FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Sparkassen-Finanzgruppe at 'A+'; Outlook Stable

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Fitch Ratings - Frankfurt am Main - 18 Apr 2023: Fitch Ratings has affirmed Sparkassen-Finanzgruppe's (Sparkassen) (SFG) Long-Term Issuer Default Rating (IDR) at 'A+' with a Stable Outlook and Viability Rating (VR) at 'a+'. A full list of rating actions is below.

Fitch has withdrawn the ratings of eight savings banks following their merger with other members of the group. A full list of rated SFG members is available at www.fitchratings.com.

KEY RATING DRIVERS

Leading Franchise, Stable Business Profile: SFG's ratings reflect its very strong domestic retail and SME franchise and stable business model, granular and sound credit exposure, strong capitalisation, solid deposit-driven funding and sound liquidity. They also factor in SFG's healthy profitability, supported by strong recurring operating revenue.

Mutual Support: SFG is not a legal entity but a savings bank network, whose cohesion is supported by a mutual support scheme. Fitch assigns "group" ratings to SFG and its savings banks. The IDRs are based on the group's VR and apply to each individual savings bank.

The group's mutual support scheme is designed as an institutional protection scheme (IPS) and recognised by the regulator as a deposit-guarantee scheme. The scheme has an impeccable record of providing protection to depositors by safeguarding its member banks' viability. Members of the group share a common strategy and brand, and joint marketing activities.

High Interest-Rate Risk: Interest-rate risk is high in the local banks' loan books and securities portfolios due to their asset/liability duration mismatches, a high share of fixed-rate lending and absence of widespread use of interest-rate hedging. However, Fitch views the group's strong deposit franchise, liquidity and capitalisation as sufficient mitigating factors.

Sound Asset Quality: We expect SFG's impaired loans ratio to deteriorate modestly in 2023 as a result of the economic downturn, rising interest rates and inflation, but for it to remain below 2% in the medium term. SFG's asset quality benefits from the savings banks' prudent risk appetites, including conservative underwriting, strong collateral and low concentrations.

Resilient Revenue: In 2022, SFG's operating profit continued to benefit from firm loan growth and minimal loan impairment charges. However, temporary write-downs in the savings banks' securities portfolios, driven by rising interest rates, dented SFG's operating profit. Depending on how the interest rate curve evolves, this could continue in the next quarters, before it is gradually reversed due to the pull-to-par effect. We expect profitability to recover in 2023 and the group's four-year average operating profit to remain at about 1% of risk-weighted assets (RWAs) through the cycle.

Strong Capitalisation: SFG's capitalisation is much stronger than the German banking sector's average and reflects the savings banks' solid profit generation and consistently high profit retention. Its common equity Tier 1 (CET1) capital ratio, of 15.7% at end-2022, remains robust, although it understates the strength of the group's capitalisation due to the high risk-weight density from the savings banks' use of a standardised approach. SFG's leverage ratio stood at a sound 9% at end-2022.

Manageable Landesbanken Risks: SFG's ratings factor in contingent risks from the savings banks' exposure to their central institutions, the Landesbanken. We view these risks as manageable despite the Landesbanken's low recurring earnings.

Stable and Granular Deposits: The savings banks' large and growing retail deposit base and stable market shares support the group's strong funding and liquidity profile. They ensure low funding costs and low sensitivity to market sentiment and underpin the group's 'F1+' Short-Term IDR.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

SFG's high ratings reflect the group's above-average crisis resilience. Rating pressure could arise from a durable and material deterioration in asset quality, earnings and capitalisation, with an impaired loans ratio above 3%, operating profit below 0.5% of RWAs, and a CET1 ratio below 13%, all on a sustained basis.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade of SFG's and of its members' ratings would require a material improvement in efficiency, which would likely necessitate a protracted streamlining of the group's structure and strengthened business profile. An upgrade would also be contingent on SFG maintaining its sound asset quality and strong capitalisation.

