

## Ratings

Issuer	Obligation	Rating	Rating Action	Trend
Sparkassen-Finanzgruppe	Long-Term Issuer Rating	A	Confirmed Mar' 19	Positive
Sparkassen-Finanzgruppe	Short-Term Issuer Rating	R-1 (low)	Confirmed Mar' 19	Positive

See back of report for complete rating list.

## Rating Drivers

## Rating Considerations

### Factors with Positive Rating Implications

Further positive rating pressure would require:

1. A restructuring of NORD/LB that not only lowers risk emanating from the entity, but also demonstrates the functioning of the IPS without triggering EU State Aid procedures.
2. Resilience in overall profitability.
3. The maintenance of competitiveness in its retail and SME customer segments.
4. Consistency in maintaining the Group's sound capital position.

### Factors with Negative Rating Implications

Given the positive trend, negative rating pressure is unlikely. However, this could result from:

1. Significant deterioration in capitalisation
2. Indication of weakening of the IPS scheme.
3. Deterioration in the core franchise of the Sparkassen reflected in substantially weakening market shares in customer loans and deposits.

**Franchise Strength:** The Sparkassen-Finanzgruppe's (SFG) aggregated balance sheet of more than EUR 2.0 trillion makes the Group of vital importance for the German economy. SFG's regional savings banks (the Sparkassen) form the backbone of the organisation. SFG's franchise is further complemented by the five wholesale and clearing institutions (Landesbanken) and other financial companies such as DekaBank.

**Very Strong/Strong**

**Earnings Power:** IBPT is healthy but currently under pressure due to lower net interest income and reduced potential for fee income increases. Provisioning needs are likely to increase going forward due to a slowdown of the German economy. For 2018, there will be a significant negative impact on group earnings due to the restructuring at Nord/LB.

**Good**

**Risk Profile:** The stable risk profile of the Sparkassen is reflective of their well-diversified and highly granular exposures. The overall Group risk profile has improved with the continued deleveraging and de-risking of the Landesbanken.

**Strong/Good**

**Liquidity and Funding:** The Sparkassen have a strong deposit base and sound liquidity. The Landesbanken have a more wholesale-oriented funding profile, albeit this is based partly on the stable covered bond franchise.

**Strong**

**Capitalisation:** Capitalisation is solid on an aggregated basis, incorporating the sound capital and stable internal capital generation at the savings banks, as well as the much-improved capital position in the Landesbanken sector.

**Strong/Good**

## Financial Information

### Sparkassen-Finanzgruppe

EUR Millions

	2017Y	2016Y	2015Y	2014Y	2013Y
Total Assets	2,129,466	2,118,773	2,157,691	2,251,882	2,264,317
Equity Attributable to Parent	161,491	157,943	152,858	149,344	146,398
Income Before Provisions and Taxes (IBPT)	12,368	13,472	12,493	12,100	13,859
Net Attributable Income	2,334	2,070	2,888	192	1,615
IBPT over Avg RWAs (%)	1.28	1.39	1.30	1.27	NA
Cost / Income ratio (%)	68.78	66.79	69.19	69.10	65.83
Return on Avg Equity (ROAE) (%)	1.46	1.33	1.91	0.13	1.13
Gross NPLs over Gross Loans (%)	NA	NA	NA	NA	NA
CET1 Ratio (Fully-Loaded) (%)	NA	NA	NA	NA	NA

Source: Company reports, DBRS (latest financial report available for the Group as of FY2017).

\*The Sparkassen published preliminary and unaudited German GAAP figures for FY18 on March 6, 2019.

## Issuer Description

Sparkassen-Finanzgruppe primarily comprises two main constituents with distinct franchises – the German savings banks (the Sparkassen) and the regional wholesale banks (Landesbanken). Together, the members of German Association of Savings Banks (DSGV) or the Sparkassen-Finanzgruppe (SFG or the Group) form one of the largest financial Groups globally, with total aggregated assets of more than EUR 2.0 trillion.

## Rating Rationale

DBRS Ratings GmbH (DBRS) has 'A'/R-1 (low) Issuer Ratings on the Sparkassen-Finanzgruppe, and all ratings have a Positive trend. The Support Assessment for the Group is SA3. These ratings also apply, in line with DBRS's floor ratings concept, to each member of Sparkassen-Finanzgruppe's Institutional Protection Scheme (IPS) rated by DBRS which, as of March 2019, includes 384 German savings banks (the Sparkassen), the five Landesbanken, eight public-sector building societies (LBS), the Group's central asset manager, DekaBank, and other specialised service providers.

The ratings reflect the underlying earnings and the very strong franchise of the Sparkassen, which is a vital component of the Group. The Group's aggregated balance sheet of EUR 2.1 trillion, as of FY17, underscores its importance to the German banking sector and the German economy. DBRS notes that approximately 60% of Germany's population has a banking relationship with the Group. Offsetting these rating strengths are the still elevated risks within the Landesbanken sector, that remains a meaningful part of the Group, as well as the high dependence on net interest income in a low rate environment.

The Positive trend continues to reflect DBRS's view that the profitability in the Sparkassen sector shows resilience despite the low interest rate environment, the strong asset quality of the Sparkassen, as well as the further de-risking of the Landesbanken sector and the consistent progress the group has made in improving its capital position.

## Franchise Strength

### Grid Grade: Very Strong/Strong

Together, the members of the German Association of Savings Banks form one of the largest financial Groups globally, the Sparkassen-Finanzgruppe (SFG), with total aggregated assets of EUR 2.13 trillion as of year-end 2017. Sparkassen-Finanzgruppe primarily comprises two main constituents with distinct franchises – the German savings banks (the Sparkassen) and the regional wholesale banks (Landesbanken). SFG's franchise is further completed by additional financial businesses including DekaBank, the Group's asset manager (the third largest mutual funds manager in Germany), the Landesbausparkassen (German building societies), Deutsche Leasing Group, and 11 regional public insurance entities. DSGV functions as an umbrella organisation, coordinating reporting, debt ratings, strategy, marketing & communication, lobbying efforts, risk management, while also respecting the autonomy of its members. In DBRS's view, the strong, resilient franchise of the Sparkassen forms the core of Sparkassen-Finanzgruppe's franchise strength, while the weaker, more wholesale-oriented franchise of most Landesbanken negatively affects the overall Group.

As per the latest available data, the organisation comprised 384 German savings banks<sup>1</sup>. DBRS notes that, due to the consolidation process in recent years within the SFG, there has been a steadily declining number of Sparkassen. In DBRS' view this intra-group consolidation generally results in larger, more viable and hence more cost-efficient and profitable entities.

The Sparkassen, which reported preliminary year-end 2018 results on March 6, 2019, maintained a strong market position in 2018, as evidenced by the 4.3% YoY growth in customer deposits to EUR 950.3 billion. The Sparkassen are market leaders across a wide range of financial services provided to retail customers and small- and medium-sized enterprises (SMEs) in Germany. As institutions under public law, Sparkassen operate under municipal trusteeship. Their responsible public bodies (Träger) are municipalities (towns, cities), districts or special-purpose associations.<sup>2</sup>

Despite ongoing competition, the member institutions of Sparkassen-Finanzgruppe enjoy a very strong position in German banking as demonstrated by their leading market shares in core products. In 2017, the Sparkassen-Finanzgruppe reported a 38.4% market share in retail lending and 36.2% in deposits. Of this, Sparkassen held a market share of 29.5%, while Landesbanken reported a 6.7% market share. The Sparkassen also commanded a market share of 28.4% of domestic loans for 2018, while the Landesbanken reported a market share of 10%.

