A successful fiscal year 2023 for FMS Wertmanagement

Christoph Müller, Spokesman of the Executive Board; Carola Falkner, Member of the Executive Board

FMS Wertmanagement (FMS-WM) closed fiscal year 2023 with a clearly positive result for the year. The *result from ordinary activities* for fiscal year 2023 came to EUR 96 million.

At EUR 528 million, *net interest income* again rose significantly compared to the previous year (EUR 391 million). This increase is due mainly to a higher interest rate level in the currencies relevant to FMS-WM and improved funding terms, which more than compensate the offsetting effects of the progressive unwinding of the portfolio. Net interest and commission income continue to exceed FMS-WM's administrative expenses by a large margin.

The balance of risk provisions and net income from investments in the amount of EUR –322 million (previous year: EUR –182 million) was impacted by valuation and sale decisions and had a considerably negative effect on the result in fiscal year 2023. Risk provisions were significantly impacted by the first-time allocation to the fund for general banking risks in accordance with Section 340g HGB.

As at 31 December 2023, total assets decreased by 11% to EUR 88.4 billion compared to the prior-year balance sheet date. This was mainly due to the unwinding of exposures and termination of derivatives as well as a decline in liquid funds.

In fiscal year 2023, *portfolio wind-up* came to EUR 5.0 billion and was the result of disposals and both scheduled and unscheduled repayments. Since the transfer from the HRE Group, and excluding countervailing currency effects, the nominal value of the portfolio was reduced by a total of EUR 133.0 billion as at 31 December 2023. The targets for the unwinding of the portfolio and further reducing its complexity were therefore achieved in fiscal year 2023 despite numerous macroeconomic challenges.

As in previous years, net retained profits reported in the amount of EUR 36 million will be accumulated rather than distributed. FMS-WM reports equity of EUR 1.9 billion as at 31 December 2023. Together with risk provisions and the fund for general banking risks, this serves as a buffer for any losses that might still arise during the further unwinding of the portfolio.

In fiscal year 2023, *employees* at all FMS-WM and FMS Wertmanagement Service GmbH (FMS-SG) locations once again made the most significant contribution in driving forward the wind-up while at the same time maintaining high-quality, stable processes.

FMS-WM's statutory auditor audited the annual financial statements as at 31 December 2023 and the management report for fiscal year 2023 and issued an unqualified auditors' report.

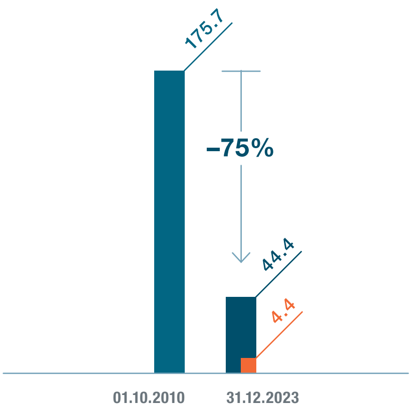
On 22 March 2024, the Supervisory Board of FMS-WM approved the annual financial statements prepared by the Executive Board.

In fiscal year 2023, FMS-WM continued to make good progress on its task of unwinding and liquidating the transferred exposures as profitably as possible.

The measures to unwind and manage the portfolio, optimise funding and further develop the business model were once again the focal point of FMS-WM's work in 2023. Based on a lower-risk and significantly less complex portfolio, the *operating model of the FMS-WM Group* (FMS-WM and FMS-SG) is being further developed to ensure high-quality, operationally stable and cost-effective portfolio management. In doing so, consideration is also being given to options to transfer some parts of exposure management to third parties insofar as this is economically worthwhile.

