FitchRatings

Banks
Retail & Consumer Banks
Germany

Sparkassen-Finanzgruppe (Sparkassen)

Update

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 believe SFG's impaired-loans ratio has deteriorated slightly in 2023 as a result of the economic downturn, rising interest rates and inflation. We expect the ratio to increase more in 2024 but to remain below 2% in the medium term. SFG's asset quality benefits from the savings banks' on average prudent risk appetites, including conservative underwriting, strong collateral and low overall concentrations.

Interest Rates Boost Revenue: Fitch expects SFG to report a record high operating profit in 2023. Revenue have substantially benefitted from higher interest rates, which were, to a large extent, not passed to depositors, while loan impairment charges (LICs) remained low. We expect deposit repricing to partly catch up in 2024 while LICs should increase in line with impaired loans. In 2022, operating profit fell below SFG's long-term average due to temporary write-downs in the savings banks' securities portfolios, driven by rising interest rates.

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 (end-2022: 15.7%) is robust. It also 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

Sparkassen-Finanzgruppe	
Long-Term IDR	A+
Short-Term IDR	F1+
Viability Rating	a+
Government Support Rating	ns
Sovereign Risk (Germany)	
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 2023)

Related Research

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

Sparkassen-Finanzgruppe (Sparkassen) (May 2023)

Global Economic Outlook – December 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 risk-weighted assets, 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

Savings Banks	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.

Significant Changes from Last Review

We expect higher interest rates to have boosted SFG's operating profit to a record high in 2023 as the savings banks' large cash and interbank holdings, and the short-term portion of their loans and securities portfolios, repriced at a much faster rate than their customer deposits. This will also strengthen the group's capital ratios, as we expect pay-outs to remain broadly in line with that of previous years, and modest growth. SFG's gross loans increased slightly ytd at end-3Q23 – and housing loans in particular, which account for the majority of SFG's loan book – despite the sharp decline in new business. This is because new business volumes are still sufficient to replace maturing loans. This, combined with the higher priced new business, should support net interest income also in 2024.

Profitability fell below the group's long-term average in 2022 due to temporary write-downs in the savings banks' unhedged securities portfolios. These were driven by the quick and sharp rise in market interest rates in 2022. The negative effect on the group's P&L was mitigated by savings banks re-classifying parts of their bonds into their investments books (held to collect measured at amortised cost) from their liquidity books (measured at market value). Interest rate swaps were increasingly used to hedge the banking book over 2022, and the share of savings banks entering into interest rate swaps for more than 10% of their total assets went up to 38% (2021: 31%), according to Bundesbank.

However, both measures could not avoid a massive release of undisclosed German GAAP reserves (under Section 340f of the German Commercial Code) and a build-up of unrealised losses, neutral to the group's regulatory capital ratios. SFG does not report the amount of its hidden reserves and unrealised losses in its investment securities portfolio, but the Bundesbank calculated that savings banks and cooperative banks on aggregate reduced their hidden reserves by EUR21 billion and had accumulated new unrealised losses of EUR11.7 billion in 2022, equivalent to 14.2% of aggregated CET1 capital at end-2022. Further valuation losses were offset by pull-to par effects in 2023, and will continue to be gradually reversed over the next years as the bonds come close to maturity.

SFG's asset quality was resilient in 2023 and we believe that the savings banks impaired loans ratio has, on aggregate, deteriorated only slightly in 2023 as a result of the economic downturn, rising interest rates and inflation. We expect the ratio to increase further in 2024, but that it will not rise above 2% in the medium term. SFG has material exposure to the real estate businesses, but this is mostly collateralised by residential properties and often backed by municipal and cooperative sponsors. We view this exposure as low risk as long as unemployment in Germany remains low. In lending to real estate with commercial use SFG benefits from its regional expertise and limited non-recourse financing. Savings banks have also increased general loan loss provision in 1H23, according to the Bundesbank.

