	24	58	0	9	59	32
Other	19	5	1	0	17	6
<b>Total</b>	<b>1,220</b>	<b>423</b>	<b>201</b>	<b>-98</b>	<b>337</b>	<b>1,007</b>

The decrease in provisions for expected losses was mainly the result of the utilisation or reversal of provisions for expected losses for stand-alone derivatives.



### ***Deferred taxes***

FMS Wertmanagement does not make use of the option to recognise surplus deferred tax assets resulting from tax benefits arising in accordance with Section 274 (1) Sentence 2 HGB. The surplus of deferred tax assets at 31 December 2014 stems from temporary differences between the financial statements and the tax base, especially with respect to loans and advances to banks, loans and advances to customers, debt instruments as well as provisions for expected losses.

Deferred taxes are calculated on the basis of the combined income tax rate of FMS Wertmanagement of currently 30.28%. The combined income tax rate comprises corporate income tax, trade tax and the solidarity surcharge. Deferred tax assets arose in the fiscal year that were not recognised.

### ***Contingent liabilities***

FMS Wertmanagement reports its potential liability under guarantees in the amount of EUR 3,641 million (31 December 2013: EUR 8,115 million) and under irrevocable loan commitments in the amount of EUR 3,853 million (31 December 2013: EUR 5,953 million).

The transfer to FMS Wertmanagement of risk positions entailed assuming their economic risk in the form of guarantees as defined in Section 8a (1) FMStFG. The total volume of guarantees as at 31 December 2014 after risk provisions was EUR 384 million (31 December 2013: EUR 3,313 million), EUR 259 million of which is attributable to the transfer guarantee (31 December 2013: EUR 3,010 million). In the case of the risk positions transferred via guarantee, the assets guaranteed are still accounted for by the holder pbb. The guarantees are designed as abstract, directly enforceable, irrevocable, unconditional guarantees. The decline in transfers via guarantee is due to the asset upgrade of the Italy portfolio, which is explained under "Loans and advances to customers".

This item also includes EUR 3,217 million in obligations arising from credit default swaps (with third parties as contracting partners) (31 December 2013: EUR 3,949 million) with FMS Wertmanagement as the guarantor.

FMS Wertmanagement also fully refinanced the existing business (Commercial Real Estate) of its subsidiaries HRECC and Flint, guaranteeing and hence assuming the default risks arising from this business through credit derivatives (credit default swaps). As a consequence of the sale of the entire loan portfolio (Commercial Real Estate) of subsidiary HRECC and the associated termination of the credit default swaps in the second quarter of 2014, the remaining nominal value as at 31 December 2014 less risk provisions was reduced to EUR 41 million (31 December 2013: EUR 853 million).



Any imminent risk of being held liable under the guarantees (including the credit default swap positions) is assessed analogous to the risk provision policy for the customary credit business. The risk provisions set up are deducted from the guarantees recognised.

Irrevocable loan commitments include liquidity facilities in the amount of EUR 1,176 million (31 December 2013: EUR 2,764 million). Of this amount, EUR 1,140 million (31 December 2013: EUR 1,200 million) can be attributed to a liquidity facility granted to pbb in connection with the assumption of the economic risk related to risk positions. The prior-year figure as at 31 December 2013 included two other liquidity facilities granted to DEPFA BANK plc in the amount of EUR 1,473 million that were terminated during the reporting period.

In connection with the agreement on the “Ersatzdeckungslösung” (substitute cover solution), FMS Wertmanagement pledged to pbb to pay out up to EUR 2,994 million to pbb on request. According to the payment plan, this figure decreased to EUR 2,530 million as at 31 December 2014. A disbursement would give rise to a claim of FMS Wertmanagement against pbb. In this respect, FMS Wertmanagement is exposed to a default risk vis-à-vis the counterparty pbb.

#### ***Other financial obligations***

On 22 December 2014, FMS Wertmanagement reached agreement with certain holders of the DEPFA Funding II, III and IV LP hybrid bonds to acquire the bonds under specified terms and conditions resulting in a financial obligation of EUR 496 million.

#### ***Assets pledged as collateral***

Apart from the securities sold under repurchase agreements as at 31 December 2014 (see the description under debt instruments) in the amount of EUR 22,329 million (31 December 2013: EUR 36,858 million), there are no other assets pledged as collateral for liabilities or contingent liabilities of FMS Wertmanagement.

#### ***Derivative financial instruments***

FMS Wertmanagement holds only OTC derivatives; none of them are held for trading. The fair values of the derivatives are determined by means of standard measurement models based on the measurement parameters available in the market.



