Rating Report

Sparkassen-Finanzgruppe

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DBRS
Insight beyond the rating.

Ratings

Issuer	Obligation	Rating	Rating Action	Trend
Sparkassen-Finanzgruppe	Long-Term Issuer Rating	A	Trend Changed Mar 18	Positive
Sparkassen-Finanzgruppe	Short-Term Issuer Rating	R-1 (low)	Trend Changed Mar 18	Positive

See back of report for complete rating list.

Rating Drivers

Factors with Positive Rating Implications

1. A continued de-risking at the Landesbanken reflected in the reduction of shipping exposures at the northern Landesbanken and/or reduced risk concentrations.
2. Continued resilience in profitability for the Sparkassen sector, reflected in strong commission income generation and the maintenance of competitiveness in its retail and SME customer segments.
3. Consistency in maintaining the Group's sound capital position.

Factors with Negative Rating Implications

1. Any significant deterioration of the capitalisation of the Sparkassen sector and/or any indication of weakening of the IPS scheme.
2. Any deterioration in the core franchise of the savings banks reflected in substantially weakening market shares in customer loans and deposits.
3. Any significant deterioration of the group's financial profile and/ or strategic challenges faced by larger members.

Rating Considerations

Franchise Strength: The Sparkassen-Finanzgruppe's (SFG) aggregated balance sheet of EUR 2.12 trillion makes the Group of vital importance for the German economy. SFG's regional savings banks (the Sparkassen) form the backbone of the organisation. SFG's franchise is further complemented by the seven wholesale and clearing institutions (Landesbanken).	**Very Strong/ Strong**
Earnings Power: Resilient performance of Sparkassen, albeit low levels of profitability, partially offset by more volatile earnings profiles at the Landesbanken.	**Good**
Risk Profile: Stable risk profile of Sparkassen reflective of their well-diversified and highly granular exposures. Overall Group risk profile improved with the continued deleveraging and de-risking of the Landesbanken. Risk pockets from cyclical lending exposures, concentrated in the Landesbanken sector, remain.	**Strong/ Good**
Liquidity and Funding: Strong deposit base and sound liquidity of Sparkassen as well as the strong covered bond franchise of Landesbanken; more wholesale-oriented funding profile of Landesbanken.	**Strong**
Capitalisation: Good aggregated level of capitalisation. This considers the overall sound capital and stable internal capital generation at the savings banks, as well as the much-improved capital position in the Landesbanken sector.	**Good**

Financial Information

Sparkassen-Finanzgruppe	31/12/2016	31/12/2015	31/12/2014	31/12/2013	31/12/2012
EUR Millions, unless otherwise noted	NGAAP	NGAAP	NGAAP	NGAAP	NGAAP
Total Assets (millions)	2,118,765	2,157,691	2,251,883	2,264,317	2,426,757
Equity (millions)	157,943	152,858	149,344	146,399	140,371
Net Income (millions)	1692.00	2887.00	191.00	1615.00	2093.00
Risk-Weighted Earning Capacity (%)	n/a	n/a	n/a	n/a	n/a
Post-provision Risk-Weighted Earning Capacity (%)	n/a	n/a	n/a	n/a	n/a
Yield on average earning assets	2.77	3.08	3.27	3.44	3.92
Cost of interest bearing liabilities	1.27	1.57	1.80	2.04	2.60
Efficiency Ratio (%)	68.41	69.19	69.10	65.83	63.61
Impaired Loans % Gross Loans	n/a	n/a	n/a	n/a	n/a
Tier 1 Capital Ratio (%)	15.63	15.11	14.60	14.60	13.10

Source: Company reports, DBRS (latest financial report available for the Group as of FY2016).
*The Sparkassen report already preliminary and unaudited German GAAP figures for FY2017 well ahead of the aggregated Group figures.

Issuer Description

Sparkassen-Finanzgruppe primarily comprises two main constituents with distinct franchises – the German savings banks (the Sparkassen) and the regional wholesale banks (Landesbanken). Together, the members of German Association of Savings Banks or Sparkassen-Finanzgruppe (SFG) form one of the largest financial Groups globally, with total aggregated assets of EUR 2.12 trillion as of year-end 2016 (the most recent date for which aggregated data is available).

Rating Rationale

DBRS rates the Sparkassen-Finanzgruppe (the Association or the Group) including the Long-Term Issuer Rating at "A", and Short-Term Issuer Rating at R-1 (low). All ratings have a Positive trend. The Support Assessment for the Group is at SA3.

