FitchRatings

Banks
Retail & Consumer Banks
Germany

Genossenschaftliche FinanzGruppe

Ratings

Foreign Currency	
Long-Term IDR	AA-
Short-Term IDR	F1+
Local Currency	
Viability Rating	aa-
Support Rating	5
Support Rating Floor	NF
National	
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

Key Rating Drivers

Strong Company Profile: Genossenschaftliche FinanzGruppe's (GFG) leading and very diversified business model, underpinned by its strong domestic retail and small SME banking franchise, has a high influence on the group's ratings. The ratings also reflect GFG's strong risk-adjusted capitalisation and low leverage, sound asset quality, well above-German average profitability and its outstanding funding profile by international standards.

Pandemic Downside Subsiding: The revision of GFG's Outlook to Stable from Negative in July 2021 reflects Fitch Ratings' view that the risk of significant deterioration in the operating environment, leading to a durable weakening of GFG's asset quality and profitability, has subsided since our previous rating action in August 2020. We expect insolvencies to rise as government support measures are progressively phased out, but the four-year average impaired loans ratio should comfortably remain within the implied 'a' category.

Large Capital Buffers: 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 stabilise in the medium term, as strong earnings retention is offset by loan growth that we anticipate will exceed the German sector average, though slower than in previous years.

Margins Under Pressure: GFG's profitability has been much more stable than that of the overall German banking sector, and we expect its pre-impairment profitability to remain sound over the next two years. However, ultra-low interest rates, combined with stiff competition in the sector, will further erode GFG's net interest margins. So far, the strong growth of GFG's loan book and net commission income has offset this erosion, but further fee increases could be increasingly challenging to impose on clients.

Long Mutual Support Record: GFG is not a legal entity but a cooperative banking network whose cohesion is ensured by a mutual support scheme. GFG's Issuer Default Ratings (IDRs) apply to each member bank, including DZ BANK AG Deutsche Zentral-Genossenschaftsbank (DZ BANK). The scheme has been highly effective and has a long record of ensuring GFG's cohesion, monitoring members' risks and enforcing corrective measures when needed. No creditor of a member of the scheme has suffered losses since its inception in 1934.

Rating Sensitivities

Upgrade Unlikely: An upgrade of GFG's and its members' IDRs is unlikely given the already high ratings and in light of the adverse interest-rate environment that is likely to prevail over the long term. An upgrade would require greater cost efficiency, which is likely to necessitate a protracted streamlining of the group's structure, especially at the local banks.

Decreasing Margins and Capitalisation: The persistence of low interest rates could eventually trigger a downgrade of the Long-Term IDRs, especially if GFG's operating profit/risk-weighted assets (RWAs) falls durably below 1%. The ratings are also sensitive to the CET1 ratio deteriorating below 13%, which could result from erosion in net interest margins and continued strong balance sheet growth. An impaired loans ratio durably above 3% or a downgrade of our operating environment score for German banks would also put pressure on GFG's ratings.

Applicable Criteria

Bank Rating Criteria (February 2020)

Related Research

Fitch Revises Outlooks on German Cooperative Banks and DZ BANK to Stable; Affirms at 'AA-' (July 2021)

Genossenschaftliche Finanzgruppe (February 2021)

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Debt Rating Classes

Rating level	Rating
DZ BANK AG Deutsche Zentral-Genossenschaftsbank	
Long-term deposit rating[a, c]	AA
Short-term deposit rating[a,c]	F1+
Long-term senior preferred debt[b,c]	AA
Short-term senior preferred debt[b,c]	F1+
Long-term senior non-preferred debt[a,c]	AA-
Tier 2 subordinated debt[a,c]	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+
814 local cooperative banks (end-1Q21)	
Long-term deposit ratings	AA-
Short-term deposit ratings	F1+

