FitchRatings

Genossenschaftliche FinanzGruppe

Update

Key Rating Drivers

Genossenschaftliche FinanzGruppe's (GFG) Long-Term Issuer Default Rating (IDR) is driven by its Viability Rating (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, underpinned by its strong domestic retail and small SME banking franchise. The ratings also reflect GFG's low leverage and outstanding funding profile by international standards, sound asset quality and a record of profitability that is considerably better than most German peers'.

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. (BVR). GFG's IDRs are group ratings that apply to each member bank, including its central institution DZ BANK AG Deutsche Zentral-Genossenschaftsbank.

Diversified Business Model: GFG's domestically focused, stable universal banking model has delivered stable profits over several economic cycles. It is based on its local cooperative 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 has strengthened the group's business model over the past decade.

High Interest-Rate Risk Exposure: 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 Ratings views the banks' strong deposit franchise, liquidity and earnings as sufficient mitigating factors.

Sound Asset Quality: GFG's asset quality was solid in 1H22, helped by a low number of corporate insolvencies in Germany due to large-scale state support during the pandemic. We expect asset quality to modestly deteriorate up to 2024, due to rising insolvencies in the group's SME and corporate portfolios, which are exposed to higher interest rates and inflation pressure.

Resilient Profitability: GFG's profitability has been more stable than the overall German banking sector's in the past. Fitch expects profitability to decline significantly in 2022 due to temporary valuation losses in the local banks' and in the insurance company's security portfolios. Profitability should recover in 2023, but is likely to remain below 2021, as loan growth subsides and loan impairment charges normalise upward. Higher interest rates will gradually increase the group's interest income in the medium term.

Strong Capitalisation: GFG's leverage ratio is high by international standards. We have adjusted up 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'.

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.

Ratings

Foreign Currency

Long-Term IDR	AA-
Short-Term IDR	F1+
Viability Rating	aa-
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

Genossenschaftliche FinanzGruppe Rating Report (July 2022)

Fitch Affirms German Cooperative Banks and DZ BANK at 'AA-'; Outlook Stable (June 2022)

Global Economic Outlook – December 2022

Analysts

Roger Schneider
+49 69 768076 242
roger.schneider@fitchratings.com

Marco Diamantini
+49 69 768076 114
marco.diamantini@fitchratings.com

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 spill-over effects of the Ukrainian war 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 we expect over (and potentially beyond) our two-year forecast horizon.

Fitch could downgrade GFG's and its members' ratings if GFG's impaired loan ratio durably rises above 3%, its operating profit/risk-weighted assets (RWAs) ratio declines below 1% and its common equity Tier 1 (CET1) ratio falls durably below 13%. A downgrade of our operating environment score for GFG from '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 the increased uncertainties surrounding the operating environment. In addition to a domestic competitive 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.

Other Debt and Issuer Ratings

	Rating
DZ BANK AG Deutsche Zentral-Genossenschaftsbank	
Long-term deposit rating[a]	AA
Short-term deposit rating[a]	F1+
Long-term senior preferred debt[a, b]	AA
Short-term senior preferred debt[a, b]	F1+
Long-term senior non-preferred debt[a]	AA-
Tier 2 subordinated debt	A
Deutsche Apotheker- und Aerztebank eG	
Long-term deposit rating	AA-
Short-term deposit rating	F1+
Muenchener Hypothekenbank eG	
Long-term deposit rating	AA
Short-term deposit rating	F1+
Local cooperative banks	
Long-term deposit ratings	AA-
Short-term deposit ratings	F1+

[a] Also applies to DZ BANK's subsidiary DZ HYP AG
[b] Also applies to DZ BANK's subsidiary DZ PRIVATBANK S.A.
Source: Fitch Ratings

The long-term deposit and senior preferred debt ratings of DZ BANK and its banking subsidiaries, Muenchener Hypothekenbank's long-term deposit rating and DZ BANK's DCR are one notch above their respective Long-Term IDRs because of the protection provided to preferred creditors by resolution buffers. 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. The predominantly deposit-funded local banks therefore 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.

Significant Changes from Last Review

Interest Rate Rises Negatively Affect GFG's Profits and Capital in 2022

GFG's near-term profitability will be negatively affected by temporary valuation losses from its largely unhedged securities portfolios, lower new business volumes and slower repricing of loan books, before its earnings see the full benefit of rising euro interest rates.