<sup>1</sup> Number of total Sparkassen within the SFG as of March 2019

<sup>2</sup> Currently there are six Sparkassen which are organized under private law (Hamburger Sparkasse AG, Sparkasse Bremen AG, Sparkasse zu Lübeck AG, Bordesolmer Sparkasse AG, Sparkasse Mittelholstein AG, Sparkasse Westholstein).

Similarly, as of year-end 2017, the saving banks reported a sizeable 34.9% market share in domestic residential real estate loans, while the Landesbanken have an additional market share of 3.7%.

Exhibit 1: SFG: Market Share in Corporate Lending, Dec 2017\*

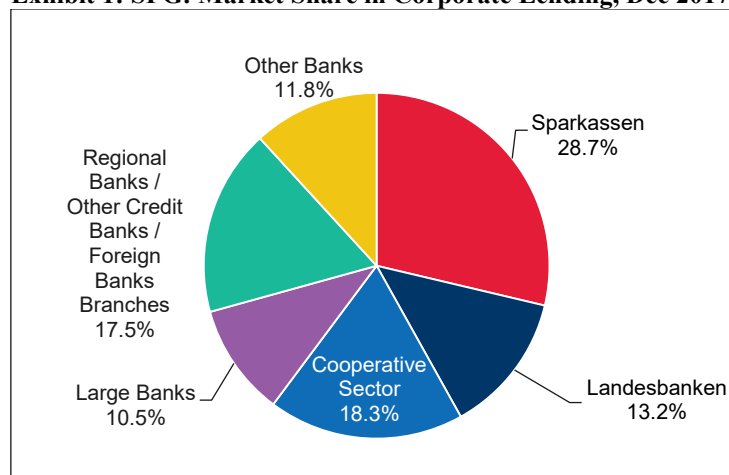
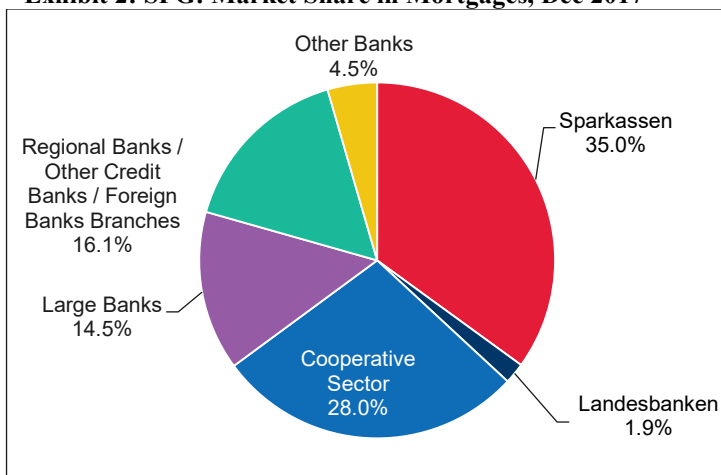


Exhibit 2: SFG: Market Share in Mortgages, Dec 2017



Source: DBRS, Company reports. Note: (\*) excluding loans to financial institutions

The Landesbanken are mostly active in wholesale banking, as well as serving as the central clearing banks for their respective regional savings bank associations. They are important lenders to medium- to large-sized corporations and public-sector entities mostly in their respective domestic regions. Landesbanken have also been significant participants in international loan syndication, money markets, securitisation and asset-based financing. Nonetheless, much of this activity has been scaled back with most of the Landesbanken having reduced international activities and/or undergone significant de-risking and/or restructuring. Most Landesbanken are jointly owned by the German federal states in which they are headquartered (reflecting their origin as state banks) and their respective regional Sparkassen associations. Nonetheless, the level of ownership and involvement of the Sparkassen with the Landesbanken can vary significantly. Indeed, some Landesbanken are majority-owned by their respective regional Sparkassen associations. Some Landesbanken have developed more diverse franchises geographically and by business line and others less so. Overall, despite this variation and an improving risk profile, DBRS continues to view the Landesbanken as more vulnerable to market dislocations than the Sparkassen and also a potentially more challenging burden for the Group's Institutional Protection Scheme as demonstrated by the most recent case of NORD/LB.

#### Privatisation of HSH Nordbank AG reduces the number of Landesbanken to five.

HSH Nordbank was privatised in November 2018 and is now owned by a number of private investors comprising Cerberus, J.C. Flowers, Golden Tree Asset Management, Centaurus Capital and BAWAG. The bank has been renamed as Hamburg Commercial Bank AG, and this brings the number of Landesbanken to five.

HSH's sale to private owners represents the first orderly exit of a member of the Sparkassen-Finanzgruppe (SFG) from the Institutional Protection Scheme (IPS). As of Jan. 1, 2022, Hamburg Commercial Bank will join the private sector deposit insurance scheme. During the transition period the SFG will remain responsible for Hamburg Commercial Bank AG's liabilities under the IPS scheme. DBRS will continue to monitor Hamburg Commercial Bank AG's performance until its full legal and economic exit from the IPS.

As part of the privatisation, HSH has undergone a thorough restructuring, which significantly reduced the amount of NPLs and cyclical assets as well as the size of the balance sheet. DBRS views the privatisation and restructuring of HSH as positive for the SFG, as this helped de-risk the Group by reducing the amount of cyclical assets held within the SFG (mainly shipping, aircraft and CRE exposures). It is also expected to reduce the risk for the IPS of having to contribute to potential compensation payments to HSH creditors. It should further improve the cohesion within the Group and help reduce reputational risks. HSH's departure from the SFG could also, in DBRS' view, help create an exit-route blue print for other Landesbanken.

#### NORD/LB and the creation of a 'Sparkassen Central Bank'

In order to clean up its balance sheet and shore up capital, Norddeutsche Landesbank GZ (NORD/LB or the Bank) had, in 2018, initiated a process of reducing its non-performing shipping portfolio while simultaneously soliciting bids for a capital injection. As a result of the reduction in shipping loans, NORD/LB reported a loss of EUR 2.35 billion for 2018 and expects to remain unprofitable in 2019 due to high restructuring costs. The Bank also announced that it accepted a bid by the DSGV and the Bank's State owners to cover its capital requirements of approximately EUR 3.6 billion. NORD/LB will receive a cash capital injection of EUR 2.835 billion, of which Lower Saxony will contribute around EUR 1.5 billion, Saxony-Anhalt around EUR 200 million and the DSGV will provide EUR 1.135 million.

Lower Saxony will also be contributing EUR 800 million in capital-relief measures. All participants are awaiting the EU's confirmation that the current proposal would not be considered State Aid under EU laws, in order for the capital injection to be finalised.

At the same time, a discussion regarding further consolidation in the Landesbanken sector involving NORD/LB, Landesbank Baden-Württemberg, DekaBank Deutsche GZ and Berlin Hyp AG emerged. At a March 6, 2019 press conference, Helmut Schleweis, president of the DSGV/SFG pointed out the benefits of a "Sparkassen-Zentralbank" (Sparkassen Central Bank) in Germany, to be owned by the Sparkassen and accomplished over time by gradually merging the above-mentioned institutions. Support for the idea is emerging, but given the number of constituents and interests involved, no quick solution is expected. DBRS would view such a development positively, as it would not only increase cost efficiencies, but also further lower the risk within the Landesbanken sector.

### Exhibit 3: Sparkassen-Finanzgruppe Group Structure (as of FY2017)

Sparkassen-Finanzgruppe							
390 Savings Banks				Total Assets: EUR 1,200 billion Employees: 216,117 Branches: 13,305			
6 Landesbanken  Total Assets: EUR 908 billion Employees: 34,836	DekaBank  Total Assets: EUR 94 billion Employees: 4,649	8 Regional Building Societies  Total Assets: EUR 68 billion Employees: 6,918	Deutsche Leasing Group  Number of Contracts: 275,000 AUM: 36.8 billion	11 Regional Public Insurance Groups  Gross Premium Income: EUR 20.8 billion Employees: 28,500			
2 Additional Leasing Companies	5 Capital Investment Companies of the Landesbanken	DSV Group	Finanz Informatik	61 Capital Investment Companies	3 Factoring Companies	7 Regional Property Companies	5 Consulting Firms

Source: DBRS, Company reports. Data as of Dec. 31, 2017. (**Marktaufstellung der Sparkasse Finanzgruppe**).  
As of March 2019, there were 384 Sparkassen and 5 Landesbanken.