No Sovereign Support Assumed: SFG's Government Support Rating (GSR) of 'no support' reflects Fitch's view that the EU's resolution framework is likely to require senior creditors participating in losses, if necessary, instead or ahead of a bank receiving sovereign support.

SFG's GSR is at the lowest level on Fitch's rating scale. Therefore, it cannot be downgraded.

We would upgrade SFG's GSR only if we see rising propensity from the sovereign to support systemically important banks, which is highly unlikely in the current regulatory environment.

SUBSIDIARIES & AFFILIATES: KEY RATING DRIVERS

Saving Banks' Long-Term IDRs

The Long- and Short-Term IDRs of SFG's 310 savings bank members (of a total of 359 German savings banks at 1 January 2023) are aligned with SFG's IDRs.

Deposit Ratings

The savings banks' deposit ratings are aligned with SFG's IDRs due to the banks' lack of material resolution debt buffers that would provide their depositors with additional protection if SFG fails to ensure its members' viability. We do not assign a deposit rating to SFG as it is not a legal entity.

We define SFG as consisting of the savings banks only. Each savings bank is predominantly deposit-funded and regulated individually as a less significant institution.

The German regulators' preferred resolution strategy for the savings banks consists of standard insolvency procedures in the highly unlikely event SFG's IPS would fail to protect their viability. Hence, the savings banks have no incentive to build up resolution buffers.

We exclude from our definition of SFG the Landesbanken, most of which have large resolution debt buffers in their capacities as domestic systemically important banks following single-point-of-entry approaches and bail-ins as preferred resolution strategies. Therefore, we do not expect the savings banks' depositors to benefit from the Landesbanken's debt buffers if SFG fails to ensure the savings banks' viability.

Short-Term Ratings

The savings banks' very large and rising retail deposit base and leading collective market share in the German retail deposit market underpin SFG's strong funding and liquidity profile, which drives the group's 'aa-' funding & liquidity score. Therefore, the 'F1+' Short-Term IDRs of SFG and the savings banks are the higher of two options mapping to their 'A+' Long-Term IDRs.

All statements regarding SFG's 2022 performance and balance-sheet items refer to preliminary data released by the German Association of Savings Banks for 2022.

SUBSIDIARIES AND AFFILIATES: RATING SENSITIVITIES

The savings banks' Long-Term IDRs and deposit ratings would be downgraded if SFG's Long-Term IDR was downgraded.

The Short-Term IDRs and deposit ratings of the savings banks would be downgraded if SFG's funding & liquidity score drops below 'aa-'.

The savings banks' Long-Term IDRs and deposit ratings would be upgraded if SFG's IDRs are upgraded. We view a rating uplift of the deposit ratings above SFG's Long-Term IDR as highly unlikely in light of the savings banks' modest senior unsecured issuance. As a result, we do not expect the group to build and maintain a large buffer of subordinated and senior non-preferred debt above 10% of the group's RWA, which would be required for an uplift of the long-term deposit ratings to one notch above their Long-Term IDRs.

The Short-Term IDRs and deposit ratings of SFG and the savings banks are at the highest level on Fitch's rating scale and therefore cannot be upgraded.

VR ADJUSTMENTS

The earnings & profitability score of 'a' is above the 'bbb' category implied score due to the following adjustment reason: risk-weight calculation (positive).

The capitalisation & leverage score of 'aa-' is above the 'a' category implied score due to the following adjustment reason: leverage and risk-weight calculation (positive).

The funding & liquidity score of 'aa-' is above the 'a' category implied score due to the following adjustment reason: deposit structure (positive).

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

We have revised SFG's ESG credit relevance score for group structure to '3' from '4' in line with the typical relevance score for comparable banks. This revision reflects our view that SFG made positive progress with regard to its cohesion in recent years, including the reform of its IPS.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 07 Sep 2022) (including rating assumption sensitivity)

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Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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Structured Finance: Covered Bonds Banks Structured Finance Europe Germany

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