

# Morningstar DBRS Confirms Sparkassen-Finanzgruppe LT Issuer Rating at 'A (high)', Trend Remains Stable

## BANKING ORGANIZATIONS

DBRS Ratings GmbH (Morningstar DBRS) confirmed the floor ratings for the Sparkassen-Finanzgruppe (SFG or the Group) including the Long-Term Issuer Rating at A (high), and the Short-Term Issuer Rating at R-1 (middle). The trend on all credit ratings remains Stable. The Support Assessment for the Group remains unchanged at SA3.

These ratings also apply, in line with Morningstar DBRS's floor ratings concept, to each member of the Sparkassen-Finanzgruppe's Institutional Protection Scheme (IPS) rated by Morningstar DBRS. As of March 2024, the members of the IPS include 353 German savings banks (the Sparkassen), the five Landesbanken, five public-sector building societies (LBS), the Group's central asset manager, DekaBank, and other specialised service providers. For a complete list of ratings, please see the table at the end of this press release.

## KEY CREDIT RATING CONSIDERATIONS

The confirmation of the ratings reflects the breadth of SFG's franchise and the market share the Groups hold in each business segment. This includes the market-leading retail franchise of the Sparkassen, complemented by a number of specialised financial service providers and the wholesale-oriented Landesbanken. Good asset quality metrics and solid capital ratios across the Group further support the ratings. Liquidity benefits from the strong deposit franchise of the Sparkassen, supplemented by wholesale funding at the larger institutions, which typically have well-developed covered bond franchises. The ratings also take into account that profitability, while significantly improved in 2023 as a result of the rapid increase in interest rates, still lags when compared to international peers. With a balance sheet of EUR 940 billion out of a total aggregate Group balance sheet of EUR 2.5 trillion, the wholesale-oriented Landesbanken constitute a material part of the overall Group. Morningstar DBRS notes that a significant de-risking has been taken place over the past decade. However, given the inherently higher concentration in single sectors, in particular the cyclical CRE sector, combined with a wholesale funding profile and a complicated ownership structure, Landesbanken still weaken the overall credit profile of the Group.

The Stable trend takes into account the strong earnings improvement in 2023, offsetting the weaker performance in previous years. Going forward Morningstar DBRS expects revenues to come off their 2023 peak and asset quality metrics to soften, but performance should remain supportive of current rating levels

## CREDIT RATING DRIVERS

A credit rating upgrade would require higher and sustained profitability while demonstrating strong risk management across all major constituents of the Group and maintaining strong capital ratios.

A significant deterioration in the Group's financial performance and or material challenges faced by larger members, would result in a credit rating downgrade. Any indication of a weakening of the IPS scheme would also lead to a downgrade.

## CREDIT RATING RATIONALE

### Franchise Combined Building Block (BB) Assessment: Very Strong / Strong

The Sparkassen-Finanzgruppe (SFG) is the largest financial service provider in Germany and one of the largest financial groups globally with an aggregated balance sheet of EUR 2.5 trillion at end-2022. The SFG is a market leader across a wide range of financial services in Germany. The Group has a market share of 38% for customer loans and 36% for customer deposits in Germany. In our view, the strong and resilient franchise of the savings banks forms the core of Sparkassen-Finanzgruppe's franchise strength. Additional financial service businesses include asset management, building societies, leasing, regional public insurance entities and wholesale banking through the Landesbanken. With a few exceptions, members are institutions under public law and operate independently under the SFG franchise.