Exhibit 4: Sparkassen and their Regional Associations

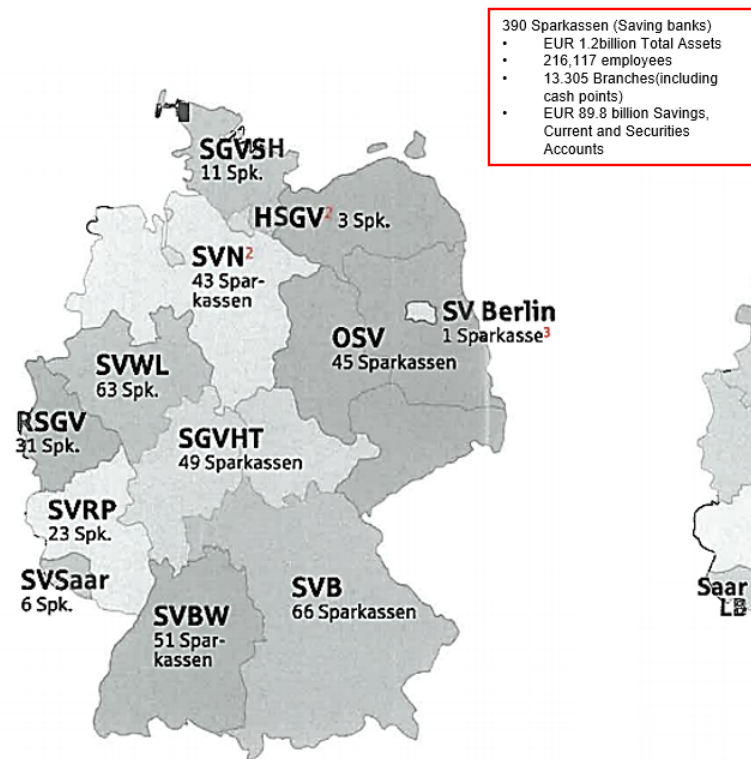
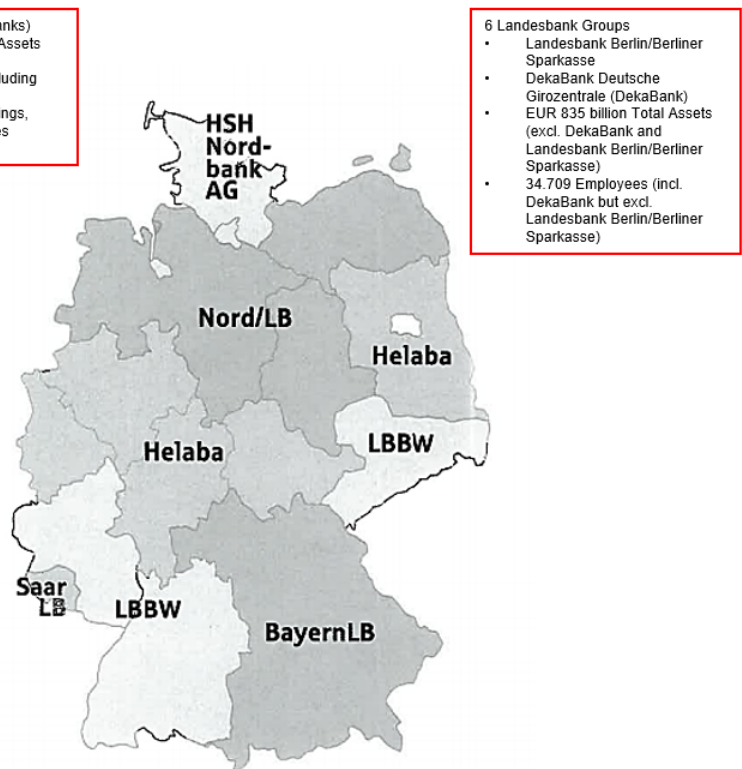


Exhibit 5: Landesbanken



Source: Sparkassen-Finanzgruppe, DBRS

\*HSH Nordbank was privatised in February 2018

## Earnings Power

### Grid Grade: Good

#### Sparkassen-Finanzgruppe (SFG)

The Group's performance in FY17 reflected good results at the savings banks, mitigated by weaker results reported by the Landesbanken sector due to sizeable provisioning expenses. The Group reported net income of EUR 2.3 billion in FY17<sup>3</sup>, up 12.8% YoY, to which the Sparkassen contributed EUR 2.1 billion, while the Landesbanken reported a net profit of EUR 188 million. The SFG posted a FY17 pre-provision profit (Betriebsergebnis vor Bewertung) of EUR 12.4 billion (down 8.2% YoY), as weaker net interest income due to the low interest rate environment and declining loan balances at the Landesbanken, was only partly compensated by improved net commission income. Administrative expenses increased by 0.6% to EUR 27.25 billion, reflecting lower administrative expenses at the Sparkassen level, offset by increases at the Landesbanken. In FY17, the cost-income ratio of the Group as a whole increased to 68.78% (2016: 66.79%), mainly due to the decline in net interest income and higher costs at the Landesbanken.

Net valuation expenses, (a German GAAP accounting category which includes mainly provisions for loan losses and securities), declined to EUR 2.0 billion in FY17 from EUR 2.7 billion in the previous year, as provisions for shipping loans reduced at the Landesbanken.

The Group further recorded EUR 4.7 billion of *Extraordinary Results* (*außerordentliches Ergebnis*), a local GAAP term referring mainly to net additions to the fund for general banking risks. These capital reserves are typically undertaken by the Sparkassen in accordance with Section 340(g) German Commercial Code (HGB), which DBRS views as an effort to further strengthen the Group's risk coverage potential (for further details see below under the section *Sparkassen*). The 340 (g) reserves also count towards regulatory capital.

Group net income for 2018 could be close to zero or even negative due to the large loss at NORD/LB. However, DBRS is of the opinion that NORD/LB's restructuring represents another step in the de-risking of the Landesbanken sector and expects less volatile earnings going forward.

<sup>3</sup> The Group's financial reporting is based on aggregated figures on the basis of local GAAP (HGB accounting standards); the Sparkassen also reported, well ahead of the Group, preliminary and unaudited figures for FY18 based on an internal accounting system (Betriebsvergleich or BV). These are discussed in this section.



## Sparkassen

The Sparkassen, for which preliminary and unaudited figures for FY18 were released on March 6, 2019 (see footnote 3), generated good revenues in 2018, albeit lower than 2017. Pre-provision profits (Betriebsergebnis vor Bewertung) were EUR 10.0 billion, down from EUR 10.5 billion a year earlier, as a decline in NII could not be offset by increases in fee and commission income. However, due to lower reserve build reported net profits of EUR 2.2 billion exceeded 2017 results by EUR 100 million.

