Helaba

Focus on: SSAs*
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German agencies: Guarantees from federal and state governments provide for maximum security

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The current situation on capital markets paints an extremely challenging picture with a combination of soaring energy prices driving up inflation, rising interest rates, an uncertain macroeconomic outlook, ongoing disruption to supply chains and a protracted conflict in Ukraine all contributing to greater risk aversion. Consequently, demand for investments in securities considered "safe havens", such as those from German development banks, is growing. Over the next few years, we expect a steady stream of new issuance due to an expansion in development funding programmes and high maturities. Between now and 2025 alone, a volume of EUR 199 billion in euro-denominated bonds issued by the development banks in this study is scheduled to be repaid. In our opinion, it is likely that a total volume of EUR 18 billion in bonds maturing between September and December this year will be completely reissued.

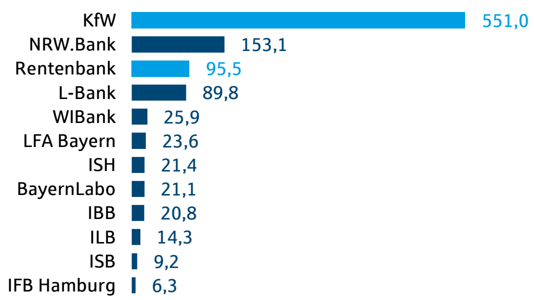
The role of development banks in Germany

The segment of government-related entities - otherwise known as supranationals, sub-sovereigns and agencies (SSAs) - forms one of the most significant pillars of European capital markets. Agencies perform tasks that are funded by the state and provide non-competitive services that are supported by a range of different mechanisms. In this way, development banks chiefly supply the economy with various forms of credit and supplement financing solutions offered by commercial banks, savings banks and cooperative banks, especially in the corporate finance sector - but they do **not**, however, act as competitors to these banks.

Every federal state in Germany has its own development bank or state development agency whose core task is to support investment and working capital for businesses, normally by means of low-interest loans. **KfW** and **Landwirtschaftliche Rentenbank** (Rentenbank) are national development banks that operate on a federal level.

The reason why SSA bonds are currently so attractive and why demand for them is so strong can be attributed to the preferential treatment of SSAs in terms of their eligibility as Liquidity Coverage Ratio (LCR) collateral as well as to their favourable regulatory treatment in other frameworks (Solvency II, Basel III).

German development banks by total assets*
EUR (billions)



Sources: Bloomberg, Helaba Research & Advisory, * 2021

*Supranationals, sub-sovereigns and agencies

No uniform definition of "agency"

There is currently no consistent definition for the term "agency" or for an agency issuer. The basic features of agencies include their public service remit as well as their strong connection to and extremely high importance for the public sector. In general, they can be divided into financials and non-financials based on their purpose and the associated services they provide, which are accompanied, in particular, by significant differences in terms of their regulatory treatment.

In this study, we **exclusively focus on financial institutions** whose activities cover those of classic development banks.
Development agencies are specialised banks with a statutory remit enshrined in their respective charters. The legal status of independent development banks is exclusively that of a public-law institution (*Anstalt des öffentlichen Rechts*) with a form of maintenance or guarantee obligation (*Anstaltslast* and *Gewährträgerhaftung*) on the part of their respective guarantors.

The guarantee and liability structures of German development banks

Explicit guarantee

As a rule, an explicit guarantee is enshrined in the relevant statutes (explicit) and any amendments to it are typically only possible by means of a legislative process (irrevocable). If an agency should experience financial difficulties, an explicit guarantee provides investors with a direct and unconditional claim against the guarantor and is therefore the strongest form of government support. In addition, it represents the definitive criterion for a 0% risk weighting under Basel III/CRD IV.

Anstaltslast

Anstaltslast is a **unique feature of the German agency market**. It describes the legal obligation of the guarantor to maintain the agency's operational viability and to compensate for any financial shortfalls in the form of subsidies or other means. Specifically, Anstaltslast requires the guarantor to provide the agency with the funds necessary to operate. In practice, Anstaltslast is equivalent to a liquidity guarantee which, however, does not involve any costs for the respective agency. It sets out a binding statutory commitment between the agency and the guarantor. This means that, should any liquidity shortfalls arise, only the agency can assert a claim against the guarantor. Investors, on the other hand, do not have any legal right of recourse against the guarantor. Anstaltslast is neither limited in amount nor in time and is regarded as a fundamental principle in German law. Meanwhile, however, it is **only of limited relevance** for investors since all German agencies subject to Anstaltslast additionally provide an explicit guarantee.

Maintenance obligation

A maintenance obligation is a more general type of Anstaltslast and obliges the owner or members of an institution to provide it with the financial resources it requires for it functioning and therefore to maintain the institution's solvency. It corresponds de facto to an implicit (liquidity) guarantee. However, unlike an explicit guarantee, an investor does not necessarily have a right of recourse against the party subject to a maintenance obligation. What is more, maintenance obligations differ in terms of how specifically they are applied and worded. For this reason, the impact of maintenance obligations on risk weightings under Basel III/CRD IV also varies accordingly.