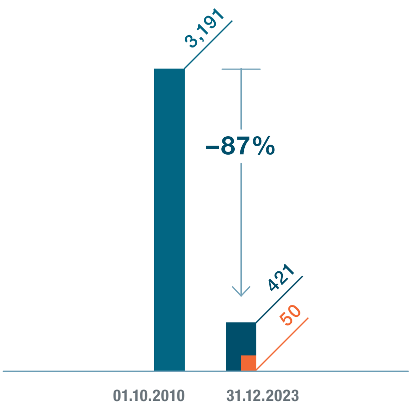
FMS-WM OVERALL PORTFOLIO

DEVELOPMENT OF THE NOMINAL VOLUME (IN EUR BILLION)



■ Portfolio subsequently acquired from the DEPFA Group

DEVELOPMENT OF THE NUMBER OF COUNTERPARTIES



■ Portfolio subsequently acquired from the DEPFA Group

Portfolio wind-up

Since the portfolio was transferred from the HRE Group on 1 October 2010, its original nominal value of EUR 175.7 billion has been reduced to EUR 44.4 billion as at the end of 2023. Adjusted for the assets acquired from DEPFA Group companies in fiscal years 2016 to 2020 with a total acquisition-date nominal value of EUR 11.8 billion, the original portfolio has been reduced by around 77% by the end of 2023.

Portfolio wind-up targets achieved in 2023

FMS-WM was able to reduce the complexity of the portfolio again in fiscal year 2023 and thus continue to pave the way for the implementation of measures to further develop the operating model. Since the portfolio was taken over in 2010, the number of countries in which FMS-WM still holds exposures has been reduced from 66 to 28 countries (see chart on page 6 and 7). In 2023, the number of countries in which exposures are still held was reduced by a further three countries. Since the portfolio was taken over, the currencies contained in the portfolio have likewise further decreased from originally 19 to 8 currencies at the end of 2023. All remaining CHF-denominated exposures were unwound in 2023.

CURRENCIES CONTAINED IN THE PORTFOLIO

AUD	DKK	ITL	SEK
CAD	ESP	**JPY**	SGD
CHF	**EUR**	**MXN**	**USD**
CLF	**GBP**	NOK	**ZAR**
CZK	INR	PLN	

■ Currencies in the portfolio as of 31.12.2023
■ Currencies already wound-up since October 2010

In 2010, there were originally 3,191 counterparties in FMS-WM's portfolio. Since the transfer from the HRE Group, the number had been reduced to 421 counterparties as at the end of 2023. Through sales as well as scheduled and actively pursued repayments, FMS-WM succeeded in reducing the number of counterparties by 95 in 2023.

There are still clear portfolio concentrations in the United Kingdom, Italy and the USA, which together accounted for around 73% of the nominal value of the portfolio as at 31 December 2023. As the portfolio is progressively wound up, these concentrations of risk caused by the long maturities of the rest of the portfolio continue to rise.

Portfolio reduced by a further three countries

The difficult market environment attributable to the ongoing wars in Ukraine and the Middle East, continued interest rate hikes by central banks and other factors was and remains very challenging for the unwinding of the portfolio, which consists largely of complex, very long-dated and illiquid financing arrangements with low margins not in line with the market. Nevertheless, in fiscal year 2023 FMS-WM was once again successful in its wind-up activities in all segments, thereby further reducing risks and complexity.

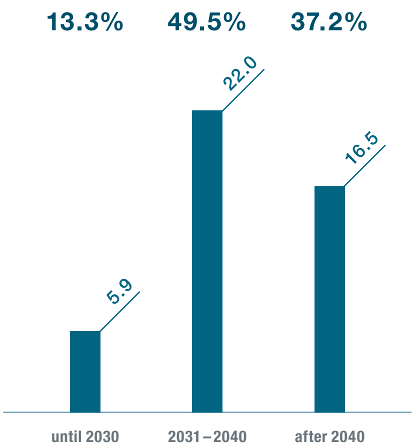
In the *Infrastructure* segment, which made up 18% of the portfolio as at 31 December 2023, FMS-WM was able to sell or liquidate a portfolio of ten long-dated loans totalling approximately EUR 125 million and a number of related derivatives. This financing was for the social infrastructure sector in the United Kingdom. The transaction is proof of the active work to reduce concentrations of risk and the complexity of the portfolio.

The *Structured Products* segment was reduced by a total of EUR 2.4 billion through repayments and selling activity, particularly in the case of French and Spanish financing and some of the last American public-sector bonds (US municipals).

