FitchRatings

Banks
Retail & Consumer Banks
Germany

Sparkassen-Finanzgruppe (Sparkassen)

Key Rating Drivers

Leading Franchise, Stable Business Profile: Sparkassen-Finanzgruppe (Sparkassen)'s (SFG) 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 Ratings assigns group ratings to SFG and its savings banks. The Issuer Default Ratings (IDRs) are based on the group's Viability Rating (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.

High Interest-Rate Risk: Interest-rate risk is high in the local banks' loan books and securities portfolios due to their asset/liability duration mismatches, a high share of fixed-rate lending, and absence of widespread use of interest-rate hedging. However, Fitch views the group's strong deposit franchise, liquidity and capitalisation as sufficient mitigating factors.

Sound Asset Quality: We expect SFG's impaired-loans ratio to deteriorate modestly in 2023 as a result of the economic downturn, rising interest rates and inflation, 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.

Resilient Revenue: In 2022, SFG's operating profit continued to benefit from firm loan growth and minimal loan-impairment charges. However, temporary write-downs in the savings banks' securities portfolios, driven by rising interest rates, dented SFG's operating profit.

Depending on how the interest rate curve evolves, this could continue in the next quarters, before it is gradually reversed due to the pull-to-par effect. We expect profitability to recover in 2023 and the group's four-year average operating profit to remain at about 1% of risk-weighted assets (RWAs) through 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 15.7% at end-2022, remains 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% at end-2022.

Stable and Granular Deposits: The savings banks' large and growing 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.

Ratings

Foreign Currency	
Long-Term IDR	A+
Short-Term IDR	F1+
Viability Rating	a+
Government Support Rating	ns

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 (September 2022)

Related Research

Fitch Affirms Sparkassen-Finanzgruppe at 'A+' Outlook Stable (April 2023)

Global Economic Outlook (March 2023)

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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. Rating pressure could arise from a durable and material deterioration in asset quality, earnings and capitalisation, with an impaired-loans ratio above 3%, operating profit below 0.5% of RWAs, and a CET1 ratio below 13%, 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.

