MANAGEMENT REPORT

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-WM), on 8 July 2010 in accordance with Section 8a of the German Financial Market Stabilisation Fund Act (Finanzmarktstabilisierungsfondsgesetz – FMStFG [1]). FMS-WM 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. It is regulated and supervised by FMSA and the Federal Financial Supervisory Authority, Bonn and Frankfurt am Main (BaFin). The Financial Market Stabilisation Fund (FMS) as the owner is obligated by law and the Charter of FMS-WM to compensate the latter's losses. The administration of the FMS created in 2008 by the FMSA was transferred to Bundesrepublik Deutschland Finanzagentur GmbH (German Finance Agency), Frankfurt am Main, on 1 January 2018. FMS-WM 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 [2] companies with a nominal value of EUR 175.7 billion (excluding derivatives) were transferred to FMS-WM effective 1 October 2010. To this end both FMSA – acting as necessary for the FMS, HRE, Deutsche Pfandbriefbank AG, Munich (pbb), DEPFA BANK plc, Dublin (DEPA BANK plc) and other HRE Group companies – and FMS-WM entered into a number of agreements pursuant to which certain risk positions and non-strategic operations of HRE Group companies were transferred to FMS-WM in accordance with Section 8a FMStFG.

[1] *The name of the law and its abbreviated version were changed to "Law Establishing a Financial Market and Economy Stabilisation Fund" (Gesetz zur Errichtung eines Finanzmarkt- und Witschaftsstabilisierungsfonds – Stabilisierungsfondsgesetz – StFG) effective 28 March 2020.*
[2] *HRE Group: HRE and its direct and indirect, domestic and foreign subsidiaries and special purpose entities*

The transferors, pbb and HRE, transferred risk positions and non-strategic operations to FMS-WM, partly by way of a spin-off for absorption, in accordance with Sections 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-WM 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-WM 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-WM on 2 December 2010.

The contracts 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-WM as part of the aforementioned spin-off. The concentration agreements were executed directly between the respective HRE Group company and FMS-WM by way of the afore-mentioned subparticipations, assignments, novations or guarantees.

Until FMS-WM is liquidated, the FMS has the obligation under Article 7 (1) of the Charter of FMS-WM to pay, on first demand by the Executive Board of FMS-WM, 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 on time and in full and (ii) to cover all losses of FMS-WM. Losses in this sense comprise all amounts that are payable to FMS-WM so that it can discharge its liabilities – as set out above – and that need not be repaid to the FMS under the conditions set out in Article 7 (2) of the Charter.

In 2012, FMS-WM established its own service entity called FMS Wertmanagement Service GmbH, Unterschleißheim (FMS-SG), which assumed responsibility for portfolio servicing and the supply of all associated services effective 1 October 2013. The scope of the services rendered by FMS-SG for FMS-WM was expanded to include accounting services effective 1 April 2015 and regulatory reporting activities effective 1 April 2016.

FMS-WM 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-WM extensive rights to obtain information and perform inspections, enabling the latter to monitor and control the servicing of the risk assets by FMS-SG.

FMS-SG operated from three sites in fiscal year 2020 (Unterschleißheim, Dublin and New York).

In addition, IBM Deutschland GmbH, Ehningen (IBM Deutschland) and DATAGROUP Financial IT Services GmbH, Düsseldorf (DG FIS), were engaged to provide essential IT services.

Strategic objectives

FMS-WM 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.

- *Wind-up of the risk assets aimed at maximising their value, operational implementation and refining of adequate wind-up strategies for the entire transferred portfolio:*
  The risk assets are unwound in a manner aimed at maximising their value subject to defined wind-up and risk strategies that are adjusted on a continuous basis. The wind-up plan – which must be deemed the key strategic management tool of FMS-WM – 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-WM itself and in part by service providers on the basis of service level agreements. Sole responsibility for the wind-up aimed at maximising value and the cost-effective servicing and management of the portfolio, however, rests with FMS-WM alone.

- *Cost-effective funding:*
  FMS-WM shall ensure cost-effective funding for the purpose of carrying out its task. Due to regulatory and statutory parameters FMS-WM can obtain funding at very favourable terms. This funding is achieved through FMS-WM's market access via the Asset Management & Treasury division's Group Treasury unit, the option to borrow through the FMS, the FMS's loss compensation obligation included in the Charter and the FMS's explicit guarantee that has been in place since 1 January 2014. The FMS has been providing FMS-WM with long-term funding in EUR since the start of 2019. FMS-WM continues to raise long-term liabilities denominated in foreign currencies, in particular pound sterling and US dollars, and short-term money market funding itself.

In accordance with its Charter, FMS-WM may engage in certain kinds of banking and financial services transactions as well as operate other kinds of businesses which serve, directly or indirectly, to unwind the portfolio; however FMS-WM 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 the entire asset and liability business related to the risk assets.

The wind-up plan generally does not permit FMS-WM to engage in new business activities. Funding and hedging transactions in the context of funding and market risk management, as well as select new business aimed at reducing risks arising from existing commitments in a cost-efficient manner or making them more manageable (required extensions as well as select restructuring measures), are exceptions to the above rule.

DEPFA BANK plc

On 19 December 2014, FMS-WM acquired 100% of the shares in DEPFA BANK plc. As an independent bank, DEPFA BANK plc is regulated by the Central Bank of Ireland and subject, among other things, to Irish banking and supervisory law. At the end of 2020, the DEPFA Group [1] still employed 90 people at its Dublin site. The Luxembourg site was closed in fiscal year 2020.

As a result of the decision by the Federal Republic of Germany's inter-ministerial steering committee on 13 May 2014 not to privatise the DEPFA Group, FMS-WM was tasked with unwinding the DEPFA Group in a way that maximises its value. This first required a strategic realignment, as prior to its transfer to FMS-WM, the DEPFA Group had been preparing to be re-privatised and resume new business rather than be wound up.

Three key value levers were identified for winding up the DEPFA Group in a way that maximises its value:

- The funding advantages enjoyed by FMS-WM due to its rating and explicit direct guarantee from the FMS are also used by the DEPFA Group as far as possible.
- Potential synergies emerging between FMS-WM, DEPFA and FMS-SG will be identified and leveraged with a view to winding up these institutions as efficiently as possible.
- Buying debt instruments from DEPFA Group companies ("DEPFA liabilities") enables the cover pools for the DEPFA Pfandbrief securities to be scaled down. These purchases are the basis on which FMS-WM assumes risk positions of DEPFA Group companies and like the purchases of DEPFA hybrid capital bonds therefore allow the total assets of individual DEPFA Group companies to be reduced.

Since the DEPFA Group's acquisition by FMS-WM, the implementation of the value levers identified has contributed to winding up the DEPFA Group in ways that maximise its value. Reducing the DEPFA Group's derivatives portfolio in fiscal year 2020 also lowered the total assets of significant companies within the DEPFA Group and thus reduced complexity. DEPFA BANK plc also made a distribution in fiscal year 2020. FMS-WM reduced the book value of its shares in DEPFA BANK plc as part of this distribution.

[1] *DEPFA Group: DEPFA BANK plc and its direct subsidiaries.*

In July 2020, FMS-WM launched the open, transparent, competitive and non-discriminatory sale of the shares in DEPFA BANK plc. The tender process was successfully completed in February 2021 and an appropriate contractual agreement was reached. At the time of preparation of the financial statements for 2020, the sale was still subject to regulatory and possible antitrust approvals.

Locations

FMS-WM is domiciled in Munich.

Branches

FMS-WM has maintained a branch in Rome, Italy, since 2013, which commenced operations in February 2014.

The branch in Rome consists of two full-time employees, who were taken on in February 2014 as part of a partial transfer of operations of DEPFA BANK plc, and a branch manager.

This branch winds up Italian assets with the public sector and infrastructure financing.

ORGANISATIONAL STRUCTURE

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

As at 31 December 2020, the Supervisory Board had eight members. The members of the Supervisory Board are delegated by the German Finance Agency. It is tasked with advising the Executive Board of FMS-WM 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 reserve 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-WM externally to legal effect. The Supervisory Board has established two committees from among its members:

- The Risk Committee acts as the Supervisory Board's central information and decision-making body for the FMS-WM risk strategy, making decisions as part of portfolio management activities and implementing the wind-up plan.
- The Audit Committee is specifically concerned with discussing the audit reports and making preparations for the Supervisory Board's decisions to adopt the annual financial statements. It is responsible for appointing and monitoring the auditor of the financial statements.

The Executive Board manages the business of FMS-WM and represents it both in and out of court. As at 31 December 2020, the Executive Board comprised Christoph Müller (Spokesman of the Executive Board) and Carola Falkner. The Executive Board is appointed by the Supervisory Board with FMSA's approval for terms of no more than four years; it may be reappointed however.

Christoph Müller heads the *CEO (Chief Executive Officer)* division. This includes the four units of *Finance, Controlling & Portfolio Steering, Risk Controlling & Quantitative Analytics, IT Sourcing & Operations and Human Resources* as well as the *Communications & Committees staff unit*. The division is responsible for external and internal accounting, the resultant reporting and independent monitoring and reporting of risks to FMS-WM. It is also responsible for developing the wind-up strategy and preparing wind-up plans for the entire portfolio. This division also handles the operations of FMS-WM and is responsible for the IT architecture, all procurement procedures and service provider management. Furthermore, this division is in charge of human resources, internal and external communications and the supervision of the committees.

Carola Falkner heads the *Asset Management & Treasury* division. This includes the four units of *Group Treasury, Asset Management, Legal & Group Compliance and Group Internal Audit*. Group Treasury is responsible for liquidity management and asset / liability management as well as support for the derivatives portfolio of FMS-WM. Asset Management is responsible for the lending and securities operations of the Public Sector, Structured Products, Infrastructure and Commercial Real Estate segments. The Legal & Group Compliance unit is responsible for legal issues and reviewing adherence to compliance-related requirements. The division is also in charge of the Group-wide internal audit function, which supports the Executive Board in its monitoring role.

There were no changes on the Executive Board of FMS-WM in fiscal year 2020.

INTERNAL MANAGEMENT SYSTEM

The control system of FMS-WM is based on the company's strategic objectives.

Unwinding of the transferred portfolio aimed at maximising value

The risk assets transferred from HRE Group companies consist of loan receivables, securities, derivative financial instruments, rights and obligations under loan commitments, guarantees and equity investments, along with the respective collateral.

FMS-WM's wind-up strategy is based on a basic allocation 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, with both steps being taken if necessary after carrying out any restructuring. Efficient management, including monitoring to identify risk or selling signals, is the focus for the more passively managed sub-portfolios.

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. to reduce both risks and the complexity of the portfolio, and if the market offers opportunities, or
- Restructure (also includes wind-up and reorganisation measures).

Within these approaches, the risk strategy of FMS-WM and its organisational structure in asset management define further steps that drive the wind-up of the portfolio in a way which aims to maximise the assets' value.

As defined by FMS-WM, the "hold" approach entails actively managing risk positions with the aim of full repayment of all amounts outstanding (loans and securities) or reaching maturity (e. g. guarantees, irrevocable loan commitments and credit derivatives). A large portion of the risk positions are unwound by holding and managing them until maturity.

FMS-WM 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 other parameters such as the operational complexity of the servicing.

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 risk exposures, are integral to the “restructuring” approach. For every restructuring measure, the aim is to ensure a winding-up of the respective risk exposures (whether non-performing or performing) aimed at maximising its value, including risk mitigation measures.

When making decisions for individual or portfolio sales and restructuring of risk exposures, the so-called control logic helps to ensure consistent and transparent consideration and documentation of the decision-making criteria identified. This framework does not provide an algorithm for generating decisions automatically. The decision-making process involves comparing and contrasting quantifiable decision-making parameters, analysing qualitative assessments and making case-by-case decisions based on FMS-WM’s regulation governing the decision-making process.

The internal management system of FMS-WM is based on the annually-updated wind-up plan, which must be approved within the existing governance framework. The key elements of the wind-up plan are the forecasts of earnings contributions of the portfolio expected in the future based on the wind-up strategy (including the estimate of expected losses), the funding plan and administrative cost budgeting.

The reporting system is managed and presented based on the four portfolio segments:

- Commercial Real Estate,
- Infrastructure,
- Public Sector
- Structured Products.

Actual results are reconciled with wind-up plan forecasts as part of this reporting.

The measures to unwind the portfolio are continually monitored by the Controlling & Reporting department. The Executive Board and the Supervisory Board’s Risk Committee are kept informed of current developments in the portfolio wind-up at segment level and the causes of any deviations from the wind-up plan in monthly reports. The balance sheet and income statement are reconciled with forecasts on a quarterly basis and the results are reported to the Executive Board in the Risk / Asset Liability Committee (RALCO). Based on this reconciliation of budgeted and actual figures, the Executive Board determines in the RALCO whether there is a need to adjust the business strategy and wind-up plan.

Pursuant to its Charter FMS-WM 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.

DEPFA BANK plc, which was taken over in December 2014, is managed as an equity investment. Among the items defined as primary management tools in an agreement with DEPFA BANK plc were comprehensive information requirements for DEPFA BANK plc with regard to FMS-WM as well as a catalogue of measures whose implementation required the prior approval of FMS-WM. Furthermore, FMS-WM appointed the two members of its Executive Board as "non-executive directors" to the Board of Directors of DEPFA BANK plc effective 31 December 2020. The DEPFA BANK plc's Board of Directors is chaired by the Spokesman of the Executive Board of FMS-WM.

The strategic goals defined by FMS-WM for the risk positions and non-strategic operations taken over from the HRE Group also apply to the unwinding of the DEPFA Group.

The risk assets transferred from HRE Group companies were supplemented by portfolio extensions in fiscal years 2016 to 2020 and thus by the transfer of additional risk positions of DEPFA Group companies. A detailed explanation can be found in the *Course of business – Business performance* section. The transferred risk assets and the extensions to the portfolio are also referred to below as the "portfolio". The internal management system of FMS-WM is also used for the portfolio extensions.

Cost-effective servicing and management

FMS-WM pursues the strategic objective of cost effectively servicing and managing its risk assets. Controlling this objective is based on budget planning and budget responsibility encompassing FMS-WM and FMS-SG.

The Controlling & Reporting department monitors the development of costs and compliance with the budget requirements. The Executive Board and the Audit Committee of the Supervisory Board are regularly informed of the development of costs and deviations from budget targets as part of the cost reporting process.

In addition, FMS-WM 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-SG and activities outsourced to other service providers. The Sourcing & Service Steering department informs the Executive Board of the contractually defined service quality as stated in the service level agreements of all material outsourcing as part of a quarterly management report.

Cost-effective funding

FMS-WM ensures cost-effective funding in order to carry out its mandate. In determining funding requirements, the cash portion of total assets which are liquid assets and their scheduled maturity form the basis of the annual funding plan. This also takes into account the expected providing of cash collateral for derivatives during the planning period. In accordance with the funding strategy planning, the future funding requirement resulting from this is met by borrowing from the FMS and raising funds on both the money market and the capital market.

Funding activities are regularly presented and discussed in the competent RALCO, in which the Executive Board is also represented through membership.

Financial performance indicators

In its management of the wind-up of the portfolio aimed at maximising its value, FMS-WM refers primarily to indicators that show the income from the wind-up. The central tool used for this purpose is the wind-up report.

