MOODY'S INVESTORS SERVICE

Credit Opinion: Sparkassen-Finanzgruppe

Global Credit Research - 09 Feb 2012

Germany

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Financial Strength	C+
Baseline Credit Assessment	(A2)
Adjusted Baseline Credit Assessment	(A2)
Corporate Family Rating -Dom Curr	Aa2

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Key Indicators

Sparkassen-Finanzgruppe (Aggregated Financials)[1]

	[2]**12-10**	[2]**12-09**	[2]**12-08**	[3]**12-07**	**Avg.**
Total Assets (EUR million)	**2601695.00**	**2582781.99**	**2684968.00**	**2683357.96**	[4]**-1.01**
Total Assets (USD million)	**3490287.20**	**3705622.74**	**3732232.41**	**3923210.08**	[4]**-3.68**
PPI / Avg RWA (%)	**1.50%**	**1.46%**	**1.20%**	**1.08%**	[5]**1.38%**
Net Income / Avg RWA (%)	**0.50%**	**-0.19%**	**-0.43%**	**0.22%**	[5]**-0.04%**
(Market Funds - Liquid Assets) / Total Assets (%)	**18.20%**	**19.65%**	**19.53%**	**21.08%**	[6]**19.61%**
Tier 1 Ratio (%)	**10.90%**	**10.12%**	**8.82%**	**8.50%**	[5]**9.95%**
Cost / Income Ratio (%)	**60.50%**	**60.25%**	**64.21%**	**67.03%**	[6]**63.00%**

[1] All ratios are adjusted using Moody's standard adjustments [2] Basel II; German GAAP [3] Basel I; German GAAP [4] Compound Annual Growth Rate based on German GAAP reporting periods [5] Basel II & German GAAP reporting periods have been used for average calculation [6] Basel I & German GAAP reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

Sparkassen-Finanzgruppe's (S-Finanzgruppe) strong bank financial strength rating (BFSR) of C+ is supported by the savings banks' very strong and deeply entrenched franchises in their regional retail banking markets in Germany, evidenced by high and well-defended market shares as well as their strong brand value and low risk profiles. The rating also captures the weaker business profiles of the Landesbanken which continue to benefit from the joint liability scheme of the sector of public banks (Haftungsverbund). The C+ BFSR maps to A2 on the long-term scale, which is also the adjusted standalone credit strength which does not benefit from any additional support uplift.

Moody's assigns a corporate family rating (CFR) of Aa2 to S-Finanzgruppe, based on its A2 standalone credit strength and a three-notch uplift as a result of our assumption of a very high probability of external support. Our support assumptions for the CFR rely on a strong likelihood of (i) regional and local government support and (ii) systemic support from the German government. In our opinion, the levels of support are closely interlinked for public-sector banks, and therefore we use a unified approach of applying support uplift from multiple sources, anticipating concerted support solutions in case of need.

The major members of this group of public-sector banks are the 429 (as of the end of 2010) German regional savings banks (savings banks) and their regional associations, the Landesbanken and DekaBank Deutsche Girozentrale (DekaBank) (Aa3/P-1/C). Taken together, the 429 savings banks' financial fundamentals continue to be very solid, underpinned by a resilient and predictable stream of quality earnings, strong liquidity and risk management as well as strong economic capitalisation, which have helped the sector to weather the financial crisis. The savings banks have continued to perform and thrive throughout the financial crisis; however, the weak financial fundamentals of several Landesbanken exert significant pressure on S-Finanzgruppe's aggregate financial and risk profile. Following numerous BFSR downgrades during the crisis, we now rate four of the nine Landesbanken below D+; these BFSRs translate into ratings on the long-term scale of Ba2 or below, reflecting not only weak fundamentals but also the challenges to their future franchises and concerns about their ability to restore their profitability and capitalisation.

