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DZ Bank AG Deutsche Zentral-Genossenschaftsbank

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DZ Bank AG Deutsche Zentral-Genossenschaftsbank

Credit Highlights

Issuer Credit Rating
A+/Stable/A-1

Overview

Key strengths	**Key risks**
Role as the central institute of the German cooperative banking sector, which makes it integral to the sector's identity and a core group member.	Weaker risk profile and capitalization than its owners, the local cooperative banks.
Benefits from mutual support within the sector and a comprehensive protection scheme.	Intense competition and margin pressure in German corporate banking.
Good market position in German corporate banking and diversification through its subsidiaries.	Earnings sensitivity to capital market conditions in its insurance and asset management subsidiaries.

DZ BANK Will Continue To Play An Integral Role For The Cooperative Banking Sector In Germany

In its role, DZ BANK provides core services to the sector such as liquidity management, funding, and wholesale banking products. We reflect this in our assessment of DZ BANK's core group status for the sector and equalize our long-term issuer credit rating (ICR) on the bank with the group credit profile of 'a+' (see "Update: Cooperative Banking Sector Germany," published on May 8, 2023, on RatingsDirect). Based on the solidarity within the sector and its comprehensive protection scheme--administered by Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR)--we expect sector banks with core group status to support each other in all foreseeable circumstances.

Services Provided By DZ BANK Group Strengthen The Sector's Overall Competitive Position

DZ BANK Group, which, beyond DZ BANK AG, consolidates specialized institutions like Union Investment, R+V Versicherung, DZ HYP, Bausparkasse Schwäbisch Hall, DZ PRIVATBANK, TeamBank, and VR Smart Finanz provides both central and tailored banking functions to the primary institutions (largely local cooperative banks). On one hand, DZ BANK Group depends on the distribution power of the local cooperative banks. On the other hand, the group supports the competitive position and extends the product offerings of the cooperative banking sector. Overall, we regard DZ BANK's more wholesale-oriented activities as carrying greater risk than the activities of cooperative banks, due to a combination of larger and more complex exposures.

Capitalization Remains Weaker Than For The Overall Cooperative Banking Sector

With a risk-adjusted capital (RAC) ratio of 10.9% as of end-2022, DZ BANK's capitalization is weaker than that of the consolidated cooperative banking sector, but in line with that of domestic peers Deutsche Bank AG and Commerzbank AG and largely on par with the average RAC ratio among the Top 50 European banks.

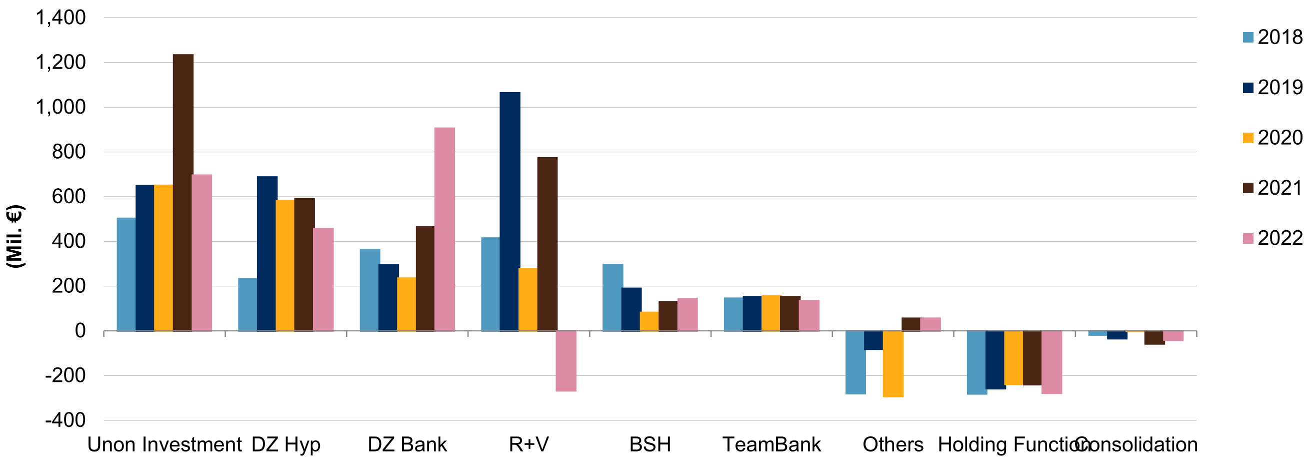
While DZ BANK's regulatory Common Equity Tier (CET) 1 ratio of 13.7% as of end-2022 indicates good capitalization, we think additional capital would be available within the sector if needed. The 1.6 percentage point decrease in the CET 1 ratio compared with year-end 2021 is mainly attributable to temporary accounting effects at R+V Versicherung. As part of the DZ BANK Group, R+V Versicherung already had to measure its assets at fair value in accordance with International Financial Reporting Standard (IFRS) 9 in the past. The liability side, and therefore liabilities to policyholders, will only be treated in the same way after the transition to IFRS 17 in 2023. This has led to the recognition of a temporary technical interest-rate risk caused by the soaring interest rates during the reporting period. However, we understand that the introduction of IFRS 17 as per June 30, 2023 will reverse the accounting impact at its insurance subsidiary, benefiting the CET 1 ratio.

