FitchRatings

Banks
Retail & Consumer Banks
Germany

Sparkassen-Finanzgruppe (Sparkassen)

Update

Key Rating Drivers

Mutual Support Drives Ratings: The Issuer Default Ratings (IDRs) of the 318 savings banks (at 15 June 2021) rated as part of Sparkassen-Finanzgruppe (SFG) are group ratings based on mutual support. SFG is not a legal entity but a banking network whose cohesion rests on a mutual support scheme. Based on Annex 4 of Fitch Ratings' *Bank Rating Criteria* for banking structures backed by mutual support schemes, SFG's IDRs apply to each member bank, and Fitch assigns a Viability Rating (VR) to SFG, but not to the individual savings banks.

Outlook Stable: The Stable Outlook on SFG's Long-Term IDR reflects the agency's view that the group's VR of 'a+' offers sufficient headroom to absorb a reasonable deterioration in asset quality or earnings as a result of the pandemic.

Resilient Asset Quality: SFG's asset quality so far through the pandemic has benefited from the savings banks' prudent risk appetites, including conservative underwriting, strong collateral and low concentrations. Borrowers have also strongly benefited from the comprehensive state support that has contained unemployment and insolvencies since the start of the pandemic.

We do not expect SFG's non-performing loans (NPL) to rise significantly in 2022, and we believe its four-year-average NPL ratio (which we estimate at about 1%-1.3% at end-2020) will remain below 2% in the medium term. Some elements of the state support to the economy, which have ensured German banks' good asset quality over the past two years, have been recently extended until end-1Q22 to accommodate the current resurgence of the pandemic.

Resilient Profitability: In 2021 we expect SFG's leading market positions underpinned by the savings banks' strong local franchises to ensure an operating profit broadly similar to 2020, in light of continued robust loan growth primarily driven by high house price inflation, and unusually high loan impairment charges (LICs) in line with 2020. In 2020, SFG's operating profit/risk-weighted assets (RWAs), which we assess in the context of SFG's very conservative RWA calculation, remained solid, supported by high new business volumes.

Capitalisation Remains Rating Strength: SFG's capitalisation is much stronger than the German banking sector average and reflects the savings banks' solid profit generation and consistently high profit retention. SFG's common equity Tier 1 (CET1) capital ratio rose slightly in 2020 as profit retention outpaced RWAs inflation driven by strong loan growth. The group's leverage ratio remained very strong and stable at 8.5% at end-2020.

Manageable Landesbanken Risks: SFG's VR factors in contingent risks from the savings banks' exposure to their central institutions, the Landesbanken. We view these risks as manageable despite the Landesbanken's low recurring earnings and, in some cases, untested restructurings.

Rating Sensitivities

Unexpectedly High Credit Losses: We view SFG as more resilient to the pandemic than the overall banking sector. However, we could downgrade the ratings if unexpected pandemic-driven disruptions derail the current recovery. In this event, SFG's ratings could come under pressure from lower revenues and, more importantly, unexpectedly high credit losses exceeding our base case assumptions, if these credit losses significantly weigh on profitability for an extended period.

Group Cohesion: The ratings are sensitive to Fitch's reassessment of SFG's relatively weak cohesion, which drives its Environmental, Social and Governance (ESG) relevance score of '4'.

Ratings

Foreign Currency	
Long-Term IDR	A+
Short-Term IDR	F1+
Viability Rating	a+
Support Rating	5
Support Rating Floor	No Floor
Sovereign Risk	
Long-Term Foreign-Currency IDR	AAA
Long-Term Local-Currency IDR	AAA
Country Ceiling	AAA

Outlooks

Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Local-Currency IDR	Stable

Applicable Criteria

Bank Rating Criteria (November 2021)

Related Research

Fitch Revises Sparkassen-Finanzgruppe's Outlook to Stable from Negative; Affirms at 'A+' (June 2021)

Global Economic Outlook (September 2021)

Sparkassen-Finanzgruppe (July 2021)

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Debt Rating Classes

Rating Level	Rating
Long-term deposit rating	A+
Short-term deposit ratings	F1+

Source: Fitch Ratings

Deposit Ratings Aligned with IDRs to Reflect Lack of Debt Resolution Buffers

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 in a resolution. We do not assign a deposit rating to SFG as it is not a legal entity.