The table below shows the breakdown of FMS Wertmanagement's interest-based and currency-based derivatives and the total return swaps:

in € million	Nominal values				
	Remaining maturities, 31.12.2014			Total 31.12.2014	Total 31.12.2013
	< 1 year	1 – 5 years	> 5 years		
Interest-based transactions	53,909	85,728	81,561	221,198	246,663
Total return swaps	0	758	4,559	5,317	5,625
Currency-based transactions	16,978	2,310	4,728	24,016	23,366
Of which: forward exchange transactions	14,592	0	0	14,592	10,821
Of which: cross currency swaps	2,386	2,310	4,728	9,424	12,545
<b>Total</b>	<b>70,887</b>	<b>88,796</b>	<b>90,848</b>	<b>250,531</b>	<b>275,654</b>

in € million	Market values			
	31.12.2014		31.12.2013	
	Positive	Negative	Positive	Negative
Interest-based transactions	6,847	-43,019	5,907	-28,081
Total return swaps	1,384	-1,457	993	-922
Currency-based transactions	1,406	-736	983	-728
Of which: forward exchange transactions	700	-17	117	-125
Of which: cross currency swaps	706	-719	866	-603
<b>Total</b>	<b>9,637</b>	<b>-45,212</b>	<b>7,883</b>	<b>-29,731</b>

The book value of these derivatives reported in the prepaid expenses / deferred income item (net amount of the book values recognised in assets and liabilities) totalled EUR – 14,356 million as at 31 December 2014 (31 December 2013: EUR – 14,006 million). The book value of these derivatives in the amount of EUR 254 million is reported in the other assets / other liabilities item (31 December 2013: EUR – 326 million).



The table below shows the breakdown of FMS Wertmanagement's credit derivatives:

in € million	31.12.2014		31.12.2013	
	Nominal values	Market values	Nominal values	Market values
Secured party credit default swaps	496	117	1,482	143
Guarantor credit default swaps	3,403	-78	4,141	-102
<b>Total</b>	<b>3,899</b>	<b>39</b>	<b>5,623</b>	<b>41</b>

The table shows the credit derivatives vis-à-vis third parties. The book value of these derivatives (net amount of the book values recognised in assets and liabilities) as at 31 December 2014 is EUR -58 million (31 December 2013: EUR 167 million).

Furthermore, there are credit default swap exposures vis-à-vis the subsidiary Flint with a nominal value of EUR 41 million after deducting existing risk provisions (EUR 82 million).

### Hedges

In accordance with Section 254 HGB, FMS Wertmanagement aggregates hedged items and hedging instruments into hedges. FMS Wertmanagement utilises the net hedge presentation method to account for the hedges. In particular, the hedged risk concerns the interest rate-induced risk of changes in value (interest rate risk). Hedged items with a nominal value of EUR 112,780 million (31 December 2013: EUR 112,633 million) were aggregated into hedges. Overall, this nominal value of these hedged items is comprised as follows:

Nominal values of the hedged items in € million	31.12.2014 in € million	31.12.2013 in € million
Assets	57,314	58,158
Liabilities	50,045	48,697
<b>Total</b>	<b>107,359</b>	<b>106,855</b>

Furthermore, hedged items with a nominal value of EUR 5,421 million (31 December 2013: EUR 5,778 million) were combined with total return swaps pursuant to IDW RS BFA 1.



The following overviews contain the maturities for assets and liabilities that are combined in hedges as at 31 December 2014 and whose countervailing changes in value or cash flows can be expected to balance in the future.

in € million	31.12.2014	31.12.2013
Up to three months	491	120
More than three months and up to one year	3,145	873
More than one year and up to five years	7,701	9,759
More than five years	45,977	47,406
<b>Assets</b>	<b>57,314</b>	<b>58,158</b>

in € million	31.12.2014	31.12.2013
Up to three months	3,053	395
More than three months and up to one year	5,661	5,444
More than one year and up to five years	33,190	29,260
More than five years	8,141	13,598
<b>Liabilities</b>	<b>50,045</b>	<b>48,697</b>

The net hedge presentation method does not require presentation of the positive and negative changes in value (expenses and income) of the hedged risk in a micro hedge. Were the gross hedge presentation method to be applied, cumulative expenses and income of EUR 21,704 million (31 December 2013: EUR 7,784 million) would arise on the basis of the current measurements.