In the *Public Sector* segment, the borrowers and issuers of securities include state and regional governments, municipalities, public law entities and semi-public companies. Above all in fiscal year 2023, FMS-WM made progress in unwinding European loan exposures and sold a fragmented, Dutch loan portfolio comprising 43 loans totalling approximately EUR 363 million and with remaining terms of up to 25 years. It was thus able to fully wind up this sub-segment of similar loans. In the first quarter of 2024, a further portfolio of 28 loans totalling approximately EUR 68 million was successfully sold to Italian municipalities. This sale was extensively prepared in 2023 and driven forward at great effort by FMS-WM and FMS-SG.

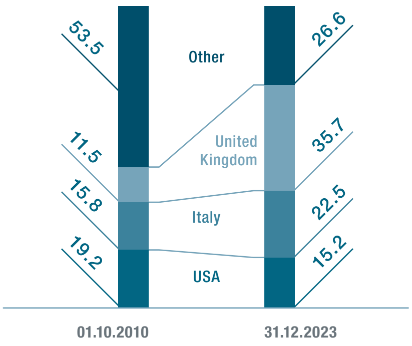
BREAKDOWN OF THE PORTFOLIO BY REMAINING MATURITIES

(IN EUR BILLION)



PORTFOLIO DISTRIBUTION BY COUNTRY

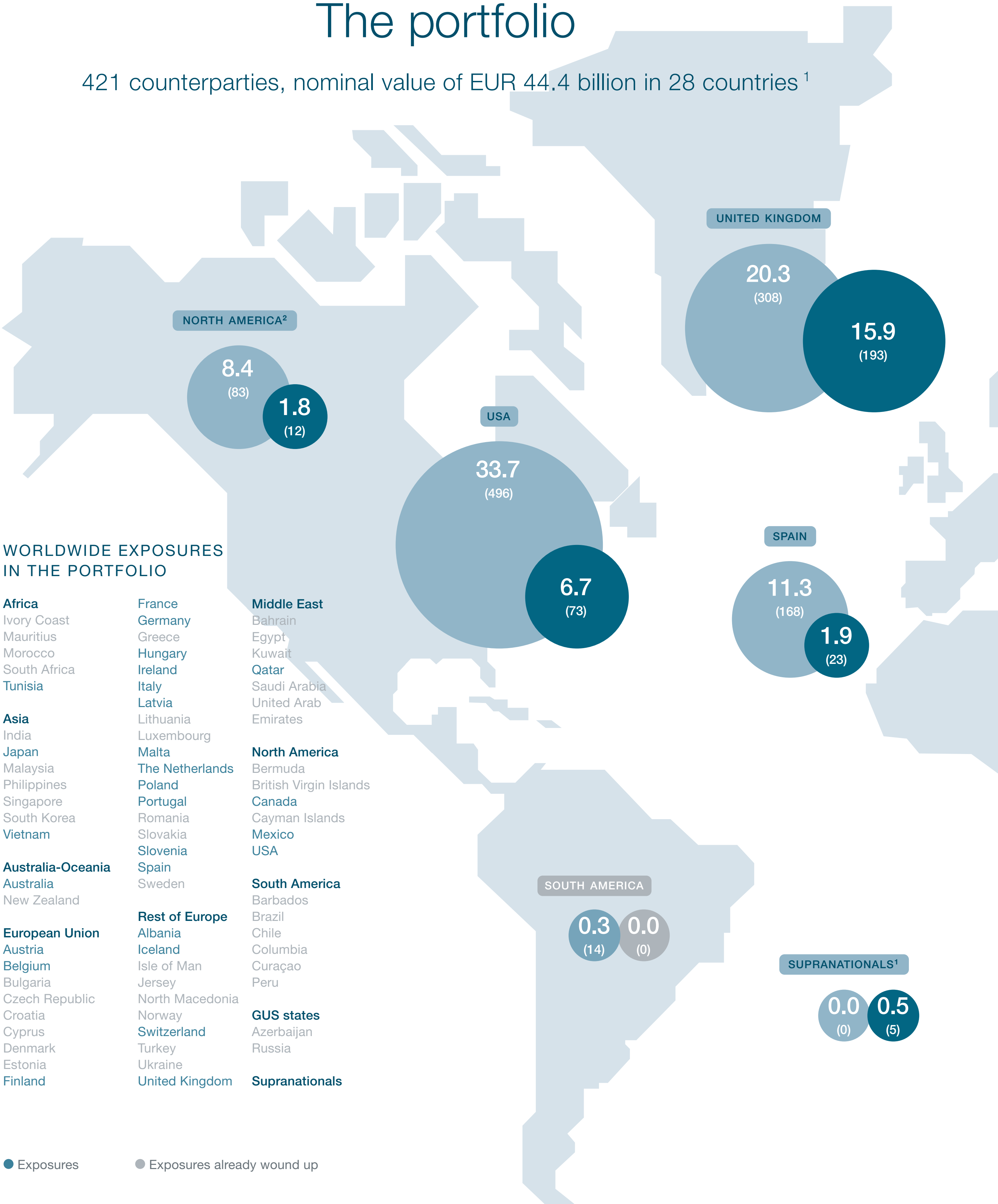
(IN % OF NOMINAL VOLUME)