The key management parameter for unwinding the portfolio is the “income from the wind-up”, i. e. the development of the portfolio adjusted for foreign currency effects. The performance of the portfolio in fiscal year 2020 and its cumulative performance since its transfer effective 1 October 2010 are presented in the chapter entitled *Course of business – Wind-up report*.

The key parameters for cost-effective management are administrative cost budgeting and development. The Executive Board and the Audit Committee of the Supervisory Board are regularly informed of the development of these management parameters and deviations from budget targets as part of the cost reporting process.

The cost reporting process is based on the expenses recognised in the income statement in the items, General and administrative expenses, and Write-downs of and valuation allowances on intangible and tangible fixed assets, in accordance with the Handelsgesetzbuch – HGB. Significant items within general and administrative expenses include the development of personnel expenses and expenses for servicing outsourced services. These represent material key financial performance indicators for FMS-WM.

The development of the general and administrative expenses management parameter and the personnel and servicing expenses contained therein are presented in the chapter entitled *Asset position, financial position results of operations of FMS Wertmanagement – Results of operations*.

The key financial performance indicator for the cost-effective funding management parameter is the total issuance volume of all capital market instruments and the funds raised via the FMS.

The development of funding activities is outlined in the chapter entitled *Asset position, financial position and results of operations of FMS Wertmanagement – Financial position*.

REPORT ON ECONOMIC POSITION

MACROECONOMIC AND PORTFOLIO-SPECIFIC DEVELOPMENTS

Macroeconomic environment

The spread of coronavirus (SARS-CoV-2 / COVID-19) and the measures taken as a result influenced the development of the global financial markets as well as economic trends in 2020.

The table on the right shows selected macroeconomic indicators in the economies relevant to FMS-WM - the euro zone, the United Kingdom and the USA. Due to the COVID-19 crisis, economic growth was negative in all of the economies considered here, with the USA significantly less strongly impacted at –2.8% than the euro zone at –4.3%. The United Kingdom, which was also adversely affected by its impending withdrawal from the EU (Brexit), recorded negative economic growth of –8.6%. Despite the negative economic trend, unemployment in Europe increased only moderately due to mitigating measures such as short-time working regulations and comparable measures implemented during the COVID-19 crisis, while unemployment in the USA more than doubled over the same period. Euro zone countries recorded slight deflation of 0.3% on average due to the decline in demand caused by the COVID-19 crisis, while inflation in the UK and USA only fell slightly compared to the previous year.

Economic growth in % [1]	2020	2019
Euro zone	–4.3	1.4
Including Germany	–4.0	0.8
Including Italy	–5.0	0.5
United Kingdom	–8.6	1.4
USA	–2.8	2.1

Unemployement rate in % [2]	2020	2019
Euro zone	8.5	7.5
Including Germany	6.3	5.0
Including Italy	9.7	9.5
United Kingdom	4.5	3.8
USA	8.8	3.6

Inflation in % [1]	2020	2019
Euro zone	–0.3	0.8
Including Germany	–0.3	1.2
Including Italy	–0.6	0.3
United Kingdom	0.5	1.7
USA	1.4	1.7

[1] *Data shown on an annualised basis as at 30 September of each year*
[2] *Figure as at 30 September of each year*

Ten-year inflation expectations for the euro zone rose from a low of around 0.6% at the start of 2020 to 1.2% at the end of 2020, thus reaching a similar level to the previous year. The European Central Bank (ECB) introduced a series of measures in 2020 to tackle the economic downturn, deflation and to ensure liquidity in the markets. One of the most comprehensive measures is the Pandemic Emergency Purchase Programme (PEPP), which entitles the ECB to purchase private and public sector bonds. In December 2020, the scope of potential purchases was expanded by EUR 500 billion to EUR 1,850 billion.

In December 2020, the British government and the EU reached a trade agreement as part of the United Kingdom's withdrawal from the EU. Although freight traffic will remain largely unregulated and customs-free, the freedom of establishment and employment between the EU and the UK has been made more difficult and non-tariff barriers such as certification obligations will restrict commercial trade. In a study, the ECB concluded that the United Kingdom's withdrawal from the EU will reduce long-term economic growth by 2.1% in the UK and by 0.4% in the EU, even when taking into account the concluded trade agreement. The International Monetary Fund (IMF) expects gross domestic product (GDP) in the United Kingdom to fall by 10% in 2020, with economic growth of 4.5% and 5.0% anticipated in 2021 and 2022 respectively. The unemployment rate in the UK increased from 3.8% in December 2019 to 4.5% in October 2020.

Commercial Real Estate

FMS-WM used the favourable market environment at the end of 2019 to successfully press ahead with the unwinding of the portfolio in the Commercial Real Estate segment at the start of 2020. The remaining portfolio now primarily consists of US financing.

The COVID-19 pandemic also had a strong negative impact on the US office real estate market from the second quarter of 2020 onwards. The nationwide vacancy rate rose from 12.9% at the end of 2019 to 15.5% at the end of 2020. This was mainly driven by a decline in demand associated with the completion of projects under construction.

Infrastructure

The Infrastructure segment was also materially impacted by the COVID-19 pandemic in 2020. This was particularly apparent in the distribution of completed transactions over the year. As investors were anxious to complete transactions promptly due to the uncertainty and market turbulence triggered by the COVID-19 pandemic, transaction volumes were highest in the second and third quarters of 2020.

Overall, global financing volumes and the number of completed transactions were even higher in 2020 than in 2019. This was particularly due to an increase in mergers and acquisitions (M&A) transactions and bond issues, as companies turned to the capital markets and portfolio optimisation measures to mitigate the effects of the uncertainty caused by the COVID-19 pandemic.

Bonds were the preferred source of financing for infrastructure projects in 2020, reaching their highest half-year figure for almost two-and-a-half years. Oil, gas, energy and telecommunications groups from Europe and North America issued corporate bonds amounting to approximately USD 475 billion via the capital markets (2019: approx. USD 322 billion).

Europe made up the largest share of global financing volumes (35%), followed by North America (32%) and Asia Pacific (14%). Financing volumes in the first half of 2020 were significantly higher than in the second half of the year.

Public Sector

In the wake of the global economic downturn triggered by the COVID-19 pandemic, many economies introduced large-scale monetary and fiscal stimulus packages.

The EU independently took on debt for the first time with its “Next Generation EU” programme in order to distribute EUR 360 billion in assistance loans and EUR 390 billion in direct transfers to individual member states. The expansion of the ECB’s potential bond purchases as part of the PEPP to a total volume of EUR 1,850 billion ensured that ten-year inflation expectations in the euro zone doubled from an all-time low of 0.6% at the start of 2020 to 1.2% at the end of 2020 while at the same enabling a reduction in risk premiums for the euro zone’s particularly hard-hit peripheral countries. As a result, risk premiums on ten-year Italian government bonds dropped from almost 190 basis points at the start of 2020 to 80 basis points at the end of 2020, while risk premiums on ten-year Spanish government bonds declined from 72 basis points at the start of 2020 to just under 30 basis points at the end of the year. By contrast, credit spreads on ten-year British government bonds have widened from –29 basis points in March 2020 to –17 basis points in December 2020 due to uncertainty surrounding the UK’s withdrawal from the EU (Brexit).

The US Federal Reserve (Fed) in turn announced its intention to purchase USD 80 billion in US government securities and USD 40 billion in mortgage-backed securities every month for an indefinite period. In December 2020, the outgoing US government agreed an economic package of USD 900 billion. The newly elected US president sought to increase this package to USD 1,900 billion, and this was approved by the US Senate in March 2021. Ten-year inflation expectations in the USA were 1.9% at the start of 2020, reached a low of just under 0.8% in March 2020 and rose to almost 2.2% by the end of the year. The measures implemented by the Fed and US government were reflected in the US dollar’s exchange rate against the euro. The euro was worth USD 1.10 at the start of 2020 and ended the year at USD 1.23.

Structured Products

US municipals

The COVID-19 pandemic also impacted the bond market for US municipals in 2020. The market value losses triggered by the pandemic in the first half of 2020 were only partially reversed in the second half of the year. Despite this, the credit quality of US municipal bonds remained stable in 2020, with defaults at their usual low level. The US municipals market also continues to be dominated by investment grade ratings.

With regard to the risk positions relevant to FMS-WM in this subsegment in California, Illinois and New Jersey, credit spreads widened in 2020, particularly in Illinois and New Jersey. Risk premiums in California remained around the previous year's level. The pension system in Illinois is significantly underfunded. Despite the COVID-19 pandemic, rating agencies did not issue any further downgrades in this area in 2020. However, it is certainly possible that these effects will only become apparent in 2021, which could have a knock-on effect on ratings.

Asset backed securities (ABS)

Risk premiums on European ABS widened in 2020, with lower prices observed in the market as a result. Issue volume was well below the expectations for 2020 at around EUR 71 billion. The volume of ABS placed in the USA also fell far short of expectations at approximately USD 174 billion.

Risk premiums for variable-rate bonds from the US Federal Family Education and Loan Program (FFELP) widened slightly during the course of 2020. However, the negative developments in the first half of 2020 were largely reversed in the second half of the year. One positive market signal for securitised FFELP student loans was the announcement by the Intercontinental Exchange Benchmark Administration (IBA) that USD LIBOR rates would continue to be listed until mid-2023, which initially took the pressure off bonds without corresponding LIBOR clauses.

COURSE OF BUSINESS

Business performance

The business activities and annual financial statements of FMS-WM as at 31 December 2020 strongly reflect both the ongoing portfolio wind-up and measures to wind up the DEPFA Group while maximising its value.

FMS-WM posted a positive result from ordinary activities of EUR 25 million (previous year: EUR 253 million) for fiscal year 2020. Taking into account the tax expense of EUR 2 million (previous year: EUR 17 million), net income for the fiscal year amounts to EUR 23 million (previous year: EUR 236 million). Performance has therefore met the statement made in the outlook for the 2020 fiscal year, which expected FMS-WM to at least break even. The contribution to earnings from net interest and net commission income totalling EUR 327 million includes one-off effects of EUR 17 million. Even excluding these one-off effects, the sum total of net interest and net commission income is well in excess of general and administrative expenses of EUR 134 million (previous year: EUR 138 million). Other operating income includes EUR 45 million of income from the accrual of WH-Erste Grundstücks GmbH & Co. KG, Munich (WH-Erste KG) to FMS-WM completed in fiscal year 2020. The balance of the items influenced by valuation and sales decisions (risk provisions and net income from investments) amounted to EUR –255 million in fiscal year 2020 (previous year: EUR 23 million). As well as disposal losses in connection with the wind-up task, net income from investments was also negatively affected by a one-off effect in the amount of EUR –201 million, which arose in connection with the complexity-reducing restructuring of a risk position in the Public Sector segment and contrasts with countervailing effects in future periods.

In connection with the mandate received in May 2014 to unwind the DEPFA Group in a way that maximises its value, FMS-WM acquired the risk positions of DEPFA Group companies with a nominal volume of EUR 11.7 billion [1] in fiscal years 2016 to 2019 (referred to as "portfolio extensions"). In the 2020 fiscal year, the portfolio was extended by a nominal volume of EUR 75 million. Unless specified in greater detail, the portfolio extensions for fiscal years 2016 to 2020 are henceforth summarised by the term "portfolio extensions". The portfolio extension in fiscal year 2020 is thus referred to as such.

As a safeguard against interest rate risks, interest rate hedges related to the described transactions were then entered into as part of the wind-up of the DEPFA Group, both in the market and with companies in the DEPFA Group.

In the course of winding up the DEPFA Group, FMS-WM implemented measures in 2020 to unwind the DEPFA Group's derivatives portfolio and thus reduce its complexity. A significant portion of the derivatives portfolio of the DEPFA Group was partially transferred to FMS-WM and / or terminated. In addition to reducing complexity and the number of derivative counterparties, this also resulted in a reduction of the total assets of DEPFA Group companies. As part of the transfer of the DEPFA Group companies' derivative positions, FMS-WM made or received corresponding compensation payments for the market values of the derivatives. This is accordingly reflected in the development of FMS-WM's prepaid expenses and deferred income.

[1] *As of each respective acquisition date: November 2016: EUR 5.2 billion, November 2017: EUR 2.0 billion, November 2018: EUR 0.5 billion, June 2019: EUR 1.6 billion, November 2019: EUR 1.0 billion, December 2019: EUR 1.4 billion.*

In fiscal year 2020, FMS-WM's liquidity was above the liquidity threshold relevant for management purposes at all times. As regards issuance activities at FMS-WM, the total issuance volume of all capital market instruments amounted to EUR 6.1 billion in 2020. Funding of EUR 5.6 billion was obtained via the FMS.

Wind-up report

The monthly wind-up report provides information on the income from the wind-up (cumulative portfolio development based on nominal values). This income is a financial performance indicator for FMS-WM.

The following table shows the cumulative portfolio development from 1 October 2010 (the date of transfer) to 31 December 2020. The cumulative portfolio development also includes the additions resulting from the extensions to the portfolio as well as the unwinding of the portfolio completed by the reporting date in relation to the extensions to the portfolio.

Development of the portfolio Cumulative			in EUR billion
	Nominal wind-up portfolio as at 01.10.2010		175.7
–	Cumulative portfolio development		–114.5
	Of which:	*Portfolio extensions (nominal)*	*+11.8*
		Portfolio wind-up (attributable to portfolio extensions: EUR –4.1 billion)	*–126.3*
+	Currency effects		+0.4
	Nominal extended wind-up portfolio as at 31.12.2020[1]		**61.6**

[1] *Translated at exchange rates as at 31 December 2020*

The following table shows the portfolio development in fiscal year 2020 (taking into account the portfolio extension in fiscal year 2020) and the reconciliation of the nominal volume of the extended wind-up portfolio to total assets as at 31 December 2020:

Development of the portfolio 2020 fiscal year			in EUR billion
	Nominal extended wind-up portfolio as at 31.12.2019		69.3
–	Portfolio development, fiscal year		–5.2
	Of which:	*Portfolio extension in fiscal year 2020 (nominal)*	*+0.1*
		Portfolio wind-up in fiscal year 2020 (attributable to portfolio extensions: EUR –1.3 billion)	*–5.3*
–	Currency effects		–2.5
	Nominal extended wind-up portfolio as at 31.12.2020[1]		**61.6**
–	Undrawn credit lines and guarantees		–0.2
+	Portfolio of own issues, nominal		+13.1
+	Other receivables / receivable components / other		+71.3
	Total assets as at 31.12.2020		**145.8**

[1] *Translated at exchange rates as at 31 December 2020*

"Other receivables incl. portions thereof / Other" mainly contain cash collateral provided for derivatives, the amortised cost of derivatives taken over, current credit balances and accrued interest.

Based on nominal values, the cumulative portfolio development since the 1 October 2010 transfer date was as follows as at 31 December 2020, taking the portfolio extensions into account:

Segment / nominal Cumulative	01.10.2010 in EUR billion	Portfolio development in EUR billion	Currency effects in EUR billion	31.12.2020 in EUR billion
Commercial Real Estate	27.2	–26.9	+0.0	0.3
Infrastructure	18.0	–8.7	–0.4	8.9
Public Sector	86.6	–54.2	–0.2	32.2
Structured Products	43.9	–24.7	+1.0	20.2
Total	**175.7**	**–114.5**	**+0.4**	**61.6**

Taking the portfolio wind-up and the additions from portfolio extensions into account, the extended wind-up portfolio decreased to EUR 61.6 billion as at 31 December 2020. Not including countervailing currency effects, this corresponds to a reduction of EUR 114.5 billion since 1 October 2010. The reduction consists of the wind-up of the portfolio transferred in 2010 and the additions resulting from portfolio extensions, as well as their wind-up by the balance sheet date. The reduction was brought about through scheduled and unscheduled redemptions as well as sales.