Obligation to compensate for losses ("Verlustausgleichspflicht")

An additional form of liability supplemented the existing guarantee schemes of European agencies when resolution agencies were established in Germany. This liability obligation is governed by Section 7 of the FMS-WN and EAA (FMS Wertmanagement and Erste Entwicklungsanstalt) charters and requires liable stakeholders to compensate the respective agency for all losses. In addition, the liable stakeholders are required to provide the agency with the financial resources necessary to meet its liabilities (liquidity guarantee) at all times. In this way, the Verlustausgleichspflicht is very similar to an implicit guarantee and is also comparable to Anstaltslast or a maintenance obligation, albeit it is more specifically defined. The German federal government was prompted to enshrine in law an explicit guarantee on the part of SoFFin for FMS-WM by the prospect of more stringent risk weighting rules under Basel III. EAA, which did not receive an explicit guarantee due to its considerably more complex structure, is governed by Article 116 (4) CRR, from which the borrower weight of the relevant regional authority (North Rhine-Westphalia) may be derived. The upshot of this is that a 0% risk weight is applicable to both agencies under the Basel II framework as well.

Gewährträgerhaftung

Just like Anstaltslast, Gewährträgerhaftung, a form of guarantee obligation, is **another distinctive feature of the German agency market**. It involves a duty on the part of the guarantor to intervene in the event of an agency's insolvency. As such, the guarantor assumes unlimited liability for an agency's liabilities should the latter become insolvent or go into liquidation. The creditors of an agency protected by Gewährträgerhaftung have a direct right of recourse against the guarantor to the extent that the agency's assets are insufficient to meet the creditors' claims. This also means that the point in time when an agency is liquidated and when the guarantor's liability is triggered do not necessarily have to be close together. Gewährträgerhaftung is neither limited in amount nor in time. As with Anstaltslast, it does not involve any costs for the respective agency. Unlike Anstaltslast, however, it is not regarded as a general principle of German law; instead, it requires a specific legal framework, such as legislation or a regulation. Meanwhile, however, it is **only of limited relevance** for investors since all German agencies subject to Gewährträgerhaftung additionally provide an explicit guarantee.

Regulatory considerations, spreads and growth

Classifying the risk weight

In line with the standard approach, EU sovereigns have a risk weight of 0 % while **Article 114 CRR** (Regulation (EU) No. 575/2013 CRR) governs the classification of exposures.

According to **paragraph 2** of the aforementioned Article, exposures to **central governments** and **central banks** for which a credit assessment by a nominated **ECAI** (external rating agency pursuant to Regulation (EC) No. 1006/2009) is available shall be assigned a risk weight in accordance with the table below which corresponds to the credit assessment of the ECAI in accordance with Article **136**.

Credit quality step	1	2	3	4	5	6
Risk weight	**0%**	**20%**	**50%**	**100%**	**100%**	**150%**

Paragraph 3 states that "Exposures to the ECB shall be assigned a 0 % risk weight" while **paragraph 4** additionally specifies that "Exposures to Member States' **central governments**, and **central banks** denominated and funded in the domestic currency of that central government and central bank shall be assigned a risk weight of 0 %".

Risk weights of regional governments and local authorities

According to **paragraph 2** of **Article 115 CRR**, the risk weight of exposures to regional governments or local authorities is equal to that of the central government in whose jurisdiction they are established where there is no difference in risk between such exposures because of the specific revenue-raising powers of the former, and the existence of specific institutional arrangements the effect of which is to reduce their risk of default.
The **EBA rulebook** and **lists** updated by the EBA on regional governments and local authorities (RGLAs) as well as public sector entities (PSEs) provide additional information for the calculation of capital requirements.

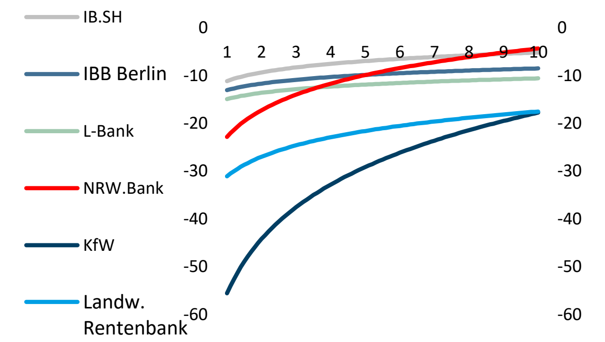
Liquidity coverage ratio (LCR)

Paragraph 1 (b) and (c) of Article 10 of the LCR Regulation (EU 2015/61) provide the basis for determining eligible liquid assets, according to which development banks are assigned an LCR credit quality step of 1.

Liability structure a key factor influencing spreads

KfW and Rentenbank benefit from spread advantage

ASW in bps, as of: 30 May 2022



Sources: Bloomberg, Helaba Research & Advisory

For agencies, the guarantee or liability structure is among the most significant factors that influence their credit spreads. Consequently, the risk of an agency can be equated to a certain extent to that of its respective guarantor or liable institution. This is a decisive criterion for rating agencies in assigning the same rating to the agency as it assigns to the agency's guarantor or liable institution. In addition, differences in guarantee and liability structures, which in some cases are very significant (especially in comparison to non-financials and agencies outside Germany), determine risk weights under Basel III and CRD IV. The better the agency's (or guarantor's) credit rating, the narrower the spread.

Ongoing trend towards further growth

The asset class of German agencies has been experiencing steady growth for many years. This is attributable to an increasing volume of funding, while wide-ranging guarantees and privileged regulatory treatment also play a role. Over the last 10 years alone, issuance volume has grown from EUR 1.8 billion to EUR 57.6 billion in 2021 - a year marked by the COVID-19 crisis. By the end of the third quarter of 2022, German development banks had already placed as much as EUR 53 billion (92 % of the previous year's figure) and are on course to exceed last year's volume.

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