The Public Sector segment also includes Lender Option Borrower Option Loans (LOBOs). These are complex financial transactions in which loans were issued to towns, cities and other local authorities in the United Kingdom. FMS-WM holds LOBOs with a nominal value of approximately GBP 2.2 billion and terms through to 2078 in some cases. In the past, selling loans and closing out hedging derivatives would have entailed heavy losses, as the hedging derivatives had high negative market values because interest rates were low. Due to the rise in interest rates in the GBP environment, FMS-WM believes that the hedging derivatives' market values have improved. Nevertheless, the products are still very illiquid.

The portfolio

421 counterparties, nominal value of EUR 44.4 billion in 28 countries [1]



WORLDWIDE EXPOSURES IN THE PORTFOLIO

Africa
Ivory Coast
Mauritius
Morocco
South Africa
Tunisia

Asia
India
Japan
Malaysia
Philippines
Singapore
South Korea
Vietnam

Australia-Oceania
Australia
New Zealand

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

Rest of Europe
Albania
Iceland
Isle of Man
Jersey
North Macedonia
Norway
Switzerland
Turkey
Ukraine
United Kingdom

Middle East
Bahrain
Egypt
Kuwait
Qatar
Saudi Arabia
United Arab Emirates

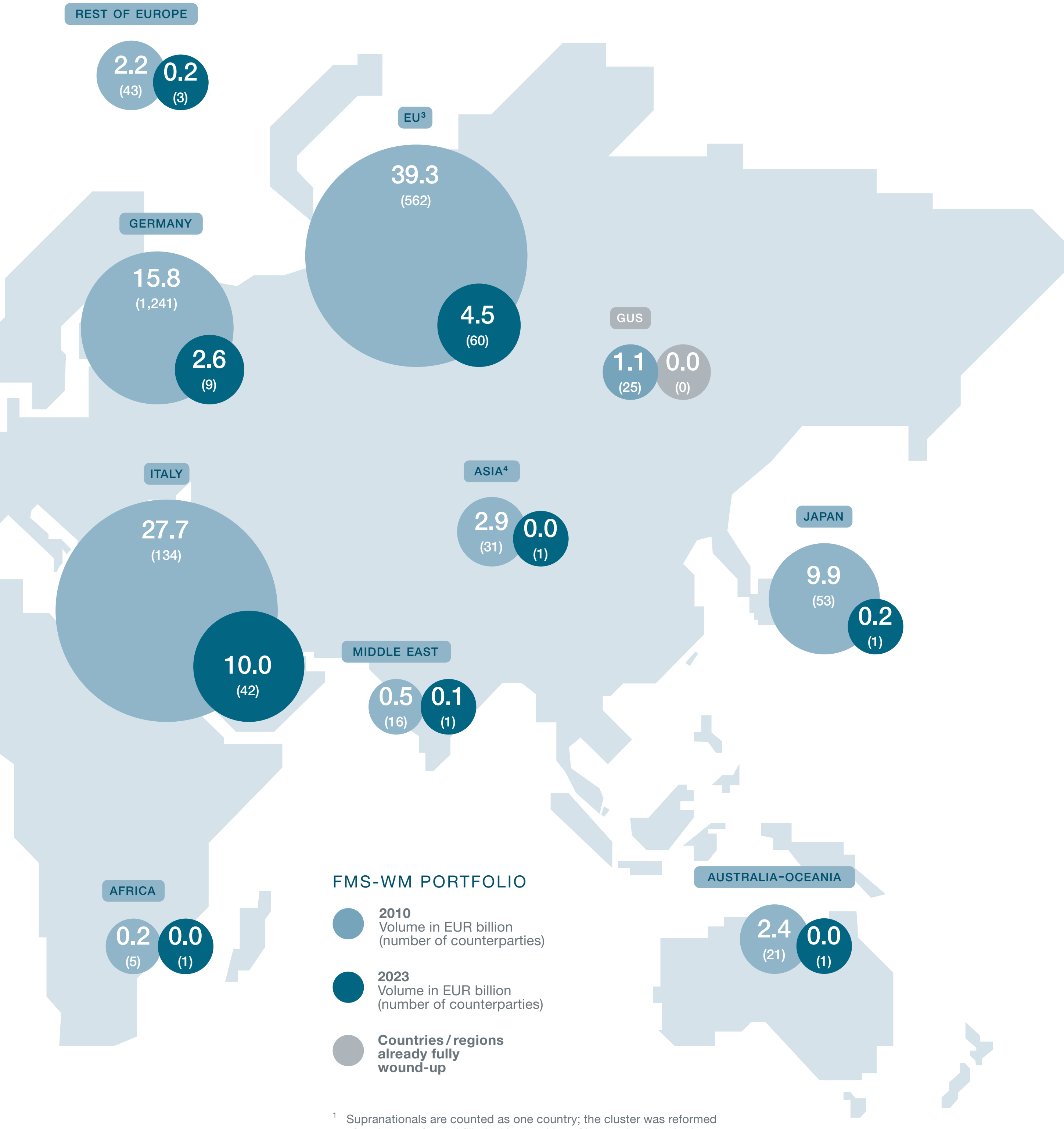
North America
Bermuda
British Virgin Islands
Canada
Cayman Islands
Mexico
USA

South America
Barbados
Brazil
Chile
Columbia
Curaçao
Peru

GUS states
Azerbaijan
Russia

Supranationals

● Exposures ● Exposures already wound up



[1] Supranationals are counted as one country; the cluster was reformed after the transfer and filled with securities of international institutions
[2] Excluding the USA
[3] Excluding Germany, Italy and Spain
[4] Excluding Japan

FMS-WM devotes considerable time and attention to this fragmented and long-dated portfolio and examines opportunities to wind down these loans or reduce their complexity.

In addition, FMS-WM continues to pursue the wind-up strategy for a portion of the *derivatives portfolio* that is not permanently in hedging relationships with portfolio exposures or funding instruments. The majority of these derivatives had been successfully unwound by the beginning of 2024 and the holdings reduced to 38 transactions with maturities after 2024. In fiscal year 2023, 223 derivatives with maturities after 2024 were closed out.

From a credit profile perspective, FMS-WM's portfolio was not affected by the wars in Ukraine and the Middle East in fiscal year 2023. FMS-WM did not hold any exposures with counterparties or maintain business relationships with parties from the countries involved. The credit quality of FMS-WM's portfolio was not materially negatively affected by the trend in interest rates, the trend in inflation expectations or the financial and capital market volatility during the course of the fiscal year. In fiscal year 2023, there were no loan defaults or cases of deferrals approved by FMS-WM. At 93%, the percentage of investment grade financing remains at a high level.