Despite the volatile operating environment, DZ BANK's 2022 pre-tax profit of €1.8 billion was well within the communicated long-term target range of €1.5 billion-€2 billion, but below the extraordinarily strong performance of 2021, when pre-tax profits climbed to a historical high of €3.1 billion. An even better result in 2022 was prevented by the temporary accounting effects at its insurance subsidiary R+V Versicherung, where pre-tax profits declined to €268 million in 2022 from €772 million in 2021. For 2023, we expect pre-tax profits at the upper end of, or potentially even exceeding, the target range.

Chart 1

2022 Group results driven by the corporate bank and the asset management business

Pretax profits by segment between 2018-2022



Source: S&P Global Ratings.

Primary Banks' Excess Liquidity Supports DZ BANK's Funding Position

The excess liquidity of the primary institutions is generally channeled to DZ BANK, enabling it to manage the sector's aggregate liquidity needs. Within DZ BANK, funding sources are well diversified, but DZ BANK and its subsidiaries largely rely on wholesale funding, particularly by issuing covered bonds through DZ HYP and other covered instruments (DZ Briefe). DZ BANK is entitled to include claims against the sector's members in its cover pool for these instruments. DZ BANK also has a $15 billion commercial paper program in place and access to the U.S. Federal Reserve through its New York branch.

Due to the changed conditions on the European Central Bank's (ECB's) TLTRO III program, DZ BANK reduced its participation to €11.0 billion in 2022 from €32.4 billion in 2021. We understand that the remaining amount will be repaid according to schedule in 2024. In June 2023, only a couple of months after the complete write-down of Additional Tier 1 (AT1) instruments at Credit Suisse, DZ BANK issued €1.14 billion of AT1 instruments to the local cooperative banks. In our view, this exemplifies the strength and cohesion of the cooperative sector in Germany.

No Uplift For Additional Loss-Absorbing Capacity (ALAC) Due To Stronger Group Support And An Unlikely Resolution Scenario

While DZ BANK is subject to the minimum requirement for own funds and eligible liabilities, we do not add any notches of uplift to the rating for ALAC. We consider group support within the cooperative banking sector to be the strongest support element. In addition, we see a bail-in scenario as highly unlikely, as that would imply a lack of solidarity within the sector. We therefore do not assign resolution counterparty ratings to DZ BANK.

Outlook

Our stable outlook on the Cooperative Banking Sector Germany, including DZ BANK and all other core group members, reflects our expectation that the sector will maintain its robust capitalization and solid operating profitability. These provide a strong buffer to absorb potential further valuation and credit losses in the sector's 2023 and 2024 consolidated financial performance amid increasing rates and weak economic performance.

Downside scenario

We could lower our ratings on the sector's core members if a sudden repricing of deposits depresses structural profitability or if credit costs rise substantially above our current expectations.

We could also lower the rating if the sector's market position deteriorates materially, leading to financial difficulties for several cooperative banks and weakening BVR's capacity to support them.