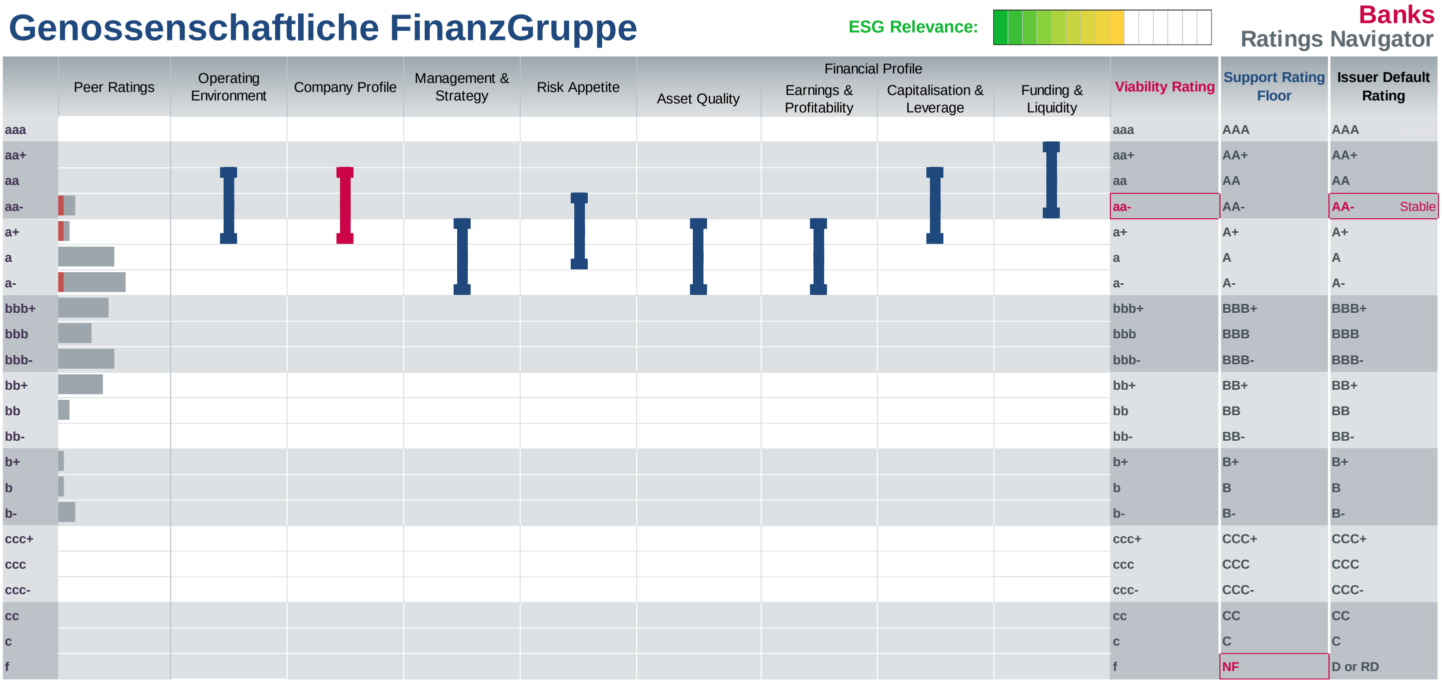
[a] Also applies to DZ BANK's subsidiary DVB BANK SE
[b] Also applies to DZ BANK's subsidiary DZ PRIVATBANK S.A.
[c] Also applies to DZ BANK's subsidiary DZ HYP
Source: Fitch Ratings

The long-term deposit and senior preferred debt ratings of DZ BANK and its banking subsidiaries, the long-term deposit rating of Muenchener Hypothekenbank eG (Muenchener Hyp) as well as DZ BANK's 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 eG's (apoBank) and of the 814 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 rather than the preferred resolution strategy of bail-in for the DZ BANK group as well as for Muenchener Hyp, 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 apoBank, 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 Viability Rating (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.

Ratings Navigator



Significant Changes

Outlook Revised to Stable from Negative on Subsiding Risk from Pandemic

We revised the Outlooks on GFG and its members' Long-Term IDRs to Stable from Negative in July 2021. The outlook revisions reflect our view that the risk of significant deterioration in the operating environment, leading to a durable weakening of GFG's asset quality and profitability, has subsided since our previous rating action in August 2020.

Fitch's June 2021 Global Economic Outlook forecasts German GDP to recover to close to its pre-pandemic level by end-2021. The German government put in place at the beginning of the pandemic large emergency programmes to support companies and households affected by the crisis. A strong export-driven rebound in the manufacturing sector in 2H20 and 1H21, continuing high demand for housing and the relatively low proportion of the economy affected by the lockdowns has also sustained economic performance in Germany. This was better than expected and better than most European peers in 2020.