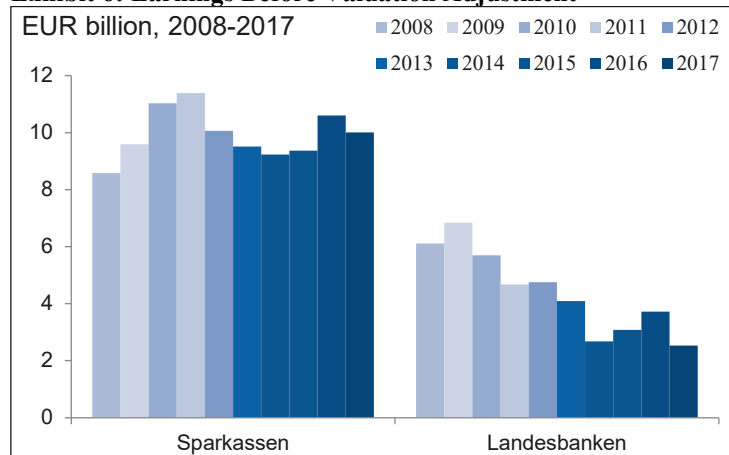
NII of EUR 20.8 billion reduced by 3.5% YoY, despite loan growth of 3.7% YoY due to net interest margin pressure and even stronger deposit growth (+4.3% YoY). Fee and commission income slowed to 2.7% YoY to EUR 7.8 billion, as re-pricing of account servicing fees have become more limited.

Total operating costs of EUR 18.9 billion remained flat YoY as staff consolidation slowed, although the branch network of over 13,000 was reduced by 485. The number of employees declined by 6,529 to 209,588.

While the Sparkassen still benefitted from a benign domestic economic environment to keep loan loss provisions stable, a negative valuation adjustment for securities in the liquidity portfolio of EUR 1.4 billion, limited the addition to their reserves to EUR 2.7 billion versus EUR 4.7 billion in the previous year. Still, accumulated reserves, part of reported capital, are significant and should provide an ample cushion for revenue deterioration, unforeseen losses or deteriorating credit quality. In general, as the Sparkassen are not under pressure to pay out dividends, capital generation capacity is high.

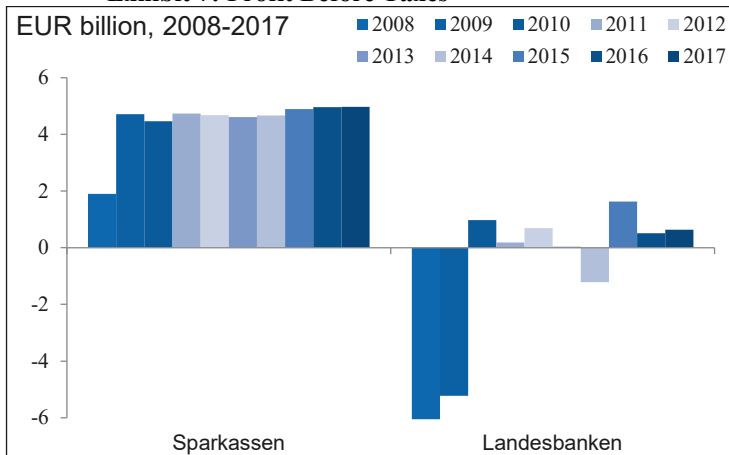
Cost efficiency for the Sparkassen is weaker when compared to European commercial banks, but is in line with the cooperative sector. The cost-income ratio in the mid-60 percent range over recent years reflects the extended branch network, which provides coverage in many rural areas in Germany, in accordance with their public-sector mission.

**Exhibit 6: Earnings Before Valuation Adjustment**



Source: DBRS, Company reports

**Exhibit 7: Profit Before Taxes**



## Landesbanken

DBRS notes that the Landesbanken sector has continued to deleverage with total assets decreasing by another 3.7% YoY to EUR 864 billion in 2017. While significant legacy problems of the past consisting mainly of structured credit portfolios have been widely addressed, exposure to shipping, concentrated in the Landesbanken located in the north of Germany continues to impact bottom line results negatively with more pronounced losses materialising in FY18.

In 2017, the Landesbanken posted a net profit of EUR 188 million after EUR 4 million in 2016. However, this did not indicate an improvement in the shipping sector, as 2018 resulted in more charges. DBRS views that 2018 has been a turning point for the Landesbanken sector. Earnings volatility should decline going forward, as legacy issues are increasingly resolved, reflecting the realignment of the business model towards a more customer-oriented business and continued de-risking activities, however the Landesbank's also have a sizable commercial real estate (CRE) exposure (see also Risk Profile section), which, due to its cyclical nature, continue to pose risks for the Landesbanken sector and for the Sparkassen-Finanzgruppe as a whole.

## Risk Profile

### Grid Grade: Strong/Good

Overall, the risk profile of the Sparkassen-Finanzgruppe has improved given the restructuring and various risk reduction measures undertaken at the weaker Landesbanken since 2008. Although elevated risks remain at NORD/LB, the steep reduction in total assets has helped towards de-risking at the Landesbanken. DBRS views the risk reduction in the Landesbanken sector as a key driver of the improved results exhibited since 2010.

DBRS continues to view the risk profile of the Sparkassen as stable and reflective of the broader German economic environment to which its retail and SME lending is integrally linked. Given the geographic concentration in Germany, Sparkassen-Finanzgruppe is exposed to the German economic and credit cycle. While the savings bank's business is concentrated in Germany, it is well diversified within the country. Moreover, the exposures in the aggregate loan portfolio of the Sparkassen are highly granular and extend across the breadth of German industry and commerce. The Group's sizeable exposures to business lending was stable in 2017, with around 42% market share including the combined lending of the Sparkassen and Landesbanken, helped by the favourable economic development of the German SME sector (or Mittelstand).

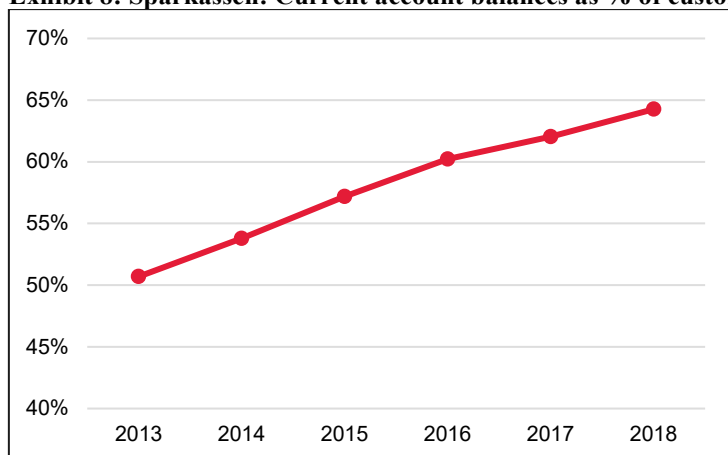
The Group is also characterised by its large exposure to residential real estate, with around 40% market share. The Group's real estate lending to private customers has performed well through the past economic cycles, a reflection of the strong real estate market environment in Germany as well as sound underwriting, adding a level of stability to overall credit quality. The strong performance of the German residential real estate market has also had a positive impact on net interest income, allowing the associated volume effect to partially compensate for the negative rate effect stemming from low yields. However, in DBRS' view the rapid increase of residential housing prices, especially in larger German cities, indicates a likely end to extraordinary residential loan volume growth in the near term.

The Sparkassen-Finanzgruppe also engages in lending to public authorities, which in DBRS view moderates the Group's risk profile given the public law guarantees which support local authorities. DBRS also views the Groups lending to private individuals (excluding real estate) as comparatively lower risk, based on the long track record of the Sparkassen (which provide most of the private loans, to their local customers) as well as the high barriers to personal bankruptcy filings in Germany.

The robustly performing German economy, as reflected in the low corporate delinquencies and the historically low unemployment rate in Germany, has led to very low loan impairment charges for the Sparkassen sector, although this also shows sound underwriting and good collateralisation in particular. For the group as a whole, net valuation expenses improved from EUR 2.7 billion in 2016 to EUR 2.0 billion in 2017. However, due to the restructuring at NORD/LB DBRS expects a spike in FY18 provisions for the group.