The interest rate risk-related changes in value of the hedged items and hedging instruments arising from hedges with negative ineffectiveness (interest rate risk hedge) can be seen in the following overview:

31.12.2014 in € million	Negative change in value (absolute figure)	Positive change in value (absolute figure)
Hedged items	1,669	9,600
Hedging instruments	9,850	1,604
<b>Total</b>	<b>11,519</b>	<b>11,204</b>
Of which: not recognised	11,204	0
Of which: recognised as a provision for expected losses	315	0



FMS Wertmanagement took over a portfolio consisting of US CMBS financial instruments. The totality of the instruments defined for this portfolio constitutes a hedge pursuant to Section 254 HGB. This portfolio hedges default risks associated with US CMBSs (commercial real estate loans). Given their complex structures, some of the financial instruments contained in this portfolio are measured based on models. As a result of the continued poor market liquidity in the reporting period, near-market measurement remains inappropriate. Therefore, as in the previous year, FMS Wertmanagement continues to use the same valuation method. Based on the valuation that was performed, the hidden reserves related to this portfolio are EUR 80 million. The portfolio contains EUR 2,668 million in guarantor positions (“long-risk”), which are contrasted by EUR 299 million in leveraged secured party positions (“short-risk”).

### **Foreign-currency items**

Total assets in foreign currencies are EUR 81,654 million (31 December 2013: EUR 70,268 million). Liabilities in foreign currencies at year end are EUR 87,366 million (31 December 2013: EUR 71,215 million).

## **NOTES TO THE INCOME STATEMENT**

### **Net interest income**

	01.01. – 31.12.2014 in € million	01.01. – 31.12.2013 in € million
<b>Interest income</b>	<b>7,847</b>	<b>8,657</b>
Lending and money market transactions	5,289	6,039
Fixed-income securities and debt claims	2,558	2,618
<b>Interest expenses</b>	<b>7,321</b>	<b>8,031</b>
Lending and money market transactions	5,379	6,139
Securitised liabilities	919	871
Loans taken out	49	91
Other	974	930
<b>Total</b>	<b>526</b>	<b>626</b>

The interest income of EUR 4,402 million (previous year: EUR 5,094 million) includes interest from derivative financial instruments. Derivative financial instruments account for EUR 5,179 million (previous year: EUR 5,918 million) in interest expenses.



The decrease in interest income on the one hand and interest expense on the other hand is attributable to the portfolio wind-up as well as to EUR money market rates, which have fallen to historical lows.

As previously, Western Europe and the United States account for most of the interest income.

Provisions with a remaining maturity of more than one year are not discounted for reasons of materiality.

### Net commission income

	01.01. – 31.12.2014 in € million	01.01. – 31.12.2013 in € million
<b>Commission income</b>	<b>81</b>	<b>139</b>
Lending business	45	82
Derivatives business	36	57
<b>Commission expenses</b>	<b>25</b>	<b>39</b>
Derivatives business	17	28
Securities and issuing business	6	7
Other	2	4
<b>Total</b>	<b>56</b>	<b>100</b>

The commission income of EUR 81 million (previous year: EUR 139 million) comprises commission income from the lending business of EUR 45 million (previous year: EUR 82 million) and from the derivatives business of EUR 36 million (previous year: EUR 57 million).

The commission income from the lending business in turn comprises commission on guarantees of EUR 21 million (previous year: EUR 67 million) and processing fees received of EUR 24 million (previous year: EUR 15 million). The decline in commission on guarantees is largely due to the lower commission income from credit default swaps with the subsidiary HRECC.

The commission income is contrasted by EUR 25 million in commission expenses. These mainly result from expenses in the derivatives business stemming from the continuous amortisation of deferred items concerning credit default swaps.

In addition, net commission income in the fiscal year was influenced to a lesser degree by positive one-off effects from additional payments by pbb/DEPFA BANK plc for assets transferred via guarantee (fiscal year 2014: EUR 3 million; fiscal year 2013: EUR 14 million).



### General and administrative expenses

	01.01. – 31.12.2014 in € million	01.01. – 31.12.2013 in € million
Personnel expenses	26	25
Other administrative expenses	219	309
<b>Total</b>	<b>245</b>	<b>334</b>

The decrease in administrative expenses is due primarily to a lower level of expenses incurred in the context of service outsourcing (servicing of the portfolio assets, administrative and back office activities, IT services, and accounting services).

In fiscal year 2014, key components of outsourced activities were performed by FMS Wertmanagement Servicegesellschaft. In addition, other service providers have been working for FMS Wertmanagement in defined capacities such as IT services (IBM Deutschland GmbH, Ehningen) or key areas of accounting (capco GmbH Wirtschaftsprüfungsgesellschaft, Eschborn). Servicing expenses totalled EUR 155 million for 2014 as a whole (previous year: EUR 194 million).