Other Debt and Issuer Ratings

Debt Rating Classes

Rating level	Rating
Long-term deposit ratings	A+
Short-term deposit ratings	F1+

Source: Fitch Ratings

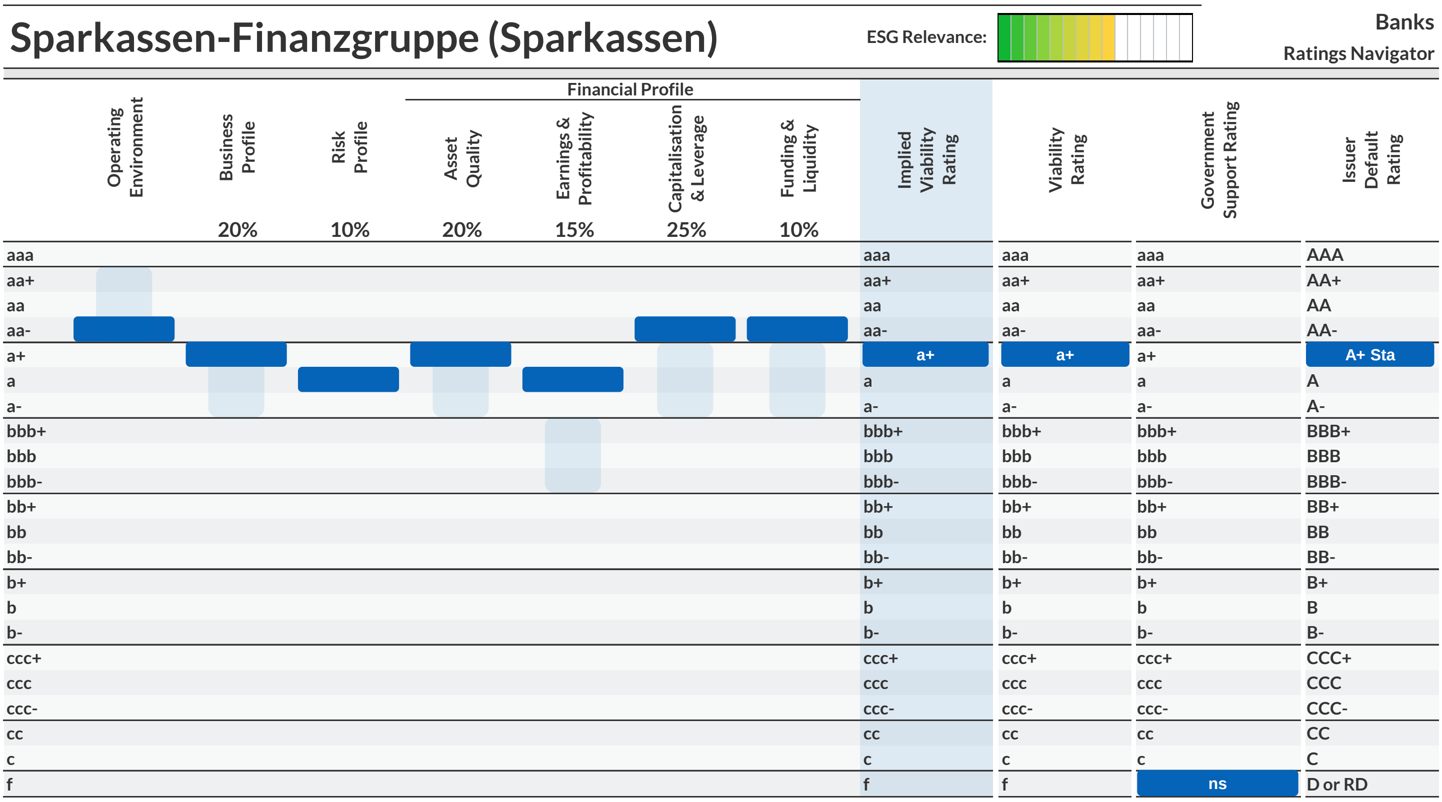
The savings banks' deposit ratings are aligned with SFG's IDRs due to the banks' lack of material resolution debt buffers that would provide their depositors with additional protection if SFG fails to ensure its members' viability. We do not assign a deposit rating to SFG as it is not a legal entity.

We define SFG as consisting 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) would fail to protect their viability. Hence the savings banks have no incentive to build up resolution buffers.

We exclude the Landesbanken from our definition of SFG, as most 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.

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.

Ratings Navigator



Die KRD-Gewichtungen (Key Rating Driver) zur Bestimmung des impliziten VR sind oben in der Tabelle in Prozent angegeben. In Fällen, in denen das implizite VR zur Berechnung des VR nach oben oder unten angepasst wurde, ist der mit dem Grund für die Bereinigung verbundene KRD rot markiert. Die farbig unterlegten Bereiche zeigen die im Benchmark implizierten Scores für jeden KRD.

VR - Adjustments to Key Rating Drivers

The earnings & profitability score of ‘a’ is above the ‘bbb’ category implied score due to the following adjustment reason: risk-weight calculation (positive).

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

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

Company Summary and Key Qualitative Factors

Business Profile

SFG's mutual support scheme has an impeccable record of protecting all creditors by safeguarding the savings banks' viability. The savings banks are generally controlled by their respective municipalities. This ensures high client loyalty within their local communities, where the banks are socially engaged and have a deep knowledge of their local economic environment.

SFG's stable and leading market positions rest on the savings banks' strong shared brand, strategy and marketing activities. Their business model focuses on lending to retail and small SME clients and does not rely on volatile businesses. Only a few larger savings banks engage in sizeable trading activities.