These ratings also apply, in line with DBRS's floor ratings concept, to each member of Sparkassen-Finanzgruppe's Institution Protection Scheme (IPS) which as of February 2018, includes 386 German savings banks (the Sparkassen), the seven Landesbanken, eight public-sector building societies (LBS), the Group's central asset manager DekaBank and other specialised service providers.

The Positive trend reflects DBRS's view that the profitability in the Sparkassen sector continues to show resilience despite the low interest rate environment, the further de-risking of the Landesbanken sector and the consistent progress the group has made in improving its capital position.

The 'A'/R-1 (low) ratings reflect the underlying earnings and the very strong franchise of the Sparkassen which is a vital component of the group. The Group's aggregated balance sheet of EUR 2.1 trillion, as of FY2016, underscores its importance to the German banking sector and the German economy, and DBRS notes that approximately 60% of Germany's population has a banking relationship with the Group. Offsetting these rating strengths are the higher risk credit profiles of several Landesbanken that remain a meaningful part of the Group.

The savings banks continue to generate strong underlying earnings, which form the core of the Group's earnings profile. In FY2017 the Sparkassen - based on preliminary and aggregated German GAAP figures - posted a net income of EUR 2.2 billion (EUR 2.0 billion in 2016). The result reflected substantially higher fee and commission income and continued low credit charges. In 2017 net interest income (NII) was EUR 21.5 billion, down by 2.9% year-on-year, impacted by the low yield environment and intensive competition in the German banking market. DBRS notes positively that net fee and commission income for the year grew by 8.4% to EUR 7.8 billion (in 2016: up by 2.8%), almost compensating for the NII decline, mainly reflecting adjustments to the pricing model on current account transactions. The result was further helped by continued low credit charges, driven by the benign German economic and credit cycle and reflected in a provision release of EUR 100 million (2016: EUR 300 million release). The Sparkassen continued to increase their reserves with a net addition of EUR 4.6 billion (vs EUR 4.7 billion in the previous year).

Looking ahead, DBRS expects margin pressure to remain throughout 2018, but the Group continues, in DBRS's view, to adapt well to its demanding operating environment. The overall risk profile of Sparkassen-Finanzgruppe has in DBRS's view improved significantly in recent years with the continued deleveraging and de-risking of the Landesbanken. DBRS notes however that risk pockets, specifically from shipping finance exposures, remain. These are concentrated in the Landesbanken sector and continue to impact the Group's aggregated financial results, albeit at lower levels than in the recent past.

DBRS considers the Group's overall liquidity position as strong based on the strong deposit base and sound liquidity of the savings banks, which is in part offset by the more wholesale-oriented funding profile of the Landesbanken.

SFG's capitalisation is in DBRS's view good. In addition, the Group has steadily strengthened its capital ratios in recent years, primarily as a result of earnings retention. The Group reported a Tier 1 ratio, as of FY2016, of 15.6% (15.1% in FY2015 and 14.6% in FY2014).