The legal obligation for companies that qualify for state support to file for bankruptcy was suspended until end-April 2021. The combination of these elements has kept the number of corporate insolvencies and GFG's incurred credit losses low in 2020. We expect insolvencies to peak between 2H21 and 1H22 as government support measures are progressively lifted, in particular in the local banks' micro and small SME portfolios. But the four-year average impaired loans ratio should comfortably remain below 3% and therefore the asset quality score within the implied 'a' category.

We expect robust pre-impairment profit in 2021 to comfortably absorb loan impairment charges (LICs), which we believe will decline from 2020. This is because we anticipate a substantial proportion of credit losses in 2021 to be covered by the EUR1.5 billion management adjustments booked under GFG's consolidated IFRS accounting in 2020.

In the medium term, profitability is likely to come under pressure from low interest rates which, combined with stiff competition in the German banking sector, will further erode the local banks' net interest margins. So far, the strong growth of GFG's loan book and net commission income has offset this erosion. We expect commission income growth will be further sustained by growing asset management volumes, as depositors are increasingly confronted with negative interest rates and account management fees. However, increasing price transparency and

Bar Chart Legend

Vertical bars – VR range of Rating Factor

Bar Colors – Influence on final VR

- Higher influence
- Moderate influence
- Lower influence

Bar Arrows – Rating Factor Outlook

⇧	Positive	⇩	Negative
⇳	Evolving	▫	Stable

consumer protection could make it more challenging to impose further fees on clients. We also expect local banks to reduce their cost base by increasingly closing branches (the network still operated 8,566 branches at end-2020).

In the long term, we believe that GFG's large absolute capital base and very low profit distribution (of less than 10% of net income on average in the past) are key advantages over listed peers in a very low-margin environment. We also view as plausible GFG's aim to diversify its revenues by using the primary banks' strong ties to their local communities to create local digital platforms offering services beyond traditional banking.

Continuously Improving Cohesion Strengthens Business Model and Risk Appetite

We upgraded GFG's Company Profile and Risk Appetite scores by one notch in July 2021 to reflect the group's improving cohesion over the last decade.

GFG is a decentralised cooperative banking network that groups more than 800 independent entities. The network's cohesion is ensured by a mutual support scheme managed by the National Association of German Cooperative Banks (BVR)[1]. A stronger strategic alignment of the group's central institution DZ BANK, the BVR and the local banks and intensified internal cooperation and cross-selling have strengthened GFG's business model over the past decade. This is evidenced by the growing fees paid by the product suppliers owned by DZ BANK to the local banks and the increasing intra-group cooperation on digitalisation and IT harmonisation.

Simultaneously, GFG's organisational structure has improved. The number of local banks declined by about a third since the 2008 financial crisis and the group's IT providers and central institutions merged in 2015 and 2016, respectively. We expect the group's consolidation and integration process to continue in the coming years.

A current illustration of the positive implication for GFG's risk appetite from the stronger strategic alignment between the local banks and DZ BANK is the ongoing wind-down of DZ BANK's ship financing business. This follows heavy LICs at DZ BANK's transportation finance unit DVB BANK, which drove the large majority of GFG's credit losses over the past six years. The volatile, wholesale, bulky, global and largely dollar-denominated ship lending operations formed the last remaining sizeable business that did not serve the local banks' business models.

Despite DVB's credit losses, GFG's LICs averaged about 10bp of gross loans over the past ten years, which is significantly lower than international peers. This reflects strong economic conditions in Germany but also the local banks' dominant focus on granular retail housing, small SMEs and professionals, high collateralisation levels in secured lending as well as low single-name and sector concentrations.

We have also lowered the influence of the predominantly unhedged high structural interest-rate risk in GFG's banking book on our assessment of risk appetite. This is because interest rates are likely to remain low for long. At the same time, the local banks' large portion of price inelastic retail deposits would mitigate the negative impact of rising interest rates.

Brief Company Summary

GFG is the German Cooperative Banking Group

GFG comprises 814 local cooperative banks (at end-1Q21), which focus on retail and small SME banking, and their central institution DZ BANK, which also consolidates GFG's banking product suppliers. DZ BANK is large (about 35% of GFG's aggregated assets) and more exposed to riskier wholesale asset classes such as shipping and commercial real estate (CRE). However, stable and low-risk retail businesses dominate its revenue mix, similar to the local banks.

