RATING ACTION COMMENTARY

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

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Fitch Ratings - Paris - 09 Apr 2024: Fitch Ratings has affirmed Sparkassen-Finanzgruppe's (SFG) Long-Term Issuer Default Rating (IDR) at 'A+' with a Stable Outlook, Short-Term IDR at 'F1+' and Viability Rating (VR) at 'a+'. A full list of rating actions is below.

Fitch has withdrawn the ratings of seven savings banks following their merger with other members of the group.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.

Conservative Risk Profile: SFG's asset quality has been sound, reflecting prudent underwriting standards, a high share of collateralised lending and a fairly standardised product offering. The savings banks' granularity, long-standing client relationships and their limited complexity also underpin the group's sound risk profile.

Interest-rate risk is high in the local banks' loan books and securities portfolios due to their asset/liability duration mismatches. However, as the rise in interest rates came to a halt, added by some pull-to-par effect and efforts to lower market risk exposure, the banks recovered unrealised valuation losses in 2023 in their local securities portfolios.

Sound Asset Quality: We expect SFG's impaired loans ratio to deteriorate modestly in 2024 as a result of the economic downturn, 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.

Interest Rates Boost Revenue: Revenue have substantially benefited from higher interest rates, which were to a large extent not passed to depositors. We expect deposit repricing to partly catch up in 2024 while loan impairment charges should remain elevated compared with previous years. We expect its four-year-average operating profit/risk-weighted assets (RWAs), which we assess in light of its conservative RWA calculation, to be slightly above 1% over 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 15.9% at end-2023, is robust, although it understates the strength of the group's capitalisation due to the high risk-weight density from the savings banks' use of the standardised approach. SFG's leverage ratio was a sound 9.3% at end-2023.

Stable and Granular Deposits: The savings banks' large 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. Negative rating pressure could arise from a durable and material deterioration in asset quality and earnings, especially if this resulted in an impaired loans ratio above 3% and operating profit below 0.7% of RWAs, 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 be likely to 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 bottom of 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' IDRS AND DEPOSIT RATINGS

The Long- and Short-Term IDRs of SFG's 303 savings bank members (out of a total of 351 German savings banks at 31 March 2024) 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 only of the savings banks. 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. Consequently, 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.

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 were 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' implied category score due to the following adjustment reason: risk-weight calculation (positive).

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

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

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

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 15 Mar 2024) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

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