FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms German Cooperative Banks and DZ BANK at 'AA-'; Outlook Stable

Wed 15 Jun, 2022 - 4:56 PM ET

Fitch Ratings - Frankfurt am Main - 15 Jun 2022: Fitch Ratings has affirmed Genossenschaftliche FinanzGruppe (GFG), its central institution DZ BANK AG Deutsche Zentral-Genossenschaftsbank and more than 750 local bank members of GFG's mutual support scheme at 'AA-' Long-Term Issuer Default Ratings (IDRs) with Stable Outlook. GFG's Viability Rating (VR) has been affirmed at 'aa-'.

Fitch has withdrawn GFG's Support Rating and Support Rating Floor following the update of its Bank Rating Criteria on 12 November 2021 as they are no longer considered by Fitch to be relevant to the agency's coverage. In line with the updated criteria, we have assigned GFG a Government Support Rating (GSR) of 'no support' (ns).

Fitch has also withdrawn the ratings of 20 local cooperative banks because they no longer exist as separate entities following their mergers with other members of the group. As a result, Fitch will no longer provide ratings or analytical coverage for these merged entities.

A full list of rating actions for all rated members of GFG is available at www.fitchratings.com.

KEY RATING DRIVERS

GFG's Long-Term IDR is driven by its VR. The VR is one notch above the implied VR, reflecting the high importance for GFG's ratings of the group's leading and highly diversified business profile, which is underpinned by its strong domestic retail and small SME banking franchise. The ratings also reflect GFG's strong risk-adjusted capitalisation and low leverage, sound asset quality, profitability that is considerably above-German peers' and an outstanding funding profile by international standards.

Mutual Support Mechanism: GFG is not a legal entity, but a cooperative banking network whose cohesion is ensured by a mutual support scheme managed by the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken e. V. GFG's IDRs are group ratings that apply to each member bank, including DZ BANK and its subsidiaries.

Strongly Diversified Business Model: GFG's domestically-focused, stable universal-banking business model has delivered stable earnings over several economic cycles. It is based on the local banks' strong retail franchise supported by DZ BANK's product suppliers. These include domestic market leaders in the insurance, asset management and real estate businesses. A stronger strategic alignment of DZ BANK and the local banks as well as intensified cooperation and cross-selling across GFG have also strengthened the group's business model over the past decade.

High Interest-Rate Risk Exposure: Structural interest-rate risk is high in the local banks' banking books due to their asset/liability duration mismatches, a high share of fixed-rate lending and absence of widespread use of interest-rate hedging. However, we view the banks' superior deposit franchise and strong earnings as sufficient mitigating factors. DZ BANK's risk profile is also sound, with modest capital-market activities. The local banks' client proximity and focus on granular lending with high collateralisation adequately mitigate credit risk.

Sound Asset Quality: GFG's asset quality remained solid in 2021, helped by a low number of corporate insolvencies in Germany due to large-scale state support through the pandemic. We expect modest deterioration in asset quality over the next two years, due to rising insolvencies in the group's SME and corporate portfolios, which are exposed to higher interest rates and inflation pressure. However, we expect GFG's impaired loan ratio to remain within the implied 'a' category.

Resilient Profitability: The stability of GFG's profitability has been higher than the overall German banking sector's. GFG's operating profit recovered strongly in 2021, driven by strong business growth, low loan impairment charges (LICs) and strong profit contribution from the insurance and asset-management businesses on the back of favourable capital markets. We expect profitability to decline in 2022 and 2023 as financial assets' valuations decline, loan growth subsides and LICs normalise upward. We believe that rising rates will gradually support net interest margin in the medium term.

Strong Capitalisation: Both the local banks and DZ BANK are well-capitalised and GFG's leverage ratio is high by international standards. We adjust positively our assessment of GFG's risk-weighted capital ratios for the use of the standardised approach by GFG's local banks to measure credit risk for all asset classes, resulting in a higher risk-weight density than international peers'. We expect GFG's common equity Tier 1 (CET1) ratio to remain close to the current level in the medium term, supported by slower loan growth than in previous years.