Based on nominal values, the development of the extended wind-up portfolio, broken down by segments, was as follows in fiscal year 2020, taking the portfolio extension in the fiscal year into account:

Segment / nominal 2020 fiscal year	31.12.2019 in EUR billion	Portfolio development in EUR billion	Currency effects in EUR billion	31.12.2020 in EUR billion
Commercial Real Estate	1.1	–0.8	+0.0	0.3
Infrastructure	9.5	–0.2	–0.4	8.9
Public Sector	34.7	–1.9	–0.6	32.2
Structured Products	24.0	–2.3	–1.5	20.2
Total	**69.3**	**–5.2**	**–2.5**	**61.6**

Taking into account the addition resulting from the portfolio extension in fiscal year 2020, the extended wind-up portfolio was reduced (before currency effects) by EUR 5.2 billion during the year under review. The portfolio extension carried out in fiscal year 2020 has been allocated to the Public Sector segment.

Excluding the effects of addition resulting from the portfolio extension in fiscal year 2020, the portfolio was reduced (before foreign currency effects) by EUR 5.3 billion in the fiscal year [1]. The wind-up envisaged in the outlook for fiscal year 2020, with a nominal volume of EUR 4 billion to EUR 6 billion, was thus achieved.

[1] *The reduction refers to the original wind-up portfolio and the portfolio extensions.*

EMPLOYEES

As at 31 December 2020, FMS-WM had 104 employees (31 December 2019: 103 employees). The target figure is adjusted regularly to reflect requirements; it currently stands at 112 employees. The trend in employee numbers and thus the balance between the target figure and the actual number of employees is a non-financial performance indicator for FMS-WM which is reviewed annually as part of the wind-up planning process and adjusted to current conditions during the year as necessary.

The Executive Board of FMS-WM is convinced that motivated, committed and loyal employees are essential to the success of FMS-WM. It is therefore important that employees are able to optimally contribute their individual skills and experience to FMS-WM, and are always given opportunities for personal development even against the backdrop of a wind-up scenario. Key elements of staff development efforts, and a central pillar for long-term employee loyalty and identification with FMS-WM, include continual feedback on performance, as well as forward-looking, systematic and needs-based continuing professional development planning. In fiscal year 2020, FMS-WM completely overhauled its existing feedback tools and processes as part of a company-wide project and introduced additional feedback formats in addition to the annual development review. The aim is to establish an everyday culture of feedback across the organisation.

With the unwinding of the portfolio, FMS-WM has assumed a complex task and committed itself to a high degree of professionalism. FMS-WM places very high demands on all of its employees. The many years of professional experience of the individual employees reflect what has been a high level of qualifications from the outset. FMS-WM considers it very important to sustain this level and thus to maintain the availability of the necessary technical expertise for the tasks it faces throughout the entire winding-up period. Existing knowledge is therefore expanded through continuous and targeted training. A key challenge is to make sure that sufficient know-how is retained despite high employee turnover and that suitable long-term internal successors can be found. Measures such as job rotation and cross-departmental and cross-division project work play an important role in passing on and securing existing know-how. In addition to professional training, great emphasis is placed on helping employees develop their personal skills and in continuously investing in leadership through concrete measures. A Staff Council, which currently comprises four members, has been in place at FMS-WM since 2016.

As classroom training sessions were only possible to a very limited extent in fiscal year 2020 due to the restrictions imposed as a result of the COVID-19 pandemic, FMS-WM largely offered virtual formats such as webinars. At the same time, these formats provided an opportunity to strengthen team spirit during the current situation in which most FMS-WM employees were working from home.

To continue fulfilling the task of winding up the portfolio and for the impending change processes required to achieve its medium-term goals, FMS-WM must be a flexible and adaptable organisation. With this in mind, FMS-WM is launching an agile transformation project together with FMS-SG in fiscal year 2021. Employees have been participating in virtual workshops on agile methods in preparation for this in recent months.

The “LIKE” project was launched in fiscal year 2018 with the aim of retaining employees as well as enhancing FMS-WM’s appeal as an employer for new employees. Numerous measures were implemented as part of this project since fiscal year 2018 with the aim of reinforcing and strengthening employees’ sense of identification with the organisation as well as increasing the quality and quantity of its applicants and accelerating the recruiting process. FMS-WM received the HR Excellence Award in the “SME Change Management” category for its “LIKE” project in fiscal year 2020. The staff turnover rate continued to decline in fiscal year 2020 compared to fiscal years 2018 and 2019.

ASSET POSITION, FINANCIAL POSITION AND RESULTS OF OPERATIONS OF FMS WERTMANAGEMENT

Asset position

The asset position of FMS-WM as at 31 December 2020 continues to be dominated by the transfer of risk positions of the HRE Group as at 1 October 2010 and FMS-WM's mandate to wind up the DEPFA Group in a way that maximise its value. As at 1 October 2010, FMS-WM 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. Since then, FMS-WM's asset position has also been significantly affected by the shares in DEPFA BANK plc acquired in the course of winding up the DEPFA Group and by the transactions related to winding up the DEPFA Group.

In fiscal year 2020, the key factors shaping the asset position of FMS-WM were the extension of the liquidity reserve (cash reserve) held by the Deutsche Bundesbank in connection with the COVID-19 pandemic, the increase in the cash collateral provided for derivatives as well as the portfolio wind-up and the reduction in own issues repurchased. In connection with the task of winding up the DEPFA Group, measures were implemented in fiscal year 2020 in order to wind up the derivatives portfolio of the DEPFA Group. A significant portion of the derivatives portfolio of the DEPFA Group was partially transferred to FMS-WM and / or terminated and thus simplified. Within the scope of the transfer of these derivative positions, FMS-WM made or received corresponding compensation payments for the market values of the derivatives. This is accordingly reflected in the development of FMS-WM's prepaid expenses and deferred income.

Taking contingent liabilities and other obligations into account, FMS-WM posted a business volume of EUR 147.1 billion as at 31 December 2020 (31 December 2019: EUR 149.1 billion). The enumeration below provides an overview of the amount and composition of the business volume of FMS-WM as at 31 December 2020:

Assets	31.12.2020 in EUR million	31.12.2019 in EUR million
Cash reserve	10,696	6,097
Loans and advances to banks	38,976	34,671
Loans and advances to customers	14,195	15,731
Debt instruments	71,852	80,270
Other long-term equity investments	0	0
Shares in affiliated companies	246	474
Intangible and tangible fixed assets	0	0
Other assets	392	478
Prepaid expenses	9,438	8,768
Total assets	**145,795**	**146,489**

Equity and liabilities	31.12.2020 in EUR Mio.	31.12.2019 in EUR Mio.
Liabilities to banks	9,085	3,545
Liabilities to customers	33,480	40,979
Securitised liabilities	82,165	80,933
Other liabilities	1,292	652
Deferred income	17,729	18,288
Provisions	270	341
Equity	1,774	1,751
Total equity and liabilities	**145,795**	**146,489**
Contingent liabilities	601	658
Other obligations	701	1,916
Business volume	**147,097**	**149,063**

The year-on-year decrease in total assets (from the point of view of the assets side of the balance sheet) as at 31 December 2020 is mainly attributable to the portfolio wind-up with a nominal volume of EUR 5.3 billion, portfolio-reducing currency effects of EUR 2.5 billion (in terms of the nominal value of the wind-up portfolio) and the reduction in own issues repurchased (EUR 1.7 billion). This was partly offset by the rise in cash collateral provided for derivatives (EUR 4.6 billion) and the cash reserve (EUR 4.6 billion).

The decrease in the below-the-line item Other obligations has mainly resulted due to the contractual expiry of a loan commitment which had amounted to EUR 0.9 billion at 31 December 2019.

The description of the following balance sheet items includes any accrued interest.

Receivables

As at 31 December 2020, loans and advances to banks mainly included cash collateral provided for derivatives of EUR 37.1 billion (31 December 2019: EUR 32.6 billion) and time deposits of EUR 0.7 billion (31 December 2019: EUR 0.7 billion).

The decrease in loans and advances to customers is mainly attributable to the portfolio wind-up with a nominal volume of EUR 1.9 billion and portfolio-reducing currency effects of EUR 0.3 billion (in terms of the nominal value of the wind-up portfolio). As at 31 December 2020, loans and advances to customers included cash collateral provided for derivatives of EUR 4.4 billion as a result of derivatives clearing with the Federal Republic of Germany, represented by the German Finance Agency (31 December 2019: EUR 4.3 billion; with Eurex Clearing AG, Eschborn (Eurex Clearing AG)).

The previously trilateral contract between the Federal Republic of Germany, represented by the German Finance Agency, FMS-WM and Eurex Clearing AG, was changed over to a bilateral contract between the Federal Republic of Germany, represented by the German Finance Agency, and FMS-WM effective 2 January 2020.

Holdings of securities

Holdings of securities in the amount of EUR 71.9 billion were recognised as at 31 December 2020 (31 December 2019: EUR 80.3 billion). The own issues bought back in the amount of EUR 13.1 billion (31 December 2019: EUR 14.8 billion) are allocated to the liquidity reserve and partly pledged as collateral. The additional holdings of securities relate solely to marketable debt instruments, which are classified as fixed assets (financial assets). The securities holdings are largely hedged against interest rate and currency risk by means of derivatives.

The portfolio wind-up by a nominal EUR 3.4 billion, portfolio-reducing currency effects of EUR 2.2 billion (in terms of the nominal value of the wind-up portfolio) and a reduction in own issues repurchased of EUR 1.7 billion had the effect of reducing securities holdings.

Shares in affiliated companies and other long-term equity investments

The book values shown for shares in affiliated companies and other long-term equity investments was EUR 246 million as at 31 December 2020 (31 December 2019: EUR 474 million). Shares in DEPFA BANK plc account for EUR 173 million (31 December 2019: EUR 323 million).

The decrease in this balance sheet item is mainly attributable to the EUR 150 million distribution made by DEPFA BANK plc in fiscal year 2020. In addition, in fiscal year 2020 WH-Erste KG accrued to FMS-WM, and Flint Nominees Ltd., London, (Flint Nominees Ltd.) implemented a capital reduction.

Liabilities

FMS-WM recognised liabilities to banks of EUR 9.1 billion as at 31 December 2020 (31 December 2019: EUR 3.5 billion). This mainly includes liabilities from securities repurchase agreements (as seller) with a nominal value of EUR 7.1 billion (31 December 2019: EUR 1.5 billion) and accrued interest for derivatives in the amount of EUR 0.9 billion (31 December 2019: EUR 1.0 billion).

Liabilities to customers totalling EUR 33.5 billion (31 December 2019: EUR 41.0 billion) mainly included funding obtained from the FMS in the amount of EUR 30.0 billion (31 December 2019: EUR 25.0 billion) as well as term and time deposits of EUR 1.8 billion (31 December 2019: EUR 0.9 billion). As at 31 December 2019, there were still liabilities of EUR 13.1 billion from securities repurchase agreements (as seller) which matured as scheduled in the fiscal year.

In addition, FMS-WM recognised securitised liabilities of EUR 82.2 billion as at 31 December 2020 (31 December 2019: EUR 80.9 billion). The holdings of FMS-WM's own debt issues as at 31 December 2020 were EUR 40.2 billion (31 December 2019: EUR 55.9 billion). This item also includes commercial paper resulting from the US Commercial Paper Programme (USCP Programme) launched in fiscal year 2020, in the amount of EUR 13.3 billion, as well as the Euro CP / CD Programme [1] (ECP / CD Programme) which has existed since 2011, in the amount of EUR 28.7 billion (31 December 2019: EUR 25.0 billion).

[1] *Commercial Paper / Certificates of Deposit Programme.*

Prepaid expenses and deferred income

Prepaid expenses in the total amount of EUR 9.4 billion (31 December 2019: EUR 8.8 billion) include the unamortised cost of derivatives in the amount of EUR 8.1 billion (31 December 2019: EUR 7.3 billion). In addition to the payments made mainly for interest rate derivatives when the portfolio was taken over as at 1 October 2010, the item also includes the as-yet unamortised payments made by FMS-WM to acquire interest rate derivatives in connection with the wind-up task related to the DEPFA Group.

Another component of prepaid expenses are those from the lending business in the amount of EUR 1.3 billion (31 December 2019: EUR 1.4 billion), consisting predominantly of payments made by FMS-WM in 2010 for hedge adjustments of the hedged items (receivables) taken over from the HRE Group companies. Furthermore, prepaid expenses were recognised for payments made in acquiring exposures (receivables) in the course of the portfolio extensions to the extent these exceed the nominal value of the acquired receivables.

Deferred income totalling EUR 17.7 billion (31 December 2019: EUR 18.3 billion) consists mainly of EUR 17.0 billion (31 December 2019: EUR 17.6 billion) of unamortised payments received for derivatives acquired. These derivatives were mostly acquired as at 1 October 2010 from HRE Group companies and to a lesser extent in connection with the wind-up task related to the DEPFA Group. Deferred income also includes deferred payments received in connection with lending and funding operations.

Equity and loss compensation claim

The capital base of FMS-WM is structured as follows:

HRE and pbb each made an equity contribution of EUR 1 million to FMS-WM 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-WM recognised net retained profits of EUR 23 million as at 31 December 2020 (previous year: EUR 236 million).

Net retained profits from fiscal year 2019 in the amount of EUR 236 million were transferred to retained earnings based on a resolution adopted on 1 April 2020. Retained earnings as at 31 December 2020 totalled EUR 1,749 million.

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

Below-the-line items on the balance sheet

As at 31 December 2020, contingent liabilities consisted predominantly of obligations under credit default swaps (CDS) where FMS-WM is the guarantor.

As at 31 December 2020, other obligations mainly included undrawn liquidity facilities, of which EUR 0.5 billion was extended to DEPFA BANK plc. The loan commitment to pbb of EUR 0.9 billion as at 31 December 2019 expired as scheduled in fiscal year 2020.

Financial position

Capital structure

Securitised liabilities totalling EUR 82.2 billion were recognised as at 31 December 2020 in connection with FMS-WM's own debt issues, the USCP Programme and the ECP / CD Programme (31 December 2019: EUR 80.9 billion). As at 31 December 2020, FMS-WM issued EUR 40.2 billion in own debt instruments (31 December 2019: EUR 55.9 billion); of this amount, EUR 13.1 billion (31 December 2019: EUR 14.8 billion) were bought back and are reported as an asset in the balance sheet under the Debt instruments item.

Financing measures

In the reporting year, FMS-WM met its targets for its funding and investor strategy. The overriding aim here is to ensure the solvency of FMS-WM 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:

- ECP / CD Programme
- USCP Programme (since July 2020), replacing the US Asset Backed CP Programme (US ABCP Programme)
- Repos (bilateral, and Eurex repos)
- Deposits from institutional investors

The US ABCP Programme via Kells Funding LLC, Delaware, USA, was discontinued at the end of 2020.