Franchise Strength

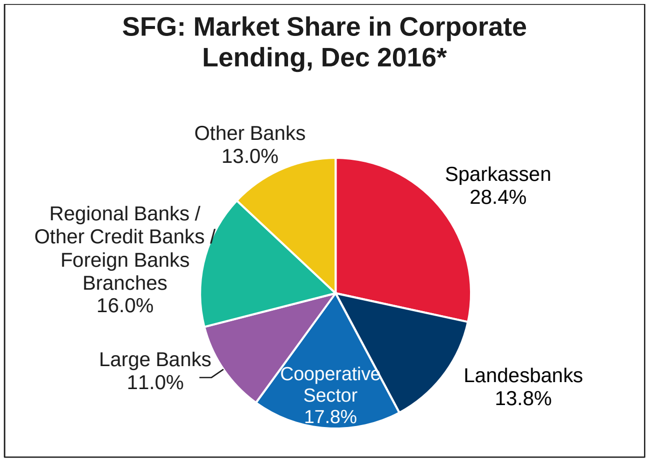
Grid Grade: Very Strong / Strong

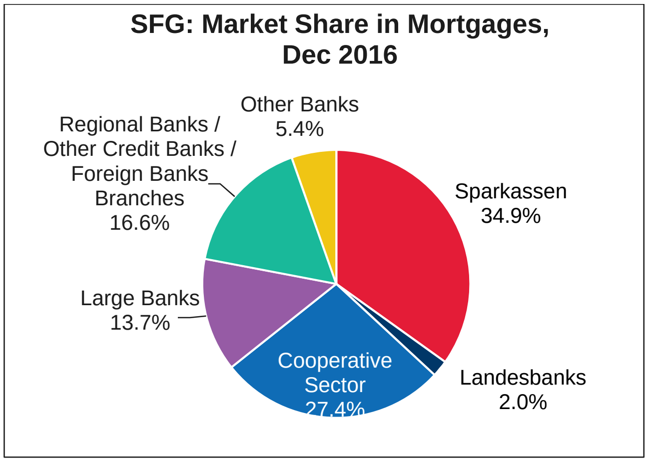
Together, the members of the German Association of Savings Banks (DSGV) form one of the largest financial Groups globally, the Sparkassen-Finanzgruppe (SFG), with total aggregated assets of EUR 2.12 trillion as of year-end 2016. Sparkassen-Finanzgruppe primarily comprises two main constituents with distinct franchises – the German savings banks (the Sparkassen) and the regional wholesale banks (Landesbanken). SFG's franchise is further completed by additional financial businesses including DekaBank, the Group's asset manager (the third largest mutual funds manager in Germany); the Landesbausparkassen (German building societies); Deutsche Leasing Group; as well as 11 regional public insurance entities. DSGV, functions as an umbrella organisation, coordinating reporting, debt ratings, strategy and lobbying efforts, while also respecting the autonomy of members. In DBRS's view, the strong, resilient franchise of the savings banks forms the core of Sparkassen-Finanzgruppe's franchise strength, while the weaker, more wholesale-oriented franchise of most Landesbanken negatively affects the overall Group. The Association launched a strategy aimed at maximising consumer satisfaction while optimising resources called "Modell Verbund". The strategy aims to coordinate activities across the Sparkassen, DekaBank, the building societies, and other members to more effectively and efficiently serve the Group's clients.

As per latest available data the organisation comprised 386 German savings banks[1]. DBRS notes that due to the consolidation process in recent years within the SFG there has been a steadily declining number of savings banks. In DBRS' view this intra-group consolidation generally results in larger, more viable and hence more cost-efficient and profitable entities.

The savings banks with their solid and stable franchise form the backbone of the Sparkassen Finanzgruppe. The savings banks, which have reported separately year-end 2017 results, maintained a strong market position in 2017 and reported EUR 1,199 billion in total assets (EUR 1,173 billion in 2016), and EUR 911.1 billion of customer deposits (EUR 890.1 billion in 2016, including certificated liabilities). The Sparkassen are market leaders across a wide range of financial services provided to retail customers and small- and medium-sized enterprises (SMEs) in Germany. As institutions under public law Sparkassen operate under municipal trusteeship. Their responsible public bodies (Träger) are municipalities (towns, cities), districts or special-purpose associations.[2]

Despite ongoing competition, the member institutions of Sparkassen-Finanzgruppe enjoy a very strong position in German banking as demonstrated by their leading market shares in core products. In 2016 the Sparkassen-Finanzgruppe reported a 37% market share in retail lending and also 42% in corporate lending. At the savings banks level, retail customer deposits totaled EUR 711 billion at 31 December 2016, representing a market share of 37%. The Landesbanken reported EUR 46 billion in customer deposits or a 2.4% market share. As of year-end 2017, the savings banks reported EUR 415.6 billion in domestic residential real estate loans, comprising a sizeable 35% market share, whilst the Landesbanken have an additional market share of 2.2%.





Source: DRBS, Company reports. Note: (*) excluding loans to financial institutions

The seven Landesbanken are mostly active in wholesale banking, as well as serving as the central clearing banks for their respective regional savings bank associations. They are important lenders to medium- to large-sized corporations and public-sector entities mostly in their respective domestic regions. Landesbanken have also been significant participants in international loan syndication, money markets, securitisation and asset-based financing. Nonetheless, much of this activity has been scaled back with most of the Landesbanken having reduced international activities and/or undergone significant de-risking and/or restructuring. Most Landesbanken are jointly owned by the German federal states in which they are headquartered (reflecting their origin as state banks) and their respective regional savings banks associations. Nonetheless, the level of ownership and involvement of the savings banks with the Landesbanken can vary significantly. Indeed, some Landesbanken are in part vertically integrated via direct ownership of savings banks. Some Landesbanken have developed more diverse franchises geographically and by business line and others less so. Overall, despite this variation and an improving risk profile, DBRS continues to view the Landesbanken as more vulnerable to market dislocations than the savings banks and also a potentially more challenging burden for the Institution Protection Scheme.

Privatisation of HSH Nordbank AG may reduce the number of Landesbanken to six.