We define SFG as consisting of the savings banks only. 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 institutional protection scheme (IPS) fails to protect their viability. Hence 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 in a resolution.

Short-Term Ratings Driven by Strong Funding and Liquidity Profile

The savings banks' very large and rising retail deposit base and leading collective market share in the German retail deposit market underpin SFG's strong funding & liquidity profile, which drives the group's 'aa-' funding & liquidity score. Therefore, the 'F1+' Short-Term IDR assigned to SFG and the savings banks is the higher of two options mapping to their 'A+' Long-Term IDRs.

Bar Chart Legend

Vertical bars – VR range of Rating Factor

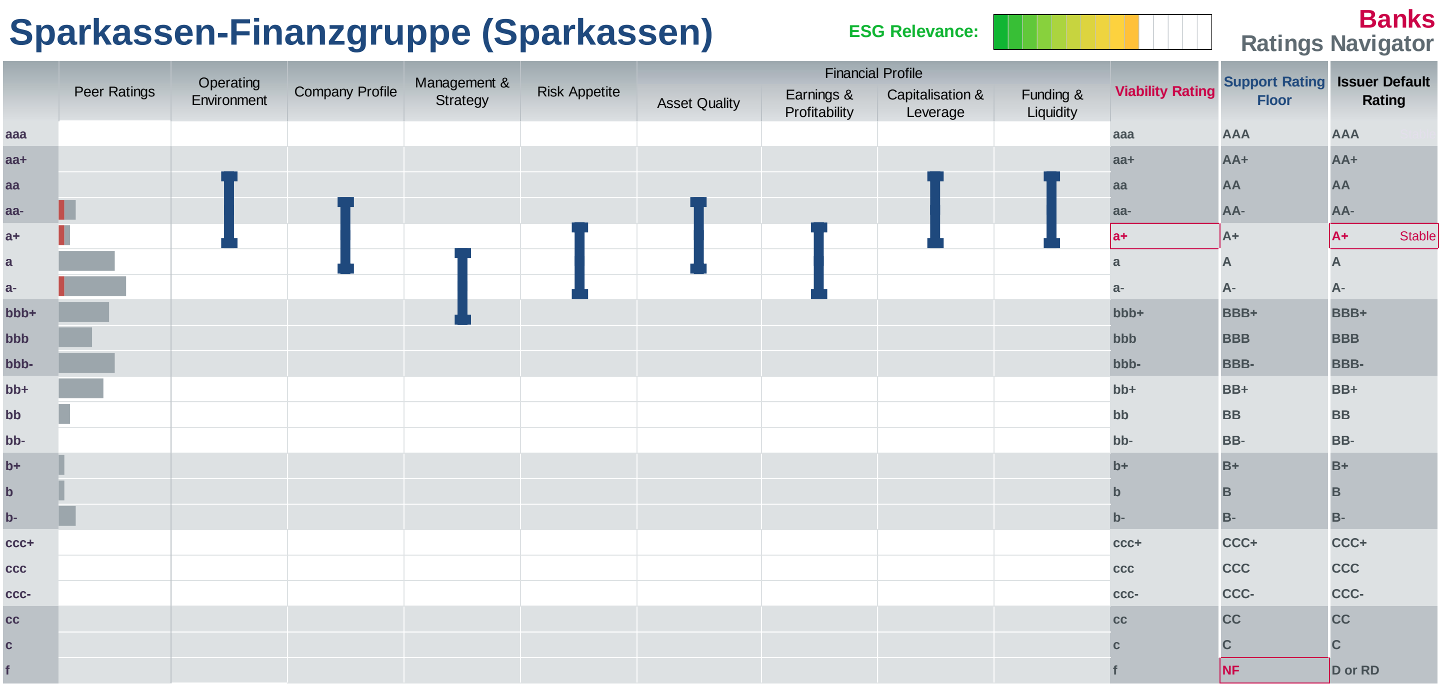
Bar Colours – Influence on final VR

- Higher influence
- Moderate influence
- Lower influence

Bar Arrows – Rating Factor Outlook

- ⇧ Positive
- ⇩ Negative
- ⇳ Evolving
- ▫ Stable

Ratings Navigator



Significant Changes

Economic Normalisation Supports Stabilisation of Banking Sector's Performance

We expect gradual economic normalisation to support stabilisation of the German banking sector's performance in 2022. However, the current resurgence of the pandemic adds uncertainty to the pace of the economic recovery in the short term, and modest profitability will remain the banking sector's main weakness in the foreseeable future. We expect SFG to continue to perform considerably better than most domestic peers, both in 2022 and in the longer term.