The money market funding had an average remaining maturity of approximately 3.2 months as at 31 December 2020 and consisted mainly of EUR, GBP and USD. Money market funding is obtained at both fixed and variable rates of interest.

Capital market funding is based on strategic benchmark issues, publicly offered issues and private placements. These three instruments primarily differ in issuance volume and marketing processes. Different issuance currencies are available, specifically USD and GBP. FMS-WM still does not issue structured products.

The total issuance volume of all capital market instruments in fiscal year 2020, including the issuance activities carried out in USD and GBP, amounted to an equivalent of EUR 6.1 billion. As a result, this financial performance indicator in 2020 exceeded the volume of capital market issues of EUR 2 billion to EUR 5 billion forecast in the management report as at 31 December 2019. Due to advantageous funding terms, funding on the USD capital market was strengthened / intensified in the in fourth quarter of 2020.

FMS-WM also obtained longer-term funding in euros of EUR 5.6 billion via the FMS in fiscal year 2020. As a result, this financial performance indicator in 2020 met the EUR 5.6 billion volume of funds raised forecast in the management report as at 31 December 2019. Following the fulfilment in fiscal year 2020 of the legal requirements for an increase in the funding facility through the FMS, from EUR 30 billion to EUR 60 billion, borrowings with a volume of EUR 30.4 billion are envisaged for fiscal year 2021.

The average maturity of the borrowings made on the capital market in fiscal year 2020 was about 2.0 years, placed in different issue formats with a respective volume of up to USD 2.0 billion and GBP 0.15 billion. Borrowings raised via the FMS in the fiscal year ended had an average maturity of around 6.2 years as at 31 December 2020.

The capital market funding in place as at 31 December 2020 (without taking into account own bonds) and the funds obtained via the FMS show the following maturity structure:

Maturities	31.12.2020 in EUR million	31.12.2019 in EUR million
Up to one year	16,069	19,252
More than one year and up to five years	29,000	36,945
More than five years	13,215	11,320
Total	**58,284**	**67,517**

The movements in the maturity structure are mainly the result of raising longer-term funding in euros through the FMS and the decrease in the level of capital market funding.

If capital market funding or borrowings via the FMS are obtained at a fixed rate of interest, FMS-WM usually hedges the funding or borrowings by way of appropriate interest rate hedges as part of general interest rate management.

FMS-WM plans to keep the proportion of long-term funding (on the capital market and through the FMS) in its overall funding volume significantly above 50% at all times (currently: approx. 53%), by increasing the volume of long-term EUR borrowings via the FMS. The EUR borrowings via the FMS are partially transformed into other currencies and are used, in particular, to cover the funding requirement in GBP.

Liquidity

FMS-WM had sufficient liquidity at all times, and in future will continue to have access to the money and capital markets as well as the option to borrow via the FMS, allowing maturing funding to be replaced by new borrowings at any time, where this cannot be repaid by inflows of funds from the wind-up of the portfolio.

Off-balance sheet obligations

Some of the outsourced services (inter alia FMS-SG, IBM Deutschland and DG FIS) are subject to long-term agreements, giving rise to other financial obligations on the part of FMS-WM. These agreements have fixed and variable performance components. An annual contractual volume of around EUR 85 million to EUR 95 million is expected for 2021 and 2022, of which around 67% is attributable to FMS-SG. The expenses for existing contracts which will continue beyond 2022 are expected to amount to EUR 50 million in 2023 and relate, almost exclusively, to FMS-SG.

FMS-WM has issued its subsidiary Flint Nominees Ltd. which is in liquidation with an undertaking that, in the period up to and including November 2022, it will be enabled to meet its liabilities and other obligations at all times.

In respect of further off-balance sheet obligations, see the chapters entitled *Contingent liabilities* and *Other obligations* in the notes to the annual financial statements as at 31 December 2020.

Results of operations

The results of operations were shaped mainly by the current income and expenses generated from the portfolio, by the measures taken to unwind the portfolio and the valuation decisions made in fiscal year 2020. At EUR 223 million (previous year: EUR 232 million), the balance of current income and expenses (net interest and net commission income, income from profit transfer and current income from shares in affiliated companies and other long-term equity investments, less general and administrative expenses and depreciation / amortisation of tangible / intangible fixed assets) was positive in fiscal year 2020. Current income from shares in affiliated companies includes income from WH-Erste KG in the amount of EUR 24 million. At EUR –255 million (previous year: EUR 23 million), the balance from Risk provisions and Net income from investments items influenced by valuation decisions and sales results was negative in the fiscal year. Net income from investments was affected by disposal losses in connection with the wind-up task as well als by an one-off effect in the amount of EUR –201 million, which arose in connection with the complexity-reducing restructuring of a risk position in the Public Sector segment and with countervailing effects in future periods.

Other operating income includes income of EUR 45 million from the accrual of WH-Erste KG to FMS-WM in fiscal year 2020.

In fiscal year 2020, there was a positive result of EUR 25 million (previous year: EUR 253 million) from ordinary activities (after deducting the balance of other operating income and expenses). Taking into account the tax expense of EUR 2 million (previous year: EUR 17 million), the net income for the fiscal year is EUR 23 million (previous year: EUR 236 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 2020

	01.01. – 31.12.2020 in EUR million	01.01. – 31.12.2019 in EUR million
Net interest income	340	325
Current income from shares in affiliated companies and other long-term equity investments	27	49
Income from profit transfer	3	1
Net commission income	–13	–5
Other operating income / loss, net	57	–2
General and administrative expenses	–134	–138
Depreciation and amortisation	0	0
Risk provisions	156	–283
Net income from investments	–411	306
Result from ordinary activities	**25**	**253**
Taxes (incl. other taxes)	–2	–17
Net income for the year	**23**	**236**
Retained profits / accumulated losses brought forward	0	0
Net retained profits	**23**	**236**

Net interest income

Net interest income in the fiscal year amounts to EUR 340 million (previous year: EUR 325 million). The year-on-year increase in net interest income is mainly attributable to funding on more favourable terms due to the borrowings via the FMS as well as the acquisition of exposures within the scope of the portfolio extensions in fiscal year 2019 and the related margins. Net interest income includes one-off effects in the amount of EUR 17 million (previous year: EUR 19 million) resulting from compensation payments received for contractual adjustments to existing credit support annexes for derivatives.

Current income from shares in affiliated companies and other long-term equity investments

Of the current income from shares in affiliated companies in the amount of EUR 27 million (previous year: EUR 49 million), EUR 24 million is attributable to WH-Erste KG. The previous year's income mainly resulted from a dividend payment disbursed by the subsidiary Flint Nominees Ltd. in the amount of EUR 49 million.

Income from profit transfer

In the fiscal year, FMS-WM collected the annual result of FMS-SG in the amount of EUR 3 million (previous year: EUR 1 million) due to the existing profit transfer agreement with FMS-SG.

Net commission income

Net commission income in the amount of EUR –13 million (previous year: EUR –5 million) primarily comprises expenses from the derivatives and issuing business and income from the lending and derivatives business. The decline in net commission income is due to the unwinding of the portfolio and the resulting decrease in income from the lending and derivatives business on the one hand and increased expenses from derivative transactions as a result of hedging portfolio exposures by means of credit derivatives on the other.

Other operating income / loss, net

The balance of other operating income and expenses in the amount of EUR 57 million (previous year: EUR –2 million) reflects the income of EUR 45 million resulting from the accrual of WH-Erste KG to FMS-WM in fiscal year 2020. The remainder mainly comprises currency translation effects. The prior-year figure was mainly the result of currency translation effects.

General and administrative expenses / Depreciation and amortisation of intangible and tangible fixed assets

The general and administrative expenses in the fiscal year amounted to EUR 134 million (previous year: EUR 138 million).

The administrative expenses primarily comprise expenses incurred in the context of service outsourcing (servicing of the portfolio, administrative and back office activities, IT services, and accounting services).

Including all active service providers, expenses for servicing the portfolio totalled EUR 92 million in the fiscal year (previous year: EUR 94 million).

Personnel expenses for the staff of FMS-WM in fiscal year 2020 were EUR 16 million (previous year: EUR 19 million).

The development of general and administrative expenses serves as a financial performance indicator for FMS-WM with regard to the strategic goal of cost-effective servicing and management. General and administrative expenses overall and expenses for the servicing of the portfolio included in this figure both decreased year-on-year. This means that the forecast made in the management report as at 31 December 2019 that administrative costs would decline slightly as a result of the ongoing portfolio reduction was fulfilled.

Risk provisions and net income from investments

Net income from risk provisions in accordance with Section 340f (3) HGB and net income from investments in accordance with Section 340c (2) HGB amounted to EUR –255 million in fiscal 2020 (previous year: EUR 23 million).

Expenses resulting from wind-up measures to reduce concentration risks and the level of complexity in the portfolio and risk provision measures to cover potential default risks contrast with income resulting from reversals of provisions and reversals of specific valuation measures.

Overall appraisal

Overall, fiscal year 2020 was a positive one for FMS-WM. FMS-WM made further progress in winding up its portfolio in spite of the uncertainty and market upheavals resulting from the COVID-19 pandemic. FMS-WM responded to the uncertainty associated with the COVID-19 pandemic and the related increase in potential default risks by means of a corresponding allocation to the general loan loss provision. FMS-WM achieved a positive result in fiscal year 2020, also due to one-off effects.

For fiscal year 2020, portfolio wind-up (before foreign currency effects) was EUR 5.3 billion [1]. The wind-up envisaged in the outlook for fiscal year 2020, with a nominal volume of EUR 4 billion to EUR 6 billion, was thus achieved despite a difficult market environment for portfolio wind-up measures.

Results of operations matched the statement made in the outlook for fiscal year 2020, which expected FMS-WM to at least break even. Current income from the portfolio was EUR 223 million (previous year: EUR 232 million) higher than expenses from current operations. The year-on-year decrease is mainly attributable to the higher one-off effects in the previous year resulting from current income from shares in affiliated companies and other long-term equity investments. This has been partially compensated for by the increased contribution from net interest income in fiscal year 2020 due to funding on favourable terms through the FMS. Net interest income includes one-off effects in the amount of EUR 17 million. Even without the one-off effects in fiscal year 2020, current income continues to significantly exceed current expenses. In addition, risk provisions and net income from investments – both items influenced by valuation decisions and sales results – showed a negative balance of EUR –255 million in fiscal year 2020 (previous year: EUR 23 million). As well as disposal losses in connection with the wind-up task, net income from investments was also negatively affected by a one-off effect in the amount of EUR –201 million. Other operating income includes income of EUR 45 million from the accrual of WH-Erste KG to FMS-WM in fiscal year 2020. FMS-WM recognised net income of EUR 23 million for fiscal year 2020 (previous year: EUR 236 million).

[1] *The reduction refers to the original wind-up portfolio and the portfolio extensions carried out and does not include the addition resulting from the portfolio extension in fiscal year 2020 (EUR 0.1 billion).*

FMS-WM had sufficient liquidity at all times. As regards issuance activities at FMS-WM, the total issuance volume across all capital market instruments came to EUR 6.1 billion in the fiscal year and thus surpassed the issuance volume of EUR 2 billion to EUR 5 billion forecast in the outlook for fiscal year 2020. Due to advantageous funding terms, additional funding was obtained on the USD capital market in the fourth quarter of 2020. FMS-WM also obtained longer-term funding in euros of EUR 5.6 billion from the FMS. The borrowing target of EUR 5.6 billion included in the outlook for the 2020 fiscal year thus was met.

FMS-WM was also affected by the COVID-19 pandemic and was obliged to implement appropriate measures. FMS-WM responded to the challenges associated with this global crisis by means of a comprehensive and effective contingency plan. A consistent “mobile office” model and a hygiene protocol were introduced in response to the social distancing measures imposed and the more stringent hygiene requirements. The existing IT infrastructure and effective crisis management ensured the stability of business operations throughout fiscal year 2020 and enabled activities which are normally carried out on site to continue reliably and without any restrictions. This is particularly true of control activities which are implemented within the scope of the internal control system, which was fully functional at all times and without any limitations.

In addition, virtual communication platforms were extensively implemented, and managers and employees received training covering digital work methods and new forms of cooperation. Thanks to these measures, even during the period of school and nursery school closures employees with childcare needs were able to achieve a balance between their work and home lives.

Within the scope of its management of service providers, FMS-WM established that the key activities outsourced to external service providers could continue to be provided as contractually stipulated during the COVID-19 pandemic.

FMS-WM’s portfolio was influenced by the global impact of the COVID-19 pandemic, even if this has not yet resulted in a significant increase in loan losses or deferrals approved by FMS-WM. Only in the Structured Products segment have deferrals of ABS transactions based on student loans resulted in contractually agreed adjustments to the terms of the securitisations. Appropriate risk provision measures were implemented in response to increased potential credit risks due to rating migrations in FMS-WM’s portfolio. In fiscal year 2020, a market uncertainty factor was added to the parameters for the calculation of the general loan loss provision. As a result, the increased latent default risks associated with the COVID-19 pandemic, which FMS-WM believes may have occurred as at the reporting date but are not yet observable based on currently available data, were taken into account when making allocations to the general loan loss provision.

Thanks to a broadly diversified funding strategy, despite the upheavals on the money and capital markets due to the COVID-19 pandemic FMS-WM's funding was safeguarded at all times. FMS-WM was solvent at all times throughout fiscal year 2020.

In summary, the Executive Board considers the asset position, financial position and results of operations of FMS-WM for fiscal year 2020 to be in order, despite the impact of the COVID-19 pandemic.

REPORT ON RISKS AND OPPORTUNITIES AND FORECAST REPORT

Risk report

The risk report has been prepared in accordance with the requirements of the 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-WM has beneficial ownership of them and thus bears the value at risk. 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). All risks are presented net of risk mitigation techniques.

FMS-WM holds exposures from DEPFA BANK plc, which was taken over on 19 December 2014, amounting to the book value of the equity investment, intragroup receivables such as liquidity facilities and DEPFA liabilities. Since FMS-WM has no obligation to assume the losses of the DEPFA BANK plc, the risk positions of DEPFA Group companies are not reported in FMS-WM'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 2020. 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 in respect of relevant adjustments of the German Minimum Requirements for Risk Management (MaRisk) and the special nature of FMS-WM.

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 MaRisk. Even though FMS-WM 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 the rules, regulations and standards because its operations establish commonalities with such institutions. Extensive exploratory talks were conducted between FMS-WM 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-WM and applied insofar as necessary.

The risk strategy defines the frameworks, principles and goals for FMS-WM's risk management on which all business decisions must be based. It provides the foundation for managing and controlling different types of risk.