In addition, certain expenses incurred in the previous year (e. g. for the IT migration) were one-time expenses no longer incurred in the year under review.

### Other operating expenses

Other operating expenses include EUR 7 million (previous year: EUR 19 million) in currency translation expenses, among others.

### Income from reversals of write-downs of receivables and certain securities and from reversals of loan loss provisions

FMS Wertmanagement avails itself of the options under Section 340f (3) HGB.

The following income and expenses are reported in this income statement item:

	01.01. – 31.12.2014 in € million	01.01. – 31.12.2013 in € million
Net revaluation gain/loss in the lending business	102	-433
Net revaluation gain/loss from securities classified as current assets	7	-7
<b>Total</b>	<b>109</b>	<b>-440</b>



The net revaluation gain in the lending business totalling EUR 102 million resulted mainly from reversals of specific and general loan loss provisions, which can be attributed to valuations and the portfolio wind-up.

The net revaluation gain on securities classified as current assets resulted from net reversals of write-downs on own debt instruments of EUR 7 million.

**Write-downs of and valuation allowances on shares in affiliated companies,  
 other long-term equity investments and securities classified as fixed assets**

FMS Wertmanagement avails itself of the options under Section 340c (2) HGB.

The following income and expenses recognised in connection with the debt instruments classified as fixed assets were recorded in this income statement item:

	01.01. – 31.12.2014 in € million	01.01. – 31.12.2013 in € million
Net revaluation gain/loss from securities	-79	113
Net revaluation gain/loss from derivatives	-133	7
Net gain/loss on sale of securities incl. net gain/loss from derivatives	127	58
Other income/expenses	8	-1
<b>Total</b>	<b>-77</b>	<b>177</b>

The net revaluation loss on securities mainly resulted from net write-downs of EUR 39 million, an addition to the general loan loss provision of EUR 45 million and the reversal of the country risk provision of EUR 5 million.

The net revaluation loss from derivatives mainly comprises net additions to provisions for expected losses from stand-alone derivatives (EUR 113 million).

The net gain/loss on sale of securities including net gain/loss from derivatives primarily resulted from the sale of securities as well as repayments of securities in excess of the purchase cost.



### **Taxes on income**

The income tax expense mainly results from payments made in the current fiscal year.

### **Other taxes**

The other taxes include value added tax refunds of FMS Wertmanagement from 2011 and 2012.

## **OTHER DISCLOSURES**

### **Auditor's fee**

The auditor's fee for auditing services during the reporting period was EUR 2.8 million (previous year: EUR 3.3 million). In addition, a total of EUR 0.0 million (previous year: EUR 0.1 million) were expended for tax consultancy services, EUR 0.3 million (previous year: EUR 0.2 million) for other confirmation and valuation services as well as EUR 0.1 million (previous year: EUR 0.0 million) for other services.

Of the total expenses recognised in the reporting year, EUR 0.3 million (previous year: EUR 0.2 million) are related to the previous year. Of this amount, EUR 0.3 million (previous year: EUR 0.2 million) concern auditing services.

### **Shareholdings**

The following overview shows the shareholdings of FMS Wertmanagement, each of which is based on the company's most recent annual financial statements.



Shares in affiliated companies at 31 December 2014:

Name and registered office	Share in capital	Of which: indirectly	Equity in thousand	Result in thousand	Currency
Airen Sostenible S.L., Barakaldo	66.67 %		2,984 <sup>1</sup>	-80 <sup>2</sup>	EUR
Awareness Capital S.L., Barakaldo	66.67 %		26,836 <sup>1</sup>	-165 <sup>2</sup>	EUR
DBE Property Holdings Ltd, Dublin	100.00 %	100.00 %	78 <sup>1</sup>	4 <sup>2</sup>	EUR
DEPFA BANK plc, Dublin	100.00 %		650,312 <sup>1</sup>	-41,525 <sup>2</sup>	EUR
DEPFA ACS BANK, Dublin	100.00 %	100.00 %	636,473 <sup>1</sup>	76,433 <sup>2</sup>	EUR
DEPFA Ireland Holding Ltd, Dublin	100.00 %	100.00 %	-5,555 <sup>1</sup>	201 <sup>2</sup>	EUR
DEPFA Funding II LP, London	100.00 %	100.00 %	30,215 <sup>1</sup>	25,969 <sup>2</sup>	EUR
DEPFA Funding III LP, London	100.00 %	100.00 %	26,028 <sup>1</sup>	3,115 <sup>2</sup>	EUR
DEPFA Funding IV LP, London	100.00 %	100.00 %	9,854 <sup>1</sup>	9,068 <sup>2</sup>	EUR
DEPFA Hold One Ltd, Dublin	100.00 %	100.00 %	36 <sup>1</sup>	3 <sup>2</sup>	EUR
DEPFA Hold Two Ltd, Dublin	100.00 %	100.00 %	0 <sup>1</sup>	0 <sup>2</sup>	EUR
DEPFA Hold Six, Dublin	100.00 %	100.00 %	-2 <sup>1</sup>	0 <sup>2</sup>	USD
DEPFA Finance N.V., Amsterdam	100.00 %	100.00 %	5,326 <sup>1</sup>	485 <sup>2</sup>	EUR
Flint Nominees Ltd., London	100.00 %		51,681 <sup>1</sup>	235 <sup>2</sup>	GBP
FMS Wertmanagement Service GmbH, Munich	100.00 %		50,000 <sup>3</sup>	0 <sup>4</sup>	EUR
Hypo Dublin Properties Ltd, Dublin	100.00 %	100.00 %	275 <sup>1</sup>	3 <sup>2</sup>	EUR
Hypo Pfandbrief Bank International S.A., Luxembourg	100.00 %	100.00 %	119,632 <sup>1</sup>	300 <sup>2</sup>	EUR
Hypo Property Investment (1992) Ltd., London	100.00 %	100.00 %	1 <sup>1</sup>	0 <sup>2</sup>	GBP
Hypo Property Investment Ltd., London	100.00 %	100.00 %	287 <sup>1</sup>	0 <sup>2</sup>	GBP
Hypo Property Services Ltd., London	100.00 %	100.00 %	114 <sup>1</sup>	0 <sup>2</sup>	GBP
Hypo Public Finance Bank, Dublin	100.00 %	100.00 %	533,076 <sup>1</sup>	3,430 <sup>2</sup>	EUR
Hypo Real Estate Capital Corp., New York	100.00 %		566,519 <sup>1</sup>	12,451 <sup>2</sup>	USD
Upgrade 1 LLC, Wilmington/ Delaware	100.00 %	100.00 %	25,239 <sup>1</sup>	307 <sup>2</sup>	USD
WH-Erste Grundstücks Verwaltungs GmbH, Schönefeld	100.00 %		125 <sup>6</sup>	-13 <sup>7</sup>	EUR
WH-Zweite Grundstücks Verwaltungs GmbH, Schönefeld	100.00 %	100.00 %	69 <sup>6</sup>	-1 <sup>7</sup>	EUR
WH-Erste Grundstücks GmbH & Co. KG, Schönefeld	93.98 %		79,097 <sup>6</sup>	6,587 <sup>7</sup>	EUR
WH-Zweite Grundstücks GmbH & Co. KG, Schönefeld	100.00 %	100.00 %	40,432 <sup>6</sup>	-117 <sup>7</sup>	EUR

<sup>1</sup> 31 December 2013

<sup>2</sup> 2013

<sup>3</sup> 31 December 2014

<sup>4</sup> After profit transfer

<sup>5</sup> Entity was established in 2014

<sup>6</sup> 31 December 2013, preliminary

<sup>7</sup> 2013, preliminary



Other long-term equity investments at 31 December 2014:

Name and registered office	Share in capital	Of which: indirectly	Equity in thousand	Result in thousand	Currency
Aerodrom Bureau Verwaltungs GmbH, Berlin	32.00 %		-659 <sup>1</sup>	15 <sup>2</sup>	EUR
Airport Bureau Verwaltungs GmbH, Berlin	32.00 %		55 <sup>1</sup>	184 <sup>2</sup>	EUR
Inula Grundstücks Verwaltungsgesellschaft mbH & Co. KG, Grünwald	10.00 %		-31,100 <sup>1</sup>	3,212 <sup>2</sup>	EUR
LMG2 LLC, Delaware	25.00 %	25.00 %	n. a. <sup>5</sup>	n. a. <sup>5</sup>	USD
Pocahontas Parkway Holdings LLC, Delaware	20.51 %	20.51 %	n. a. <sup>5</sup>	n. a. <sup>5</sup>	USD
Projektentwicklung Schönefeld Verwaltungsgesellschaft mbH, Schönefeld	50.00 %		29 <sup>1</sup>	0 <sup>2</sup>	EUR
SP Projektentwicklung Schönefeld GmbH & Co. KG, Schönefeld	50.00 %		16,655 <sup>1</sup>	471 <sup>2</sup>	EUR
Vierte Airport Bureau Center KG Airport Bureau Verwaltungs GmbH & Co., Berlin	32.00 %		-3.136 <sup>1</sup>	-315 <sup>2</sup>	EUR