Interest rate risk exposure in the banking book has increased for the Group. The gradual shift of customer deposits from longer-term savings accounts towards sight deposits during the ultra-low yield environment poses challenges for the maturity transformation of the banking book for many Sparkassen. If and when rates rise, deposits will reprice faster than the longer dated loans.

#### Exhibit 8: Sparkassen: Current account balances as % of customer deposits



Source: Company reports

As noted above, the Sparkassen are linked to the domestic economic cycle. DBRS sees the Sparkassen as benefitting from risk management tools offered by the Group's federal association, the DSGV. These include credit pooling programmes to limit concentration risks at the individual savings bank level, centralised software and credit scoring systems, which provide shared information and statistics useful in controlling credit decisions.

The Group's risk profile is further supported by the existence of an early warning system in relation to the Institutional Protection Scheme

and the use of guarantee schemes. Individual guarantee support funds monitor potential risks of their member institutions through risk monitoring committees, and report to the central transparency committee of the German Savings Banks Association. Guarantee schemes have right of information and response along with the power to conduct audits at all covered institutions at any time. If the risk situation deteriorates at any institution, the guarantee scheme can decide countermeasures to be implemented.

Historically, DBRS has viewed the highest credit risk for Sparkassen-Finanzgruppe to be the cyclical part of the corporate loan portfolios of several Landesbanken (e.g. shipping exposures, CRE). The financial crisis in 2008 primarily affected the Landesbanken securities portfolios, yet the subsequent poor market conditions and capital pressure forced restructuring at the Landesbanken level. In DBRS's view, the worst period for risk from the Landesbanken has passed, particularly as many have reined in riskier foreign bank and international corporate activities. Nonetheless, the wholesale nature of the Landesbanken business models may continue to pose future risks relative to the more stable profile of the Sparkassen.

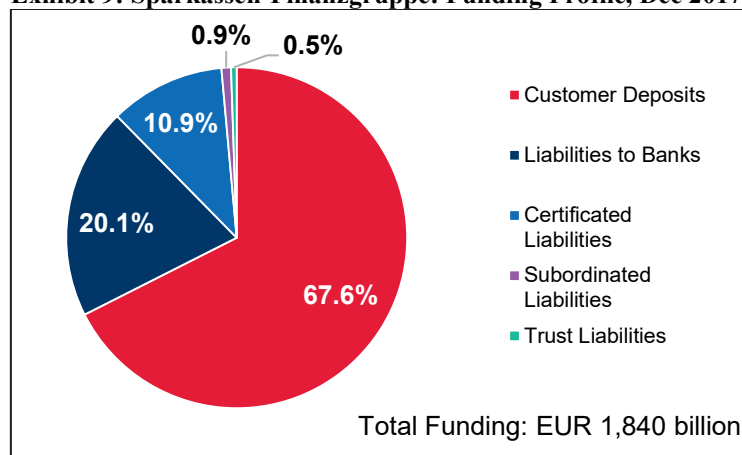
## Funding and Liquidity

### Grid Grade: Strong

DBRS views the liquidity and funding position of Sparkassen-Finanzgruppe as strong as it benefits from its strong and stable customer deposits franchise provides the principal source of funding for most of its businesses. This is partially offset by the more wholesale-oriented funding profile of the Landesbanken.

In DBRS's opinion, the deposit base of the savings banks is a core element in maintaining strong liquidity at the Group level. Furthermore, DBRS notes that within the Sparkassen-Finanzgruppe allocating excess liquidity among its members plays an important role. This typically takes place when Sparkassen with excess liquidity place funds with Landesbanken (either in form of deposits and Schuldscheine or by subscribing to their debt issues). These funding relationships, which are helped by regulatory zero-risk weighting within the Group, can reduce the dependence of Landesbanken on volatile wholesale market funding. In DBRS's view, this helps Landesbanken manage through periods of market disruption and can add a level of stability to their funding profile. Customer deposits of EUR 1.2 trillion at FY17 accounted for nearly two thirds of Group funding.

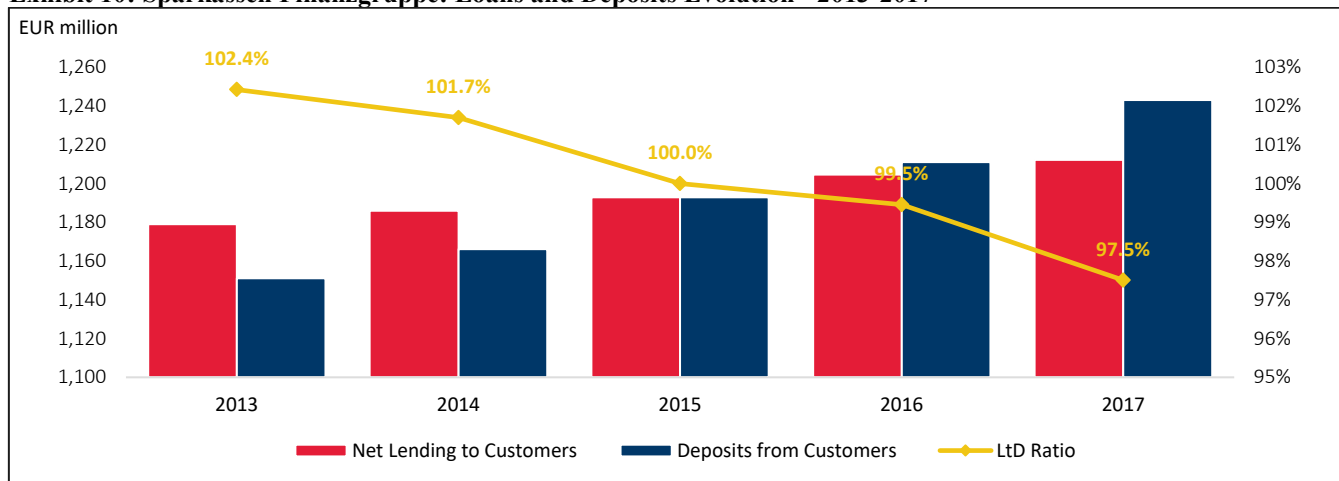
**Exhibit 9: Sparkassen-Finanzgruppe: Funding Profile, Dec 2017**