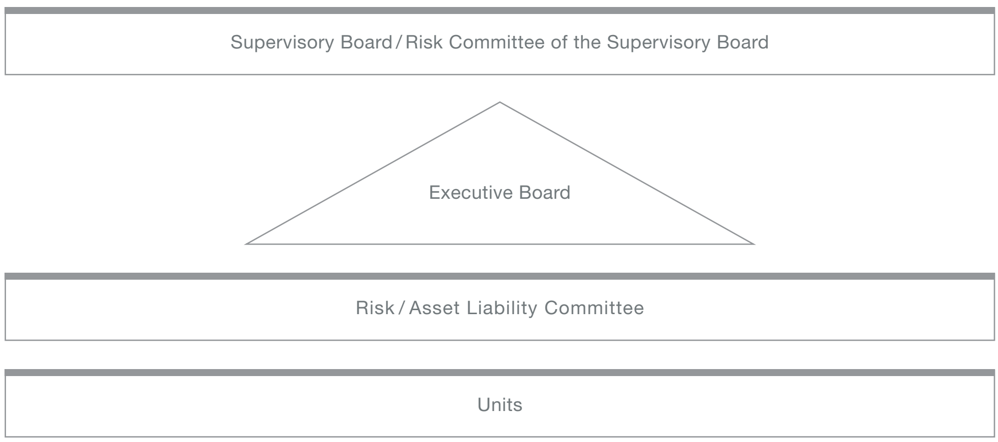
The current risk strategy is derived from the aims of FMS-WM as set out in its Charter and from the wind-up plan, which describes the business strategy and risk tolerance. Economic efficiency, operational feasibility of all risk steering activities and ensuring cost-effective funding constitute additional requirements for reducing risk. The risk strategy, including individual strategies for the five relevant risk categories of credit, market price, liquidity, operational and other risks, is outlined in established written policies and procedures.

Because the capital adequacy requirements pursuant to the German Banking Act do not apply to FMS-WM and FMS-WM is not obligated to prepare an internal capital adequacy assessment process and to manage its business based on economic capital pursuant to MaRisk standards, FMS-WM's reporting system has to meet fewer requirements than other financial institutions. Nevertheless, FMS-WM's approach to risk management is designed to avoid seeking recourse with the FMS 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-WM, in particular the CEO. 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-WM 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-WM's success or possess major strategic significance. It reviews and approves transactions and measures, 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.

Committee

The RALCO, which meets regularly and can be convened at short notice, has been established at FMS-WM to support and advise the Executive Board as well as to make certain decisions. The RALCO has the following tasks and responsibilities:

- As an operational credit decision-making body at management level of the FMS-WM, it makes individual credit decisions for all asset classes that fall within the committee's authority level. It is also tasked with making decisions on measures related to individual exposures and to propose transactions, strategies and objectives with regard to portfolio wind-up and to monitor relevant portfolio decisions.

- It acts as a strategic control and information body at Executive Board level, which prepares decisions with regard to adjustments to the wind-up plan, among other things.

- The Committee also serves the Executive Board as the central information, monitoring and management body for strategic decisions on balance sheet structure, liquidity and market risk positions, funding and hedging strategies, limits and methodological guidelines for risk control and the management of all types of risk.

Units

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

The Risk Controlling department within the Risk Controlling & Quantitative Analytics 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. In addition, the Quantitative Analytics department reviews the adequacy of the models used to determine credit risk and model-based market price valuation. The Finance, Controlling & Portfolio Steering unit is responsible for updating FMS-WM's wind-up plan on an annual basis. The monthly wind-up report represents the centralised reporting system for all risk types.

Credit risk management is one of the main tasks performed by FMS-WM and the responsibility of the Asset Management unit. The main tasks of the asset management departments entail monitoring borrower and issuer risks and making decisions on loans and securities at both the individual and the portfolio level. This is where the decisions of the RALCO whether to sell or restructure risk positions are prepared and carried out.

The Asset Management unit comprised three teams with responsibilities based on segments or product groups in fiscal year 2020:

- The Infrastructure, Commercial Real Estate & Credit Office team primarily manages infrastructure financing and real estate loans.
- The Public Sector, FI & Structured Products team handles both public-sector securities and structured products.
- The Rome Branch team is responsible for FMS-WM's Italian branch, which manages loans to Italian Public Sector or Infrastructure borrowers.

The Group Treasury unit is responsible for operational management of market risk, especially interest rate and foreign exchange risk, as well as the funding strategy and the associated tactical and strategic liquidity management. As the Center of Competence for derivatives, the unit also advises the asset management departments and conducts derivative-specific analyses.

The IT, Sourcing & Operations unit comprises the following three departments with corresponding responsibilities:

- IT Steering & Project Planning: managing IT risk, monitoring and managing the contractually compliant provision of outsourced IT services, establishing appropriate guidelines and processes, and monitoring the IT project portfolio.
- Sourcing & Servicer Steering: service provider management and managing outsourcing risks.
- Operations Management: managing operational back-office processes and the associated risks.

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

In the reporting year, the Group Internal Audit unit performed risk-based and process-independent audits relating to the efficacy and adequacy of risk management at FMS-WM and on behalf of FMS-SG. In addition, Group Internal Audit examines processes and matters implemented throughout the Group and complements the activities of the DEPFA Group's internal audit department.

PROCESS ORGANISATION OF RISK MANAGEMENT

Risk management comprises the

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

of risks.

The material types of risk associated with FMS-WM's business model are:

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

A regular 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-WM. In addition, FMS-WM is subject to operational risk as a result of the extensive outsourcing of processes, and considerable equity risk since the takeover of DEPFA BANK plc. Since the FMS is obliged to compensate any losses, none of the risk types constitute a going-concern risk for FMS-WM.

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, cross-risk type stress scenarios are run and reported on quarterly. 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 portfolio level of FMS-WM.

FMS-WM is fully liable for managing and monitoring each individual risk type. FMS-WM has outsourced significant operating duties and activities to FMS-SG 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 and DG FIS. Extensive service level agreements safeguard IT system functionality, also providing for future adaptation of the systems to the special needs of FMS-WM by means of change requests.

CREDIT RISKS

Definition

The credit risk of FMS-WM 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 or in a timely manner or that a credit event defined in derivative contracts occurs. Borrower and issuer risks are distinguished as follows:
  - 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-WM suffers a financial disadvantage as a result. In many cases, FMS-WM is in possession of marketable collateral to which it has recourse in case of default. The liquidation of such collateral may be subject to uncertainties, however.
  - Migration risk: Risk that a borrower's or issuer's creditworthiness might deteriorate over time. The deterioration in creditworthiness does not immediately result in direct losses, but it increases the risk of incurring such losses in future. At the portfolio level the deterioration is reflected in the rating profile. Irrespective of the required or actual 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. Counterparty risk is distinguished as follows:
  - 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-WM delivers an asset that it has sold to a counterparty or makes a payment but does not receive the stipulated monetary amount or asset in return for that delivery.
  - Credit valuation adjustment (CVA): The risk that a counterparty's creditworthiness might deteriorate, thereby reducing the positive fair value. Derivatives may only be entered into to hedge risks if there is a credit support annex (CSA).

- Country risk comprises borrower, issuer 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 repayment (transfer risk) or
  - 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).

Risk strategy

FMS-WM's credit risk strategy entails to minimise losses by holding assets to maturity or winding them up as in a way that maximises its value. As a rule, taking on new lending business or acquiring securities for other purposes than hedging risks is not stipulated in the wind up plan. In accordance with the business strategy, selective new business is only permitted in individual cases for the cost-efficient reduction of risks from existing positions or equity investments.

Risk identification

A catalogue of early warning signs, which is coordinated with FMS-SG, is used to continuously monitor risk exposures so as to ensure early identification of problem assets. Exposures 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-SG 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-SG and coordinated with the responsible units within FMS-WM.

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-WM. The expected loss (EL) is calculated for a one-year horizon based on one-year PD, EaD and LGD. The EL is calculated on a per-transaction basis and aggregated at segment and portfolio level.

In addition, the cumulative expected loss for a longer planning horizon and for the entire term of the positions in the portfolio is calculated as a risk parameter, which, together with other data and information, is used for analysing the risk in 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 the section entitled *Organisational structure of risk management* are responsible for steering credit risks, which due to the limited business purpose of FMS-WM involve strategies to wind up assets while maximising their value. In addition to Holding receivables, restructuring and selling receivables are the two most important tools that are available to FMS-WM for steering borrower and issuer risks. Monitoring limits are set for borrower and issuer risks, and their utilisation is measured and reported daily. The limits are reviewed regularly and as needed.

Various decision-making criteria are used to manage the portfolio, e. g. the long-term intrinsic value of a position is compared with the potential proceeds from its sale, while the current market environment and asset management's assessment of credit quality are also taken into account. Changes in market values are also 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 limits and application of the "gross future exposure" approach, which does not only take current market values and collateral received or granted into account, but also the potential future changes of derivatives' market values. Both replacement and settlement risks are managed by FMS-WM. 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 ("predeal limit check"). All transactions are applied to the given borrower-specific limits immediately.

Limiting and managing counterparty risks distinguishes between two customer groups:

- *Counterparty risks involving customers in the portfolio:* The exposures also include derivatives with customers in the portfolio. These derivatives are generally not collateralised. New transactions may only be entered into in exceptional circumstances, for example with the aim of stabilising the overall exposure. Therefore, limiting these risks is not an activity performed for management purposes but solely for monitoring purposes, i. e. it is intended to help Risk Controlling identify implausible increases in exposure. Risk Controlling asks FMS-SG to adjust these limits on a regular or ad hoc basis. It becomes necessary to adjust limits in particular as transactions mature or in response to changes in market conditions.

- *Counterparty risks involving capital market partners:* The Group Treasury unit enters into money market transactions, derivatives and repos to manage the risk and liquidity positions of FMS-WM. Managing these business activities requires limits that give the unit enough flexibility while enabling Risk Controlling to carry out its monitoring duties. The activities are restricted to a defined pool of counterparties (white list); they are typically collateralised and are subject to an independent limit monitoring and escalation process by Risk Controlling.

Country risk provisions are recognised as generalised specific loan loss provisions.

Risk monitoring and reporting

Pursuant to the current wind-up plan, borrower and issuer risks are primarily monitored at portfolio level but also at the level of individual exposures, if necessary, and described in the wind-up report to be prepared monthly – for the Executive Board among others. Furthermore, a detailed credit risk and stress test report for the Executive Board evaluates credit-risk specific as well as integrated stress test scenarios once every quarter. This report is then presented to the RALCO.

At the level of individual exposures, FMS-SG 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-SG reports monthly on the development of the watchlist and problem assets to the responsible asset managers at FMS-WM. Based on the data delivered and their own analyses, the asset 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 Group Treasury unit. An escalation process ensures timely reaction and communication to the Executive Board if limits are exceeded.

Country risks are measured and presented to the RALCO quarterly.

Risk position

The portfolio of FMS-WM 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 product-specific add-ons, which constitute a cushion for possible future market value increases.

The EL as an additional risk parameter for managing the portfolio is determined for the entire portfolio for a period of one year. The only risk positions exempted from the determination of the EL are those for which a specific loss provision was already recognised or which have an internal rating of 29 or 30.

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 portfolio

Breakdown of the EaD and the EL of the portfolio (incl. customer derivatives and CDS) by segment:

EaD and EL in EUR billion	Commercial Real Estate		Public Sector		Structured Products		Infrastructure		Total (excluding hedge derivatives)		Hedge derivatives (incl. collateral deposited with banks)	
31.12.	2020	2019	2020	2019	2020	2019	2020	2019	2020	2019	2020	2019
EaD	0.4	1.2	40.7	43.9	21.0	25.0	12.9	13.9	75.0	84.0	2.6	3.7
EL	0.00	0.00	0.03	0.03	0.01	0.01	0.03	0.03	0.07	0.07	0.00	0.00

As at 31 December 2020, the EaD of the risk positions excluding hedge derivatives was EUR 75.0 billion. The decline of EUR 9.0 billion (11%) compared to the previous year primarily resulted from scheduled and unscheduled repayments as well as currency effects. Sales only made a limited contribution to the unwinding of the portfolio in fiscal year 2020 (EUR –0.7 billion). The portfolio extension in fiscal year 2020 increased EaD by EUR 0.08 billion.

While the portfolio's EaD (excluding hedge derivatives) fell by 11% year-on-year, EL increased to EUR 71 million (previous year: EUR 67 million). In relation to the EUR 74.7 billion in EaD from loans and advances 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 0.1%. The reduction in EL caused by the unwinding of the portfolio was offset by rating migrations and LGD adjustments. In the case of public sector counterparties (e. g. central government, regional government, local authorities), deteriorations in LGD result from the deterioration in input parameters caused by the COVID-19 pandemic; in the case of companies, deteriorations in LGD primarily result from the overhaul of the LGD process that in turn results from the control process.

Counterparty risks from hedge derivatives amounted to an EaD of EUR 2.6 billion as at 31 December 2020, down EUR 1.1 billion on the previous year. This reduction is mainly due to market movements. The one-year EL from hedge derivatives was at a similar level to the previous year at EUR 1 million.

Not included in the portfolio presented are the shares in affiliated companies, whose risks are reflected in equity risk, and the following exposures vis-à-vis affiliated companies:

- Liquidity facilities extended to DEPFA BANK plc for
  - an unsecured maximum facility of EUR 0.25 billion, no drawdown as at 31 December 2020.
  - a secured facility of EUR 0.25 billion, no drawdown as at 31 December 2020.

- Purchased DEPFA liabilities with an EaD of EUR 0.03 billion

Breakdown of the portfolio by currencies

EaD in EUR billion [1]	Commercial Real Estate		Public Sector		Structured Products		Infrastructure		Total	
31.12.	2020	2019	2020	2019	2020	2019	2020	2019	2020	2019
EUR	0.1	0.3	29.0	30.8	4.2	4.6	0.9	1.0	34.2	36.7
USD	0.3	0.4	2.0	2.3	15.8	19.3	0.4	0.5	18.5	22.5
GBP	0.0	0.5	8.7	9.3	0.4	0.5	9.5	10.2	18.6	20.5
Other FX	0.0	0.0	1.0	1.5	0.6	0.6	2.1	2.2	3.7	4.3
Total	**0.4**	**1.2**	**40.7**	**43.9**	**21.0**	**25.0**	**12.9**	**13.9**	**75.0**	**84.0**

[1] *Excluding hedge derivatives with an EaD of EUR 2.6 billion*

Changes in exchange rates compared with 31 December 2019 had the overall effect of reducing the portfolio's EaD by EUR –2.9 billion, the main reason being the depreciation of the US dollar (9.2%) and the British pound (5.7%), which primarily affected the Infrastructure, Public Sector and Structured Products segments.

Breakdown of the portfolio by internal rating classes (IR)

EaD in EUR billion [1]	Commercial Real Estate		Public Sector		Structured Products		Infrastructure		Total	
31.12.	2020	2019	2020	2019	2020	2019	2020	2019	2020	2019
IR 1–7	0.0	0.0	17.9	20.1	14.2	17.6	1.3	1.4	33.4	39.1
IR 8–10	0.0	0.0	20.9	21.9	5.1	6.8	9.6	10.2	35.6	38.9
IR 11–13	0.0	0.0	1.8	1.8	1.6	0.5	1.5	1.8	4.9	4.1
IR 14–22	0.4	0.5	0.1	0.1	0.0	0.0	0.4	0.3	0.9	0.9
IR 23–27	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IR 28–30	0.0	0.7	0.0	0.0	0.1	0.1	0.1	0.2	0.2	1.0
Total	**0.4**	**1.2**	**40.7**	**43.9**	**21.0**	**25.0**	**12.9**	**13.9**	**75.0**	**84.0**

[1] *Excluding hedge derivatives with an EaD of EUR 2.6 billion*

The breakdown of the portfolio into rating groups did not change significantly year-on-year. The percentage of investment grade financing (IR 10 and better) was 92% (previous year: 93%). The significant decline in the exposure in rating group IR 1 to 7 is also attributable to the unwinding of the portfolio, as approximately two-thirds of the portfolio amount reduced during the year under review was in this rating group.