<sup>1</sup> 31 December 2013

<sup>2</sup> 2013

<sup>3</sup> 31 December 2014

<sup>4</sup> After profit transfer

<sup>5</sup> Entity was established in 2014

<sup>6</sup> 31 December 2013, preliminary

<sup>7</sup> 2013, preliminary



## **Corporate bodies of FMS Wertmanagement**

### ***Members of the Executive Board***

Dr. Christian Bluhm, CRO/CFO, Spokesman of the Executive Board  
Ernst-Albrecht Brockhaus, Treasury / Markets & CRE  
Frank Hellwig, COO (since 1 January 2015)

### ***Members who left the Executive Board during the 2014 fiscal year***

Norbert Kickum, CRE (until 30 November 2014)

### ***Members of the Supervisory Board***

Jan Bettink (since 6 January 2014)  
Chairman of the Supervisory Board (since 27 January 2014)  
Chief Executive Officer of Berlin Hyp AG and President of the Association of German Pfand-  
brief Banks

Klemens Breuer (since 6 January 2014)  
Deputy Chairman of the Supervisory Board (since 27 January 2014)  
Member of the Management Board of Raiffeisen Bank International AG, Global Markets

Dr. Axel Berger (since 17 June 2014)  
Auditor and tax adviser

Rita Geyermann  
Director Loan Securitisation at KfW Bankengruppe

Dr. Andreas Ricker  
Head of Strategy at Bundesrepublik Deutschland Finanzagentur GmbH

Dr. Herbert Walter (since 21 January 2015)  
Chairman of the Steering Committee of the Federal Agency for Financial Market Stabilisation



*Members who left the Supervisory Board during the 2014 fiscal year*

Prof. Dr. Harald Wiedmann (until 31 May 2014)  
Deputy Chairman of the Supervisory Board (until 31 May 2014)  
Lawyer, auditor and tax adviser

Dr. Christopher Pleister (until 31 December 2014)  
Chairman of the Supervisory Board (from 11 July 2013 to 27 January 2014)  
Chairman of the Steering Committee of the Federal Agency for Financial Market Stabilisation  
(until 31 December 2014)

***Loans to members of the corporate bodies***

At the reporting date, there were no claims in respect of incumbent members of the corporate bodies arising from loans or advances.

***Remuneration of the corporate bodies***

The members of FMS Wertmanagement's Executive Board were paid remuneration of EUR 1,364 thousand for the 2014 fiscal year (previous year: EUR 1,378 thousand). They were also paid benefits in kind of EUR 56 thousand (previous year: EUR 54 thousand). In addition, a total of EUR 675 thousand (previous year: EUR 675 thousand) were expended in the reporting period for the pension plans applicable to the members of the Executive Board.

Total remuneration of EUR 120 thousand was paid to the members of FMS Wertmanagement's Supervisory Board for 2014 (previous year: EUR 99 thousand).



### ***Annual average number of employees***

At 31 December 2014, FMS Wertmanagement had 141 employees (previous year: 145). The average number of employees in the 2014 fiscal year was:

	Women	Men	Total
Full-time employees	43	101	144

### ***Seats held by Executive Board members and employees***

In the fiscal year, the following members of the Executive Board and employees of FMS Wertmanagement held seats on a supervisory board or other supervisory bodies of large corporations in accordance with Section 340a (4) No. 1 in conjunction with Section 267 (3) HGB.

- ▶ Ernst-Albrecht Brockhaus: Non-Executive Member of the Board of Directors of DEPFA BANK plc, Dublin; DEPFA ACS Bank, Dublin; and Hypo Pfandbrief Bank International S.A., Luxembourg (Group offices held)
- ▶ Frank Hellwig: Non-Executive Member of the Board of Directors of DEPFA BANK plc, Dublin; DEPFA ACS Bank; (Group offices held)
- ▶ Christoph Müller: Non-Executive Member of the Board of Directors of DEPFA BANK plc, Dublin; DEPFA ACS Bank, Dublin; and Hypo Pfandbrief Bank International S.A., Luxembourg (Group offices held)



**RESPONSIBILITY STATEMENT  
IN ACCORDANCE WITH SECTION 264 (2) SENTENCE 5 HGB  
AND SECTION 289 (1) SENTENCE 5 HGB**

To the best of our knowledge, and in accordance with the applicable reporting principles, the annual financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of FMS Wertmanagement, and the management report includes a fair review of the development and performance of the business and the position of FMS Wertmanagement, together with a description of the material opportunities and risks associated with the expected development of FMS Wertmanagement.