Each savings bank is allowed to operate only within its local area, but SFG collectively has leading nationwide market shares of 35% in mortgage and SME lending and is the largest domestic deposit taker with a 30% market share at end-2020. The savings banks also closely cooperate with specialist members of the broader public-sector banking group (especially Landesbanken, insurers and asset managers). This underpins SFG's above-average market position, especially in rural areas, where competition is less intense.

SFG does not produce consolidated financial accounts, and its aggregated risk reporting is less sophisticated than at its peers. However, the national savings bank association's initiatives to make savings banks adhere to common strategic projects including digitalisation, process automation, standardisation, data collection, analytics and risk management are producing positive results, even though the complexity of the organisation often results in protracted implementation.

Risk Profile

The savings banks focus on typically highly collateralised granular lending and have adequate local risk monitoring. Their conservative risk profile and stable through-the-cycle profit benefit from the low complexity of their business models and their long-standing business relationships, which result in extensive knowledge of their customers.

Similar to German cooperative banks peers, the duration mismatch between the savings banks' assets and liabilities has steadily increased over the past decade as the banks have increased their share of sight deposits, the average maturity of fixed-rate housing loans, and the duration of their bond portfolios to mitigate net interest margin pressure.

Moreover, savings banks typically do not hedge their loans, deposits and securities, which makes them more vulnerable to the current rapid increase in market interest rates compared with large universal banks. The large proportion of price-inelastic retail deposits should mitigate the negative impact of rising interest rates on the savings banks' assets valuations and net interest income until a large portion of the mortgage books has repriced upwards. However, if interest rates keep increasing at the same rate on 2022, savings banks will face increasing pressure to remunerate their depositors.

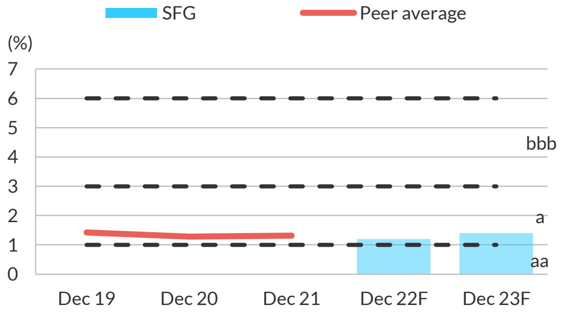
Financial Profile

Asset Quality

SFG's asset quality has been resilient so far, despite the gradually worsening operating environment in Germany. Fitch estimates the impaired-loans ratio remained stable at about 1.2% at end-2022, which is stronger than the German banking sector average. It continues to benefit from its granular loan portfolio, which focuses on domestic mass retail and small SMEs customers.

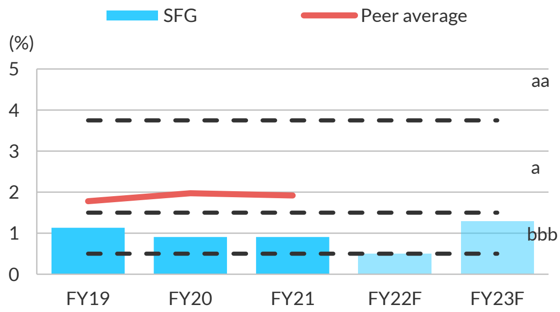
However, given the economic downturn in Germany, we expect an increase in impaired loans of up to 40bp/gross loans over the next 24 months. We expect little pressure on retail mortgage loans, given their prudent collateralisation and borrowers' strong payment behaviour. We expect the four-year-average impaired loans ratio to remain below 2% in the medium term.