GFG's domestic market shares are close to 20% in most deposit and loan segments, second only to the savings banks (Sparkassen-Finanzgruppe, SFG). Like SFG, GFG is particularly strong in retail and small business banking. More than 60% of the group's 30 million clients are also the local banks' owners. This significantly enhances the stability of GFG's client base, as does the local banks' strong commitment to their home regions.

[1] For a description of GFG's structure refer to the Rating Report published in February 2021

GFG has steadily increased its market shares in most core products over the past decade, gradually reducing the gap with SFG, and still has some potential to improve its penetration of the vast German mid-sized SME market.

Decentralised Risk Management but Adequate Risk Controls

Each local bank defines its risk appetite, and underwriting decisions are not subject to GFG-wide centralised approvals or limits. However, BVR's monitoring system indirectly influences the banks' risk-taking, because their individual contributions to GFG's mutual support fund BVR-Sicherungseinrichtung (BVR-SE) depend on BVR-SE's assessment of each bank's risk profile. The local banks also use a shared internal credit rating system for retail and SME loans (the VR Rating System) and a synthetic risk diversification tool, both managed by BVR and DZ BANK.

The local banks' low risk appetite and their diversified and granular exposures adequately mitigate GFG's credit risk. The banks' strong focus on owner-occupied housing loans, which account for over one third of GFG's total loans, as well as their good knowledge of their local areas of operation and close client proximity, are also important risk mitigating factors.

High Structural Interest Rate Risk in the Banking Books

The banking books of GFG's local banks are exposed to high structural interest-rate risk, which is predominantly unhedged. The local banks' large portion of price inelastic retail deposits would mitigate the negative impact of rising interest rates. However, interest rates are likely to remain low for long. We expect most banks to react by increasingly passing on negative rates to retail depositors, and not only to institutional and corporate clients. However, we believe this will not prevent ultra-low interest rates from further eroding the local banks' net interest margins and, consequently, increase pressure on the group's profitability in the long term.

Key Financial Metrics - Latest Developments

Resilient Operating Income in 2020 Further Builds Up Strong Capital Base

Operating income in 2020 was sustained by strong growth of mortgage loans, which led to a 1% increase in net interest income yoy. Simultaneously, net commission income increased by 5%, driven by higher volumes of clients' securities transactions and assets under management.

GFG's earnings before tax declined to EUR7.2 billion in 2020 from EUR10.2 billion in 2020. The lower result was driven by two components: a EUR1.5 billion management adjustment that increased LICs to EUR2.3 billion in 2020 from EUR832 million in 2019; and exceptional valuation gains in the local banks' and DZ BANK's liquid securities portfolios owing to strong market conditions in 2019, which were not repeated in 2020.

High profit retention led to a EUR5.8 billion increase in GFG's equity to EUR122 billion. This, in combination with the favourable revision of the regulatory supporting factor applied to the calculation of RWAs on SME lending exposures, resulted in a regulatory CET1 ratio of 14.4% at end-2020. The group could increase its CET1 ratio to 16.1% if its member banks, at their discretion, transfer their undisclosed German GAAP reserves built under section 340f into the fund for general banking risk (section 340g reserves). The former are only included in regulatory Tier 2 capital whereas 340g reserves are part of regulatory CET1 capital.

In our assessment of GFG's capitalisation we also positively adjust our implied capitalisation score to reflect the standardised approach used by GFG's local banks to measure credit risk for all asset classes. We believe the use of the standardised approach considerably overstates the riskiness of GFG's balance sheet compared with similar European peers which use the internal-rating based approach.