House Price Inflation and Deposit-Charging Crucial to Mitigate Margin Erosion

Despite isolated evidence that some German competitors have begun to approach new business somewhat more selectively, excessive competition will still prevent the restoration of adequate loan pricing in the German banking sector. As a result, banks will continue to rely on strong housing loan growth (we expect 7% in both 2021 and 2022) to counter the creeping erosion of net interest margins. The housing loan growth is driven by high house price inflation (Fitch expects 7% in 2022 after 13% growth in 2021, resulting in a doubling of prices nationwide since 2010).

Charging negative rates on retail deposits is still much less widespread and systematic than for corporates in Germany. However, besides housing loan growth, this is likely to be the banking sector's main earnings stabiliser in 2022, although legal challenges could impede the further implementation of negative rates.

Passing the ECB's deposit facility rate of minus 50bp on to all retail deposits above EUR10,000 could soon become the market standard as German banks are pricing increasingly aggressively, not least because of the rapidly dwindling inhibition of savings and cooperative banks, which dominate the retail market, in doing so. The need to progress on this front is pressing, as households' rising reinvestment of excess cash into higher-yielding securities has failed to curb the banks' accumulation of retail deposits, which have grown by 5% on average in recent years, including in 2021.

Supply Chain Disruption the Main Short-Term Risk Alongside the Pandemic

We expect muted corporate loan growth of 2% in Germany in 2022, i.e. half Fitch's expected GDP growth rate, despite some catching-up recently. Given German corporates' deep involvement in global trade flows, the recovery in German industrial activity (and demand for corporate loans) is particularly vulnerable to global supply chain disruptions and inflationary pressures that seem likely to persist well into 2022. German corporates' accumulation of precautionary funding at the start of the pandemic could also weigh on loan demand.

Asset Quality to Remain Strong

Some corporates have yet to fully recover and adapt to the post-crisis environment. But the German corporate sector's strengthened capitalisation over the last decade, precautionary funding in 2020, and the current opportunistic margin increases amid inflationary pressures, should keep defaults low and the German banking sector's NPL ratio close to 1.6%. Even if the current resurgence of the pandemic prompts banks to delay the release of their sizeable residual stock of loan loss provisions driven by post-model adjustments, we expect German banks' net LICs in 2022 to be equivalent to less than 1% of the banking sector's CET1 capital, similar to 2021.

Capital Generation Can Easily Accommodate Loan Growth

The combination of restructuring at large listed banks and non-shareholder-driven mutual groups will continue to result in immaterial profit distribution. As a result, we expect the German banking sector to generate about EUR20 billion of capital in 2022, equivalent to about 20% of RWAs growth and 8x net LICs. This is despite still modest pre-impairment incomes by international comparison. This will allow German banks to easily accommodate the expected strong loan growth.

Sovereign Support Assessment

The Support Rating and Support Rating Floor (SRF) reflect our view that, due to the bank resolution framework, senior creditors cannot rely on full extraordinary state support.

Actual country D-SIB SRF			NF
Support Rating Floor:			**NF**
Support Factors	Positive	Neutral	Negative
Sovereign ability to support system			
Size of banking system relative to economy			✓
Size of potential problem	✓		
Structure of banking system		✓	
Liability structure of banking system		✓	
Sovereign financial flexibility (for rating level)	✓		
Sovereign propensity to support system			
Resolution legislation with senior debt bail-in			✓
Track record of banking sector support		✓	
Government statements of support			✓
Sovereign propensity to support bank			
Systemic importance		✓	
Liability structure of bank	✓		
Ownership		✓	
Specifics of bank failure		✓	