Impaired Loans/Gross Loans



Source: Fitch Ratings, Fitch Solutions, SFG

Operating Profit/Risk-Weighted Assets



Source: Fitch Ratings, Fitch Solutions, SFG

Earnings and Profitability

SFG's preliminary 2022 results show its operating profit before valuation losses increasing by 19% to EUR11.5 billion, driven by a higher net interest income (+9% yoy), and supported by the higher interest rates and firm loan growth, continued fee growth (+4% yoy) and only moderate cost inflation (+2% yoy). SFG's reported cost-to-income ratio improved to 62.6% (2021: 66.2%). SFG's return on equity declined to 4.6% (2021: 6.3%) and includes EUR7.9 billion impairments, the vast majority of this refers to temporary valuation losses on securities, while LICS remained at a low EUR0.4 billion (4bp/gross loans).

SFG is well equipped to remain adequately profitable in 2023, due to its leading franchise in lower-risk domestic activities, strong execution through several credit cycles and well above-average resilience during previous crises. We expect its four-year-average operating profit/RWAs, which we assess in light of its conservative RWA calculation, to remain close to 1% over the cycle.

Improvements in NII will depend on new business volumes and consequently SFG's ability to reprice its asset side, as a significant portion of lending is fixed-rate, particularly mortgage loans. Fitch expects a prolonged repricing cycle as mortgage origination remains low in 2023. At the same time, we expect loan book growth to remain slightly positive, because the back book that will mature over the coming quarters was originated at times of low growth rates. SFG's net interest margin remains sensitive to an unexpected substantial increase in retail deposit pricing, which could tighten its NII and drag on SFG's overall profitability. In the next years, valuation loss reversals in the bond portfolios will gradually flow into the results. However, profitability will be diluted by cost inflation and increasing LICs, due to the low economic growth and high inflation in Germany.

Capital and Leverage

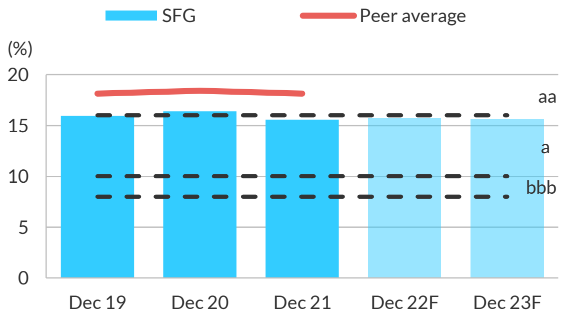
SFG's CET1 capital ratio slightly improved to a sound 15.7% at end-2022 (end-2021: 15.6%) as RWA inflation – driven by 5.7% loan growth – was compensated by SFG's operating result and the release of reserves for general banking risks. SFG's earnings retention should remain strong and support the CET1 capital ratio above 15% in the medium term.

The saving banks' use of the standardised approach for credit-risk RWAs for all asset classes limits the vulnerability of SFG's capital ratios to negative rating migration and regulatory RWA inflation. The standardised approach also understates the group's CET1 and total capital ratios by about a third compared with European mutual banking groups that operate in similar environments with similar risk profiles but make extensive use of the internal rating-based approach. SFG's sound Basel leverage ratio of 9% at end-2022 is much stronger than those of domestic and foreign peers.

SFG is not regulated as a group. Therefore, it is not subject to regulatory capital or resolution-planning requirements at group level. Each savings bank is subject to individual SREP requirements, which mainly address their vulnerability to unhedged structural interest-rate risks in their banking books.

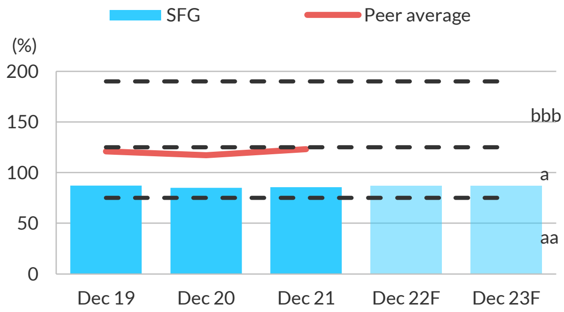
The savings banks' status as public-law institutions constrains their ability to raise capital from the controlling municipalities. Instead, capital weaknesses at individual savings banks are generally proactively addressed by merging them into stronger neighbouring savings banks.