Summary Financials and Key Ratios

	31 Dec 20		31 Dec 19	31 Dec 18	31 Dec 17
	(USDm)	(EURm)	(EURm)	(EURm)	(EURm)
Summary income statement					
Net interest and dividend income	22,364	18,382	18,185	18,368	18,638
Net fees and commissions	9,050	7,439	7,092	6,816	6,491
Other operating income	2,151	1,768	3,665	817	2,247
Total operating income	33,565	27,589	28,942	26,001	27,376
Operating costs	21,943	18,036	18,142	18,079	17,884
Pre-impairment operating profit	11,622	9,553	10,800	7,922	9,492
Loan and other impairment charges	2,831	2,327	832	151	576
Operating profit	8,791	7,226	9,968	7,771	8,916
Other non-operating items (net)	n.a.	n.a.	211	n.a.	n.a.
Tax	2,667	2,192	3,133	2,369	2,843
Net income	6,124	5,034	7,046	5,402	6,073
Other comprehensive income	n.a.	n.a.	1,055	-453	-208
Fitch comprehensive income	6,124	5,034	8,101	4,949	5,865
Summary balance sheet					
Assets					
Gross loans	1,083,475	890,576	844,552	794,916	761,880
Loan loss allowances	12,738	10,470	9,119	8,988	7,363
Net loans	1,070,737	880,106	835,433	785,928	754,517
Interbank	24,004	19,730	22,439	18,800	51,042
Derivatives	n.a.	n.a.	25,232	20,530	22,325
Other securities and earning assets	509,265	418,597	390,104	371,554	363,597
Total earning assets	1,604,005	1,318,433	1,273,208	1,196,812	1,191,481
Cash and due from banks	147,161	120,961	87,421	75,169	32,594
Other assets	44,448	36,535	23,459	21,196	19,241
Total assets	1,795,615	1,475,929	1,384,088	1,293,177	1,243,316
Liabilities					
Customer deposits	1,141,020	937,876	880,398	842,420	801,031
Interbank and other short-term funding	195,780	160,924	156,316	119,300	113,065
Other long-term funding	76,410	62,806	46,793	58,677	68,581
Trading liabilities and derivatives	56,932	46,796	54,896	48,742	44,181
Total funding	1,470,142	1,208,402	1,138,403	1,069,139	1,026,858
Other liabilities	177,304	145,737	129,525	116,160	111,608
Preference shares and hybrid capital	n.a.	n.a.	204	243	492
Total equity	148,170	121,790	115,956	107,635	104,358
Total liabilities and equity	1,795,615	1,475,929	1,384,088	1,293,177	1,243,316
Exchange rate		USD1 = EUR0.821963	USD1 = EUR0.89015	USD1 = EUR0.873057	USD1 = EUR0.83382

Source: Fitch Ratings, Fitch Solutions, CFG

Summary Financials and Key Ratios

	31 Dec 20	31 Dec 19	31 Dec 18	31 Dec 17
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	1.0	1.5	1.2	1.5
Net interest income/average earning assets	1.4	1.5	1.5	1.6
Non-interest expense/gross revenue	65.4	63.2	69.9	65.6
Net income/average equity	4.2	6.3	5.1	6.0
Asset quality				
Growth in gross loans	5.5	6.2	4.3	3.9
Loan impairment charges/average gross loans	0.3	0.1	0.0	0.1
Capitalisation				
Common equity Tier 1 ratio	14.4	13.6	13.5	13.3
Tangible common equity/tangible assets	8.3	8.2	8.3	8.4
Basel leverage ratio	8.4	7.0	6.9	6.8
Funding and liquidity				
Loans/customer deposits	95.0	95.9	94.4	95.1
Liquidity coverage ratio	n.a.	174.3	166.0	161.0
Customer deposits/funding	77.6	79.0	80.5	79.9

Source: Fitch Ratings, Fitch Solutions, CFG

Sovereign/Institutional Support Assessment

The Support Rating and Support Rating Floor reflect our view that, due to the EU's Bank Recovery and Resolution Directive, GFG's senior creditors can no longer rely on full extraordinary support from the German sovereign if a member bank becomes non-viable.

Support Rating Floor:			NF
Support Factors	Positive	Neutral	Negative
Sovereign ability to support system			
Size of banking system relative to economy			✓
Size of potential problem	✓		
Structure of banking system		✓	
Liability structure of banking system		✓	
Sovereign financial flexibility (for rating level)	✓		
Sovereign propensity to support system			
Resolution legislation with senior debt bail-in			✓
Track record of banking sector support		✓	
Government statements of support			✓
Sovereign propensity to support bank			
Systemic importance		✓	
Liability structure of bank		✓	
Ownership		✓	
Specifics of bank failure		✓	

Environmental, Social and Governance Considerations

FitchRatings **Genossenschaftliche FinanzGruppe**

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

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.

			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	Company Profile; Management & Strategy; Risk Appetite; 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	Company Profile; Management & Strategy; Risk Appetite	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; Company Profile; Management & Strategy; Risk Appetite	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy	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	Company Profile; Financial Profile	1

Governance (G)

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

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.