In assigning the BFSR and CFR to S-Finanzgruppe, we assess the group as if it acted as a single entity. This approach takes into consideration the cohesion and solidarity within S-Finanzgruppe - in particular between the savings banks - as well as the high level of co-operation amongst the members, which, in our view, allows for the assignment of both ratings. However, the constituent members of this group do not constitute a single economic entity with centralised management and control at the group level. The BFSR and CFR do not apply to individual members of the group, but only to the creditworthiness of the group as a whole.

Credit Strengths

- In retail and SME banking, S-Finanzgruppe has a leading market position

- S-Finanzgruppe's franchise is well-entrenched and diversified

- The liquidity profile is strong, whilst aggregate capitalisation remains solid

- Group-specific mutual-support mechanisms are available to each member of this group

Credit Challenges

- Earnings volatility is high, with the inadequate risk-adjusted profitability and the considerable credit-risk concentrations of several large group members that have wholesale business models

- Maturing of more than EUR200 billion grandfathered debt until 2015 mainly at the level of the Landesbanken and the resulting transition of the Landesbanken to a stand-alone business model relying on whole sale funding at market rates

- Four Landesbanken are to undergo profound restructuring and downsizing, following external support measures, with one of them to be dissolved by June 30, 2012

- Weak risk culture and poor management of several Landesbanken and some individual savings banks, with adverse affects for - among other things - the group's reputation

- Relatively high yield-curve exposure may cause volatility in the earnings of the savings banks

- The interests of Landesbanken public-sector owners are sometimes not aligned with S-Finanzgruppe interests, affecting strategy, governance and efficiency

Rating Outlook

The outlook on the BFSR is stable, reflecting our expectation that (i) the aggregate financial strength of S-Finanzgruppe, despite being somewhat weakened, remains sufficiently robust at the C+ rating level; and (ii) that it is sufficiently capitalised to withstand further adverse market conditions in a moderate downside scenario. Given the group's leading market position in Germany (its domestic market), the group's fundamental strength is also a function of the recent strong performance of the German economy and moderate asset-price development.

What Could Change the Rating - Up

There is currently no upside pressure on the ratings, given the vulnerability of several of the Landesbanken and uncertainties regarding their future performance. Positive rating pressure would be subject to a material stabilisation in the Landesbanken sector, whereby all major players that form the S-Finanzgruppe display satisfactory financial fundamentals and sustainable business models.

What Could Change the Rating - Down

Developments that would likely exert downward pressure on S-Finanzgruppe's BFSR include (i) a negative trend in its market positions in retail banking products - for example, if it were to lose out on market trends and the use of new technology relative to its competitors; and (ii) a significant deterioration in asset quality as a result of a more pronounced downturn compared with our central macroeconomic scenario, along with a deterioration in the group's risk-return profile. A significant weakening of the German economy may exert pressure on S-Finanzgruppe's standalone credit strength.

Likewise, a weakening in the cohesion of the group and solidarity amongst the members could also have negative implications for the ratings. If further support actions become necessary for the group's larger members, this could critically test the group's existing mutual-support mechanisms. Also a significant weakening of the credit profile of the German government could exert pressure on S-Finanzgruppe's long term debt rating as it may reduce its capacity (and potentially willingness) to support the group. We currently do not foresee any weakening in the commitment of the German government at any level (central, regional, nor local) to S-Finanzgruppe.

Recent Results and Company Events

For 2010, S-Finanzgruppe reported one of its best results ever. In particular, the savings banks - accounting for 44% of the sector's balance sheet - posted record profits of EUR4.2 billion. The Landesbanken returned to profitability (net income of EUR1.8 billion) after accumulated losses of more than EUR11 billion during 2009 and 2008. Their performance continued to improve throughout H1 2011 with net income of EUR1.7 billion. Given the substantial exposure of these banks outside Germany and the slowdown in growth in the Eurozone we expect results to weaken in H2 2011. Given the strong performance of the German economy and the favourable interest environment we expect results for the savings banks to be in line with results in 2010. Medium perspectives will very much depend on the broader macroeconomic development in the Eurozone which will eventually also affect Germany.