Similar to the German savings banks (Sparkassen-Finanzgruppe, A+/F1+), a majority of cooperative banks have not hedged their securities portfolios against rising interest rates. According to the German central bank, the steepening of the euro interest rate curve resulted in valuation losses in the cooperative and saving banks' liquidity portfolios of EUR12.3 billion on aggregate in 1H22. This is equivalent to 5.6% of the two group's CET1 capital. In addition, the savings and cooperative banks offset further valuation losses of EUR21.8 billion by releasing undisclosed German GAAP reserves. Further interest rate rises in 2H22 have likely increased the valuation losses and, depending on how the interest rate curve evolves in the coming quarters, this could continue into 2023.

In the long term, we believe that virtually all valuation losses will gradually be reversed by the pull-to-par effect. This is because the cooperative and savings banks' strong liquidity (GFG's 'aa' score for Funding & Liquidity is among the highest worldwide in Fitch's rated universe) makes fire sales of securities holdings highly unlikely, allowing for securities to be held to maturity. Moreover, we understand that only a negligible portion of bonds was bought above par. We also expect valuation losses triggered by widening credit spreads, as well as actual losses driven by bond issuers' defaults, to be low, due to the predominantly high quality of the banks' securities portfolios.

GFG's insurance segment headed by DZ BANK's subsidiary R+V Versicherung AG, also reported a EUR30 million loss in 1H22 (1H21: EUR482 million profit) driven by interest-rate induced fair-value losses in its liquidity portfolio. We expect this loss to increase in 2H22 in line with the higher interest rates, but we still expect DZ BANK to report a pre-tax profit in 2022 close to its guidance of EUR1.5 billion. In addition, losses in R+V's bond portfolio booked at fair value through other comprehensive income resulted in a decline in DZ BANK's CET1 ratio to 12.01% at end-3Q22 (excluding 3Q22 interim profit, end-2021: 15.33%). DZ BANK expects the ratio to recover to above 13% at end-2022. Moreover, the DZ BANK's CET1 ratio will benefit at the beginning of 2023 from the implementation of IFRS 17 at R+V.

GFG's 2022 IFRS accounts will fully reflect the lower market values of the group's securities holdings, including the valuation losses partly mitigated by the release of undisclosed reserves. To limit the impact of their securities holdings' decreasing market values, the local banks reclassified some of their holdings from their liquidity portfolios to their securities investment portfolios during 2022. This is because the local banks only report under German GAAP, where only the liquidity portfolios (not the securities investment portfolios) must be marked to market. However, in GFG's IFRS accounts, the lower market values of the banks' liquidity and investment portfolios will reduce the group's 2022 profits and other comprehensive income, respectively and, consequently, GFG's end-2022 capital.

Slow Repricing of Balance Sheet, Declining New Lending Volumes in 2023

Most local cooperative banks do not hedge their predominantly long-term, fixed-rate mortgage loans and their mostly overnight deposits. The resulting asset-liability duration mismatch is therefore significantly larger than that of large commercial peers. This means that it will take longer for higher interest rates to feed into GFG's asset margins. In addition, unlike large German banks, GFG's local banks do not earn positive liability margins from macro deposit hedges. However, previous phases of higher interest rates suggest that, thanks to their stronger retail deposit franchises and excess liquidity, GFG's local banks will tend to remunerate their depositors less than their large commercial peers in the medium term. In addition, the possibility of liquidity transfers within GFG should limit funding costs and liquidity outflows for local banks operating in more competitive regions.

The local banks' strong retail franchises have allowed them to benefit more than their peers from Germany's strong mortgage lending growth that was driven by record-low interest rates over most of the past decade. Following the ECB's recent interest rate increases, demand for mortgage loans fell rapidly in 2H22. As a result, housing loan production in Germany was down 34% yoy in October 2022, despite the offsetting effect of inflation on building costs and the absence of price correction in the housing market. We expect mortgage origination to remain low in 2023. At the same time, we expect loan book growth to decelerate but remain slightly positive, because the back book that will mature over the coming quarters was originated at times of low growth rates.