CET1 Ratio



Source: Fitch Ratings, Fitch Solutions, SFG

Gross Loans/Customer Deposits



Source: Fitch Ratings, Fitch Solutions, SFG

Funding and Liquidity

The savings banks' large stock of retail deposits, as well as their high and stable market shares, underpin SFG's strong funding and liquidity profile. The group's size and resilience in previous crises, owing to its strong brand recognition and entrenched customer relationships, make its deposit base less sensitive to market sentiment compared with listed commercial banks.

SFG's client deposits rose by 2.7% to EUR1.15 billion by end-2022, which is about 30% of the German deposit market. Savings banks typically have highly liquid balance sheets, as shown by SFG's high aggregated liquidity coverage ratio of 168% at end-2022.

Additional Notes on Charts

The forecasts in the charts in this section reflect Fitch's forward view on the bank's core financial metrics, as per Fitch's Bank Rating Criteria. They are based on a combination of Fitch's macroeconomic forecasts, outlook at the sector level, and company-specific considerations. As a result, Fitch's forecasts may differ materially from the guidance provided by the rated entity to the market.

To the extent Fitch is aware of material non-public information with respect to future events, such as planned recapitalisations or M&A activity, Fitch will not reflect these non-public future events in its published forecasts. However, where relevant, such information is considered by Fitch as part of the rating process.

Black dashed lines represent indicative quantitative ranges and implied scores for Fitch's core financial metrics for banks operating in the environments that Fitch scores in the 'aa' category. Light-blue columns represent Fitch's forecasts.

Peer average includes Sparkassen-Finanzgruppe Hessen-Thueringen (VR: a+), Genossenschaftliche FinanzGruppe (aa-), Desjardins Group (aa-), Credit Agricole (a+), Credit Mutuel Alliance Federale (a+), Svenska Handelsbanken AB (aa). Latest average uses FY22 data for Desjardins Group, Credit Agricole, Svenska Handelsbanken AB; 1H22 data for Credit Mutuel Alliance Federale.

Financials

Financial Statements

	31 Dec 21		31 Dec 20	31 Dec 19	31 Dec 18
	(USDm)	(EURm)	(EURm)	(EURm)	(EURm)
Summary income statement					
Net interest and dividend income	21,785	19,262	19,944	20,397	21,152
Net fees and commissions	10,150	8,974	8,402	8,168	7,694
Other operating income	16	14	9	-58	-571
Total operating income	31,951	28,250	28,355	28,507	28,275
Operating costs	22,164	19,597	19,615	20,136	19,290
Pre-impairment operating profit	9,787	8,653	8,740	8,371	8,985
Loan and other impairment charges	1,357	1,200	1,822	0	n.a.
Operating profit	8,429	7,453	6,918	8,371	8,985
Other non-operating items (net)	-3,517	-3,110	-2,909	-4,091	-4,412
Tax	3,039	2,687	2,528	2,449	2,775
Net income	1,873	1,656	1,481	1,831	1,798
Summary balance sheet					
Assets					
Gross loans	1,080,094	954,990	905,586	861,208	823,009
- Of which impaired	n.a.	n.a.	n.a.	n.a.	n.a.
Loan loss allowances	n.a.	n.a.	n.a.	n.a.	n.a.
Net loans	1,080,094	954,990	905,586	861,208	823,009
Interbank	57,365	50,721	58,783	57,673	63,822
Other securities and earning assets	340,380	300,955	295,111	287,691	289,252
Total earning assets	1,477,840	1,306,666	1,259,480	1,206,572	1,176,083
Cash and due from banks	193,541	171,124	135,108	77,156	50,668
Other assets	19,851	17,552	16,838	16,239	15,851
Total assets	1,691,232	1,495,342	1,411,426	1,299,967	1,242,602
Liabilities					
Customer deposits	1,262,081	1,115,898	1,067,029	987,421	941,996
Interbank and other short-term funding	215,158	190,237	161,654	135,421	127,565
Other long-term funding	19,557	17,292	16,569	17,418	17,702
Total funding and derivatives	1,496,796	1,323,427	1,245,252	1,140,260	1,087,263
Other liabilities	47,859	42,316	40,669	39,601	40,490
Total equity	146,577	129,599	125,505	120,106	114,849
Total liabilities and equity	1,691,232	1,495,342	1,411,426	1,299,967	1,242,602
Exchange rate		USD1 = EUR0.884173	USD1 = EUR0.821963	USD1 = EUR0.89015	USD1 = EUR0.873057

