

PRESS RELEASE

MARCH 29, 2023

# 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 2023, the members of the IPS include 359 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 retail franchise of the Sparkassen, complemented by a number of specialised financial service providers and the wholesale-oriented Landesbanken. The Group has an aggregate balance sheet of EUR 2.4 trillion and holds significant market shares in various business segments, underscoring the Group's importance to the German banking sector and the German economy overall. 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 are constrained by the relatively modest profitability when compared to international peers as well as by the somewhat complicated ownership structure.

The Stable trend takes into account the earnings potential from the higher interest environment. However, given the liability sensitivity of the savings banks, the extent of the benefit will depend on their deposit beta. The tailwinds from higher rates could be offset by a number of challenges including a decline in GDP, high inflation, and higher borrowing costs that could lead to deteriorating asset quality or lower demand for financial services.

## RATING DRIVERS

A 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 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 a downgrade.

## 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 2.4 trillion at end-2021. 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

In DBRS Morningstar's opinion, SFG's modest earnings power is improving as a result of the higher rate environment and the increasingly profitable Landesbank sector. SFG has been less profitable than similarly rated international peers due to a variety of factors such as the low rate environment, a competitive banking market, an extensive branch network, and restructuring in the Landesbanken sector. This has been mitigated by the relative stability of earnings at the savings banks. In 2021, the Group reported a profit of EUR 6.0 billion (including 340(g) reserves), up from EUR 4.6 billion a year earlier, driven by sound operating results and a significantly lower valuation result (impairments on loans and securities). The Group posted 2021 income before valuation (Betriebsergebnis vor Bewertung) of EUR 11.3 billion (up 6.2% YOY), as somewhat lower net interest income was offset by increases in net commission income and net trading revenues). Costs increased by a moderate 0.6% YOY, and as a result, the cost/income ratio (CIR) improved to 70.4% in 2021 (2020: 71.6%). Savings banks reported preliminary 2022 results based on an internal accounting system (Betriebsvergleich). Income before valuation of EUR 11.5 billion increased by 19.1% YOY, driven by higher net interest income, moderate fee growth and well-contained cost increases. The CIR improved from 66.2% in 2021 to 62.6% in 2022. Generally, we expect continued support from higher rates, however, higher financing costs and the weakening economy could lead to lower lending volumes and higher credit costs.

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

DBRS Morningstar views the overall 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. 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 0.09 billion in 2021 down from EUR 2.6 billion in the previous year, when uncertainties created by the COVID-19 pandemic led to higher loan loss provisions. Preliminary 2022 results reported by the Sparkassen show loan loss provisions of EUR 0.4 billion or 4 bps in terms of Cost of Risk (CoR), slightly up from EUR 0 billion in 2021. For 2023, DBRS Morningstar's expects higher credit costs given the slowdown of the German and global economy and challenges such as volatile energy markets, inflation, increased lending costs, and supply chain disruptions, all of which could affect the financial health of SFG's clients. The substantial volume of long-term loans underwritten during the low-rate period could pose some interest rate risk for the Sparkassen, if pressure increases to raise deposit rates, while the unprecedented house price increase entails some risk to asset quality. For the Landesbanken, DBRS Morningstar notes the relatively high exposure to commercial real estate, however, given the conservative underwriting, risks should be contained.

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

In DBRS Morningstar's view, 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 of the Group, supplemented by the more wholesale-oriented funding profile of the Landesbanken. While beneficial from a liquidity perspective, the high deposit balances in 2021 weighed on the Sparkassen's profitability, whereas most Landesbanken have benefited from TLTRO III. In 2021, the Group's liabilities to customers

grew by 4.0% YOY to EUR 1.45 trillion and savings bank deposits from customers grew 4.5% YOY to EUR 1.12 trillion, According to preliminary 2022 numbers, the savings banks saw YOY deposit growth slow to 2.7% YOY from 4.5% in 2021 to a total of EUR 1.15 trillion. The LCR ratio for the Sparkassen was 168% at end-2022.