Large Fiscal Stimulus to Mitigate Impact of Recession and High Inflation in 2023

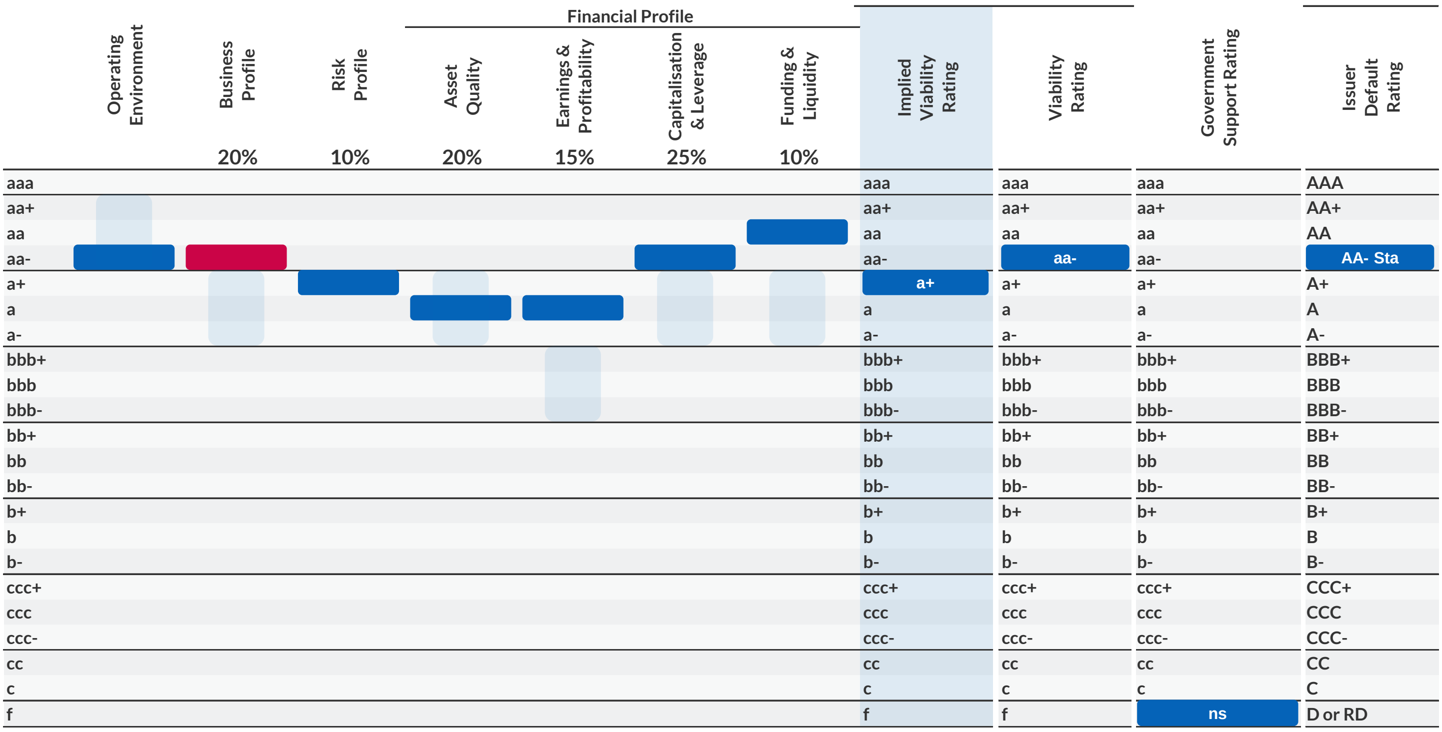
Fitch believes that Germany is likely to avoid widespread energy rationing over the coming winter months, due to swift diversification of energy sources and substantial cuts to domestic consumption. Nevertheless, Fitch forecasts an economic contraction during the 2022-2023 winter due to the severe energy shock triggered by the war in Ukraine, while growth is further weakened by slower growth in China, Germany's second-largest export market.

Fitch forecasts GDP growth of 1.8% for Germany in 2022 followed by 0.5% contraction in 2023 and 1.9% recovery in 2024. Year-end CPI inflation is expected to peak at 12.2% in 2022 before declining to 4.1% in 2023 and 2.3% in 2024. Fitch forecasts the unemployment rate to remain below 4%, preserving most of the gains of the previous years.

The German government has announced various measures since February 2022 to mitigate the energy shock in the private sector, including up to EUR200 billion (5.3% of projected 2022 GDP) in energy subsidies until early 2024. This will be financed from the economic stabilisation fund set up in 2020 for the pandemic. The government's strategy is to maintain a sound fiscal position – consistent with its domestic fiscal rule – while providing temporary stimulus.

We maintained our stable outlook on the operating environment score for German banks. The gas crisis could trigger material asset-quality deterioration for most banks, particularly on exposures to vulnerable corporate sectors. However, this is not an immediate rating sensitivity for most banks, whose asset quality is sound. We expect insolvencies to increase materially in GFG's SME loan book in 2023 and 2024, but to remain manageable, resulting in an impaired loans ratio commensurate with its Asset Quality score of 'a'.

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 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).