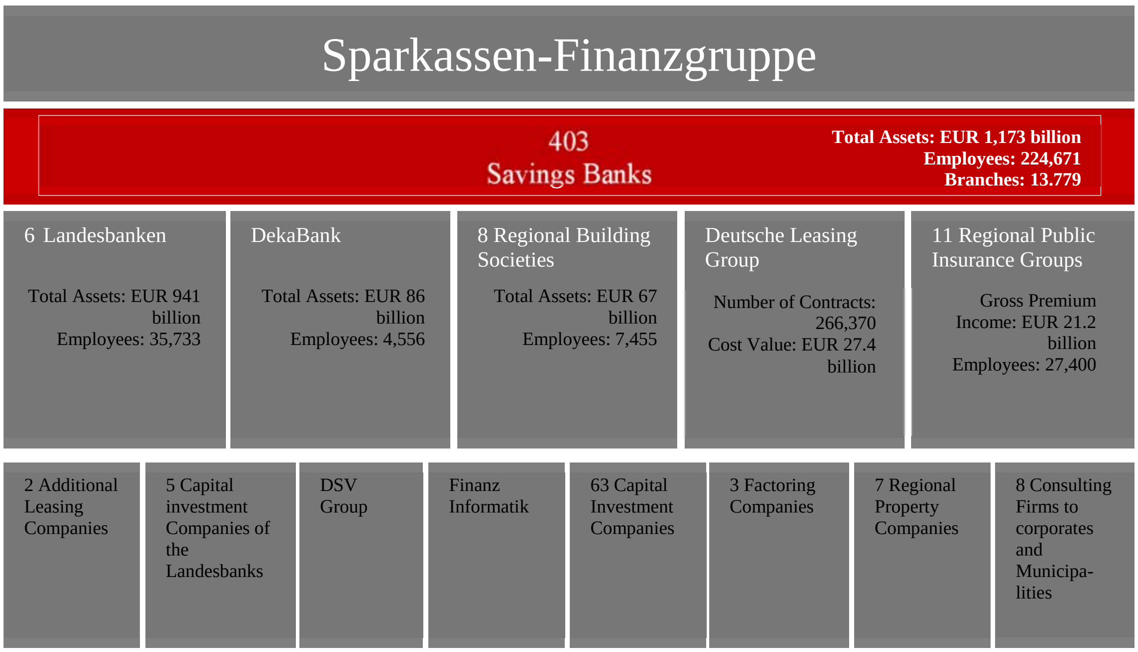
On February 28th, 2018, HSH's public owners signed a sale agreement for a 94.9% stake of the entire bank (including the Non-Core division) with a number of private investors comprising of Cerberus, J.C. Flowers, Golden Tree Asset Management, Centaurus Capital and BAWAG.

[1] Number of total savings banks within the SFG as of 01.03.2018

[2] Currently there are five savings banks which are organized under private law (Hamburger Sparkasse AG, Sparkasse Bremen AG, Sparkasse zu Lübeck AG, Bordesholmer Sparkasse AG, Sparkasse Mittelholstein AG, Sparkasse Westholstein).

HSH's sale to private owners will have, in DBRS' understanding, triggered the first orderly exit of a member of the Sparkassen-Finanzgruppe (SFG) from its Institution Protection Scheme (IPS). DBRS understands that this exit will, according to SFG's statutes, unfold under a two-year grandfathering transition period. During this period the SFG will remain responsible for HSH's liabilities under the IPS scheme. DBRS will continue to monitor closely this privatisation process until HSH's full legal and economic exit from the SFG. During this process, HSH aims to transition from its public-sector deposit guarantee scheme (currently covered for under the IPS) to the deposit guarantee scheme of private commercial banks in Germany (Deposit Protection Fund of the Association of German Banks, BdB). DBSR understands that presently important open issues remain with respect to HSH's overlapping membership at both deposit protection schemes.