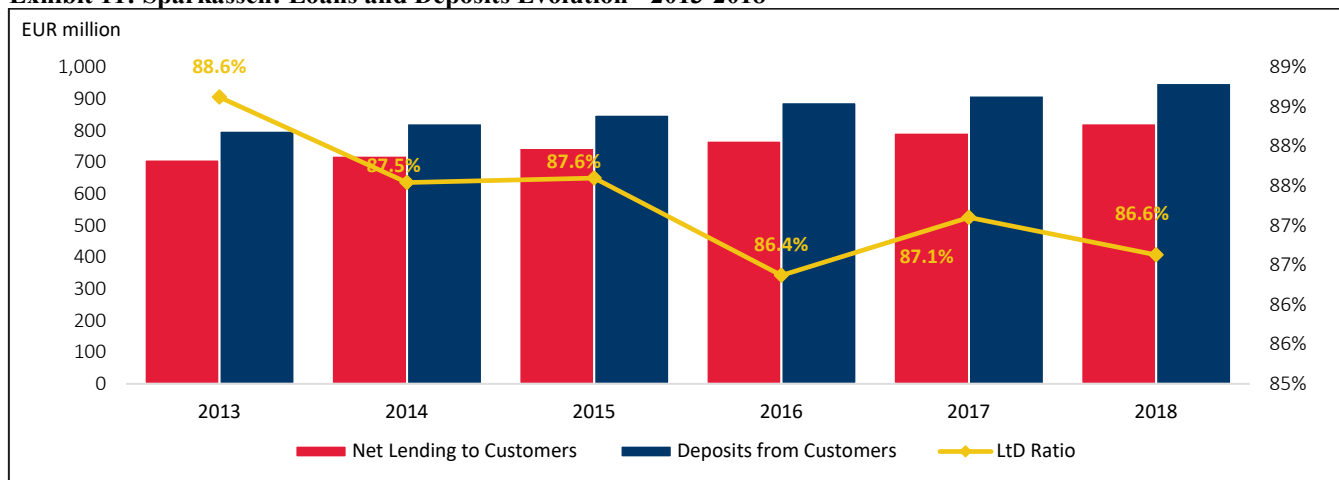
Source: Company reports

Despite the increased competition versus private sector and foreign banks, the Sparkassen continue to attract deposits via strong brand recognition and customer relationships. Deposits of the Sparkassen of EUR 950 billion at FY18 were up 4.3% from the previous year, providing a solid foundation for the Group. Liquidity at the Sparkassen is further illustrated by customer deposits exceeding customer loans by EUR 127 billion at FY18 versus EUR 109 billion at FY17 – leading to a strong loan to deposit ratio of 86.6% (2017: 87.9%). The LCR ratio for the Sparkassen was 199.6 % at the end of FY18, up from 189.9% a year earlier. While positive from a risk perspective, the high amount of deposits also has a negative impact on profitability of the Sparkassen in the current negative rate environment.

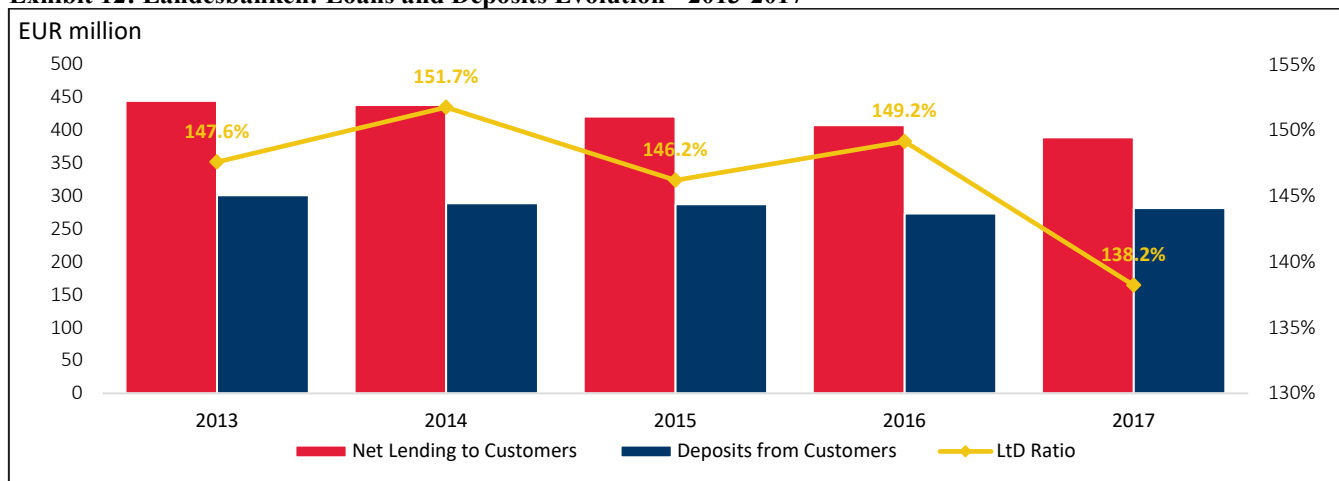


**Exhibit 10: Sparkassen Finanzgruppe: Loans and Deposits Evolution - 2013-2017**

Source: Company reports

**Exhibit 11: Sparkassen: Loans and Deposits Evolution - 2013-2018**

Source: Company reports

**Exhibit 12: Landesbanken: Loans and Deposits Evolution - 2013-2017**

Source: Company reports

Given their largely wholesale-oriented business model, the Landesbanken in aggregate rely much more on market funding. The increased wholesale funding reliance in the Landesbanken sector highlights their vulnerability to market disruption. DBRS notes, however, the rebalancing of the liability structure of Landesbanken after the global financial crisis in favour of deposits from their customer base (intra-group and corporate deposits). Additionally, DBRS notes the strong covered bond franchise of the Landesbanken, which DBRS views as a more stable form of market funding. Cover pools in the Landesbanken sector continue to benefit from wide-ranging CRE finance activities and the traditionally close ties to public sector financing in Germany.

## Capitalisation

**Grid Grade: Strong/Good**

SFG's capitalisation is at the higher end of its peer group. This considers the overall sound capital and solid underlying earnings of the Sparkassen, the improved capital position in the Landesbanken sector as well as the more challenging situation at NORD/LB.

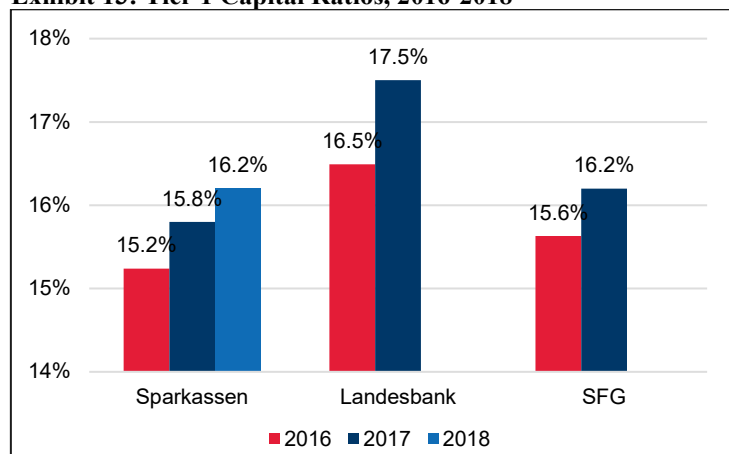
The Group's aggregated Tier 1 ratio improved to 16.3% at FY17 from 15.6% a year earlier. The improvement reflects stronger capital ratios in both the Sparkassen and the Landesbanken sectors.

The Sparkassen reported an aggregated Tier 1 ratio of 16.3% at FY18 (15.8% in 2017) and a total capital ratio of 17.6% (17.4% in 2017), both improving compared to the prior year. Capitalisation at the Sparkassen has been supported by high rates of retained earnings in the recent past and slow growth in risk-weighted assets, which DBRS expects to continue in 2019.

The capital of the Sparkassen is good and of high loss absorbing quality and is supported by existing silent capital reserves (under 340f HGB) which further strengthen the risk coverage potential of the Sparkassen sector. The Tier 1 capital ratio and the CET1 ratio are almost identical. However, given the low interest rate environment, which is adding pressure to earnings, some individual saving banks might be challenged to internally generate significant levels of capital. Given the legal structures of the Sparkassen, raising capital externally is difficult and in the past capital improvement has often been achieved through mergers with stronger institutions.

At the Landesbanken level, the aggregate Tier 1 ratios increased at FY17 to 17.5% from 16.5% one year earlier. The development continued to reflect the reduction of risk and deleveraging at the Landesbanken. In absolute terms, the equity of Landesbanken decreased from EUR 53.5 billion to EUR 49.9 YoY billion as the combined balance sheet has been shrinking. For 2018, DBRS expects a decline in capital ratios, which would be reversed as NORD/LB get recapitalised.