### Earnings Combined Building Block (BB) Assessment: Moderate

Similar to other European banks, SFG's earnings power has benefitted from the rate increases since mid-2022. However, the Group still lags similarly rated peers due to factors such as a very competitive banking market and an extensive branch network and the Group members public mandate. This has been partly mitigated by the relative stability of earnings at the savings banks and we also note the improving profitability of the Landesbank sector. The Group's aggregate 2023 results are not available yet. In 2022, the Group reported a profit of EUR 5.1 billion (including 340(g) reserves), down from EUR 6.5 billion a year earlier despite significantly higher operating results, due to significant impairments of the Sparkassen fixed income portfolios, which will revert over time. Savings banks reported preliminary 2023 results based on an internal accounting system (Betriebsvergleich). Income before valuation was EUR 18.2 billion, up 56% from EUR 11.5 billion a year earlier, driven by higher net interest income, moderate fee growth and a reversal in security impairment, somewhat offset by higher operating expenses and higher credit costs. The Landesbanken that have reported already released significantly stronger earnings as well. We expect the interest rate environment to continue to support strong revenue performance, but we believe that a peak in interest margins has been reached. In addition, the higher financing costs and the weaker economy could lead to higher credit costs and lower lending volumes.

### Risk Combined Building Block (BB) Assessment: Strong / Good

Overall, Morningstar DBRS views the Group risk profile as stable, supported by the well-diversified and highly granular exposures of the Sparkassen, and the de-risking of the Landesbanken in recent years. However, we note the high concentration of Landesbanken in commercial real estate (CRE) finance. The sharp rise in interest rates has had an adverse impact on valuations and the financial flexibility of borrowers. Office properties have been particularly affected due to the trend towards hybrid work, a trend most visible in the U.S. office market. In terms of asset quality, there are no aggregate metrics available for the Group. 2023 metrics released so far by Landesbanken and the savings banks point to a deteriorating trend. Landesbanken show an increase in nonperforming loans, while loan loss provisions increased mainly due to CRE. Preliminary 2023 results reported by the Sparkassen show loan loss provisions of EUR 2.3 billion or 23 bps in term of Cost of Risk (CoR), up significantly from 4 bps in 2022 and the highest since 2010. This is on the conservative side and should protect the savings bank well for 2024, considering the still sluggish German economy, elevated borrowing costs, and the weak commercial real estate market.

### Funding and Liquidity Combined Building Block (BB) Assessment: Strong

Morningstar DBRS views the liquidity and funding position of Sparkassen-Finanzgruppe continues to be sound, with the savings banks' extensive deposit base serving as the major funding source for the group, supplemented by the more wholesale-oriented funding profile of the Landesbanken. In 2022, the Group's liabilities to customers grew by 3.9% YOY to EUR 1.51 trillion. According to preliminary 2023 numbers, the savings banks experienced a slight 0.5% YOY decline in deposits in 2023 resulting in a total of

EUR 1.15 trillion. There has also been a shift from current account (-9.7%) and savings accounts (-17.9%) to higher yielding term deposits and bearer bonds. The Liquidity Coverage Ratio (LCR) for the Sparkassen was strong at 186% at end-2023.

Capitalisation Combined Building Block (BB) Assessment: Strong / Good

In Morningstar DBRS's opinion, SFG maintains solid capital ratios with a capital cushion well above regulatory minimum requirements supported mostly by earnings retention. The Group's aggregated Tier 1 ratio (including Landesbausparkassen) was 15.7% at end-2022, stable YOY, as moderate growth in risk weighted assets (RWA) could be absorbed by capital retention. In our view, it is important for the Group to maintain healthy capital cushions as options to raise external capital are limited due to their public ownership structure. According to preliminary 2022 results, the savings banks' Tier 1 capital ratio increased slightly to 15.9% at end-2023 from 15.7% at end-2022 supported by strong earnings. The Landesbanken were able to increase their Tier 1 capital ratio to 15.5% from 15.0% a year earlier. Currently, all banks have to comply with a 0.75% countercyclical buffer (CCyB) on all domestic risk-weighted assets (RWA) and a 2.0% sectoral systemic risk buffer (sSyRB) on RWAs related to loans collateralised by residential real estate.

Further details on the Scorecard Indicators and Building Block Assessments can be found at <https://dbrs.morningstar.com/research/429942>.

## ENVIRONMENTAL, SOCIAL, AND GOVERNANCE CONSIDERATIONS

### Governance (G) Factors

The subfactor Corporate Governance is relevant to the rating of Sparkassen-Finanzgruppe, and this is reflected in the franchise grid grades for the bank.