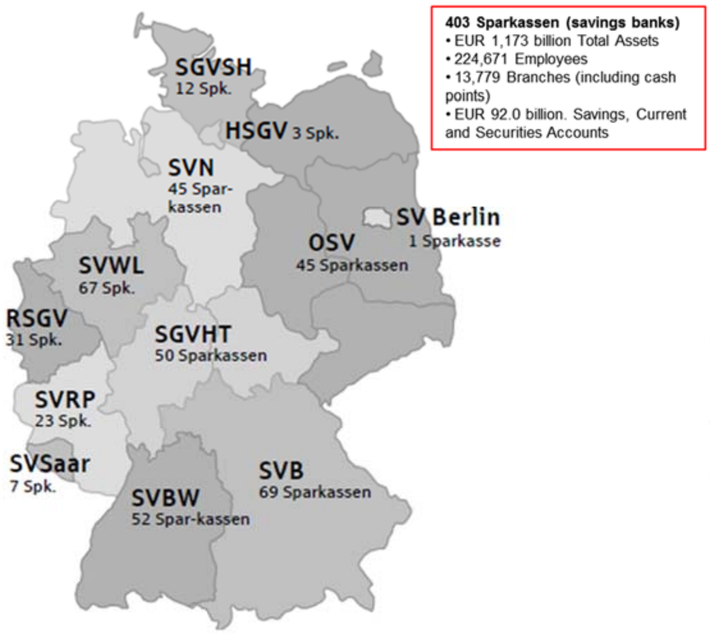
DBSR views the privatisation of HSH as positive for the SFG in the medium term (after the passage of grandfathering) as this should help de-risking the Group by reducing the amount of cyclical assets held within the SFG (mainly shipping and CRE exposures). It is also expected to reduce the risk for the IPS of having to contribute to potential compensation payments to HSH creditors. It should further improve the cohesion within the Group and help reduce reputational risks. HSH's departure from the SFG could also, in DBRS' view, help to create an exit-route blue print for other Landesbanken.



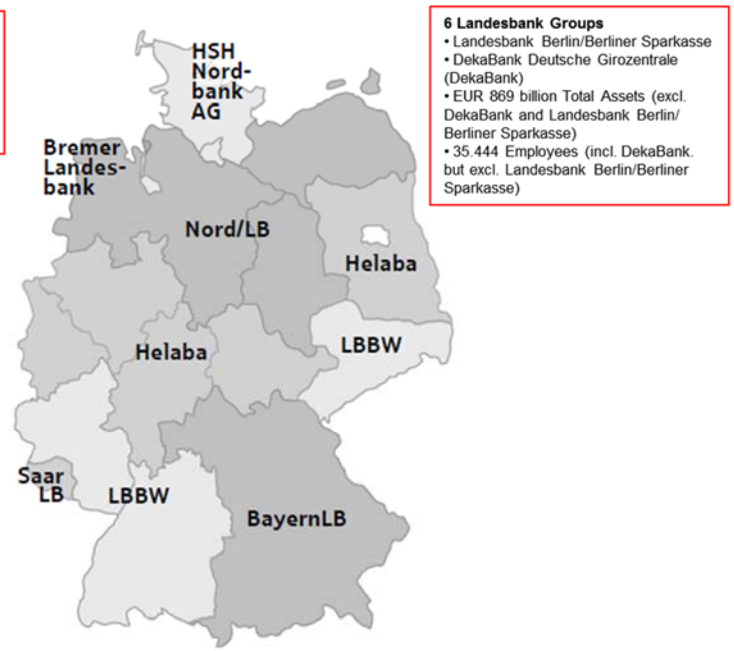
Note: Data as of as of Dec 2016; (*) As of March 1, 2018 there were 386 saving banks

The eight regionally-focused public-sector building societies (Landesbausparkassen, or LBS) which are members of the Sparkassen-Finanzgruppe enjoy a combined market-leading position in home savings and loans products which are mainly distributed by the savings banks. The LBS are mostly owned by regional savings banks associations and Landesbanken. Other members of the IPS of Sparkassen-Finanzgruppe include DekaBank, the central asset manager of Sparkassen-Finanzgruppe, and other smaller providers of specialised financial products. The savings banks collectively own 100% of DekaBank,, which was previously 50% owned by the Landesbanken. DekaBank is the third largest mutual funds manager in Germany, providing key asset management products that the savings banks offer to their retail customers. The broader Sparkassen-Finanzgruppe also includes 11 primary public-sector insurers that together occupy strong positions in individual products such as property insurance, life, retirement products and health insurance. However, the public-sector insurers are not part of the Institution Protection Scheme and therefore do not benefit from DBRS's floor ratings.

Savings Banks and their Regional Associations



Landesbanken



Source: Sparkassen-Finanzgruppe, DBRS
*As of May 15, 2018, there were 385 saving banks; The six Landesbank Groups in the chart do not include DekaBank, the Group's asset manager, and Landesbank Berlin (LBB) which has been re-branded to Berliner Sparkasse.

Earnings Power

Grid Grade: Good

Sparkassen-Finanzgruppe (SFG)

The Group's performance in 2016 reflected good results at the savings banks, contrasted by a net loss in the Landesbanken sector due to sizeable provisioning expenses. DBRS views that 2016 was a challenging year for the Landesbanken located in the northern part of Germany.