Upside scenario

We currently consider a positive rating action on the sector and DZ BANK as remote. A prerequisite is that we revise upward the anchor for German domestic banks to 'a-', highlighting that the economic environment has become more supportive and structural challenges in German retail and small and midsize enterprise banking have eased.

Rated Subsidiaries

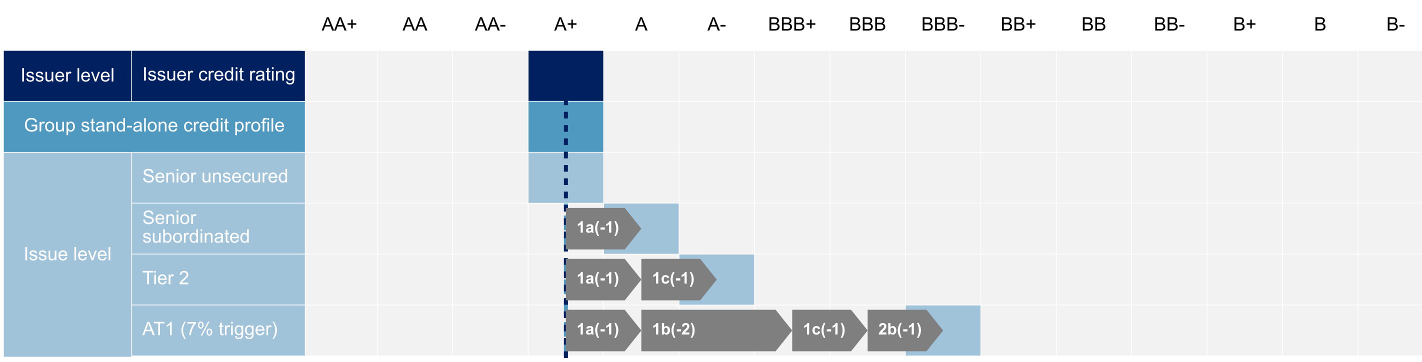
We rate DZ BANK's material subsidiaries based on their core group status in the Cooperative Banking Sector Germany. This also holds for Deutsche WertpapierService Bank AG (dwpbank), of which DZ BANK only owns 50% of the shares. DZ Bank developed dwpbank, and it caters to a wide range of German savings banks and some other commercial banks in Germany. Nevertheless, we see dwpbank as a core subsidiary given its close integration with the overall sector and its membership of the sector's protection scheme.

Rated Hybrids

The protection scheme governing body and administrator, BVR, has introduced guidelines on member banks' AT1 issuances in 2023. It underlines that BVR does not seek to protect discretionary payments for AT1 investors and sets guidelines that require issuing banks to reconsider AT1 payments if they receive extraordinary support from the sector. We understand these guidelines are predominantly targeted toward local cooperative issuers but also apply to DZ BANK. We see this new BVR policy as increasing coupon nonpayment risk for DZ BANK's AT1s and apply an additional notch deduction beyond our four-notch standard minimum notching for AT1s from the ICR.

At the same time, we continue to see some circumstances in which DZ BANK would receive extraordinary support from its affiliates and yet continue to pay its discretionary coupons. We therefore continue to use our 'A+' long-term ICR on DZ BANK as the appropriate starting point for our hybrid notching ("Ratings Affirmed On Germany-Based DZ Bank's AT1 Instruments Despite Revised Notching Approach," published on April 5, 2023).

DZ BANK AG Deutsche Zentral-Genossenschaftsbank: Notching



Key to notching

- Group stand-alone credit profile
- Issuer credit rating
- 1a Contractual subordination
- 1b Discretionary or mandatory nonpayment clause and whether the regulator classifies it as regulatory capital
- 1c Mandatory contingent capital clause or equivalent
- 2b Other nonpayment or default risk not captured already

Note: The number-letter labels in the table above are in reference to the notching steps we apply to hybrid capital instruments, as detailed in table 2 of our “Hybrid Capital: Methodology And Assumptions” criteria, published on March 2, 2022.
AT1--Additional Tier 1.