**Exhibit 13: Tier 1 Capital Ratios, 2016-2018**



Source: DBRS, Company Reports

**Annex: Institutional Protection Scheme**

DBRS sees the Institutional Protection Scheme as a key factor underpinning the floor rating, as it allows for resources of the Group to be made available to all members. Since the Scheme's inception in 1973, no member of Sparkassen-Finanzgruppe has defaulted. However, the Institutional Protection Scheme is not equivalent to a cross-guarantee. Creditors and members do not have a legal claim on support from the scheme. Instead, the Scheme is based on mutual support between its members. Therefore, the structure of the system and the ability and willingness of its members to support each other become important components of the strength of the Scheme, and therefore factors considered in the floor ratings.

The Scheme comprises a system of connected support funds, including 11 regional Sparkassen support funds, plus one support fund each for the Landesbanken and the LBS. If a decision has been made to support a member, such support is initially provided by the regional support fund to which the institution belongs. If a savings bank requires support that exceeds the resources of its regional support fund, then in the next step the resources of all 11 Sparkassen support funds can be activated. If this still proves insufficient, then the resources of the whole Institutional Protection Scheme can be utilized, requiring a 75% majority vote. However, the decentralised structure of the system could pose a challenge in DBRS's view, as it increases the number of steps that are needed to leverage the full resources of the system and could lead to a delay in the provision of timely support.

The mechanisms of the Institutional Protection Scheme are available to strengthen and restructure Sparkassen that face challenges. In DBRS's opinion, these cases, while generally involving smaller support amounts, help ensure the ability of the system to function smoothly. With the exception of the Landesbanken, most support cases of the Institutional Protection Scheme have involved small institutions. Sparkassen-Finanzgruppe reports that 90% of all support cases at the Sparkasse level can be handled by the challenged member's regional support fund alone, without additional resources from the system of support funds. Yet, DBRS recognises that the combined resources of the Institutional Protection Scheme are not sufficient, nor was the Scheme designed, to address a wider systemic crisis or the possible burden of larger and less risk averse Landesbanken should complementary support from its public-sector owners prove unavailable. This is viewed as a weakness that negatively affects the floor ratings. In the past, examples of important support for the Landesbanken has included assistance from their public owners, from the central German government, and from regional support funds that Sparkassen and Landesbanken have established. The administrators of the support funds can use their discretion to require additional support from the public owners of a challenged member and to effect management and business strategy changes to ensure a successful restructuring and protect the Scheme's funds. Member contributions to the Scheme are risk-based, providing an incentive for members to exercise prudent risk management.

The Deposit Guarantee Act in Germany was introduced in July 2015 and transposed relevant EU directives into German national law. This development mandated modifications to the Group's Institutional Protection Scheme (formerly known as Joint Liability Scheme). The changes essentially entailed the implementation of i) early intervention rights for the IPS in order to stabilise ailing members at the early stages of financial distress, ii) a significant increase of rescue funds available to the IPS, which are also available for preventive support measures, iii) the inclusion of non-cash support elements (e.g. guarantees). Additionally, the IPS has been enhanced by new governing and reporting structures within the Group, as well as investment in personnel, procedures and technology targeted to ensure that customers can be timely refunded the guaranteed amount of € 100,000 per depositor per institution. The Sparkassen-Finanzgruppe's Institutional Protection Scheme has been officially recognised by the German regulator as a deposit guarantee scheme under the Deposit Guarantee Act. The Institutional Protection Scheme serves therefore a mixed purpose as both a rescue scheme and a deposit guarantee scheme with common financial resources which are not mutually ring-fenced.

As mentioned, the Sparkassen-Finanzgruppe is taking steps to strengthen the pre-funding of resources available for the Institutional Protection Scheme, something DBRS will continue to evaluate. The recent changes in the regulatory environment with the implementation of the European Bank Recovery and Resolution Directive (BRRD) in Germany in 2015 mean that the likelihood of state support has decreased and any form of state intervention, such as has been previously made available to the Landesbanken during the global financial crisis in 2008, has to be guided by the rules of the BRRD directive. This means that public owners (German federal states) are prohibited from providing emergency support to distressed Landesbanken. DBRS has in September 2015 removed the systemic support considerations from the floor rating of the SFG and the rating no longer incorporates uplift for broader systemic support. The removal of the one notch of systemic support reflected DBRS's view that there is less certainty about the likelihood of timely systemic support. This is reflected in an SA3 support assessment for the Sparkassen Finanzgruppe.

DBRS notes that the members of the Institutional Protection Scheme have strong incentives to support each other, which is critical to ensure the functioning of the system, due to the lack of a legally binding cross-guarantee. A default by any member would cause reputational damage for the overall Group. Customers and counterparties may not differentiate between Group members and may view a default by any one member as a sign of weakness for the overall Group. This reputational link is furthered by the common "Sparkassen" brand and the red "S" logo shared by all Sparkassen. Similarly, most Landesbanken carry the "Landesbank", or short "LB", brand in their name, and all public-sector building societies share the "LBS" brand. The cost of such reputational damage likely outweighs the costs of providing the support mechanism in most stress cases.

	Sparkassen- Finanzgruppe	Sparkassen- Finanzgruppe	Sparkassen- Finanzgruppe	Sparkassen- Finanzgruppe	Sparkassen- Finanzgruppe
EUR Millions	2017Y	2016Y	2015Y	2014Y	2013Y
Balance Sheet	31/12/2017	31/12/2016	31/12/2015	31/12/2014	31/12/2013
Cash and Deposits with Central Banks	86,446	50,869	30,837	26,036	22,995
Lending to/Deposits with Credit Institutions	271,056	265,222	294,241	338,108	371,863
Financial Securities	429,611	447,241	475,162	502,056	510,451
Financial Derivatives Instruments	NA	NA	NA	NA	NA
Net Lending to Customers	1,212,232	1,204,590	1,192,957	1,186,005	1,179,018
- Gross Lending to Customers	NA	NA	NA	NA	NA
- Loan Loss Reserves	NA	NA	NA	NA	NA
Investment in Associates or Subsidiaries	24,154	25,037	25,730	27,620	30,285
Total Intangible Assets	0	0	0	0	0
Fixed Assets	11,831	NA	NA	NA	NA
Insurance Assets	NA	NA	NA	NA	NA
Other Assets (including DTAs)	94,136	125,814	138,764	172,057	149,705
<b>Assets</b>	<b>2,129,466</b>	<b>2,118,773</b>	<b>2,157,691</b>	<b>2,251,882</b>	<b>2,264,317</b>
Deposits from Banks	369,612	371,422	408,855	452,892	475,006
Deposits from Central Banks	NA	NA	NA	NA	NA
Deposits from Credit Institutions	NA	NA	NA	NA	NA
Deposits from Customers	1,243,222	1,211,165	1,192,943	1,166,101	1,151,077
Issued Debt Securities	201,145	203,340	204,104	247,959	275,714
Issued Subordinated Debt	18,005	23,430	24,158	31,868	32,535
Financial Derivatives Instruments	NA	NA	NA	NA	NA
Insurance Liabilities	0	NA	NA	NA	NA
Other Liabilities	505,603	522,895	583,628	656,610	658,593
Equity Attributable to Parent	161,491	157,943	152,858	149,344	146,398
Minority Interests	0	0	0	0	0
<b>Liabilities &amp; Equity</b>	<b>2,129,466</b>	<b>2,118,773</b>	<b>2,157,691</b>	<b>2,251,882</b>	<b>2,264,317</b>