As was the case when the portfolio was taken over in 2010, most of the exposures are usually part of asset swap packages in which they are attached to derivatives that are used to hedge interest rate, inflation or currency risk. If the exposures were sold prematurely, those derivatives would have to be closed out ahead of the maturity date, possibly causing heavy losses. The balance of hidden losses and reserves relating to the portfolio and the associated derivatives, determined in part based on model valuations and assuming saleability of loans, amounted to EUR –9.6 billion as at 31 December 2023, a decrease of EUR 0.3 billion compared with 31 December 2022. It is still the case that selling all exposures immediately or at short notice while at the same time closing out the related derivatives would only be possible at a considerable loss.

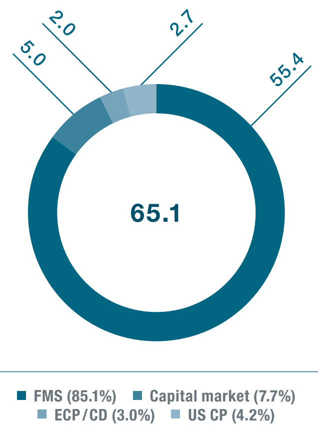
Cost-effective funding

FMS-WM continues to hold the highest ratings from rating agencies Standard & Poor's and Moody's due to the loss compensation obligation contained in the Charter and the explicit direct guarantee from the German Financial Market Stabilisation Fund (FMS).

Since January 2019, longer-term euro-denominated funding of FMS-WM has been carried out by funds provided by the FMS. FMS-WM also continued to optimise its funding in 2023, utilising most of the EUR 60 billion funding facility provided via the FMS. In total, new funding of EUR 6.0 billion was raised. As at 31 December 2023, funding drawn via the FMS therefore accounted for 85% of FMS-WM's total funding.

FMS-WM uses the funds drawn down via the FMS for funding in euros and, in conjunction with foreign exchange derivatives, for selected foreign currencies. This strategy enabled the funding costs both for the long-dated portfolio in British pounds and for fund raising in US dollars to be reduced significantly.

FUNDING STRUCTURE OF FMS-WM
(IN EUR BILLION)



In return, FMS-WM rolled back its own activities in the capital markets. In 2023, FMS-WM for the first time did not launch any issues under the debt issuance programme, enabling it to save the related costs. Although it remains possible to raise funds through the capital market going forward, there are no plans to do so at the present time.

Funding strategy makes a significant contribution to FMS-WM's success

FMS-WM itself continues to ensure *short-term money market funding* via the two established money market programmes (European Commercial Paper Programme and US Commercial Paper Program). The two programmes had a funding volume equivalent to EUR 4.7 billion at 31 December 2023 (previous year: EUR 9.0 billion).

In fiscal year 2023, FMS-WM also worked on the overhaul of benchmark interest rates for floating-rate financial instruments (benchmark reform) after the successful completion of the Post-IBOR project. The focus here was on the remaining US dollar-denominated contracts, which in 2023 were changed over to the risk-free benchmark the Secured Overnight Financing Rate (SOFR).

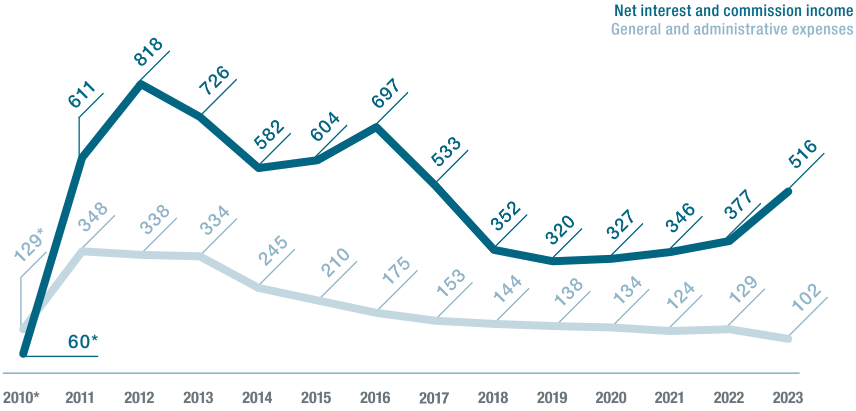
Portfolio management

Net interest and commission income again was up year-on-year to EUR 516 million (previous year: EUR 377 million), continuing the previous year's positive trend, primarily as a result of the rise in interest rates in currencies relevant to FMS-WM.