In 2010, S-Finanzgruppe reported total net interest income of EUR34.8 billion (-0.6% year-on-year) and net commission income of EUR7.4 billion (+5.9%). On an aggregate basis, the group posted net income of EUR6.0 billion compared with a net loss of EUR2.9 billion in 2009. Whilst the savings banks maintained a balance sheet of around EUR1 trillion throughout the financial crisis, the Landesbanken have deleveraged significantly, offloading more than EUR250 billion or 17% of their total assets between 2007 and 2010. As a result the total balance sheet of S-Finanzgruppe declined to EUR 2.5 billion in 2010 (excluding derivatives in the trading book) from 2.7 billion in 2007. Equity declined to EUR122 billion from EUR127 billion in 2009, mainly because of the losses incurred by the Landesbanken during 2009. This was only partly offset by the profit retention of the savings banks.

Given the existing mutual support arrangements, the support of the financially weaker (and at the same time larger) members of S-Finanzgruppe places a heavy burden on the stronger members of the group, although most of the external support required during the financial crisis was provided by German federal states. On a positive note, the pressure on Landesbanken to de-risk and to reform business models continues to be extremely high and should - in our view - yield positive results over the next few years. Moreover, as several of the weaker Landesbanken are downsized, S-Finanzgruppe should become stronger in line with the greater weight attached to the more stable savings banks. We also note that the individual risk culture, risk profiles and the size of the largest surviving institutions will continue to represent important rating drivers - and potentially rating constraints - for the group.

The Landesbanken sector is in transition

In 2011, S-Finanzgruppe's structure was simplified, supporting better governance and strategic alignment. Dekabank is now fully owned by the savings banks, whilst S-Finanzgruppe aimed for a squeeze-out of the remaining minority shareholders (share of 1.33%) at Landesbank Berlin AG (A1/P-1/D+) in order to achieve 100% ownership from the savings banks. We expect S-Finanzgruppe to take advantage of the full ownership of both institutions to further optimize their set-up to the needs of the savings banks.

The Landesbanken have made significant progress in downsizing their operations since the outbreak of the financial crisis. Total assets decreased again by 10% in 2010, whilst HSH (Baa2/P-2/E+) and WestLB AG (A3 ratings under review uncertain/P-2/E+ developing outlook) obtained approval for their restructuring plans from the EU. We expect that the EU will make its decision about compensation for state aid for BayernLB (Baa1/P-2/D-) in H1 2012. HSH will see significant further downsizing, with the effect that its core operations will only account for EUR82 billion at the end of 2014 compared with EUR208 billion in 2008.

WestLB (A3 ratings under review uncertain/P-2/E+ developing outlook)will cease to exist in its current form by mid-2012. The business related to the savings banks will be carved out into a new "Verbundbank" with EUR 40-EUR 45 billion in total assets and freshly capitalised with EUR 1.0 billion by the savings bank associations in NRW and S-Finanzgruppe. Landesbank Hessen-Thueringen GZ (A1/P-1/C-) is expected to take-over the Verbundbank including the funding from the savings banks. For the transition period WestLB's shareholders including the savings bank associations committed to agree on "appropriate measures" to ensure WestLB's liquidity and its ability to act as market counterparty during the transformation. By July 1 most of WestLB's remaining liabilities will have been transferred into EAA Erste Abwicklungsanstalt (EAA, Aa1 stable/Prime-1) and the savings banks will exit WestLB. WestLB will then no longer engage in new banking business and will be transformed into a servicing platform including a run-down vehicle that holds legacy positions transferred to or hedged by EAA.

An important driving force in transforming the Landesbanken franchises is the expiring of more than EUR200 billion grandfathered debt outstanding by the end of 2015. By this time, the Landesbanken will have to be self-sufficient in terms of market funding and able to achieve adequate returns to compensate for the cost of risk.