Migrations across rating groups during fiscal year 2020 primarily occurred from rating group IR 8 to 10 to rating group IR 11 to 13 with an EaD of EUR 1.5 billion. This mostly affected the Structured Products segment. There were downgrades within individual rating classes, i. e. changes by individual notches within a rating group, for risk positions with a total EaD of EUR 9.7 billion. Of this total, approximately EUR 5.7 billion was attributable to counterparties from the previous year's rating group IR 1 to 7. These primarily consisted of British and Irish local authorities, although the corresponding EL contribution of these counterparties remains very low (< EUR 1 million). Downgrades with an EaD of around EUR 1.8 billion resulted from counterparties from the previous year's rating group IR 8 to 10, with the corresponding EL increasing by less than EUR 2 million. A volume from the previous year's rating group IR 11 to 13 with an EaD of EUR 1.3 billion was also downgraded. This consisted of exposures to Italian local authorities, regional government or companies with a state-owned background. The EL of these positions increased by approximately EUR 5 million. In addition, there were upgrades to individual rating classes for risk positions with an EaD totalling EUR 3.3 billion. Of this volume, EUR 2.3 billion is attributable to companies, primarily British utility providers from the previous year's rating groups IR 8 to 10 and IR 11 to 13.

Most of the rating migrations in fiscal year 2020, particularly the downgrades, were attributable to the expected impact of the COVID-19 pandemic.

Breakdown of the portfolio by countries and regions

EaD in EUR billion[1]	Commercial Real Estate		Public Sector		Structured Products		Infrastructure		Total	
31.12.	2020	2019	2020	2019	2020	2019	2020	2019	2020	2019
PIIGS[2]	0.0	0.0	23.0	24.2	1.0	1.1	0.4	0.5	24.4	25.8
Including Italy	0.0	0.0	19.6	20.6	0.7	0.7	0.3	0.3	20.6	21.6
United Kingdom	0.0	0.5	8.3	8.8	4.2	4.5	9.6	10.4	22.1	24.2
Germany	0.1	0.2	0.1	0.4	2.8	2.8	0.1	0.1	3.1	3.5
Rest of Europe	0.0	0.1	8.0	8.9	0.3	0.4	0.1	0.2	8.4	9.6
USA	0.3	0.4	0.0	0.0	11.3	14.4	0.6	0.5	12.2	15.3
Asia	0.0	0.0	0.4	0.4	0.0	0.0	0.2	0.2	0.6	0.6
Rest of world	0.0	0.0	0.9	1.2	1.4	1.8	1.9	2.0	4.2	5.0
Total	**0.4**	**1.2**	**40.7**	**43.9**	**21.0**	**25.0**	**12.9**	**13.9**	**75.0**	**84.0**

[1] Excluding hedge derivatives with an EaD of EUR 2.6 billion
[2] There is no exposure as regards Greece
Allocation by country of the economic risk

The percentage of European borrowers increased slightly year-on-year to 77% (previous year: 75%). The largest shares of the portfolio are still attributable to United Kingdom at 29% (+ / –0 percentage points year-on-year), Italy at 27% (+1 percentage point year-on-year) and the USA at 16% (–2 percentage points year-on-year) of the portfolio volume.

After the portfolio wind-up achieved in 2020, the Commercial Real Estate segment primarily consists of financing of US properties (EaD of EUR 0.3 billion).

The Public Sector segment comprises securities and loans with an EaD of EUR 40.7 billion. Significant exposures exist in connection with Italian (EaD of EUR 19.6 billion) and UK borrowers (EaD of EUR 8.3 billion). The Rest of Europe region accounts for financing with an EaD of EUR 8.0 billion, including government bonds and loans in Belgium (EaD of EUR 2.3 billion), the Netherlands (EaD of EUR 1.6 billion) and France (EaD of EUR 1.5 billion).

In the Structured Products segment with an EaD of EUR 21.0 billion, EUR 11.3 billion – or 54% – is attributable to the United States, with EUR 6.2 billion comprising FFELP student loan securitisations and EUR 4.3 billion being accounted for by securitised receivables from municipal borrowers. Furthermore, there are material risk positions totalling EUR 4.2 billion in respect of borrowers from the United Kingdom, EUR 2.8 billion in respect of borrowers from Germany and EUR 1.4 billion in respect of borrowers from Canada.

In the Infrastructure segment, around 74% of the segment's EaD of EUR 12.9 billion – an EaD of EUR 9.6 billion – is attributable to UK borrowers. Another infrastructure financing focal point is Canada with an EaD of EUR 1.3 billion.

Breakdown of the portfolio by remaining maturities

EaD in EUR billion [1]	Commercial Real Estate		Public Sector		Structured Products		Infrastructure		Total	
31.12.	2020	2019	2020	2019	2020	2019	2020	2019	2020	2019
Due	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Up to 1 year	0.0	0.1	1.1	1.2	0.6	0.5	0.0	0.0	1.7	1.8
1 to 5 years	0.2	0.5	3.7	4.1	2.0	2.9	0.9	0.5	6.8	8.0
5 to 10 years	0.1	0.4	3.5	4.6	3.3	3.7	0.5	0.8	7.4	9.5
10 to 20 years	0.1	0.1	22.1	21.7	9.9	11.0	3.0	2.8	35.1	35.6
20 to 30 years	0.0	0.0	4.2	5.9	4.9	6.6	3.6	4.4	12.7	16.9
More than 30 years	0.0	0.0	6.1	6.4	0.3	0.3	4.9	5.4	11.3	12.1
Total	**0.4**	**1.2**	**40.7**	**43.9**	**21.0**	**25.0**	**12.9**	**13.9**	**75.0**	**84.0**

[1] Excluding hedge derivatives with an EaD of EUR 2.6 billion
Remaining maturities in years (time at which the next adjustment of terms will be made)

The remaining maturities of risk positions differ greatly depending on the segment. The majority of Commercial Real Estate exposures mature in ten years at the latest. Only exposures with an EaD of EUR 0.1 billion have a longer maturity.

In contrast, around two-thirds of the infrastructure loans have a remaining term of more than 20 years. Infrastructure financing with an EaD of EUR 4.9 billion has a remaining term of more than 30 years. These are mostly inflation-indexed bonds issued by UK utility companies.

Of the receivables from borrowers in the Public Sector and Structured Products segments, financing with an EaD of EUR 10.3 billion (25%) and EUR 5.2 billion (25%), respectively, will become due in more than 20 years.

Watchlist and Problem Assets

EaD in EUR billion [1]	Commercial Real Estate		Public Sector		Structured Products		Infrastructure		Total	
31.12.	2020	2019	2020	2019	2020	2019	2020	2019	2020	2019
Watchlist Assets	0.0	0.0	0.8	0.3	0.2	0.3	0.6	0.5	1.6	1.1
Problem Assets	0.0	0.7	0.2	0.2	0.1	0.1	0.1	0.2	0.4	1.2
Restructuring Assets	0.0	0.6	0.2	0.2	0.1	0.1	0.0	0.1	0.3	1.0
Workout Assets	0.0	0.1	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.2
Total	**0.0**	**0.7**	**1.0**	**0.5**	**0.3**	**0.4**	**0.7**	**0.7**	**2.0**	**2.3**

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 risk positions for which specific loan loss provisions were recognised as well as risk positions that have defaulted according to the Basel III 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 specific loan loss provision has been recognised. "Restructuring Assets" and "Workout Assets" are combined in the "Problem Assets" category.

The decline in watchlist and problem assets exposures to EUR 0.0 billion in the Commercial Real Estate segment is due to the unwinding of the portfolio. Conversely, EaD in the Watchlist Assets category for the Public Sector and Infrastructure segments rose slightly by EUR 0.6 billion overall. These exposures were also monitored more closely as a reaction to the global COVID-19 situation. Only around 3% of the portfolio exposure is managed as Watchlist or Problem Assets in non-performing loan management. This rate remains unchanged from the previous year.

The early warning system is designed to identify and closely monitor borrowers of FMS-WM whose credit or collateral quality might deteriorate. Non-performing risk positions where the 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 and submitted for decision to the relevant committee.

The amount of the general loan loss provision is determined based on the EaD and by considering the probability of default (PD) and the loss given default (LGD). In fiscal year 2020, a market uncertainty factor was added to the parameters for the calculation of the general loan loss provision. As a result, the increased latent default risks associated with the COVID-19 pandemic, which FMS-WM believes may have occurred as at the reporting date but are not yet observable based on currently available data, were taken into account when making allocations to the general loan loss provision.

Major challenges arising from credit risks

FMS-WM has assumed large risks by taking over the portfolio effective 1 October 2010 and extending the portfolio. These risks can lead to further recourse to the FMS's loss compensation obligation and therefore to additional burdens on Germany's federal budget. The most important of these risks are:

- Portfolio concentration: The EL of a 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 losses may deviate considerably from this. The greater the concentrations in the portfolio, the greater the danger that actual losses will differ significantly from the average losses expected. The portfolio shows high concentrations, particularly in relation to exposures in Italy and the United Kingdom.

- Long maturities: 89% of the risk positions have a remaining maturity of more than five years, and 79% will not be due for more than ten years. 15% of the risk positions have a remaining maturity of over 30 years, and many of these are inflation-indexed securities for which the exposure might grow over time.

- Risks of hedging transactions: FMS-WM's risk strategy stipulates broad hedging of the portfolio against market risks, such as interest rate, foreign exchange or inflation risks. In the event of default of the underlying credit risk positions, substantial additional losses can arise from the associated market risk hedging transactions.

- Financing structures: The financial and economic crisis has fundamentally changed the credit and capital markets. A significant number of FMS-WM's risk positions comprise exposures that were liquid at one time but have turned out to be illiquid since the crisis that occurred prior to the founding of FMS-WM. To make matters worse, in some market segments overall positive earnings contributions for FMS-WM are hardly realistic any longer, even in view of the currently extremely favourable funding options, since the margins agreed at the time of entry into the agreements no longer correspond to today's expectations of default for the risk positions.

If one or more of the aforementioned risks should materialise, this may have a significant impact on the risk provisions to be recognised under commercial law. FMS-WM recognises specific loan loss provisions on risk positions 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-WM 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 decrease 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-WM:

- *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 risk describes the change in the present value of products whose interest or principal payments are linked to certain national or regional consumer price indices (inflation rates).

According to the current risk profile, the key market risk factors relevant for FMS-WM's risk management are interest rate risk and foreign exchange risk.

As previously, FMS-WM 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 obligation of the FMS to supply FMS-WM with liquidity in a crisis situation.

Risk strategy

Market risks may not be entered into purely based on a profit motive, but instead only with the aim of winding up existing risk positions or avoiding new risk positions from arising. This limits possible fluctuations in portfolio value.

The objective of the market risk strategy is to minimise the fluctuations in the fair value and profit / loss of the asset portfolio induced by market risk factors. The accounting and the income statement according to the standards of the Handelsgesetzbuch – HGB are relevant in this context. 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 the Asset Management unit, hedge 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 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 Asset Management unit and reported on regularly (at least quarterly) to the Executive Board.

For all activities of Group Treasury, the principle applies that Group Treasury can trade within the previously set limits without further restrictions. Its market units are responsible for the operational management of open positions; Risk Controlling is responsible for monitoring; and the RALCO is responsible for 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 wind-up task they are not limited. Recognition of all third-party securities held to maturity 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.

The daily data deliveries of FMS-SG 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 relevant risk positions. Separate analyses by maturity ranges enable FMS-WM 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. In measuring interest rate risk, FMS-WM takes into account neither the margin components of cash flows nor credit spreads when discounting.

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 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 quarterly 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, scenarios similar to those proposed by Deutsche Bundesbank. Aside from these scenarios arising from changes in each type of market risk, FMS-WM 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 for all types of market risk.

Risk steering

The Group 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-WM to short-term interest rate risks, for example. 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, write-downs are recognised appropriately for risk positions.

The Asset Management and Group Treasury units 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 currency and maturity range, including an escalation process for limit breaches.

For interest rate risks from risk positions whose hedge 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 the Group Treasury unit in accordance with the stipulations from the wind-up strategies.

The approach to manage 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, specific limits are defined per primary currency along with a limit for secondary currencies and 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 and monitored on a daily basis. Significant changes trigger 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 in a way that maximises its value. These risks are managed by Asset Management as part of the 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-SG and analysed by FMS-WM's Risk Controlling department. The report, which also includes the credit spread sensitivities, is made available to both the Executive Board and the Group 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 defined for this event by the adopted strategies are triggered.

Additionally, market risks are regularly reported in the RALCO and as part of the monthly wind-up report to the Executive Board. The Supervisory Board is also informed about market risks on a quarterly basis via the wind-up report.

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 portfolio's interest rate sensitivity as at 31 December 2020 was EUR –0.77 million (31 December 2019: EUR –0.45 million). This means that the present value of the portfolio would decrease by EUR 0.77 million in case the interest rate curves of all currencies rise by one basis point simultaneously. Material interest rate sensitivity exposures concern the euro in the amount of EUR –0.42 million (31 December 2019: EUR –0.50 million). The change in interest rate sensitivity is largely due to positions in the short-term maturity range. The positions from approved wind-up strategies entail additional risks of EUR 0.17 million as at 31 December 2020 (31 December 2019: EUR 0.19 million).

On all trading days in fiscal year 2020, interest rate sensitivity lay within a bandwidth of EUR –0.77 million to EUR –0.08 million. The interest rate sensitivity of exposures from agreed wind-up strategies ranged from EUR 0.16 million to EUR 0.20 million.

Given the stress scenarios defined for interest rate risks, a flattening of the curve amid a general increase in interest rates would have the greatest negative impact of EUR –150 million on the present value as at 31 December 2020. This compares to an impact of EUR –135 million as at 31 December 2019. The change in the impact of this scenario results from the change in interest rate exposures, mainly in the short-term maturity range.

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 as at 31 December 2020 amounted to EUR 1.7 million 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 of EUR –24 million on the net present value (31 December 2019: EUR –6 million).

Since interest rate exposure in the portfolio is largely closed, any future changes in interest rate curves will only minimally influence the value of FMS-WM'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-WM 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 liquidity risk strategy aims to ensure that FMS-WM is solvent at all times, even under stress conditions. To ensure that this is the case, FMS-WM in addition to an appropriate cash reserve (cash position) holds highly liquid, ECB-eligible assets in the form of own and third-party bonds, which, indirectly through securities repurchase agreements, represent a sufficient liquidity reserve, and also limits daily net cash outflows of the next ten days (net cash flow position) to no more than EUR 2 billion. Furthermore, an average remaining maturity of the borrowings of at least 90 days is targeted for money market instruments.

In addition, FMS-WM diversifies its funding in terms of the investor base, maturities (money and capital market), product range (secured and unsecured products and programmes), markets (e. g. countries) and currencies. FMS-WM establishes original access to foreign currency funding (in particular in USD and GBP) and is able to tap liquid FX markets (FX spot and FX derivatives) at all times.

The FMS has been providing longer-term funding in EUR since the start of 2019. When obtaining liquidity, FMS-WM ensures that its credit rating is not adversely affected. Within this framework, FMS-WM optimises its liquidity costs.