FitchRatings

Financials

Financial Statements

	31 Dec 21 (USDm)	31 Dec 21 (EURm)	31 Dec 20 (EURm)	31 Dec 19 (EURm)	31 Dec 18 (EURm)
Summary income statement					
Net interest and dividend income	20,620	18,232	18,272	18,185	18,368
Net fees and commissions	9,811	8,675	7,439	7,092	6,816
Other operating income	1,821	1,610	1,709	3,665	817
Total operating income	32,253	28,517	27,420	28,942	26,001
Operating costs	21,011	18,577	18,036	18,142	18,079
Pre-impairment operating profit	11,242	9,940	9,384	10,800	7,922
Loan and other impairment charges	-381	-337	2,327	832	151
Operating profit	11,623	10,277	7,057	9,968	7,771
Other non-operating items (net)	277	245	159	211	n.a.
Tax	3,412	3,017	2,189	3,133	2,369
Net income	8,488	7,505	5,027	7,046	5,402
Other comprehensive income	150	133	377	1,055	-453
Fitch comprehensive income	8,639	7,638	5,404	8,101	4,949
Summary balance sheet					
Assets					
Gross loans	1,067,696	944,028	890,576	844,552	794,916
Loan loss allowances	10,371	9,170	9,830	9,119	8,988
Net loans	1,057,325	934,858	880,746	835,433	785,928
Interbank	17,863	15,794	19,651	22,439	18,800
Derivatives	22,275	19,695	29,443	25,232	20,530
Other securities and earning assets	465,798	411,846	399,375	390,104	371,554
Total earning assets	1,563,261	1,382,193	1,329,215	1,273,208	1,196,812
Cash and due from banks	177,537	156,973	120,961	87,421	75,169
Other assets	30,859	27,285	25,715	23,459	21,196
Total assets	1,771,657	1,566,451	1,475,891	1,384,088	1,293,177
Liabilities					
Customer deposits	1,113,952	984,926	937,876	880,398	842,420
Interbank and other short-term funding	234,153	207,032	170,802	156,316	119,300
Other long-term funding	87,404	77,280	75,071	46,793	58,677
Trading liabilities and derivatives	24,805	21,932	32,589	54,896	48,742
Total funding and derivatives	1,460,314	1,291,170	1,216,338	1,138,403	1,069,139
Other liabilities	164,809	145,720	137,725	129,525	116,160
Preference shares and hybrid capital	199	176	246	204	243
Total equity	146,334	129,385	121,582	115,956	107,635
Total liabilities and equity	1,771,657	1,566,451	1,475,891	1,384,088	1,293,177
Exchange rate		USD1 = EUR0.884173	USD1 = EUR0.821963	USD1 = EUR0.89015	USD1 = EUR0.873057

Source: Fitch Ratings, Fitch Solutions, Genossenschaftliche FinanzGruppe

Key Ratios

	31 Dec 21	31 Dec 20	31 Dec 19	31 Dec 18
Profitability				
Operating profit/risk-weighted assets	1.4	1.0	1.5	1.2
Net interest income/average earning assets	1.3	1.4	1.5	1.5
Non-interest expense/gross revenue	65.1	65.8	63.2	69.9
Net income/average equity	6.0	4.2	6.3	5.1
Asset quality				
Growth in gross loans	6.0	5.5	6.2	4.3
Loan impairment charges/average gross loans	-0.1	0.3	0.1	0.0
Capitalisation				
Common equity Tier 1 ratio	15.1	15.3	13.6	13.5
Tangible common equity/tangible assets	8.2	8.2	8.2	8.3
Basel leverage ratio	8.0	8.0	7.0	6.9
Funding and liquidity				
Gross loans/customer deposits	95.9	95.0	95.9	94.4
Liquidity coverage ratio	160.1	177.6	174.3	166.0
Customer deposits/total non-equity funding	77.4	78.9	79.0	80.5

Source: Fitch Ratings, Fitch Solutions, Genossenschaftliche FinanzGruppe

FitchRatings

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	Neutral
Ownership	Neutral

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

GFG's Government Support Rating (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.

Subsidiaries and Affiliates

The IDRs and debt ratings of DZ BANK's subsidiaries are group ratings and, as such, their key rating drivers are identical to those of DZ BANK's ratings and ultimately to those of GFG. A downgrade of DZ BANK's issuer or debt ratings would lead to a downgrade of its subsidiaries' issuer or debt ratings.

Environmental, Social and Governance Considerations

FitchRatings **Genossenschaftliche FinanzGruppe** Banks Ratings Navigator

Credit-Relevant ESG Derivation

				Overall ESG Scale
Genossenschaftliche FinanzGruppe has 5 ESG potential rating drivers Genossenschaftliche FinanzGruppe 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.	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.

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.

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.