Source: Fitch Ratings, Fitch Solutions, SFG

Key Ratios

	31 Dec 21	31 Dec 20	31 Dec 19	31 Dec 18
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	0.9	0.9	1.1	1.3
Net interest income/average earning assets	1.5	1.6	1.7	1.8
Non-interest expense/gross revenue	69.4	69.2	70.6	68.2
Net income/average equity	1.3	1.2	1.6	1.6
Asset quality				
Growth in gross loans	5.5	5.2	4.6	7.1
Loan impairment charges/average gross loans	0.0	0.2	0.1	n.a.
Capitalisation				
Common equity Tier 1 ratio	15.6	16.4	16.0	16.2
Tangible common equity/tangible assets	8.7	8.9	9.2	9.2
Basel leverage ratio	9.2	8.5	8.5	8.5
Funding and liquidity				
Gross loans/customer deposits	85.6	84.9	87.2	87.4
Customer deposits/total non-equity funding	84.3	85.7	86.6	86.6

Source: Fitch Ratings, Fitch Solutions, SFG

Support Assessment

Commercial Banks: Government Support	
Typical D-SIB GSR for sovereign's rating level (assuming high propensity)	A+ to A-
Actual jurisdiction D-SIB GSR	ns
Government Support Rating	**ns**
Government ability to support D-SIBs	
Sovereign Rating	AAA/ Stable
Size of banking system	Negative
Structure of banking system	Neutral
Sovereign financial flexibility (for rating level)	Positive
Government propensity to support D-SIBs	
Resolution legislation	Negative
Support stance	Negative
Government propensity to support bank	
Systemic importance	Neutral
Liability structure	Positive
Ownership	Neutral

The colours indicate the weighting of each KRD in the assessment.
Higher influence Moderate influence Lower influence

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.

Environmental, Social and Governance Considerations

FitchRatings **Sparkassen-Finanzgruppe (Sparkassen)**

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

Sparkassen-Finanzgruppe (Sparkassen) has 5 ESG potential rating drivers				Overall ESG Scale
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.	key driver	0	issues	5
Governance is minimally relevant to the rating and is not currently a driver.	driver	0	issues	4
	potential driver	5	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	Business Profile (incl. Management & governance); Risk Profile; 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	Business Profile (incl. Management & governance); Risk Profile	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; Business Profile (incl. Management & governance); Risk Profile	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Business Profile (incl. Management & governance)	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	Business Profile (incl. Management & governance); Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Business Profile (incl. Management & governance)	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	Business Profile (incl. Management & governance); Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Business Profile (incl. Management & governance)	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Business Profile (incl. Management & governance)	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.

We have revised SFG's ESG credit relevance score for group structure to '3' from '4' in line with the typical relevance score for comparable banks. This revision reflects our view that SFG has made progress with regard to its cohesion in recent years, including the reform of its IPS.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/esg

For information on the solicitation status of the ratings included within this report, please refer to the solicitation status shown in the relevant entity's summary page of the Fitch Ratings website.

For information on the participation status in the rating process of an issuer listed in this report, please refer to the most recent rating action commentary for the relevant issuer, available on the Fitch Ratings website.