Morningstar DBRS views certain weaknesses in the group structure as relevant from a corporate government perspective. Notably, the Landesbanken are majority or part-owned by German Federal States. State governments, in our view, have limited capabilities to effectively supervise the banks' activities. In the past, Landesbanken have taken outsized risks, resulting in high costs to tax payers and the Sparkassen. Sparkassen associations, while part-owners of some Landesbanken have had only limited influence over the risk taking by the Landesbanken. The ownership mix and the parliamentary process involved in decision making, has also made it difficult at times to swiftly react to challenges. In 2020, the ECB has requested better pre-emptive risk controls within the IPS, which are in the process of being implemented. In addition, aggregate financial information for the Group is limited.

There were no Environmental or Social factors that had a significant or relevant effect on the credit analysis.

A description of how Morningstar DBRS considers ESG factors within the Morningstar DBRS analytical framework can be found in the Morningstar DBRS Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings (23 January 2024), <https://dbrs.morningstar.com/research/427030/morningstar-dbrs-criteria-approach-to-environmental-social-and-governance-risk-factors-in-credit-ratings>

### Notes:

All figures are in EUR unless otherwise noted.

The principal methodology is the Global Methodology for Rating Banks and Banking Organisations (22 June 2023) <https://www.dbrsmorningstar.com/research/415978/global-methodology-for-rating-banks-and-banking-organisations>. In addition Morningstar DBRS uses the Morningstar DBRS Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings at <https://dbrs.morningstar.com/research/427030/morningstar-dbrs-criteria-approach-to-environmental-social-and-governance-risk-factors-in-credit-ratings>

governance-risk-factors-in-credit-ratings in its consideration of ESG factors.

The credit rating methodologies used in the analysis of this transaction can be found at: <https://dbrs.morningstar.com/about/methodologies>

The sources of information used for this credit rating include Morningstar, Inc. and company documents, Sparkassen-Finanzgruppe 2018-2022 Annual Reports, Bilanzpressekonferenz der Sparkassen 2024. Morningstar DBRS considers the information available to it for the purposes of providing this credit rating to be of satisfactory quality.

Morningstar DBRS does not audit the information it receives in connection with the credit rating process, and it does not and cannot independently verify that information in every instance.

The conditions that lead to the assignment of a Negative or Positive trend are generally resolved within a 12-month period. Morningstar DBRS' outlooks and credit ratings are under regular surveillance.

For further information on Morningstar DBRS historical default rates published by the European Securities and Markets Authority (ESMA) in a central repository, see: <https://registers.esma.europa.eu/cerep-publication>. For further information on Morningstar DBRS historical default rates published by the Financial Conduct Authority (FCA) in a central repository, see <https://data.fca.org.uk/#/ceres/craStats>.

The sensitivity analysis of the relevant key credit rating assumptions can be found at: <https://dbrs.morningstar.com/research/429951>

This credit rating is endorsed by DBRS Ratings Limited for use in the United Kingdom.

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Initial Rating Date: January 18, 2007

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For more information on this credit or on this industry, visit [dbrs.morningstar.com](https://dbrs.morningstar.com).

## Ratings

### Sparkassen-Finanzgruppe

Date Issued	Debt Rated	Action	Rating	Trend	Attributes
21-Mar-24	Long-Term Issuer Rating	Confirmed	A (high)	Stb	<b>EU</b> <b>U</b>

Date Issued	Debt Rated	Action	Rating	Trend	Attributes
21-Mar-24	Short-Term Issuer Rating	Confirmed	R-1 (middle)	Stb	<b>EU</b> <b>U</b>
21-Mar-24	Senior Non-Preferred Debt	Confirmed	A	Stb	<b>EU</b> <b>U</b>
21-Mar-24	Short-Term Debt	Confirmed	R-1 (middle)	Stb	<b>EU</b> <b>U</b>
21-Mar-24	Long-Term Senior Debt	Confirmed	A (high)	Stb	<b>EU</b> <b>U</b>

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