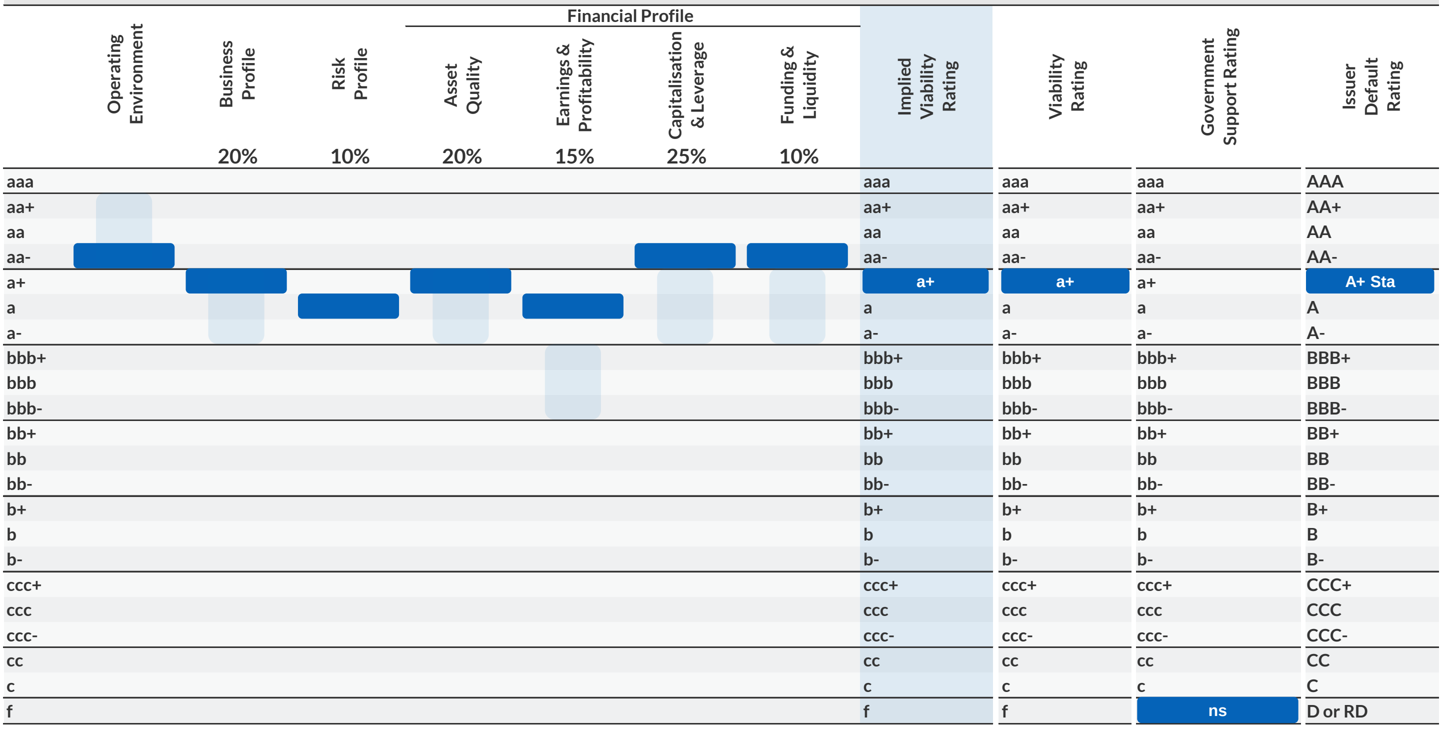
SFG's deposits decreased by 2.6% in 10M23. The decrease was driven by sight deposits (-10% in 10M23), which were partially replaced by term deposits. The outflow was small considering the relatively low interest rates offered on deposits by savings banks to their customers and the pick-up in domestic competition. This is indicative of the savings banks' very strong local franchises. We expect deposit repricing to partly catch up in 2024 and offset the effect of repricing assets, leading to a slight decline of the group's net interest margin.