Mergers among Landesbanken may play a role as well for which we have started to observe increased political support more recently as in the example of Landesbank Hessen-Thueringen GZ (A1/P-1/C-) proposed acquisition of the core business related to the sector from WestLB. Further merger activity could lead to accelerated de-risking, important synergies and may positively affect the strength of S-Finanzgruppe as a whole. Nevertheless, we do not expect any large-scale consolidation in the near future and caution that potential losses from non-core portfolios might be a burden for any merger negotiations, in particular if they are not contained by already existing government-guarantee schemes. As a result, we expect further consolidation to happen only over a longer time horizon.

DETAILED RATING CONSIDERATIONS

Detailed considerations for S-Finanzgruppe's currently assigned ratings are as follows:

Bank Financial Strength Rating

We assign a C+ BFSR to S-Finanzgruppe. As a point of reference, the assigned BFSR is one notch higher than the outcome of our bank financial strength scorecard. However, certain financial adjustments - in particular the recognition of undisclosed reserves in our scores for capital adequacy - lead to an adjusted outcome of C+, which is in line with the assigned rating.

The C+ BFSR is based on (i) the group's leading market share in German retail and SME banking; (ii) the well-diversified franchises of the majority of its members, which support the group in adverse market conditions; (iii) a moderate aggregate financial profile; (iv) the strong co-operation and co-ordination within the network of savings banks, which increasingly allows for synergies; and (v) the progress that S-Finanzgruppe has made towards strengthening the risk-management systems of its group members, especially amongst the savings banks. Furthermore, the C+ BFSR positively considers the group-specific mutual-support mechanisms available to each member of this group.

The BFSR is constrained by (i) portfolio concentration risks, in particular at the Landesbanken; (ii) modest profitability; and (iii) a high cost structure compared with those of its global peers.

The standalone creditworthiness of the group is underpinned by the intrinsic strength of the savings banks. However, it is constrained by the weaker business models, risk profiles and financial results of the Landesbanken.

Qualitative Factors (50%)

Factor 1: Franchise Value

Trend: Neutral

Public-sector banks - essentially savings banks and Landesbanken - continue to have a leading role in the German banking market and together form S-Finanzgruppe. At the end of 2010, this association of banks comprised about 363,000 employees from 429 savings banks, nine Landesbanken, DekaBank and about 125 other financial service providers, mainly in the fields of life and non-life insurance, central building societies, leasing and factoring, brokerage, asset management and real estate.

The franchise of the S-Finanzgruppe is one of the strongest in the German market, driven largely by the strong positioning of the local savings banks. With about 50 million customers and leading market shares of approximately 40% for deposits and lending, the savings banks benefit from their very strong and deeply entrenched franchises in their regional retail banking markets and a strong brand value. Increasingly, the savings banks are using their strong market position and expanding their wealth management and brokerage activities for retail customers to provide a better balance between interest and fee income.

Our assessment also includes major challenges for some of the Landesbanken's franchises, which account for approximately 55% of the assets of the total group. Since 2007, four of the Landesbanken have received substantial support in the form of capital injections and state guarantees. They remain under the scrutiny of the EU commission to adapt their business models and divest major parts of their assets.

Overall, the score for franchise value is B.

Factor 2: Risk Positioning

Trend: Neutral

The members of S-Finanzgruppe have always had to comply with German banking regulations and are subject to the supervision of the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht or BaFin). The group members, as public-sector banks, are also subject to the supervision of their respective federal states (Sparkassenaufsicht) via the Ministry of Finance, the Ministry of Economics, or the Ministry of the Interior (depending on the state).

Pilot projects to explore credit-risk management processes, which are of importance to all savings banks, are increasingly centralised with some or all of the constituent associations and a number of pilot savings banks. This is aided by a rising awareness and focus on profitability and efficiency by the traditionally balance-sheet-focused savings banks.