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 Group 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 account balances

- 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-WM analyses two scenarios in its daily risk report whose methodology reflects the special situation of FMS-WM. 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. The assumptions for the normal case and the stress scenario remained the same as in the previous year.

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-WM’s own funding cost rate on net interest income is carried out.

Risk steering

The tactical liquidity is managed by Liquidity Management in the Group 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 also ensured by the Group Treasury unit. Group Treasury 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 of securities and by obtaining funding via the FMS with maturities of more than one year.

The one scenario that would significantly affect FMS-WM, 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-WM 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 shortage.

Risk monitoring and reporting

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

- Group 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 Group Treasury unit are kept abreast daily of the degree to which agreed-upon steps have been implemented. The RALCO is also informed of the limit breach as part of the regular reporting.

Independently of this, the liquidity position is reported monthly to the Executive Board and quarterly to the Supervisory Board as part of the wind-up report.

Risk position

In fiscal year 2020, FMS-WM's funding strategy was validated in the money and capital markets by a stable and broadly diversified investor base.

FMS-WM's issuing activity for the purpose of money market funding under the existing ECP / CD Programme and the new USCP Programme (replacing the US ABCP Programme since July 2020) further contributed to a stable and sustainable funding structure for FMS-WM in 2020. The money market funding had an average remaining maturity of approximately 3.2 months as at 31 December 2020.

After having established itself in recent years as a regular issuer on international capital markets, FMS-WM placed capital market issues in USD and GBP equivalent to EUR 6.1 billion in fiscal year 2020. FMS-WM also obtained long-term EUR funding of EUR 5.6 billion from the FMS.

As at 31 December 2020, FMS-WM's positive liquidity cushion is EUR 28.3 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 2019: EUR 12.6 billion).

OPERATIONAL RISKS

Definition

Operational risks include all risks that can arise from the inadequacy or failure of internal processes, employees, systems, or due to external events. The following operational risks are of particular relevance for FMS-WM:

- Outsourcing risk: Refers to potential losses from the outsourcing of institute-specific activities and processes 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-WM cannot fulfil key functions and meet planned goals for department-related and / or IT projects, or fulfil or meet these adequately, owing to unsuccessful or late implementation, or implementation at higher than anticipated project costs.

- IT risk: Denotes all risks to FMS-WM's asset position, financial position and results of operations as a result of shortcomings related to IT management and IT steering respectively, the availability, confidentiality, integrity and authenticity of data, the internal control system of the IT organisation, the IT strategy, IT guidelines and IT aspects of the rules of procedure or the use of information technology.

- Legal risk: Denotes the risk of financial loss arising from the breach of applicable legal (including contractual) provisions, from the unenforceability of contractual claims and from legal disputes generally.

Risk strategy

The main objective is generally to prevent and reduce these risks and specifically in relation to

- outsourcing risk to ensure excellent performance by service providers and therefore operating stability as well as to guarantee profitable portfolio management,
- project risk to achieve the project objective on schedule and within the budgeted project costs,
- IT risk to ensure a risk- and earnings-oriented approach to IT management addressing the proper functioning of IT, the stability of the applications used and the data contained in the applications,
- legal risk to avoid of such risks by involving the Legal & Group Compliance unit of FMS-WM at an early stage.

Risk identification

Operational risks at FMS-WM and likewise at FMS-SG are identified through the annual Operational Risk Self-assessment (ORSA), the documentation of operational risk events and possibly resulting losses, and the Key Risk Indicators as early warning indicators required to be captured on a regular basis.

Given the considerable significance of outsourcing risk, FMS-WM has set up a competence team in the Sourcing & Servicer Steering department that is dedicated to managing and monitoring outsourcing. The relevant departments / units participate in identifying risks concerning the outsourced activities and processes.

Project risks are identified in a two-step process by which risks are reported and recorded by the project manager in question. On certain projects, a risk database is used to perform a full risk identification.

IT risk is identified by means such as error logs in the event of the unavailability of or interruptions to IT systems. The internal control system and the IT controls defined there are also used in the process.

Legal risks due to changes in the existing legal environment are identified by the individual units on the basis of a tool that receives information from the Association of German Public Banks (Bundesverband Öffentlicher Banken Deutschlands).

Risk analysis and assessment

Operational risks at FMS-WM and at FMS-SG are analysed and assessed

- ex post via the recorded relevant operational (loss) events in the common event / loss database within the common operational risk workflow tool,
- ex ante via the results of the standardised ORSA conducted each year, which includes estimating the frequencies of occurrence and potential losses in a common operational risk workflow tool,
- and by analysing agreed early warning indicators.

The Sourcing & Servicer Steering department analyses and then assesses outsourcing risk as part of the risk analyses in conjunction with the affected departments / units and with Risk Controlling. In this context, the first step is to classify the outsourced activities according to materiality using a structured questionnaire with risk assessments. Additional risk analyses and assessments are carried out for material outsourcing activities. These risk analyses are updated as necessary but at least once a year. If material risks are identified, the affected unit is required to document the risk immediately in the ORSA. Non-material risks are recorded in the course of the annual ORSA. Group Internal Audit receives the risk analyses for information.

The risk in respect of relevant projects is analysed and assessed based on evaluations of the project risk's probability of occurring and its potential impact using defined scales. Combining the two parameters yields an overall assessment that entails classifying each individual project risk into a risk matrix. Based on specific combinations risks are classified as low, high or critical. Analysing and assessing the risks is the job of the project manager, who determines the criticality of the risks depending on their degree of influence on the major goals of the project.

IT risks are identified using methods such as searching a catalogue of risk types to determine permanent and ad-hoc risks arising from the operation of IT applications. In the event of the unavailability of or interruptions to IT systems, error logs are also analysed and incorporated into the overall IT risk situation. IT risks are analysed, assessed and consolidated on a regular or ad hoc basis by the IT-Retained organisation within FMS-SG that is responsible for tasks such as controlling IT outsourcing.

The legal risks of a transaction are analysed and assessed by staff brought in from the Legal & Group Compliance unit, if necessary with the involvement of external law firms. General legal risks arising from changes in the legal environment are analysed and assessed by the unit responsible for the relevant requirements.

Risk steering

For potential operational risks classified as critical in the ORSA, 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 workflow tool. These risks are managed by FMS-SG or by the affected unit of FMS-WM in accordance with assigned responsibilities. A contingency plan has been defined for all business-critical processes as an operational risk mitigation measure within FMS-WM. The new-product process (NPP) serves to lower risks from operating new products, for example.

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 assessments factor in timeliness and quality, and are documented in service management software. 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-WM. Escalation processes that start with the responsible staff member and end with the Executive Board have been defined for performance of the measures.

Project risks are managed by project managers using suitable risk-reducing measures which are presented to the project steering committee for information purposes. The implementation and effectiveness of these measures is monitored.

IT risks are monitored using appropriate technical and manual controls. FMS-SG consolidates and assesses IT risks and initiates or coordinates any risk mitigation measures with the FMS-WM that go beyond controls.

FMS-WM uses clearly defined governance structures and processes to manage legal risks. FMS-WM's close cooperation with FMS-SG 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.

In cooperation with the executive management of FMS-SG, FMS-WM's Legal & Group Compliance unit controls and monitors legal risks which could arise for FMS-WM in its dealings with third parties.

In particular, FMS-WM counteracts the risk of internal and external fraud based on an internal control system, an Internal Audit unit and ongoing measures to safeguard employees' risk awareness and sense of vigilance. Both FMS-WM and FMS-SG have established the legally required central function to prevent other criminal acts.

Risk monitoring and reporting

Operational risks that concern the services provided by FMS-SG are monitored directly at FMS-SG. Operational risks and losses incurred by FMS-WM, or by FMS-SG that have an effect on FMS-WM, are reported to the Executive Board in the monthly wind-up report and to the Supervisory Board once every quarter. The results of the ORSAs are reported to the Executive Board and Supervisory Board either in a separate ORSA report or in the annual operational risk report, which also covers the operational events and loss events that occurred and the risk early warning indicators.

FMS-SG publishes a quarterly report on relevant early warning indicators agreed with FMS-WM's Risk Controlling; this report addresses potential operational risks at FMS-WM, FMS-SG and potential operational outsourcing risks of FMS-WM and is presented the Executive Board once a year as part of operational risk reporting.

The aforementioned reports provide the Executive Board of FMS-WM with a comprehensive overview of operational risks, both at FMS-SG and at FMS-WM.

Monitoring outsourcing risk is the responsibility of the Sourcing & Servicer Steering 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.

Project risks are reported in regular project meetings, steering boards and / or regularly to the Executive Board of FMS-WM depending on the scope of the project in question. These reports also cover changes in the project risk situation as well as the status of implementation and effectiveness of mitigation measures. Significant risks arising from IT projects are consolidated and reported to the Executive Board via quarterly IT risk management reporting. In the case of significant non-IT projects, regular reports that also take project risks into account are submitted to the Executive Board. The latest IT risk situation regarding the capability of IT service providers is also monitored and reported to the Executive Board via quarterly IT risk management reporting.

In parallel, regular checks are performed on IT processes and workflows. In doing so, measures to mitigate IT risks are implemented and any shortcomings identified are documented and remedied.

The relevant decision-makers are informed if significant legal risks emerge or threaten to emerge in relation to individual transactions. Legal and regulatory changes as well as changes in general case law are monitored by the individual units.

Risk position

The expected losses in FMS-WM and FMS-SG estimated in the ORSA remained virtually unchanged compared to the previous year.

An EL of EUR 13.8 million (previous year: EUR 13.7 million) was determined for the fiscal year. Detailing the surveyed IT risks led to an increase, whereas estimated project risks due to project progress or completion and an elimination of double counting for compliance risks resulted in a reduction.

Out of the total of all identified operational risks, around 96.3% have an EL of less than EUR 0.1 million, while 3.6% haven an EL between EUR 0.1 million and EUR 0.5 million; only one risk was determined to have an EL of more than EUR 0.5 million.

OTHER RISKS

Equity risk

Equity risk arises at FMS-WM especially from the investment in DEPFA BANK plc and FMS-SG.

Following a distribution of EUR 150 million made by DEPFA BANK plc in fiscal year 2020, the book value of DEPFA BANK plc's equity instruments held by FMS-WM amounted to EUR 173 million as at 31 December 2020 (previous year: EUR 323 million). Assuming a one-year forecast horizon and a confidence level of 99.95%, the DEPFA Group estimates in the Group-wide analysis of its risk-bearing capacity, which includes all DEPFA Group risk positions, that its capital requirement for covering unexpected losses stood at EUR 41 million as at December 2020 (previous year: EUR 49 million). This corresponds to the equity risk as at the reporting date of 31 December 2020.

Risk Controlling at FMS-WM receives the quarterly wind-up report of the DEPFA Group, which is the primary tool for monitoring and managing changes in various risk types affecting the DEPFA Group. Suspicious or implausible developments and ad-hoc queries regarding the DEPFA Group's risk positions can be tracked using the daily market liquidity and counterparty risk reports as well as other reports prepared at different intervals.

For major parts of the DEPFA Group Wind Down Report, triggers have been defined which, if exceeded, require a report to be made to the head of Risk Controlling & Quantitative Analytics outlining the event that occurred, including the measures already taken by the DEPFA Group. Major operational risk events and identified material operational risks are reported on an ad-hoc basis to Risk Controlling at FMS-WM. In addition, according to the Framework Agreement in place between FMS-WM and the DEPFA BANK plc certain material business transactions require the approval of FMS-WM.

The risks arising from FMS-SG continue to be measured and managed by way of direct documentation of the operational risk in the uniform risk management processes applicable to both FMS-WM and FMS-SG.

Tax risk

Tax risk assessed on a qualitative basis results from potential changes in tax legislation, from potential changes in tax jurisdiction and from interpretations in the application of tax laws by FMS-WM that potentially differ from those of the tax authorities. Adequate processes are in place at FMS-WM for the analysis and management of tax risk. It turns to external advisers as necessary in connection with tax matters.

Regulatory risk

Regulatory risk, which is also assessed on a qualitative basis, is the risk that lawmakers or regulatory authorities will change the existing legal framework, with the change entailing a negative impact on FMS-WM. Among other things, a data service distributed by the Association of German Public Banks is used to identify regulations relevant to FMS-WM. The Group Compliance department monitors the implementation of necessary measures and reports to the Executive Board at regular intervals.

ASSESSMENT OF THE OVERALL RISK EXPOSURE AND OUTLOOK

The largest risks to which FMS-WM is exposed still are credit risk and operational risk, especially outsourcing risk.

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

The portfolio comprises financing, with some positions having very long maturities. Furthermore, the portfolio also carries high concentration risks which are expected to intensify further over time due to the varying speed with which the portfolio will be wound up through scheduled and unscheduled principal repayment or sales. Portfolio concentrations are monitored as part of the determination of credit risk but can only be managed to a limited extent due to the task of winding up the portfolio. This is done implicitly by incorporating them into the control logic (including unexpected loss) and explicitly by developing wind-up strategies and making decisions on individual assets. The greater the concentrations in the portfolio, the greater the danger that actual losses will differ significantly from the average losses expected at 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 maximising the assets' value, FMS-WM intends to reduce the credit risks incrementally pursuant to the guidance in the wind-up plan.

Most the portfolio reduction in the current fiscal year was achieved through repayments, mainly in the Structured Products segment.

FMS-WM 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. In the case of specific unwinding measures, provision is also made for foreseeable losses. 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 funding and hedging activities. In the case of certain 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. Regular reports are issued on the progress of the wind-up strategies. If necessary when market conditions or the prospects of implementing the individual strategy change, the positions are hedged again.

Measures such as the “LIKE” project as well as individual development and training opportunities make a significant contribution to operational stability. They enhance FMS-WM’s competitiveness and attractiveness as an employer for both external and internal employees. Among other things, the effectiveness of these measures is reflected in the increase in employee satisfaction as well as the continuous reduction in the staff turnover rate since 2018.

Besides managing FMS-WM’s portfolio, the focus in the 2020 reporting period was again on winding up the DEPFA Group. In July 2020, FMS-WM launched the open, transparent, competitive and non-discriminatory sale of the shares in DEPFA BANK plc. The tender process was successfully completed in February 2021 and an appropriate contractual agreement was reached. At the time the 2020 annual financial statements were prepared in accordance with commercial law, the sale was still subject to supervisory and possible antitrust approval. After closing, the equity risk for DEPFA BANK plc will cease to exist.

Winding up the portfolio in a way that maximises value will continue to be the focus in fiscal year 2021. The portfolio is expected to be unwound further by an estimated EUR 5 billion to EUR 7 billion nominally in fiscal year 2021, especially in the Structured Products and Public Sector segments. The anticipated wind-up depends heavily on the prevailing market environment. The uncertainty surrounding economic developments in individual regions caused by the COVID-19 pandemic, as well as the depth in markets relevant to FMS-WM, could complicate measures to unwind the portfolio.

Report on opportunities and forecast report

MACROECONOMIC DEVELOPMENTS

Unless otherwise indicated, the following data is presented on an annualised basis.