The overall Group reported net income of EUR 1.7 billion at end-2016[3], for which the savings banks contributed EUR 2.0 billion, while the Landesbanken reported a net loss of EUR 386 million versus a net profit of EUR 868 million in 2015. The Sparkassen-Finanzgruppe posted in FY2016 a pre-provision profit (Betriebsergebnis vor Bewertung) of EUR 12.6 billion (EUR 12.5 billion in 2015) benefitting from stronger net trading income from the Landesbanken, improved net commission income but counterbalanced by lower net interest income due to the low interest rate environment. Administrative expenses decreased by 2.5% to EUR 27.3 billion, reflecting lower administrative expenses. In 2016, the cost-income ratio of the Group as a whole increased to 70.4% (2015: 69.8%), mainly due to the decline in Net Interest Income (NII).

The FY2016 results of the Group were mainly driven by an increase in loan loss provisions for the Landesbanken. Net valuation expenses, (a German GAAP accounting category which includes mainly provisions for loan losses and securities), increased to EUR 3.0 billion from EUR 1.1 billion in the previous year. The substantial increase in 2016 reflected mainly high loan impairment charges for shipping loans at two Landesbanken located in the North of Germany.

The Group further recorded in its 2016 income statement EUR 4.4 billion under the category *Extraordinary Result* (*außerordentliches Ergebnis*), a local GAAP term referring mainly to net additions to the fund for general banking risks. These capital reserves are typically undertaken by the Sparkassen -in accordance with Section 340(g) German Commercial Code (HGB)- which DBRS views as an effort to further strengthening the Group's risk coverage potential (for further details see below under the section *Sparkassen*).

Sparkassen

The Sparkassen, for which preliminary and unaudited German GAAP figures for FY2017 were already available, maintained their ability to generate solid and sustainable revenues in 2017. The Sparkassen continue to generate strong underlying earnings, which form the core of the Group's earnings profile. In 2017 NII was EUR 21.5 billion, down by 2.9% year-on-year (in 2016: down by 3.7%), impacted by the low yield environment and intensive competition in the German banking market.

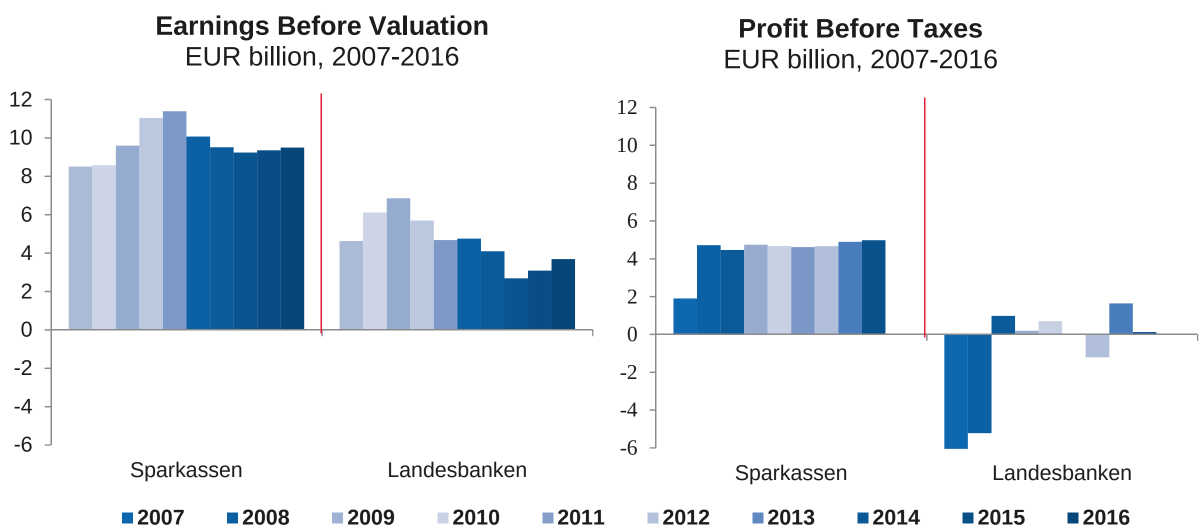
[3] Please note that the Group financial reporting is based not on consolidated but on aggregated figures on the basis of local GAAP (HGB accounting standards); please also note that the Sparkassen reported, well ahead of the Group, preliminary and unaudited German GAAP figures for FY2017, which are discussed in this section.

DBRS notes positively that net fee and commission income for the year grew by 8.4% to EUR 7.8 billion (in 2016: up by 2.8%), almost compensating for the NII decline, mainly reflecting adjustments to the pricing model on current account transactions.