Risk appetite and positioning is the responsibility of each individual institution. Since neither the German Savings Banks Association (DSGV), nor the regional associations have any power to enforce a centralisation of activities or the use of a specific model, the group relies heavily on aggregated benchmarking and best-practice examples developed in the manner described above. However, best-practice examples are available to all savings banks and back-office credit activities benefit from a standardised approach supported by uniform instruments.

The liquidity profile and management in the sector is a key strength, given the liquidity surplus of the savings banks that can be made available for the Landesbanken's treasury activities. The liquidity management score is at C as the Landesbanken would need to retrench their business if they had no access to the funding markets over the next 12 months.

Our assessment of market risk shows that interest-rate risks are the savings banks' primary source of market risk. This is due to their traditional commercial banking profiles with maturity mismatches between short-term deposits and longer-term lending in combination with the Landesbanken's trading and investment activities, which leads to considerable market risk for the group. We expect the appetite for market risk to decrease because of the further de-risking and deleveraging of the Landesbanken.

The score for risk positioning is D.

Factor 3: Regulatory Environment

All German banks are subject to the same score on the regulatory environment. This factor does not address bank-specific issues; instead, it evaluates whether or not regulatory bodies are independent and credible, demonstrate enforcement powers and adhere to global standards of best practices for risk control. Refer to Moody's Banking System Outlook for Germany to obtain a detailed discussion on the regulatory environment.

Factor 4: Operating Environment

Trend: Neutral

This factor is also common to all German banks. We assign a B score for the overall operating environment. Refer to our Banking System Outlook for Germany for a detailed discussion on the operating environment.

Quantitative Factors (50%)

Factor 5: Profitability

Trend: Improving

The members of S-Finanzgruppe, as public-sector banks, have to strike a balance between their public-service mission and the need to ensure a level of profitability that allows them to protect their financial health and to fund growth internally. At most member banks, management typically opts for a strategy that aims to ensure a stable evolution of profits and a satisfactory level of profitability to preserve the bank's financial independence in the long term.

The sector's profitability has historically been sub-par for the assigned rating and remains an important rating constraint. Profitability is skewed towards interest income, and net interest margins have been - and for most savings banks continue to be - under pressure because of fierce competition in the German retail and SME market. In line with our expectations, net interest income stabilised at the prevailing low funding costs from deposits. S-Finanzgruppe bolstered its provision income on the back of increased fees at the savings banks (EUR6.3 billion up from EUR5.9 billion in 2009) and stable fees at the Landesbanken of EUR1.2 billion.

Their large and increasing deposit funding base (EUR740 billion as of 2010) allows the savings banks to benefit from the current yield curve which supports relatively strong net interest income. However, their earnings potential remains constrained by the current low interest rate environment which continues to put pressure on margins and which we expect to persist for several years. Additional pressure on pre-tax profitability will likely be exerted by rising risk charges following the exceptionally benign credit environment in 2011, as a result of the European sovereign crisis and the likely negative impact of austerity measures across Europe on the real economy.

The weaker and more volatile profitability of the Landesbanken continues to be constrained by narrow interest margins due to intense competition in the corporate segment, volatile trading income as well as due to the notably higher cost of wholesale funding. To some extent this may partly be compensated by the ongoing deleveraging of their balance sheets that mostly focuses on low-yielding investments. At the same time the Landesbanken face the challenge of reducing operating costs in tandem with decreasing business volumes and related revenues.

The earnings volatility resulting from a relatively high yield-curve exposure at the savings banks adds to the various challenges and constitutes a major rating constraint for S-Finanzgruppe.

The score for profitability is E+ with an improving trend, mainly as a result of weaker years dropping out of the three year averages.