Ratings Navigator

Sparkassen-Finanzgruppe (Sparkassen)

ESG Relevance:

Banks
Ratings Navigator



The Key Rating Driver (KRD) weightings used to determine the implied VR are shown as percentages at the top. In cases where the implied VR is adjusted upwards or downwards to arrive at the VR, the KRD associated with the adjustment reason is highlighted in red. The shaded areas indicate the benchmark-implied scores for each 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).

Financials

Financial Statements

	31 Dec 22		31 Dec 21	31 Dec 20	31 Dec 19
	(USDm)	(EURm)	(EURm)	(EURm)	(EURm)
Summary income statement					
Net interest and dividend income	23,689	22,210	19,262	19,944	20,397
Net fees and commissions	9,962	9,340	8,974	8,402	8,168
Other operating income	11	10	14	9	-58
Total operating income	33,662	31,560	28,250	28,355	28,507
Operating costs	20,319	19,050	19,597	19,615	20,136
Pre-impairment operating profit	13,343	12,510	8,653	8,740	8,371
Loan and other impairment charges	6,496	6,090	1,200	1,822	0
Operating profit	6,848	6,420	7,453	6,918	8,371
Other non-operating items (net)	-2,581	-2,420	-3,110	-2,909	-4,091
Tax	2,784	2,610	2,687	2,528	2,449
Net income	1,483	1,390	1,656	1,481	1,831
Summary balance sheet					
Assets					
Gross loans	1,076,740	1,009,507	954,990	905,586	861,208
Net loans	1,076,740	1,009,507	954,990	905,586	861,208
Interbank	175,559	164,597	50,721	58,783	57,673
Other securities and earning assets	321,393	301,325	300,955	295,111	287,691
Total earning assets	1,573,692	1,475,429	1,306,666	1,259,480	1,206,572
Cash and due from banks	26,912	25,232	171,124	135,108	77,156
Other assets	20,097	18,842	17,552	16,838	16,239
Total assets	1,620,701	1,519,503	1,495,342	1,411,426	1,299,967
Liabilities					
Customer deposits	1,222,248	1,145,930	1,115,898	1,067,029	987,421
Interbank and other short-term funding	185,286	173,717	190,237	161,654	135,421
Other long-term funding	18,549	17,391	17,292	16,569	17,418
Total funding and derivatives	1,426,084	1,337,038	1,323,427	1,245,252	1,140,260
Other liabilities	50,919	47,740	42,316	40,669	39,601
Total equity	143,698	134,725	129,599	125,505	120,106
Total liabilities and equity	1,620,701	1,519,503	1,495,342	1,411,426	1,299,967
Exchange rate		USD1 = EUR0.937559	USD1 = EUR0.884173	USD1 = EUR0.821963	USD1 = EUR0.89015

Source: Fitch Ratings, Fitch Solutions, SFG

Key Ratios

	31 Dec 22	31 Dec 21	31 Dec 20	31 Dec 19
Ratios (%; annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	0.8	0.9	0.9	1.1
Net interest income/average earning assets	1.6	1.5	1.6	1.7
Non-interest expense/gross revenue	60.4	69.4	69.2	70.6
Net income/average equity	1.1	1.3	1.2	1.6
Asset quality				
Growth in gross loans	5.7	5.5	5.2	4.6
Loan impairment charges/average gross loans	0.0	0.0	0.2	0.1
Capitalisation				
Common equity Tier 1 ratio	15.7	15.6	16.4	16.0
Tangible common equity/tangible assets	8.9	8.7	8.9	9.2
Basel leverage ratio	9.0	9.2	8.5	8.5
Funding and liquidity				
Gross loans/customer deposits	88.1	85.6	84.9	87.2
Customer deposits/total non-equity funding	85.7	84.3	85.7	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

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

- 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.
- Governance is minimally relevant to the rating and is not currently a driver.

			Overall ESG Scale
key driver	0	issues	5
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

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.

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

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.

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.

SOLICITATION & PARTICIPATION STATUS

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.