

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

BANKING ORGANIZATIONS

DBRS Ratings GmbH (DBRS Morningstar) 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 ratings remains Stable. The Support Assessment for the Group remains unchanged at SA3.

These ratings also apply, in line with DBRS Morningstar's floor ratings concept, to each member of the Sparkassen-Finanzgruppe's Institutional Protection Scheme (IPS) rated by DBRS Morningstar. As of March 2022 the members of the IPS include 367 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. For a complete list of ratings, please see the table at the end of this press release.

KEY RATING CONSIDERATIONS

The confirmation of the ratings reflects the very strong franchise of the Sparkassen which form the backbone of the Group. The Group has an aggregate balance sheet of EUR 2.4 trillion and holds significant market shares in all business segments, underscoring the Group's importance to the German banking sector and the German economy overall. The ratings are also underpinned by good asset quality metrics benefitting from the granular loan portfolios of the Sparkassen and the de-risking within the Landesbanken sector in recent years. Capital levels are solid and liquidity is supported by the strong deposit franchise of the Sparkassen, supplemented by the covered bond franchises of the larger institutions. Offsetting these rating strengths are the relatively modest profitability when compared to international peers as well as the historically higher risk associated with the Landesbanken.

The Stable trend reflects the limited ratings upside due to near-to mid-term revenue pressures for German banks in current low interest rate environment, potentially delayed effects of the COVID-19 pandemic as well as the fallout from the war in Ukraine. It also reflects DBRS Morningstar's current view that any deterioration in SFG's credit metrics as a result of these developments would remain with the A (high) rating range.

RATING DRIVERS

Given the continuing pressure from the low rate environment, the still ongoing impact from the COVID-19 pandemic, and new challenges arising from Russia's invasion of Ukraine, a near-term rating upgrade is unlikely. A rating upgrade would require the Group to significantly improve profitability while maintaining prudent risk management.

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

RATING RATIONALE

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

With an aggregated balance sheet of EUR 2.4 trillion, SFG is the largest financial service provider in Germany. With a few exceptions members are institutions under public law and operate independently under the SFG franchise. SFG's 367 regional savings banks, five wholesale and clearing institutions (Landesbanken) as well as a number of specialised institutions offer a full set of financial services to their customers with considerable market share in their respective markets. The Group's market share for loans to domestic non-banks was 38% at end-FY2020 and 35% for client deposits. In DBRS Morningstar's view, the strong, resilient franchise of the savings banks forms the core of Sparkassen-Finanzgruppe's franchise strength. The Landesbanken, while providing important services to the savings banks, have negatively affected the overall strength of the Group. However, DBRS Morningstar notes the progress made in de-risking and refocussing of the Landesbanken in recent years.

Earnings Combined Building Block (BB) Assessment: Moderate

In DBRS Morningstar's opinion, SFG's earnings power compares well to German peers, but less favourably to international peers. However, the somewhat modest profitability of the savings banks is mitigated by the relative stability of earnings. The Landesbanken on average have been less profitable and earnings have been more volatile. However, the de-risking in the sector should lead to a higher degree of earnings stability going forward. Overall, the Group's revenues have been affected by the low interest rate environment. This has been partly mitigated by higher fee revenues, higher lending volumes and cost initiatives. As a large part of the loan portfolio has repriced to lower rates, we expect pressure on net interest income to subside. However, new uncertainties have arisen from the war in Ukraine, which could affect the Group's P&L in various ways at a time when the impact from the COVID-19 pandemic has not fully subsided yet. At the same time, higher countercyclical buffers and the planned sectoral systematic risk buffer could reduce banks' willingness to lend.

In FY2020 the Group reported a profit of EUR 4.6 billion (including 340(g) reserves), down from EUR 6.5 billion a year earlier. The Group posted a FY2020 income before valuation (Betriebsergebnis vor Bewertung) of EUR 10.9 billion (up 8.1% YoY), driven by higher net commissions income (up 1.8% YoY to EUR 9.8 billion) and lower costs (down 3.1% YoY). Net interest income was down slightly (0.4% YoY to EUR 27.6 billion). Operating expenses decreased by 3.1% YoY to EUR 27.2 billion, supported by a 2.0% decline in staff expenses and a 4.6% decrease in administrative expenses. As a result, the cost-income ratio (CIR) of the Group as a whole decreased to 71.3% (2019: 73.5%) in FY2020. Net valuation expenses (a German GAAP accounting category which includes mainly provisions for loan losses and fair value adjustments of securities) increased to EUR 2.9 billion in FY2020 from EUR 579 million in the previous year, driven by higher loan loss provisions due to the COVID-19 pandemic. Based on preliminary unaudited FY2021 results using internal accounting methods (Betriebsvergleich) the savings banks reported a 2.8% YoY increase of income before valuation to EUR 9.7 billion, driven by strong fee and commission income, up 6.6% YoY to EUR 9.1 billion and slightly lower costs, partly offset by a 1.6% decline in NII to EUR 19.2 billion.