Factor 6: Liquidity

Trend: Neutral

The savings banks benefit from high funding levels from retail deposits and most have surplus liquidity. However, Landesbanken rely on wholesale funding and will face significant refinancing needs over the coming years. In particular, during 2014-15, the bulk of grandfathered debt (more than EUR200 billion) will mature, which could exert pressure on their liquidity profiles in the years ahead.

Our liquidity measure - defined as market funds minus liquid assets as a percentage of total assets - has yielded an average of approximately 20% over the past three years for S-Finanzgruppe. We adjusted our liquidity score, taking a more conservative stance towards the group's liquidity buffer, which no longer includes its substantial securities portfolio. Together with its accounts held with other banks, this would balance its bank and capital market financing and reflect the structural liquidity of the group. While the savings banks continue to benefit from their preferential access to a broad depositor base given their vast network, the Landesbanken suffer from the strained funding conditions in wholesale funding markets. To reflect this pressure we have lowered the liquidity management score to C comparing still better to most of its competitors and in line with the guidance in our report "European Banks: How Moody's Approach Reflects Evolving Challenges", published on January 19, 2012.

Overall, the score for liquidity is C-.

Factor 7: Capital Adequacy

Trend: Neutral

The financial fundamentals of the 429 savings banks are underpinned by strong economic capitalisation. When including the sizeable undisclosed, fully taxed reserves that they put aside under local GAAP, their aggregate capitalisation is considered solid and able to absorb considerable shocks. That said, the described practice of building undisclosed reserves and maintaining sound capital levels is appropriate because it mitigates their limited access to equity capital markets and has historically helped them to finance gradual internal growth.

The Landesbanken display considerably higher leverage compared with the savings banks, which leaves them more vulnerable to event risk or any renewed market disruption. Capitalisation as well as the quality of capital improved with recent support measures for four of the nine Landesbanken, which was necessary given substantial shortfalls during the financial crisis. We also saw significant further capital strengthening at NordLB (A2/P-1/D+) and a restructuring of silent participations at Landesbank Hessen-Thüringen that ensures recognition as core Tier 1 capital of these instruments under Basel III. However, related costs will affect their performance over the next few years and weigh on their future ability to internally generate and retain capital. Capitalisation will remain a concern in the Landesbanken sector because they currently remain highly leveraged, and also since a significant part of their capital still constitutes (non-core Tier 1) hybrid capital, which will need to be restructured or replaced in order to comply with Basel III. We note that expected losses on domestic assets have decreased due to the strong performance of the German economy. At the same time, we believe that material losses may materialise in international commercial real estate or ship financing, potentially affecting several Landesbanken, which would weigh on the group's capitalisation.

On an aggregated basis, S-Finanzgruppe has a capital base of EUR168.1 billion, representing a slight decrease from the EUR174.7 billion capital the year before and again at the same level as in 2008. This indicates that the net capital injections and generation since then - if it was not paid out as dividends - were largely absorbed by the losses of the Landesbanken in 2008 and 2009. On an aggregate basis, capital ratios are comfortable, with total capital amounting to 16.0% of risk-weighted assets and core capital of 10.9%. Reported capitalisation levels of the Landesbanken at the end of 2010 were higher than for the savings banks (Tier 1 of 12.1% compared with 9.9%), mainly due to significant deleveraging of the Landesbanken in 2010 (risk positions down by 22%) and the ongoing benefit from significant risk shields provided by their shareholders, namely at BayernLB (Baa1/P-2/D-), HSH (Baa2/P-2/E+) and LBBW (A2/P-1/D+). We note that the savings banks benefit from substantial fully taxed but undisclosed reserves (§340f HGB), which are not included in the reported Tier 1 capital.