Total Operating costs decreased marginally by 0.8% (in 2016: down by 0.9%) during 2017 to EUR 19.1 billion driven by ongoing staff consolidation measures. Total Operating income (before valuation) for the Sparkassen increased by 1% to EUR 10.5 billion in 2017 (in 2016: down by 4.1%), impacted mostly by increased fee revenues.

Overall the Sparkassen used the benign domestic economic environment to have a net release of loan loss provisions of EUR 100 million (release of EUR 300 million in 2016). The Sparkassen continued the increase of their 340(g)-reserves, which are Tier 1 capital eligible. These reserves increased (net addition) by EUR 4.6 billion as of year-end 2017 (vs. EUR 4.7 billion at end-2016) and are made as additions to the Fund for General Banking Risks in accordance with Section 340(g) of the German Commercial Code. The Sparkassen view those accumulated buffers as a necessary precaution against the prolonged low-interest rate environment in Europe which exerts steady pressure on their net interest income, its biggest revenue contributor. Profit before tax increased by 3.4% (in 2016: up by 1.6%) to EUR 5.1 billion, while net income increased by 7.4% to EUR 2.2 billion as of year-end 2017.

Cost efficiency for the savings banks is relatively weak in an international context and has also been impacted by the low interest rate environment. The cost-income ratio (pre-valuation) of 65% in 2017 (in 2016: 64.2%) reflects their extended branch network, providing coverage in many rural areas in Germany, in accordance with their public-sector mission. DBRS recognises that efforts by the savings banks to centralise back-office functions in recent years have shown some results. The "Modell Verbund" strategy introduced by the Association is aimed to contribute towards improved efficiency, however DBRS continues to view the Group's overall cost structure as high.



Landesbanken

DBRS notes that the Landesbanken sector has continued to deleverage with total assets decreasing by 7.2% to EUR 879 billion in 2016. While significant legacy problems of the past consisting mainly of structured credit portfolios and extensive credit substitution business have been widely addressed, exposure to shipping, mainly concentrated in the Landesbanken located in the north of Germany continued to impact bottom line results negatively with more pronounced losses in FY2016.

In 2016 the Landesbanken, returned to negative profitability, posting EUR 386 million (net loss after taxes) after an aggregated positive net income of EUR 868 million in 2015 and a EUR 1.7 billion net loss in 2014. For most Landesbanken, DBRS expects that earnings volatility should reduce going forward as legacy issues are increasingly resolved, reflecting the realignment of their business model towards more customer oriented business and continued de-risking activities. DBRS notes however the presence of sizable commercial real estate (CRE) exposures (see also Risk Profile section) which due to their cyclical nature continue to pose risks for the Landesbanken sector and for the Sparkassen-Finanzgruppe overall.

Risk Profile

Grid Grade: Strong / Good

Overall, the risk profile of the Sparkassen-Finanzgruppe has improved given the restructuring and various risk reduction measures undertaken at the weaker Landesbanken since 2008. Although elevated risks remain at some Landesbanken, the steep reduction in total assets and the parallel reduction in securitised liabilities have helped towards de-risking the Landesbanken. DBRS views the overall risk reduction in the Landesbanken sector as a key driver of the improved results exhibited since 2010.

DBRS continues to view the risk profile of savings banks as stable and reflective of the broader German economic environment to which its retail and SME lending is integrally linked. Given the geographic concentration in Germany, Sparkassen-Finanzgruppe is exposed to the German economic and credit cycle. While the savings bank's business is concentrated in Germany, it is well diversified within the country. Moreover, the exposures in the aggregate loan portfolio of the savings banks are highly granular and extend across the breadth of German industry and commerce. The Group's sizeable exposures to business lending was stable in 2016, with around 42% market share including the combined lending of the Sparkassen and Landesbanken, helped by the favourable economic development of the German SME sector (or Mittelstand).

The Group is also characterised by its large exposure to residential real estate, with around 37% market share driven mainly by the 35% share in housing loans of the Sparkassen. The Group's real estate lending to private customers has performed well through past economic cycles, a reflection of the strong real estate market environment in Germany, adding a level of stability to overall credit quality. The strong performance of the German residential real estate market has also had a positive impact on net interest income, allowing the associated volume effect to compensate for the negative rate effect stemming from low yields. In DBRS' view the rapid increase of residential housing prices, however, especially in larger German cities, indicates a likely end to extraordinary residential loan volume growth in the near term.