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

The overall Group risk profile comprises the stable risk profile of the Sparkassen, which is reflective of their well-diversified and highly granular exposures combined with a relative conservative approach to risk taking, and the historically higher risk appetite of the Landesbanken. We note, however, that the continued deleveraging and de-risking of the Landesbanken has improved the overall Group risk profile in recent years. For the Group, net valuation expenses (a German GAAP accounting category which includes provisions for loan losses and fair value changes for securities) were EUR 2.9 billion in FY2020 up from EUR 0.6 billion in the previous year, in response to the uncertainties created by the COVID-19 pandemic. Preliminary 2021 results reported by the Sparkassen show loan loss provisions of EUR 0.1 billion, down from EUR 1.3 billion in 2020. However, in DBRS Morningstar's view this trend could reverse again, as the war in Ukraine exacerbates existing challenges for the German and global economy, ranging

from high energy and commodity prices, to higher labour costs, potential interest rate hikes, supply chain disruptions and a decrease in demand, all of which could affect the financial health of SFG's clients.

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

DBRS Morningstar continues to view the liquidity and funding position of Sparkassen-Finanzgruppe as benefitting from its extensive deposit base and sound liquidity of the savings banks, which is partly offset by the more wholesale-oriented funding profile of the Landesbanken. Nevertheless, in the current negative rate environment, deposit growth has weighed on the Sparkassen's profitability, whereas most Landesbanken have benefited from TLTRO III. In FY2020 the Group's liabilities to customers grew by 5.0% YoY to EUR 1.41 trillion and savings banks' deposits from customers grew 7.9% YoY to EUR 1.07 trillion, driven by factors such as the lack of spending opportunities during the lock-down and precautionary liquidity balances by corporates. According to preliminary 2021 numbers the savings banks saw YoY deposit growth slow to 4.5% in FY2021 to a total of EUR 1.12 trillion. The LCR ratio for the Sparkassen was 174.1% at end-FY2021.

Capitalisation Combined Building Block (BB) Assessment: Good

SFG's capitalisation is, in DBRS Morningstar's view, solid, reflecting the overall sound capital cushion over regulatory minimum requirements and consistent earnings retention of the savings banks. This is partly mitigated by the fact that Sparkassen and SFG as a Group cannot raise capital in the capital markets. The Group's aggregated Tier 1 ratio (including Landesbausparkassen) increased to 16.5% at end-FY2020 from 16.1% a year earlier. All Landesbanken now carry capital cushions well above their regulatory requirements. According to preliminary FY2021 results, the savings banks' Tier 1 capital ratio dropped to 15.6% at end-FY2021 from 16.4% at end-FY2020 due to strong asset growth.

Further details on the Scorecard Indicators and Building Block Assessments can be found at <https://www.dbrsmorningstar.com/research/394677>.

ESG CONSIDERATIONS

A description of how DBRS Morningstar considers ESG factors within the DBRS Morningstar analytical framework can be found in the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings at <https://www.dbrsmorningstar.com/research/373262>.

Notes:

All figures are in EUR unless otherwise noted.

The principal methodology is the Global Methodology for Rating Banks and Banking Organisations (19 July 2021) <https://www.dbrsmorningstar.com/research/381742/global-methodology-for-rating-banks-and-banking-organisations> Other applicable methodologies include the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings (3 February 2021) <https://www.dbrsmorningstar.com/research/373262/dbrs-morningstar-criteria-approach-to-environmental-social-and-governance-risk-factors-in-credit-ratings>

The sources of information used for this rating include Morningstar Inc. and Company Documents, Sparkassen-Finanzgruppe 2016-2020 Annual Reports, Bilanzpressekonferenz der Sparkassen 2022. DBRS Morningstar considers the information available to it for the purposes of providing this rating to be of satisfactory quality.

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

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

For further information on DBRS Morningstar historical default rates published by the European Securities and Markets Authority (ESMA) in a central repository, see: <http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml>. DBRS Morningstar understands further information on DBRS Morningstar historical default rates may be published by the Financial Conduct Authority (FCA) on its webpage: <https://www.fca.org.uk/firms/credit-rating-agencies>.

The sensitivity analysis of the relevant key rating assumptions can be found at: <https://www.dbrsmorningstar.com/research/394676>.

This 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 www.dbrsmorningstar.com.

Ratings

Sparkassen-Finanzgruppe

Date Issued	Debt Rated	Action	Rating	Trend	Attributes
01-Apr-22	Long-Term Issuer Rating	Confirmed	A (high)	Stb	EU U
01-Apr-22	Short-Term Issuer Rating	Confirmed	R-1 (middle)	Stb	EU U
01-Apr-22	Senior Non-Preferred Debt	Confirmed	A	Stb	EU U
01-Apr-22	Short-Term Debt	Confirmed	R-1 (middle)	Stb	EU U
01-Apr-22	Long-Term Senior Debt	Confirmed	A (high)	Stb	EU U

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