Very Stable Funding: The local banks are predominantly funded by granular domestic retail deposits, and their structurally large excess liquidity covers most of DZ BANK's short-term funding needs. As a frequent issuer of unsecured debt and the largest German covered bond issuer to an established and geographically diversified investor base, DZ BANK provides GFG with reliable access to wholesale markets. The group's Short-Term IDR of 'F1+' maps to the Long-Term IDR of 'AA-'.

No Government Support Assumed: GFG's GSR of 'no support' reflects our view that extraordinary sovereign support for EU banks is possible but cannot be relied on due to the Bank Recovery and Resolution Directive and the Single Resolution Mechanism's resolution tools and mechanisms. It is likely that senior creditors will be required to participate in losses, if necessary, instead of, or ahead of, the group receiving sovereign support.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

GFG's and its members' high ratings reflect the group's considerably above-average resilience to crises. However, negative rating pressure could arise from spillover effects of the Ukrainian conflict and of the resulting sanctions on Russia, if they severely and durably derail Germany's post-pandemic economic recovery. In this event, rating pressure would reflect an increased likelihood of significantly lower revenue and larger credit losses than in our base case through (and potentially beyond) our two-year forecast horizon.

We could downgrade GFG's and its members' ratings if GFG's impaired loan ratio durably rises above 3%, operating profit/risk-weighted assets (RWAs) declines below 1% and its regulatory CET1 ratio falls durably below 13%. A downgrade of our operating-environment score for GFG (aa-/stable) would also put pressure on its ratings.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade of GFG's and of its members' ratings is unlikely given the already high ratings and in light of increased uncertainties surrounding the operating environment. In addition to a domestic environment that would allow higher lending margins, an upgrade would also require greater cost efficiency, which is likely to necessitate a protracted streamlining of the group's structure, especially at the local banks.

We would upgrade GFG's GSR only if we see rising propensity from the sovereign to support systemically important banks, which is highly unlikely in the current regulatory environment.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

The long-term deposit ratings and long-term senior preferred debt ratings of DZ BANK and its banking subsidiaries, the long-term deposit rating of Muenchener Hypothekenbank as well as DZ BANK's Derivative Counterparty Rating (DCR) are one notch above their respective Long-Term IDRs because of the protection provided by resolution buffers to preferred creditors. In our view, resolution would only occur in the extremely unlikely event that GFG's mutual support scheme fails to protect group members' viability.

The deposit ratings of Deutsche Apotheker- und Aerztebank and of the local cooperative banks are aligned with GFG's IDRs due to the absence of sustainable significant resolution debt buffers at these entities. Each local bank is regulated individually as a less significant institution. Consequently, the German regulator's preferred resolution strategy for these banks consists of standard insolvency procedures, as opposed to the preferred bail-in resolution strategy for the DZ BANK group and Muenchener Hypothekenbank, each of which is directly supervised by the European Single Resolution Board (SRB) and follows a single-point-of-entry approach. Therefore, the predominantly deposit-funded local banks have no incentive to build up resolution buffers. This is also the case for Deutsche Apotheker- und Aerztebank, which is directly supervised by the SRB, but is not required to maintain resolution buffers in excess of its capital requirements.

The ratings of the subordinated Tier 2 notes issued by DZ BANK and its subsidiaries are two notches below GFG's VR, which is the standard notching for this type of debt under Fitch's criteria. We use the VR as anchor rating as we believe that GFG, by protecting the viability of DZ BANK and its subsidiaries, increases the likelihood that all due payments on these notes will continue to be met.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

A downgrade of GFG's VR would lead to a downgrade of its members' long-term debt and deposit ratings. We could also downgrade DZ BANK's DCR and DZ BANK and its subsidiaries' long-term senior preferred debt and deposit ratings as well as Muenchener Hypothekenbank's long-term deposit rating if we no longer expect them to maintain senior non-preferred and junior debt buffers sustainably above 10% of the banks' respective RWAs.