From our stress-testing of S-Finanzgruppe's earnings, assets and capital, we conclude that overall aggregate capital levels remain sound and are capable of absorbing major credit losses. However, it is important to note that capital cannot be freely allocated to single members within the group, and that the risk of renewed cases of distress due to capital shortfalls cannot be ruled out. In addition - and despite the recent capital injections by regional governments - we consider that there is limited political appetite for further capital injections. In addition, there are forthcoming austerity measures at the level of the regional governments which may make it more difficult for them to afford capital measures in the future. Fiscal debt brakes may be established at the level of the regional government and will then provide for an additional institutional constraint for further capital measures.

The score for capital adequacy, which is based on the ratios for 2010, is B+.

Factor 8: Efficiency

Trend: Improving

S-Finanzgruppe shows a satisfactory level of operating efficiency, albeit comparing less favourably with its international peers. As savings banks continue to operate through an extensive branch network - and as their organisational structure remains fragmented - the potential for achieving economies of scale is therefore limited. The target cost-to-income ratio for savings-bank members is 60%. Although the majority of the savings banks still fall short of this benchmark, we note an improving trend for the group because of the more efficient cost structures.

We believe that the group will continue to benefit from centralised solutions and outsourcing, in particular, for investment requirements in IT, risk management and customer segmentation; this should help the group achieve the stated target over the next few years. In this context, we note positively that in contrast to many commercial banks and Landesbanken, the savings banks typically do not rely on restructuring charges. Instead, they adjust to changing market conditions, as and when changes arise.

The score for efficiency is C, with an improving trend.

Factor 9: Asset Quality

Trend: Neutral

S-Finanzgruppe has a strong focus on the domestic market, with diverse lending exposures including public sector finance, financial institutions, residential mortgages (which form the lion's share of retail lending), consumer loans and corporate lending with a strong focus on SMEs. Additionally, the Landesbanken are exposed to diverse international lending and asset-finance activities as well as large investment portfolios, which have led to major market and credit losses during the global financial crisis. Although we believe that the bulk of the risks related to structured credit products will likely be written-off or provided for, the group remains vulnerable to sizeable commercial real-estate and ship-financing exposures, whose performance may yet cause further credit losses.

S-Finanzgruppe's asset quality benefited from the strong performance of the German economy in 2010 and 2011. At the same time we caution that eroding investor confidence and a weakening of many regional economies across Europe has weakened the credit profile of many of S-Finanzgruppe's counterparties. Given substantial public finance books and CDS exposure, in particular with the Landesbanken, S-Finanzgruppe will not remain unaffected. Whilst we saw significantly reduced risk charges in 2010, we continue to be cautious given the deteriorating macro environment, particularly in the economies of Germany's main trading partners.

A very high proportion of the loan book is backed by conservatively valued residential property, particularly in retail business, where most loans have loan-to-value ratios below 80%, partly due to the relatively stable conditions in the German housing market. In addition, within the corporate customers segment that includes SMEs and self-employed clients, a significant proportion of lending is supported by collateral, with unsecured lending mainly consisting of shorter-term facilities for working capital.

In general, we believe that the loan portfolio is well managed, due to prudent lending criteria and strong diversification across a large number of borrowers. The current state and expected performance of the German economy alleviates some of the risk related to sector concentrations in the automotive and construction sectors, amongst both the savings banks and the Landesbanken.

Overall, the score for asset quality is D+.

Global Local Currency Deposit Rating (Joint Default Analysis)

S-Finanzgruppe's Aa2 CFR is based on the A2 standalone credit strength (mapped from the BFSR) and our view that the probability of support in the event of need is very high, both from (i) the group's responsible public-sector bodies (amongst them the various German federal states and local municipalities); and (ii) the government of the Federal Republic of Germany (Aaa, stable).

Our assessment of a very high probability of support for S-Finanzgruppe from the regional and local governments is based on our view that the individual members of the group will benefit from support forthcoming from its responsible public-sector bodies (mostly federal states and municipalities) in the event of need. In addition to the ownership considerations, the support assessment is also based on two additional factors:

(i) The fact that the vast majority of the group's members are of vital importance to their respective local retail and SME markets, in particular the savings banks that have leading market positions and strong links to their local economies.