#### Capitalisation Combined Building Block (BB) Assessment: Good

In DBRS Morningstar's view, SFG displays solid capital ratios with capital cushions well-above regulatory minimum requirements supported mostly by earnings retention. This is partly mitigated by the fact that Sparkassen and SFG as a Group cannot raise equity capital in the capital markets due to their public ownership structure. The Group's aggregated Tier 1 ratio (including Landesbausparkassen) decreased to 15.7% at end-2021 from 16.3% a year earlier, as capital retention did not entirely offset growth in risk weighted assets (RWA). According to preliminary 2022 results, the savings banks' Tier 1 capital ratio increased slightly to 15.7% at end-2022 from 15.6% at end-2021, as strong asset growth and the significant writedowns of the savings banks' security portfolios were absorbed through a combination of higher operating income and a small release of 340 (g) reserves.

Further details on the Scorecard Indicators and Building Block Assessments can be found at <https://www.dbrsmorningstar.com/research/412037>.

#### ENVIRONMENTAL, SOCIAL, 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.

DBRS Morningstar 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 and more transparent processes in case of a recapitalisation, which was addressed in 2021. 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 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/396929/dbrs-morningstar-criteria-approach-to-environmental-social-and-governance-risk-factors-in-credit-ratings> (17 May 2022)

Notes:

All figures are in EUR unless otherwise noted.

The principal methodology is the Global Methodology for Rating Banks and Banking Organisations <https://www.dbrsmorningstar.com/research/398692/global-methodology-for-rating-banks-and-banking-organisations> (23 June 2022). In addition DBRS Morningstar uses the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings <https://www.dbrsmorningstar.com/research/396929/dbrs-morningstar-criteria-approach-to-environmental-social->

and-governance-risk-factors-in-credit-ratings (17 May 2022) in its consideration of ESG factors.

The sources of information used for this rating include Morningstar Inc. and Company Documents, Sparkassen-Finanzgruppe 2017-2021 Annual Reports, Bilanzpressekonferenz der Sparkassen 2023. 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.

The conditions that lead to the assignment of a Negative or Positive trend are generally 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: <https://cerep.esma.europa.eu/cerep-web/statistics/defaultx.html>. 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/412036>.

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

Lead Analyst: Sonja Förster, CFA, Vice President - Global FIG

Rating Committee Chair: William Schwartz, Senior Vice President - Credit Practices Group

Initial Rating Date: January 18, 2007

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DBRS Ratings GmbH

Neue Mainzer Straße 75

Tel. +49 (69) 8088 3500

60311 Frankfurt am Main Deutschland

Geschäftsführer: Detlef Scholz

Amtsgericht Frankfurt am Main, HRB 110259

For more information on this credit or on this industry, visit [www.dbrsmorningstar.com](http://www.dbrsmorningstar.com).

## Ratings

### Sparkassen-Finanzgruppe

Date Issued	Debt Rated	Action	Rating	Trend	Attributes
29-Mar-23	Long-Term Issuer Rating	Confirmed	A (high)	Stb	<b>EU</b> <b>U</b>
29-Mar-23	Short-Term Issuer Rating	Confirmed	R-1 (middle)	Stb	<b>EU</b> <b>U</b>
29-Mar-23	Senior Non-Preferred Debt	Confirmed	A	Stb	<b>EU</b> <b>U</b>

Date Issued	Debt Rated	Action	Rating	Trend	Attributes
29-Mar-23	Short-Term Debt	Confirmed	R-1 (middle)	Stb	<b>EU</b> <b>U</b>
29-Mar-23	Long-Term Senior Debt	Confirmed	A (high)	Stb	<b>EU</b> <b>U</b>

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## Contacts

### **Sonja Förster**

*Vice President - Global Financial Institutions Group*

+49 69 8088 3510

[sonja.forster@dbrsmorningstar.com](mailto:sonja.forster@dbrsmorningstar.com)

### **William Schwartz**

*Senior Vice President - Credit Practices Group*

+1 212 806 3233

[william.schwartz@dbrsmorningstar.com](mailto:william.schwartz@dbrsmorningstar.com)

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