The ratings of the subordinated Tier 2 notes issued by DZ BANK and its subsidiaries would be downgraded if GFG's VR is downgraded.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade of the long-term debt and deposit ratings of GFG's members as well as of DZ Bank's DCR would require an upgrade of GFG's Long-Term IDR.

The ratings of the subordinated Tier 2 notes issued by DZ BANK and its subsidiaries would be upgraded if GFG's VR is upgraded.

VR ADJUSTMENTS

The business profile score of 'aa-' is above the 'a' category implied score due to the following adjustment reason: business model (positive).

The earnings and profitability score of 'a' is above the 'bbb' category implied score due to the following adjustment reason: earnings stability (positive).

The capitalisation and 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 and liquidity score of 'aa' is above the 'a' category implied score due to the following adjustment reason: deposit structure (positive).

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

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 www.fitchratings.com/esg

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Roger Schneider
Director
Primary Rating Analyst
+49 69 768076 242
roger.schneider@fitchratings.com
Fitch Ratings – a branch of Fitch Ratings Ireland Limited
Neue Mainzer Strasse 46 - 50 Frankfurt am Main D-60311

Marco Diamantini
Associate Director
Secondary Rating Analyst
+49 69 768076 114
marco.diamantini@fitchratings.com

Olivia Perney
Managing Director
Committee Chairperson
+33 1 44 29 91 74
olivia.perney@fitchratings.com

MEDIA CONTACTS

Louisa Williams
London
+44 20 3530 2452
louisa.williams@thefitchgroup.com

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

Bank Rating Criteria (pub. 12 Nov 2021) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Aachener Bank eG	EU Issue
Abtsgmuender Bank -Raiffeisen- eG	EU Issue
Aktivbank AG	EU Issue
Allgaeuer Volksbank eG Kempten-Sonthofen	EU Issue
Alxing-Brucker Genossenschaftsbank eG	EU Issue
BAG Bankaktiengesellschaft	EU Issue
Bank 1 Saar eG	EU Issue
Bank fuer Kirche und Caritas eG	EU Issue
Bank fuer Kirche und Diakonie eG - KD-Bank	EU Issue
Bank fuer Sozialwirtschaft AG	EU Issue
Bank Im Bistum Essen eG	EU Issue
Bankhaus RSA eG	EU Issue
Bausparkasse Schwaebisch Hall AG	EU Issue
Bayerische BodenseeBank -Raiffeisen- eG	EU Issue
BBBank eG	EU Issue
Bensberger Bank eG	EU Issue
Berliner Volksbank eG	EU Issue
Bernhauser Bank eG	EU Issue
Bopfinger Bank Sechta-Ries eG	EU Issue

Brandenburger Bank Volksbank-Raiffeisenbank eG EU Issue

DISCLAIMER & DISCLOSURES

All Fitch Ratings (Fitch) credit ratings are subject to certain limitations and disclaimers. Please read these limitations and disclaimers by following this link: https://www.fitchratings.com/understandingcreditratings. In addition, the following https://www.fitchratings.com/rating-definitions-document details Fitch's rating definitions for each rating scale and rating categories, including definitions relating to default. ESMA and the FCA are required to publish historical default rates in a central repository in accordance with Articles 11(2) of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 and The Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019 respectively.

Published ratings, criteria, and methodologies are available from this site at all times. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance, and other relevant policies and procedures are also available from the Code of Conduct section of this site. Directors and shareholders' relevant interests are available at https://www.fitchratings.com/site/regulatory. Fitch may have provided another permissible or ancillary service to the rated entity or its related third parties. Details of permissible or ancillary service(s) for which the lead analyst is based in an ESMA- or FCA-registered Fitch Ratings company (or branch of such a company) can be found on the entity summary page for this issuer on the Fitch Ratings website.

In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided “as is” without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.
Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

READ LESS

SOLICITATION STATUS

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

ENDORSEMENT POLICY

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's Regulatory Affairs page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

Structured Finance: Covered Bonds Non-Bank Financial Institutions Banks

Structured Finance Europe Germany Luxembourg