(ii) The often significant contribution of the members to the tax revenues of their respective regional and local governments.

Our assessment of a very high probability of systemic support for S-Finanzgruppe is based on the group's significant role in the national payments system and its high importance to the national economy. In addition, we note the group's strong deposit and loan market shares in the German market.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. BFSRs do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honor its domestic or foreign currency obligations. Factors considered in the assignment of BFSRs include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although BFSRs exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Corporate Family Rating

Moody's Corporate Family Rating (CFR) for banking groups (public sector, mutualist or cooperative) is an opinion of a banking group's or association's ability to honour its financial obligations, and is assigned to a banking group as if it had a single class of debt and a single, consolidated, legal-entity structure. A CFR does not reference an obligation or class of debt and thus does not reflect priority of claim. The CFR does not apply to individual members of the group, but only to the creditworthiness of the group as a whole.

According to Moody's joint default analysis (JDA) methodology, the Corporate Family Rating of a banking group is determined by the incorporation of external elements of support into the bank's Baseline Credit

Assessment. In calculating the Corporate Family Rating for a banking group, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of systemic support for the bank in the event of a stress situation and the degree of dependence between the issuer rating and the Local Currency Deposit Ceiling.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the BFSR as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, they are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, which includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Credit Assessment. In calculating the Global Local Currency Deposit rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of systemic support for the bank in the event of a stress situation and the degree of dependence between the issuer rating and the Local Currency Deposit Ceiling.

National Scale Rating

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. A Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt ratings may also be constrained by the country ceiling for foreign currency bonds and notes; however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Factors

Sparkassen-Finanzgruppe

Rating Factors [1]	**A**	**B**	**C**	**D**	**E**	**Total Score**	**Trend**
Qualitative Factors (50%)						**C+**	
Factor: Franchise Value						**B**	**Neutral**
Market Share and Sustainability	**x**						
Geographical Diversification		**x**					
Earnings Stability			**x**				
Earnings Diversification [2]							
Factor: Risk Positioning						**D+**	**Neutral**
Corporate Governance [2]							
- Ownership and Organizational Complexity							
- Key Man Risk							
- Insider and Related-Party Risks							
Controls and Risk Management			**x**				
- Risk Management			x				
- Controls			x				
Financial Reporting Transparency					**x**		
- Global Comparability					x		
- Frequency and Timeliness					x		
- Quality of Financial Information					x		
Credit Risk Concentration			**x**				
- Borrower Concentration			x				
- Industry Concentration			x				
Liquidity Management		**x**					
Market Risk Appetite			**x**				
Factor: Operating Environment						**B**	**Neutral**
Economic Stability			**x**				
Integrity and Corruption		**x**					
Legal System	**x**						
Financial Factors (50%)						**C-**	
Factor: Profitability						**E+**	**Improving**
PPI / Average RWA - Basel II				1.37%			
Net Income / Average RWA - Basel II					0.00%		
Factor: Liquidity						**C+**	**Neutral**
(Mkt funds-Liquid Assets) / Total Assets				19.04%			
Liquidity Management		x					

Factor: Capital Adequacy						**B+**	**Neutral**
Tier 1 Ratio - Basel II		9.96%					
Tangible Common Equity / RWA - Basel II	--	--	--	--	--		
Factor: Efficiency						**C**	**Improving**
Cost / Income Ratio			62.10%				
Factor: Asset Quality						**D+**	**Neutral**
Problem Loans / Gross Loans	--	--	--	--	--		
Problem Loans / (Equity + LLR)	--	--	--	--	--		
Lowest Combined Score (15%)						**D**	
Economic Insolvency Override						**--**	
Aggregate Score						**C**	
Assigned BFSR						**C+**	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non public information [2] - A blank score under Earnings diversification or Corporate Governance indicates the risk is neutral

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