The general and administrative expenses in fiscal year 2023 amounted to EUR 102 million (previous year: EUR 129 million). In the previous year, this figure still included one-off effects of EUR 15 million associated with the IT transition in 2022. Independently of this, expenses associated with outsourcing were further reduced significantly in fiscal year 2023. One key factor here was the fall in expenses for FMS-SG, whose New York office ceased operations at the end of 2022

NET INTEREST AND COMMISSION INCOME VS. ADMINISTRATIVE COSTS

(IN EUR MILLION)



*Short fiscal year

Net interest and commission income continues to exceed administrative expenses by far

In order to achieve the medium-term objectives, FMS-WM and FMS-SG continue to work on simplifying processes and optimising the organisational structure of the FMS-WM Group. In recent years, measures have been brought forward, enabling savings to be achieved earlier than originally planned. The measures are aimed at reducing IT, personnel and other operating expenses.

By making the successful transition in 2022, FMS-WM took a major step forward in modernising its IT landscape. At the same time, FMS-WM laid the foundations for implementing digitalisation projects, expanding IT security measures and achieving its targets for reducing IT expenses. Due to increased regulatory requirements applicable to IT and IT security, FMS-WM is also seeing a general increase in market prices for IT services. These effects were successfully countered by adapting the requirements for IT services and license expenses to the development of FMS-WM, and current expenses were kept largely stable. FMS-WM is continuously working together with IT service providers to identify potential, in particular to achieve further savings on current IT costs related to IT infrastructure and licences and by using software-as-a-service or cloud solutions.

The changes to headcount in the FMS-WM Group went to plan again in fiscal year 2023. The measures taken over the past few years have already enabled significant savings to be made on personnel costs in the FMS-WM Group.

Other operating costs were also reduced substantially in 2023. This was due mainly to savings on rent.

In 2022, the licences to provide financial services requiring approval were returned, thereby achieving further savings for FMS-SG, as the related regulatory requirements ceased to apply. In addition to the complete dismantling of FMS-SG's processes, other processes that are not subject to regulations for banks can be designed more flexibly to cater to the requirements of FMS-SG. The dissolution of the Supervisory Board of FMS-SG in September 2023 further simplified corporate management in the FMS-WM Group.

Overall in fiscal year 2023, the FMS-WM Group once again successfully carried out measures to implement its medium-term objectives while reducing administrative expenses and lay the necessary foundations.

Employees

As at 31 December 2023, 99 people were employed at FMS-WM and 216 at FMS-SG.

Unwinding the portfolio is a complex task where FMS-WM has undertaken to act with the utmost professionalism and is convinced that motivated, qualified and loyal employees are an essential success factor for the organisation.

Together, FMS-WM and FMS-SG entered the next phase of the *transformation process* in fiscal year 2023. In this context, the FMS-WM Group faces the challenge of driving forward the portfolio wind-up and the further development of the operating model while at the same time maintaining high-quality, stable processes. In this transformation process, employees receive active support involving the entire organisation. This includes a clear strategy and set of objectives on the part of the Executive Board as well as open communication with employees with a view to overcoming resistance and creating acceptance of change. The transformation is to be given increasing consideration in processes and decisions. Challenges such as the progressive reduction in headcount are also addressed and integrated into the transformation. Individual development paths are crucial if employees are to take responsibility and identify with the FMS-WM Group.

In order to connect the levels of the organisation with that of the individual employee, the units conducted a series of strategy workshops in fiscal year 2023 with the involvement of management. Through these formats, FMS-WM and FMS-SG open up the opportunity for employees to actively participate in further developing the FMS-WM Group's operating model.

Flexibility in actions and reactions is standard operating procedure

The process is accompanied by an internal transformation team to enable the organisation to adapt to the gradual, increasingly rapid and fundamental changes and challenges in all phases of the transformation. This team is the service provider for employees and helps to establish new routines and adapt mindsets, ways of working and decision-making to the ever greater steps in the process of change.