Key Statistics

Table 1

DZ BANK AG Deutsche Zentral-Genossenschaftsbank--Key figures

	--Year-ended Dec. 31--				
(Mil. €)	**2022**	**2021**	**2020**	**2019**	**2018**
Adjusted assets	520,423.0	497,465.0	472,219.0	445,327.0	417,416.0
Customer loans (gross)	203,646.0	195,665.0	190,294.0	186,224.0	174,438.0
Adjusted common equity	21,263.0	16,787.7	15,534.4	15,269.0	14,458.0
Operating revenues	6,513.0	7,241.0	6,163.0	7,116.0	5,567.0
Noninterest expenses	4,447.0	4,265.0	4,036.0	4,074.0	4,059.0
Core earnings	1,052.1	2,176.0	976.0	1,873.7	1,038.6

Table 2

DZ BANK AG Deutsche Zentral-Genossenschaftsbank--Business position

	--Year-ended Dec. 31--				
(%)	**2022**	**2021**	**2020**	**2019**	**2018**
Total revenues from business line (currency in millions)	6,548.0	7,241.0	6,169.0	7,115.0	5,578.0
Commercial banking/total revenues from business line	51.8	36.9	47.7	42.8	44.4
Retail banking/total revenues from business line	23.5	20.0	22.4	19.6	23.1
Commercial and retail banking/total revenues from business line	75.2	56.9	70.1	62.4	67.6
Insurance activities/total revenues from business line	-4.1	10.7	4.5	15.7	7.4
Asset management/total revenues from business line	28.8	32.5	25.4	21.9	25.0
Return on average common equity	4.6	8.2	3.8	8.0	4.1

Table 3

DZ BANK AG Deutsche Zentral-Genossenschaftsbank--Capital and earnings

	--Year-ended Dec. 31--				
(%)	**2022**	**2021**	**2020**	**2019**	**2018**
Tier 1 capital ratio	15.2	16.8	16.6	15.9	14.3
S&P Global Ratings' RAC ratio before diversification	10.9	9.5	9.9	9.1	8.3
S&P Global Ratings' RAC ratio after diversification	11.7	10.3	10.8	9.8	9.0
Adjusted common equity/total adjusted capital	90.8	88.6	87.8	87.9	87.3
Net interest income/operating revenues	50.5	38.0	44.4	37.9	49.5
Fee income/operating revenues	42.2	40.5	34.4	27.8	35.1
Market-sensitive income/operating revenues	6.5	7.4	9.4	11.2	5.1
Cost to income ratio	68.3	58.9	65.5	57.3	72.9
Preprovision operating income/average assets	0.3	0.5	0.4	0.6	0.3
Core earnings/average managed assets	0.2	0.4	0.2	0.3	0.2

RAC--Risk-adjusted capital.

Table 4

DZ Bank AG Deutsche Zentral-Genossenschaftsbank, Frankfurt am Main--Risk-adjusted capital framework data

(Mil. €)	**Exposure***	**Basel III RWA**	**Average Basel III RW(%)**	**S&P Global Ratings' RWA**	**Average S&P Global Ratings' RW (%)**
Credit risk					
Government and central banks	129,966	3,803	3	2,672	2
Of which regional governments and local authorities	17,722	226	1	838	5
Institutions and CCPs	159,786	8,176	5	35,695	22
Corporate	123,125	58,436	47	86,938	71
Retail	81,285	18,066	22	22,086	27
Of which mortgage	64,843	9,372	14	12,036	19
Securitization§	8,325	4,650	56	6,183	74
Other assets†	4,501	2,482	55	8,227	183
Total credit risk	506,988	95,613	19	161,800	32

Table 4

DZ Bank AG Deutsche Zentral-Genossenschaftsbank, Frankfurt am Main--Risk-adjusted capital framework data (cont.)