The IMF[1] anticipates global economic growth of 5.5% for 2021, although this growth will be very unevenly distributed. For example, although China was the first country to suffer the effects of coronavirus, it is expected to be one of only a few countries to return rapidly to its original growth trajectory. The majority of economies will remain below the growth rates they have recorded in recent years. Less developed countries in particular are not expected to be able to benefit from an economic recovery. There is also a high degree of uncertainty surrounding these forecasts, as they depend on the availability of vaccines and medication, the further development of the COVID-19 pandemic, particularly with regard to mutations and political decisions such as lockdowns, as well as the fiscal and monetary stimulus packages introduced to tackle the COVID-19 crisis. Other important factors include the consequences of political events such as Brexit, the change of government in the USA and uncertainty surrounding a stable government in Italy, which could have a significant impact on the global economy and European economies in particular.

The IMF is significantly more optimistic about its January 2021 forecasts for the USA and Japan than it has been in previous months, primarily due to the economic recovery measures announced there. Conversely, the IMF adjusted its forecasts downwards for the euro zone and the United Kingdom. The IMF justifies these varying assessments by citing the effectiveness of medical and economic measures in individual states as well as the existing structural strengths and weaknesses of individual economies even prior to the emergence of the COVID-19 pandemic.

According to the IMF, countries that depend heavily on commodity exports and tourism and have a relatively weak industrial and service sector will have to grapple with low economic growth for several years. Emerging markets are particularly affected by this. The IMF even fears that the COVID-19 pandemic could reverse two decades of progress in tackling poverty. One country apart from China that is predicted to buck this trend is India, where the IMF expects economic growth of 2.7% for the current year.

In its outlook, the IMF notes that the forecasts are subject to a much greater degree of uncertainty than in previous years.

Macroeconomic opportunities and risks could materialise from the following factors (note that these are not included in the assumptions underlying the statements made in the *Development of FMS Wertmanagement* section):

- Additional and improved vaccines, effective therapies to treat COVID-19 as well as further fiscal and government assistance programmes could ensure that economic development is better than currently expected in the forecasts.

[1] *Source: IMF World Economic Outlook, January 2021 (also applies to further references to the IMF in this section)*

- Even greater spread of coronavirus or mutations that make the virus even more dangerous. Setbacks in the development, production and distribution of vaccines could put countries' healthcare systems under even greater pressure and make additional measures unavoidable.

- Premature limitations on economic support packages could trigger a dramatic rise in insolvencies that could also affect economically sustainable companies.

- The COVID-19 pandemic has significantly accelerated existing change processes such as the digitalisation of all areas of life and economic activity. This could lead to further social division in many economies.

- Additional risks could arise from social unrest connected with existing discontent among the population about lockdown measures and the potential influence of extremist parties in several countries.

- Added to this are other existing uncertainties such as the trade conflict between China and the USA, the long-term impact of Brexit, uncertainty regarding a stable government in Italy, a variety of local conflicts, climate change, global migration flows and uncertainty surrounding the development of interest rates on the money and capital markets, which could make refinancing more difficult for governments and companies. These issues may once again come to the fore once the COVID-19 pandemic subsides.

FMS-WM, with the help of external sources, believes that these macroeconomic developments will have the following effects on the portfolio:

Commercial Real Estate

The recovery in the USA is expected to continue in 2021, particularly in the second half of the year. Vacancy rates for office space are likely to rise further as the impact of the job cuts resulting from the COVID-19 pandemic continues to be felt and the move towards working from home adversely affects the office sector. An economic upturn will in all likelihood trigger a renewed increase in office letting activity. Quoted rents are expected to fall over the next few quarters due to pressure from a growing stock of subletting space.

Infrastructure

According to Moody's, the COVID-19 pandemic will continue to impact market activity in 2021. Due to the development of vaccines and improved management of the COVID-19 pandemic, an increasing economic recovery is expected in the Europe, Middle East and Africa (EMEA) region from the second quarter of 2021 in particular, although this recovery is likely to be uneven across different countries and transport sectors. Further waves of infection and a slower-than-anticipated vaccine rollout pose significant risks.

According to Moody's forecasts, the outlook for the global transport industry varies considerably in 2021. The development of Australian airports is expected to remain stable, as the adverse effects of coronavirus have subsided in Australia. By contrast, expectations for the development of European airports are considered negative. Based on the anticipated recovery of traffic figures in Europe for 2021 (approx. 20%), the outlook for European toll roads is considered stable.

Moody's expects regulated providers of electricity and gas distribution networks in the EMEA region to remain stable in 2021, as their credit quality will continue to be supported by established and transparent regulation and the COVID-19 pandemic has had only a limited impact on the financial situation of these companies so far.

Moody's also predicts a stable outlook for the EMEA public-private partnership sector. This sector is characterised by long-term, contractually tied revenues and is only marginally vulnerable to changes in the economic growth of the respective economies. The risks of a slump in user demand are also extremely low in this sector, and the credit quality of the counterparties from which the borrowers receive almost all of their income (public institutions) is usually very high. Moody's outlook for this sector has been stable since 2009 and is thus barely affected by the COVID-19 pandemic.

Public Sector

For Europe, extensions and escalations of existing lockdowns cannot be ruled out in 2021 due to the sluggish distribution of coronavirus vaccines and the disparate development of the COVID-19 pandemic. This particularly dampens the region's prospects for the first half of 2021. Despite this uncertainty and EU countries' extreme levels of new debt as a result of the COVID-19 pandemic, no significant deterioration in creditworthiness is expected at sovereign and sub-sovereign level in the medium term due to the measures introduced by the ECB as well as the EU assistance programme. This is particularly true of Italy, which has been severely impacted by both coronavirus itself as well as the economic effects associated with it. As a result of the aforementioned EU programme, from which Italy derived the greatest benefit in absolute terms, as well as the appointment of former ECB president Mario Draghi as Italy's prime minister, the risk premiums between ten-year Italian government bonds and ten-year German government bonds narrowed from around 130 basis points in October 2020 to approximately 40 basis points in February 2021. Although the United Kingdom's economy is expected to develop slightly less favourably compared to continental Europe, risk premiums are likely to remain stable. This is primarily due to the UK's withdrawal from the EU and the consequences associated with this. In the USA, however, the situation on the credit markets is viewed as less critical thanks to the stimulus packages and the country's relatively successful start to its vaccine rollout compared to the EU.

Structured Products

US municipals

Players in the US municipals market are pinning their hopes for 2021 on a successful COVID-19 vaccination programme. Although there will initially be a surplus of rating downgrades compared to rating upgrades, it remains to be seen what long-term developments will result from the COVID-19 pandemic. In 2021, the issue volume for US municipals is expected to rise year-on-year to between EUR 500 million and USD 550 million, representing an increase of around 7% to 11% compared to the previous year.

ABS

There is still the potential for risk premiums on European ABS to narrow slightly in 2021, as the market had already largely recovered from the negative effects of the peak of the COVID-19 pandemic towards the end of 2020. A new issue volume of around EUR 90 billion is anticipated for European ABS in 2021.

The ABS issue volume in the USA could return to a higher level in 2021 than in 2020 with a volume of USD 225 billion to USD 245 billion.

However, the assumptions for the unwinding of the portfolio (economic repayment profile) are derived from the market data available at an individual asset level on the planning date.

DEVELOPMENT OF FMS WERTMANAGEMENT

Portfolio

The portfolio is expected to be unwound further by an estimated EUR 5 billion to EUR 7 billion nominally in fiscal year 2021, especially in the Public Sector and Structured Products segments. The forecast is based on the contractual terms of the portfolio, factoring in assumptions about the economic repayment profile for structured products and assumptions by FMS-WM portfolio managers about sales, required compulsory extensions and restructuring measures.

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-WM'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.

There were no developments in the 2021 fiscal year that contradicted this forecast.

Results of operations

To the extent that the developments in the core markets materialise as described above and no unforeseen events trigger other critical developments affecting the portfolio of FMS-WM, the company is again expected to at least break even in the years to come. The result from ordinary activities is mainly dependent on risk provisions and net income from investment – volatile items which are heavily influenced by valuation decisions and sales results. Due to the high concentration risks in individual counterparties and in some individual markets, valuation parameters may lead to corresponding positive and negative deviations in these items, resulting in deviations from the forecasted result.

FMS-WM anticipates current contributions from net interest and commission income to decline in the 2021 fiscal year due to the progression of the portfolio wind-up and the further decrease in one-off effects.

Excluding one-time expenses in connection with the ongoing IT outsourcing tender, administrative expenses should show a slightly declining trend in connection with the progressive wind-up of the portfolio. However, according to current planning, FMS-WM assumes that current income will decline more quickly than administrative expenses.

Based on the above assumptions, FMS-WM's 2021 forecast predicts to at least break even in terms of its result from ordinary activities, because it expects the positive balance from current income less administrative expenses to be at least equal to a possible negative balance of the Risk provisions and Net income from investments items influenced by valuations and the proceeds of sales.

There were no developments in the 2021 fiscal year that contradicted these forecasts.

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

Funding

FMS-WM assumes that it will be able to raise funds as planned for 2021. After the funding facility via the FMS was increased from its previous level of EUR 30 billion to EUR 60 billion, borrowings of EUR 30.4 billion are planned via the FMS for fiscal year 2021. As a result, drawdowns from the funding facility will increase as planned from EUR 30 billion as of the 31 December 2020 reporting date to EUR 55 billion by the end of 2021. In the following years, the plan is to keep the funding volume via the FMS at the highest level possible.

FMS-WM is also aiming for capital market issues equivalent to EUR 0.7 billion to EUR 1.5 billion in 2021, particularly in USD and GBP. This means that the proportion of long-term funding in the overall funding volume will remain well in excess of 50%. FMS-WM will continue to raise short-term money market funding itself.

Opportunities for future development

In addition to the opportunities arising from a positive trajectory in the markets relevant to FMS-WM and the resulting chances for accelerated portfolio wind-up at maximum profit, opportunities for FMS-WM may also be created by strategic projects and legislative changes.

The opportunities listed below also involve risks that could arise when implementing these projects.

The overhaul of the reference interest rates for variable-rate financial instruments ("benchmark reform") represents a significant challenge for FMS-WM. In light of this, FMS-WM launched the Post-IBOR project in January 2019 to systematically analyse and process the economic and legal challenges posed by the benchmark reform and manage potential opportunities and risks. In fiscal year 2020, Eurex Clearing AG changed the interest rate for EUR-denominated collateral to ESTR. This also affected the derivatives held by FMS-WM which are in derivatives clearing at Eurex Clearing AG via contracting party the Federal Republic of Germany, represented by the German Finance Agency. For the majority of counterparties, the interest rate was also amended in the credit support annexes for OTC derivatives.

With regard to the UK's withdrawal from the EU, FMS-WM carried out a cross-functional analysis of potential effects, particularly on FMS-WM's portfolio, funding activities and payment transactions. In doing so, FMS-WM considered the possibility of the United Kingdom making a disorderly exit from the EU as well as the likelihood of reaching a trade agreement. FMS-WM implemented preparatory measures wherever possible; among other things, this included switching the existing derivatives portfolio with counterparties (banks) from the UK to contractual partners that maintain a branch in an EU member state. As the trade agreement reached between the EU and the United Kingdom in December 2020 only contained a few regulations for the financial sector, FMS-WM is continuing to monitor developments, particularly those relating to relevant regulatory announcements. However, no material effects have yet been identified that FMS-WM has not already proactively prepared for.

In fiscal year 2019, FMS-WM defined medium-term objectives aimed at ensuring operational stability and a sustainable cost structure in the future that takes into account all risks within the portfolio. Reducing complexities within the portfolio should significantly bring down the expenses for risks and portfolio management and give FMS-WM more room for manoeuvre in the management of the portfolio. These objectives are regularly reviewed and adjusted where necessary based on new knowledge and developments. Efforts to implement measures relating to both the managed portfolio and internal processes and procedures began in fiscal year 2019. As not all projects could be implemented as planned in fiscal year 2020 due to the effects of the COVID-19 pandemic, some had to be postponed, although this has not yet had a lasting negative impact on the existing objectives. There were no developments in the 2021 fiscal year to date, that preventing the continuation of these measures. As a result, FMS-WM is currently continuing to implement its medium-term objectives and will continue to monitor market developments closely. If it becomes necessary to restrict the implementation of these objectives in future because of a sustained deterioration in the economic situation due to the COVID-19 pandemic, for example, this may mean that FMS-WM cannot meet its defined objectives either in whole or in part.

INTERNAL CONTROL / RISK MANAGEMENT SYSTEM RELEVANT TO THE FINANCIAL REPORTING PROCESS

The internal control and risk management system relevant to the financial reporting process (ICS / RMS) and focused on business-critical processes of FMS-WM serves to ensure compliance particularly with financial reporting standards and requirements and the reliability of the accounting.

Responsibility for the ICS rests with the central ICS entity in the IT, Sourcing & Operations unit, which is part of the CEO division.

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

FMS-WM has outsourced material aspects of its accounting, with its subsidiary FMS-SG essentially handling portfolio management, general ledger and subledger accounting including financial accounting, master data management, payment transaction handling, and regulatory reports and annual financial statement preparation.

In addition to services directly related to accounting, IT services were also outsourced; these are also relevant to the ICS. IT services are monitored by the IT Steering & Project Planning department in the IT, Sourcing & Operations unit. The IT service providers are also subject to the ICS at FMS-WM pursuant to contractual provisions.

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

In addition to its responsibilities for monitoring and managing outsourced services, FMS-WM 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
- Preparing certain booking instructions, e. g. for valuations, provisions and the recognition of taxes.

An interdepartmental NPP managed by Sourcing & Servicer Steering, which is part of the CEO division, ensures the correct mapping of products and product enhancement not yet existing.

The basic task of FMS-WM's ICS is to fulfil the following material 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-WM 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 possibility 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-WM'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 affect the statements and disclosures in the annual financial statements as to completeness, recognition, accuracy, measurement, presentation and compliance with the accrual basis of accounting.

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

Overall responsibility for the FMS-WM internal control system lies with the FMS-WM Executive Board.

The central ICS entity makes sure that the ICS framework is firmly integrated in the units of FMS-WM and its service providers. It handles the centralised management of the ICS database, the coordination of the annual standard ICS procedure, and the consolidation of the ICS control confirmation into a high-level ICS report. To ensure the effectiveness of the FMS-WM ICS, the ICS framework is regularly reviewed for compliance with legal provisions and industry standards, and updated as appropriate.

The relevant unit heads are responsible for identifying the controls required, implementing an appropriate control system in conjunction with the risks relevant to bookkeeping and accounting and business-critical risks, and monitoring performance of the controls. The identified control owner is responsible for defining and performing the relevant ICS controls.

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

As part of the annual ICS control process carried out by the central ICS entity, the existing controls are validated in the context of Group-wide service performance processes. This validation is based on interviews with the relevant unit heads and control owners, and takes into account the results of the annual ORSA conducted by the Risk Controlling department as well as the findings of internal and external audits.

For fiscal year 2020, the establishment of the ICS and proper performance of the controls were confirmed in an ICS Control Attestation by the relevant unit heads at FMS-WM and the department heads and managing directors of FMS-SG. The comprehensive mobile office model introduced at FMS-WM and FMS-SG in connection with the impact of the COVID-19 pandemic did not result in any impairments to the accounting-related internal control system.

The control system applicable to outsourced parts of IT services was approved by a report prepared pursuant to ISAE 3402. Furthermore, FMS-WM has performed additional IT controls relating to the IT services as needed. These did not reveal any evidence of control system impairments triggered by the consequences of the COVID-19 pandemic.