The success factors used to measure the progress of the transformation process were reevaluated again in 2023. The result shows that FMS-WM and FMS-SG employees are aware of the need for the transformation and realise that they can make their own, individual contribution to the process. On a particularly positive note, FMS-WM Group employees attest to a high degree of self-organisation and interaction across units has continued to increase.

For FMS-WM, a conflict arises between employee retention and headcount reduction. Any uncertainties that emerge could have a negative impact on operational stability. It is therefore key to find a balance between these two challenges.

To rise to these challenges, FMS-WM fosters the individual skills and experience of its employees in specific areas. Continuous feedback, needs-based continuing professional development and knowledge transfer are essential. 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. FMS-WM invests in its employees' personal development and offers support for a possible follow-on position, also drawing on external careers and prospects advice. A supportive severance management process plays a key role not only in facilitating a respectful departure for the employees concerned, but also in having a positive impact overall on the corporate culture and positioning the Group as a responsible employer.

FMS-WM meets the increased expectations of employers in the modern world of work through a hybrid office model and thus enables office working and mobile working to be efficiently combined. FMS-WM employees are generally free to decide on which and on how many days they wish to use mobile working; this is based on unit and team self-organisation. At FMS-WM, it is also possible to work up to 20 working days a calendar year from different European countries. For FMS-WM, this makes a significant contribution to work-life balance and to increasing employee loyalty. These measures meet both operational and employee requirements.

FMS-WM's attractiveness as an employer with a finite, yet unique and meaningful task and demanding and challenging assignments is attested to on a regular basis. In 2023, FMS-WM was once again named a top employer by employer rating platform kununu.

Time and time again, former employees also confirm what distinguishes FMS-WM from their external perspective. They say, for example, that problem-solving always starts with the question of what the actual challenge is. In addition, space is deliberately given to a variety of perspectives, as this leads to sustainable solutions.

> *"At the FMS-WM Group, the focus is on asking the right questions"*
>
> *(former employee)*

By integrating collaboration and the principles of modern working relationships into day-to-day working life of the FMS-WM Group, it remains competitive in comparison with other employers. A low rate of employee turnover underscores its success and enables stable and successful business operations.

Outlook

In fiscal year 2023, FMS-WM implemented further measures aimed at achieving its medium-term objectives. This is intended to ensure high-quality, operationally stable, cost-effective and efficient portfolio management and create more scope to transfer portfolio management to third parties insofar as this is economically worthwhile.

In fiscal year 2024, FMS-WM will once again work on actively reducing complexity and risks as part of its efforts to unwind the portfolio as profitably as possible. Depending on the market environment, it expects to reduce the portfolio by a further nominal amount of around EUR 4 billion to EUR 6 billion.

Flexible employees remain the success factor and, with them, the FMS-WM Group will continue to best fulfil the wind-up task in fiscal year 2024.

At the same time, the organisational and cost structure will be continuously simplified and optimised. In the course of implementing the medium-term objectives, FMS-WM has been working together with FMS-SG since the second half of 2023 to evaluate the strategic options available to a future organisational and operational structure. In the process, various possible models of collaboration in the form of outsourcing arrangements and optimised in-house management are undergoing structured analysis and, if economically advantageous, are being underpinned with more detailed measures that will be implemented over the coming years.

If the interest rates observed in currencies relevant to FMS-WM at the start of 2024 do not fall considerably, net interest income in fiscal year 2024 is expected to remain at the same level as fiscal year 2023. In 2024, FMS-WM expects administrative expenses, which have been declining in recent years, to be in line with the 2023 figure despite inflation in the procurement markets of importance to FMS-WM.

Subject to further geopolitical developments, particularly in connection with the wars in Ukraine and the Middle East, the related effects and other unforeseeable events, FMS-WM expects to at least break even in its ordinary activities in fiscal year 2024, as it anticipates that the positive balance of the current result less administrative expenses will be at least equal to any negative balance of risk provisions and net income from investments, items influenced by valuation measures and proceeds of sales.