Credit valuation adjustment					
Total credit valuation adjustment	--	1,462	--	2,828	--
Market risk					
Equity in the banking book	10,657	5,243	49	26,202	246
Trading book market risk	--	7,369	--	10,267	--
Total market risk	--	12,612	--	36,469	--
Operational risk					
Total operational risk	--	10,727	--	13,555	--
	Exposure	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global Ratings' RWA**	**% of S&P Global Ratings' RWA**
Diversification adjustments					
RWA before diversification	--	121,672	--	214,652	100
Total diversification/ Concentration adjustments	--	--	--	(15,163)	(7)
RWA after diversification	--	121,672	--	199,489	93
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings' RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		20,912	17.2	23,413	10.9
Capital ratio after adjustments‡		20,912	17.1	23,413	11.7

*Exposure at default. §Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to tier 1 ratio are additional regulatory requirements (e.g. transitional floor or pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of Dec. 31, 2022, S&P Global Ratings.

Table 5

DZ BANK AG Deutsche Zentral-Genossenschaftsbank--Risk position

	--Year-ended Dec. 31--				
(%)	**2022**	**2021**	**2020**	**2019**	**2018**
Growth in customer loans	4.1	2.8	2.2	6.8	0.0
Total diversification adjustment/S&P Global Ratings' RWA before diversification	-7.1	-7.2	-8.2	-7.6	-7.5
Total managed assets/adjusted common equity (x)	29.5	37.4	38.3	36.6	35.9
New loan loss provisions/average customer loans	0.1	-0.1	0.4	0.2	0.0
Net charge-offs/average customer loans	0.0	0.0	0.0	0.0	0.0
Gross nonperforming assets/customer loans + other real estate owned	1.3	1.5	2.0	2.1	2.4
Loan loss reserves/gross nonperforming assets	71.9	66.5	60.0	57.0	52.6

RWA--Risk-weighted assets.

Table 6

DZ BANK AG Deutsche Zentral-Genossenschaftsbank--Funding and liquidity

	--Year-ended Dec. 31--				
(%)	**2022**	**2021**	**2020**	**2019**	**2018**
Core deposits/funding base	34.7	31.1	32.1	33.4	35.9
Customer loans (net)/customer deposits	126.5	139.3	140.2	139.8	129.5
Long-term funding ratio	72.3	73.3	72.5	68.0	71.3
Stable funding ratio	107.0	109.0	104.1	95.3	97.9
Short-term wholesale funding/funding base	29.0	28.4	29.3	34.1	30.4
Regulatory net stable funding ratio	122.3	127.1	N/A	N/A	N/A
Broad liquid assets/short-term wholesale funding (x)	1.3	1.3	1.2	1.0	1.0
Broad liquid assets/total assets	28.1	26.4	24.2	23.1	22.6
Broad liquid assets/customer deposits	110.3	119.2	107.4	98.1	88.1
Net broad liquid assets/short-term customer deposits	58.0	78.5	50.5	-13.6	10.6
Regulatory liquidity coverage ratio (LCR) (x)	145.9	155.2	N/A	N/A	N/A
Short-term wholesale funding/total wholesale funding	44.1	40.9	42.8	50.8	47.0
Narrow liquid assets/3-month wholesale funding (x)	1.5	1.4	1.3	1.0	1.1

N/A--Not applicable.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions , March 2, 2022
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions , Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology , Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings , Oct. 10, 2021
- General Criteria: Group Rating Methodology , July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology , July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Principles Of Credit Ratings , Feb. 16, 2011

Related Research

- Update: Cooperative Banking Sector Germany, May 08, 2023
- Ratings Affirmed On Germany-Based DZ Bank's AT1 Instruments Despite Revised Notching Approach, April 05, 2023

Ratings Detail (As Of August 10, 2023)*	
DZ Bank AG Deutsche Zentral-Genossenschaftsbank Frankfurt am Main	
Issuer Credit Rating	A+/Stable/A-1
Commercial Paper	
Foreign Currency	A+/A-1
Local Currency	A-1
Junior Subordinated	BBB-
Senior Secured	AA+/Stable
Senior Subordinated	A
Senior Unsecured	A+
Short-Term Debt	A-1
Subordinated	A-
Issuer Credit Ratings History	
24-Jun-2021	A+/Stable/A-1
17-Sep-2019	AA-/Negative/A-1+
05-Dec-2011	AA-/Stable/A-1+
Sovereign Rating	
Germany	AAA/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.