Munich, 27 March 2015

FMS Wertmanagement  
The Executive Board

A handwritten signature in blue ink, appearing to be 'Bluhm'.

Dr. Christian Bluhm

A handwritten signature in blue ink, appearing to be 'Ernst-Albrecht Brockhaus'.

Ernst-Albrecht Brockhaus

A handwritten signature in blue ink, appearing to be 'Hellwig'.

Frank Hellwig



## AUDITORS' REPORT

We have audited the annual financial statements — comprising the balance sheet, the income statement, the notes to the financial statements, the cash flow statement and the statement of changes in equity — together with the bookkeeping system and the management report of FMS Wertmanagement AöR for the fiscal year from 1 January to 31 December 2014. The maintenance of the books and records and the preparation of the annual financial statements and the management report in accordance with German commercial law and supplementary provisions of FMS Wertmanagement's Charter are the responsibility of the Executive Board of FMS Wertmanagement. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, and the management report based on our audit.

We conducted our audit of the annual financial statements in accordance with Section 317 of the German Commercial Code (Handelsgesetzbuch — HGB) and the German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (Institute of Public Auditors in Germany — IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the annual financial statements in accordance with (German) principles of proper accounting and in the management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of FMS Wertmanagement and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the books and records, the annual financial statements and the management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by the Executive Board as well as evaluating the overall presentation of the annual financial statements and the management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion based on the findings of our audit, the annual financial statements comply with the legal requirements and supplementary provisions of FMS Wertmanagement's Charter and give a true and fair view of the net assets, financial position and results of operations of FMS Wertmanagement in accordance with the (German) principles of proper accounting. The management report is consistent with the annual financial statements and on the whole provides a suitable understanding of FMS Wertmanagement's position and suitably presents the opportunities and risks of future development.

Munich, 27 March 2015

PricewaterhouseCoopers  
Aktiengesellschaft  
Wirtschaftsprüfungsgesellschaft

Heiko Röhrig  
*Wirtschaftsprüfer [German Public Auditor]*

ppa. Axel Menge  
*Wirtschaftsprüfer [German Public Auditor]*



## GLOSSARY

### **Asset Liability Committee (ALCO)**

As a committee of the Executive Board, ALCO is the key management and information committee for strategic issues pertaining to asset liability management (ALM). The purpose of ALCO is to monitor FMS Wertmanagement's performance and balance sheet structure in respect of the wind-up plan and to provide strategic guidance relating to the key aspects of liquidity, funding and market risk

### **Audit Committee**

Audit committee of the Supervisory Board; key information committee of the Supervisory Board for preparing and reviewing the annual financial statements and preparing the statement of the Supervisory Board on the approval of the annual financial statements

### **Chief Financial Officer (CFO)**

Member of the Executive Board and Head of the Chief Risk Officer (CRO) division of FMS Wertmanagement

### **Chief Risk Officer (CRO)**

Division of FMS Wertmanagement

### **Commercial Real Estate (CRE)**

- Division of FMS Wertmanagement
- Term used for commercial real estate loans

### **Compliance**

Ensures compliance with external and internal requirements in connection with money laundering, combating fraud, prevention of terrorism funding, compliance with financial and trade sanctions, compliance with the requirements of the German Securities Trading Act (WpHG), prevention of conflicts of interest as well as IT security

### **Cooperation agreement**

Agreement dated 30 September 2010 between FMS Wertmanagement and pbb in respect of the comprehensive management of the risk assets in their totality by Deutsche Pfandbriefbank AG; recorded in the German Register of Notarial Deeds No. H 1569/2010 of the notary public, Dr. Eva-Maria Hepp, Munich



**Counterparty limits**

Upper limit fixed by the Executive Board's Risk Committee for counterparty exposures. Under MaRisk, trades may only be made with counterparties that are subject to counterparty limits. All trades with a specific counterparty must be allocated to the limit applicable to that counterparty

**Department**

Organisational unit of FMS Wertmanagement below the units

**Division**

Organisational unit at the Executive Board level

**EFSF bonds (European Financial Stability Facility)**

Bonds that serve to finance loans of EU member states

**Euro Commercial Paper (ECP)**

Short-term bearer debentures issued and traded on the international money markets

**Exposure at default (EAD)**

Exposure relevant to risk; the expected amount of the receivable at default

**Federal Agency for Financial Market Stabilisation (FMSA)**

Federal entity under public law with full legal capacity subject to the Federal Ministry of Finance; see Section 3a (1) FMStFG