Summary Financials and Key Ratios

	31 Dec 20	31 Dec 19	31 Dec 18
	(EURm)	(EURm)	(EURm)
Summary Income Statement			
Net interest and dividend income	19,944	20,397	21,152
Net fees and commissions	8,402	8,168	7,694
Total operating income	28,355	28,507	28,275
Operating costs	19,615	20,136	19,290
Pre-impairment operating profit	8,740	8,371	8,985
Loan and other impairment charges	1,822	0	0
Operating profit	6,918	8,371	8,985
Other non-operating items (net)	-2,909	-4,091	-4,412
Tax	2,528	2,449	2,775
Net income	1,481	1,831	1,798
Summary Balance Sheet			
Gross loans	905,586	861,208	823,009
Interbank	58,783	57,673	63,822
Other securities and earning assets	295,111	287,691	289,252
Total earning assets	1,259,480	1,206,572	1,176,083
Cash and due from banks	135,108	77,156	50,668
Other assets	16,838	16,239	15,851
Total assets	**1,411,426**	**1,299,967**	**1,242,602**
Customer deposits	1,067,029	987,421	941,996
Interbank and other short-term funding	161,654	135,421	127,565
Other long-term funding	16,569	17,418	17,702
Total funding	1,245,252	1,140,260	1,087,263
Other liabilities	40,669	39,601	40,490
Total equity	125,505	120,106	114,849
Total liabilities and equity	**1,411,426**	**1,299,967**	**1,242,602**
Ratios (annualised as appropriate)			
Profitability			
Operating profit/risk-weighted assets	0.9	1.1	1.3
Net interest income/average earning assets	1.6	1.7	1.8
Non-interest expense/gross revenue	69.2	70.6	68.2
Net income/average equity	1.2	1.6	1.6
Asset quality			
Growth in gross loans	5.2	4.6	7.1
Loan impairment charges/average gross loans	0.2	0.1	n.a.
Capitalisation			
Common equity Tier 1 ratio	16.4	16.0	16.2
Tangible common equity/tangible assets	8.9	9.2	9.2
Funding and liquidity			
Loans/customer deposits	84.9	87.2	87.4
Customer deposits/funding	85.7	86.6	86.6

Source: Fitch Ratings, Fitch Solutions, SFG

Environmental, Social and Governance Considerations

FitchRatings **Sparkassen-Finanzgruppe (Sparkassen)**

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

Sparkassen-Finanzgruppe (Sparkassen) has 1 ESG rating driver and 4 ESG potential rating drivers

- Sparkassen-Finanzgruppe (Sparkassen) has exposure to organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership which, in combination with other factors, impacts the rating.
- Sparkassen-Finanzgruppe (Sparkassen) has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- Sparkassen-Finanzgruppe (Sparkassen) has exposure to operational implementation of strategy but this has very low impact on the rating.
- Sparkassen-Finanzgruppe (Sparkassen) has exposure to board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions but this has very low impact on the rating.
- Sparkassen-Finanzgruppe (Sparkassen) has exposure to quality and frequency of financial reporting and auditing processes but this has very low impact on the rating.

			Overall ESG Scale
key driver	0	issues	5
driver	1	issues	4
potential driver	4	issues	3
not a rating driver	4	issues	2
	5	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference	E Scale
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Company Profile; Management & Strategy; Risk Appetite; Asset Quality	1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Company Profile; Management & Strategy; Risk Appetite	5
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Company Profile; Management & Strategy; Risk Appetite	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy	3
Employee Wellbeing	1	n.a.	n.a.	2
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Company Profile; Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Management & Strategy	5
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Management & Strategy; Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	4	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy	2
				1

How to Read This Page
ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI) and the Sustainability Accounting Standards Board (SASB).

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

CREDIT-RELEVANT ESG SCALE	
How relevant are E, S and G issues to the overall credit rating?	
5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

SFG has an ESG Relevance Score of '4' for Group Structure in contrast to a typical relevance score of '3' for comparable banks. This reflects our view that SFG is one of the least cohesive groups to which Fitch assigns group ratings. SFG does not produce consolidated financial accounts and its aggregated risk reporting is less advanced than other European mutual support banking groups rated by Fitch. This means that ESG issues are credit relevant to the issuer, but not a key rating driver by itself. However, the score has a moderate negative impact on the rating in combination with other factors. The score also reflects the often lengthy and complex decision-making process of the group and limited enforcement rights, because SFG is not a consolidated legal entity.

Except for the matters discussed above, the highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit neutral or have only a minimal credit impact on SFG, either due to their nature or to the way in which they are being managed by the SFG. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

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