	Sparkassen- Finanzgruppe	Sparkassen- Finanzgruppe	Sparkassen- Finanzgruppe	Sparkassen- Finanzgruppe	Sparkassen- Finanzgruppe
EUR Millions	2017Y	2016Y	2015Y	2014Y	2013Y
Income Statement	31/12/2017	31/12/2016	31/12/2015	31/12/2014	31/12/2013
Interest Income	51,062	55,491	61,434	66,739	72,058
Interest Expenses	21,578	24,325	28,807	34,100	39,394
<b>Net Interest Income</b>	<b>29,483</b>	<b>31,165</b>	<b>32,627</b>	<b>32,639</b>	<b>32,664</b>
Net Fees and Commissions	8,710	8,050	7,588	7,123	6,802
Results from Financial Operations	1,070	1,033	516	121	1,359
Equity Method Results	NA	NA	NA	NA	NA
Net Income from Insurance Operations	0	NA	NA	NA	NA
Other Operating Income	357	314	-188	-720	-269
<b>Total Operating Income</b>	<b>39,620</b>	<b>40,562</b>	<b>40,543</b>	<b>39,163</b>	<b>40,556</b>
Staff Costs	15,911	15,799	16,772	16,223	15,628
Other Operating Costs	11,342	NA	NA	NA	NA
Depreciation/Amortisation	NA	NA	NA	NA	NA
<b>Total Operating Expenses</b>	<b>27,252</b>	<b>27,090</b>	<b>28,050</b>	<b>27,063</b>	<b>26,697</b>
<b>Income Before Provisions and Taxes (IBPT)</b>	<b>12,368</b>	<b>13,472</b>	<b>12,493</b>	<b>12,100</b>	<b>13,859</b>
Loan Loss Provisions	1,975	2,724	1,052	1,483	3,237
Securities & Other Financial Assets Impairments	0	0	0	0	0
Other Impairments	0	0	0	5,089	3,725
Other Non-Operating Income (Net)	-4,696	-5,179	-4,830	-1,950	-2,055
<b>Income Before Taxes (IBT)</b>	<b>5,697</b>	<b>5,569</b>	<b>6,611</b>	<b>3,578</b>	<b>4,842</b>
Tax on Profit	3,363	3,499	3,723	3,386	3,227
Discontinued Operations	0	0	0	0	0
Other After-tax Items	0	0	0	0	0
Minority Interest	0	0	0	0	0
<b>Net Attributable Income</b>	<b>2,334</b>	<b>2,070</b>	<b>2,888</b>	<b>192</b>	<b>1,615</b>

	Sparkassen- Finanzgruppe	Sparkassen- Finanzgruppe	Sparkassen- Finanzgruppe	Sparkassen- Finanzgruppe	Sparkassen- Finanzgruppe
	2017Y	2016Y	2015Y	2014Y	2013Y
<b>Earnings Power</b>					
<b>Earnings</b>					
Net Interest Margin (%)	1.52	1.57	1.61	1.58	1.49
Yield on Average Earning Assets (%)	2.63	2.80	3.04	3.23	3.29
Cost of Interest Bearing Liabilities (%)	1.18	1.34	1.55	1.78	1.99
IBPT over Avg Assets (%)	0.58	0.63	0.57	0.54	0.59
IBPT over Avg RWAs (%)	1.28	1.39	1.30	1.27	NA
<b>Expenses</b>					
Cost / Income ratio (%)	68.78	66.79	69.19	69.10	65.83
Operating Expenses by Employee	87,123	84,242	84,463	79,201	76,386
LLP / IBPT (%)	15.97	20.22	8.42	12.26	23.36
<b>Profitability Returns</b>					
Return on Avg Equity (ROAE) (%)	1.46	1.33	1.91	0.13	1.13
Return on Avg Assets (ROAA) (%)	0.11	0.10	0.13	0.01	0.07
Return on Avg RWAs (%)	0.24	0.21	0.30	0.02	NA
Dividend Payout Ratio (%)	NA	NA	NA	NA	NA
Internal Capital Generation (%)	NA	NA	NA	NA	NA
<b>Funding and Liquidity</b>					
Bank Deposits over Funding (%)	20.16	20.51	22.31	23.82	24.52
- Interbank over Funding (%)	NA	NA	NA	NA	NA
- Central Bank over Funding (%)	NA	NA	NA	NA	NA
Customer Deposits over Funding (%)	67.81	66.87	65.11	61.34	59.43
Wholesale Funding over Funding (%)	12.03	12.63	12.58	14.84	16.05
- Debt Securities over Funding (%)	10.97	11.23	11.14	13.04	14.23
- Subordinated Debt over Funding (%)	1.06	1.40	1.44	1.80	1.82
Liquid Assets over Assets (%)	36.96	36.03	37.09	38.47	39.98
Non-Deposit Funding Ratio (%)	36.83	38.23	40.50	44.54	45.65
Net Loan to Deposit Ratio (%)	97.51	99.46	100.00	101.71	102.43
LCR (Phased-in) (%)	NA	NA	NA	NA	NA
NSFR (%)	NA	NA	NA	NA	NA
<b>Capitalisation</b>					
CET1 Ratio (Phased-In) (%)	NA	NA	NA	NA	NA
CET1 Ratio (Fully-Loaded) (%)	NA	NA	NA	NA	NA
Tier 1 Capital Ratio (Phased-In) (%)	16.32	15.62	15.11	14.59	14.62
Total Capital Ratio (Phased-In) (%)	NA	NA	NA	NA	NA
Tang. Equity / Tang. Assets (%)	7.58	7.45	7.08	6.63	6.47
Leverage Ratio (DBRS) (%)	NA	NA	NA	NA	NA
<b>Growth</b>					
Net Attributable Income YoY (%)	12.8	-28.3	1,404.2	-88.1	-22.8
Net Fees and Commissions YoY (%)	8.2	6.1	6.5	4.7	-0.5
Total Operating Expenses YoY (%)	0.6	-3.4	3.6	1.4	1.2
IBPT YoY (%)	-8.2	7.8	3.2	-12.7	-8.1
Assets YoY (%)	0.5	-1.8	-4.2	-0.5	-6.7
Gross Lending to Customers YoY (%)	NA	NA	NA	NA	NA
Net Lending to Customers YoY (%)	0.6	1.0	0.6	0.6	-3.0
Loan Loss Provisions YoY (%)	-27.5	158.9	-29.1	-54.2	5,481.0
Deposits from Customers YoY (%)	2.6	1.5	2.3	1.3	-2.3



## Rating Methodology

The applicable methodology is Global Methodology for Rating Banks and Banking Organisations (July 2018), which can be found on our website under Methodologies.

## Ratings

Issuer	Debt	Rating	Rating Action	Trend
Sparkassen-Finanzgruppe	Long-Term Issuer Rating	A	Confirmed	Positive
Sparkassen-Finanzgruppe	Short-Term Issuer Rating	R-1 (low)	Confirmed	Positive
Sparkassen-Finanzgruppe	Long-Term Senior Debt	A	Confirmed	Positive
Sparkassen-Finanzgruppe	Short-Term Debt	R-1 (low)	Confirmed	Positive

## Rating History

Debt	Current	2018	2017	2016	2015
Long-Term Issuer Rating	A	A	-	-	-
Short-Term Issuer Rating	R-1 (low)	R-1 (low)	-	-	-
Long-Term Senior Debt	A	A	A	A	A
Short-Term Debt	R-1 (low)	R-1 (low)	R-1 (low)	R-1 (low)	R-1 (low)
Senior Non-Preferred Debt	A (low)	A(low)	-	-	-

## Previous Actions

- [DBRS Confirms Sparkassen-Finanzgruppe Long-Term Issuer Rating at 'A', Trend remains Positive](#), March 25, 2019
- [DBRS Confirms Sparkassen Group at 'A', Trend now Positive](#), March 27, 2018
- [DBRS Rates 383 Members of Sparkassen Group at A, Trend Pos](#), March 27, 2018

## Related Research

- [DBRS: Senior Debt of 6 German Banking Groups Downgraded by 1 Notch with New Legislation](#), July 27, 2018.

## Previous Report

- [Sparkassen-Finanzgruppe Rating Report](#), May 30, 2018

## Note:

All figures are in Euros unless otherwise noted.

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