**Financial Market Stabilisation Fund Act (FMStFG)**

German Law Establishing a Financial Market Stabilisation Fund, enacted as Section 1 of the Law on the Implementation of Measures to Stabilise the Financial Markets dated 17 October 2008, Federal Law Gazette I, page 1982, as amended

**FMS Wertmanagement**

Organisationally and financially independent public-law entity with partial legal capacity under the auspices of the Federal Agency for Financial Market Stabilisation; see Article 1 (1) of the Charter of FMS Wertmanagement

**German Banking Act**

German Banking Act as amended 9 September 1998



**German Commercial Code (HGB)**

German Commercial Code, as amended and published in Federal Gazette Part III, classification number 4100-1

**German Minimum Requirements for Risk Management (MaRisk)**

Minimum requirements governing the structure of risk management in German credit institutions; initially published in BaFin Circular 18/2005 (BA) dated 20 December 2005 and most recently amended by BaFin Circular 11/2010 (BA) dated 15 December 2010, all as amended

**HRE Group**

Hypo Real Estate Holding AG and its direct and indirect, domestic and foreign subsidiaries and special purpose entities

**Internal auditing department**

Risk-based audits uninvolved in business processes of the efficacy and adequacy of FMS Wertmanagement's risk management in general and its internal control system in particular as well as of the propriety of all activities and processes

**Other long-term equity investments**

Equity investments of the HRE Group that were transferred to FMS Wertmanagement

**PIIGS countries**

Portugal, Ireland, Italy, Greece, Spain

**Portfolio**

The risk assets transferred to FMS Wertmanagement, broken down into four segments: Public Sector, Structured Products, Infrastructure and Commercial Real Estate

**Portfolio decision**

Collective term for all decisions pertaining to the portfolio of FMS Wertmanagement, for example lending decisions, decisions respecting valuation allowances etc.

**Portfolio management**

Encompasses the following four units of FMS Wertmanagement: (1) Global Credit Management, (2) Structured Products & Quantitative Analytics, (3) Credit Markets, (4) Global Workout



**Portfolio servicer**

Assumes responsibility for the operational management of the portfolio under the cooperation agreement

**Portfolio Steering Committee**

A committee of the Executive Board; serves as the latter's key management and information committee for strategic issues related to portfolio management and the wind-up plan as well as for regularly defining, managing and monitoring wind-up targets

**Pre-deal limit check**

Review of the extent to which a limit has been exhausted before a new transaction takes place

**Reporting system**

Encompasses periodic reports by the portfolio servicer including wind-up reports, reports required under the German Commercial Code and internal reports

**Risk assets**

Risk positions and non-strategic operations; Section 8a (1) clause 1 FMStFG

**Risk Committee**

The Executive Board's key management and information committee for individual decisions related to the management of the transferred risk assets and the implementation of the wind-up plan and for lending decisions related to the implementation of the wind-up plan as well as for timely communication between FMS Wertmanagement and the portfolio servicer in respect of lending decisions

**Risk Committee of the Supervisory Board**

Risk Committee of the Supervisory Board; the latter's key information and decision-making committee for decisions/lending decisions pertaining to individual assets in connection with the management of the risk assets transferred and the implementation of the wind-up plan; reviews and decides transactions as well as actions, strategies and targets related to individual exposures in respect of the unwinding of the portfolio and the monitoring of relevant portfolio decisions

**Risk management process**

Comprises the identification, assessment, steering and monitoring of all risks

**Service level agreement**

Detailed specifications of the services to be rendered by the portfolio servicer, including definitions of the end products and the quality criteria applicable to them, broken down by the portfolio servicer's units



**Set of rules allocating authority**

Rules governing decision-making authority in respect of portfolio decisions, Treasury decisions, costs and signatory powers

**Unit**

Organisational unit of FMS Wertmanagement below the divisions

**Winding-up institution**

Independent public-law entity with partial legal capacity under the auspices of the Federal Agency for Financial Market Stabilisation pursuant to Section 8a (1) clause 1 FMStFG

**Wind-up plan**

Business plan setting out the nature and scope of the planned transactions serving to realise and unwind the transferred assets, including the planned realisation and wind-up activities as well as a timeline for the complete unwinding of FMS Wertmanagement's assets (see Article 5 of the Charter of FMS Wertmanagement)

**Wind-up reports**

Monthly, quarterly and annual reports on the process of realising and unwinding the portfolio as well as on the implementation of the wind-up plan (see Article 6 of the Charter of FMS Wertmanagement)



## FMS Wertmanagement

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