Furthermore, the Sparkassen-Finanzgruppe engages in lending to public authorities, which in DBRS view moderates the Group's risk profile given the public law guarantees which support local authorities. DBRS also views the Groups lending to private individuals (excluding real estate) as comparatively lower risk, based on the long track record of the savings banks (which provide most of the private loans, to their local customers) as well as the high barriers to personal bankruptcy filings in Germany.

The robustly performing German economy led to very low loan impairment charges for the Sparkassen sector within the Group (the savings banks recorded a net release of EUR 300 million in 2016). In DBRS' view this is positively correlated to the low interest rate environment in Europe with low corporate delinquencies and the unemployment rate at historical lows in Germany. Losses from interest rate risk exposure in the banking book pose a future challenge for the Group, as the gradual shift of customer deposits from longer term savings accounts towards sight deposits during the ultra-low yield environment, poses challenges for the maturity re-structuring of the banking book for many savings banks.

As noted above, the savings banks are linked to the domestic economic cycle through their broad lending relationships to SMEs. DBRS sees the savings banks as benefitting from risk management tools offered by the Group's federal association, Deutscher Sparkassen- und Giroverband (DSGV). These include credit pooling programmes to limit concentration risks at the individual savings bank level, centralised software and credit scoring systems which provide shared information and statistics useful in controlling credit decisions.

The Group's risk profile is further supported by the existence of an early warning system in relation to the Institution Protection Scheme and the use of guarantee schemes. Individual guarantee support funds monitor potential risks of their member institutions through risk monitoring committees, and report to the central transparency committee of the German Savings Banks Association. Guarantee schemes have right of information and response completed with the power to conduct audits at all covered institutions at any time. If the risk situation deteriorates at any institution, the guarantee scheme can decide countermeasures to be implemented.

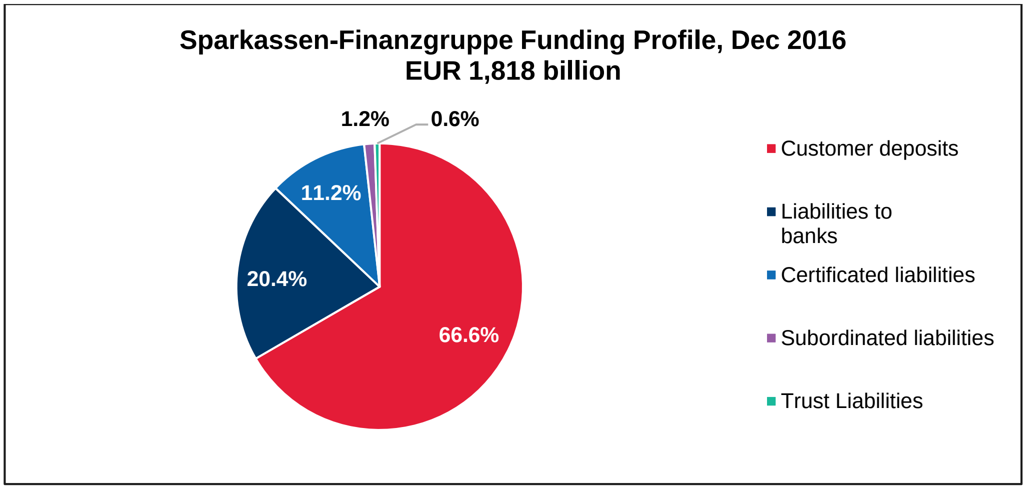
Historically, DBRS has viewed the highest credit risk for Sparkassen-Finanzgruppe in the cyclical part of the corporate loan portfolios of several Landesbanken (e.g. shipping exposures, CRE). The financial crisis in 2008 primarily affected the Landesbanken securities portfolios, yet the subsequent poor market conditions and capital pressure helped to de-risk the loan portfolios and in some cases forced restructuring at the Landesbanken level. In DBRS's view, the worst period for risk from the Landesbanken has passed, particularly as many have reined in riskier foreign bank and international corporate activities. Nonetheless, the wholesale nature of the Landesbanken business models may continue to pose future risks relative to the more stable profile of the savings banks.

Funding and Liquidity

Grid Grade: Strong

DBRS views the liquidity and funding position of Sparkassen-Finanzgruppe as strong. The Group benefits from its strong pillar of customer deposits providing the principal source of funding for most of its businesses. This is partially offset by the more wholesale-oriented funding profile of the Landesbanken.

DBRS views the deposit base of the savings banks as a core element in maintaining strong liquidity at the Group level. Furthermore, DBRS notes that the Sparkassen-Finanzgruppe holds an important role in allocating excess liquidity among its members. This intra-group lending, which is advantageous for all members, typically takes place when retail-orientated Sparkassen, with excess of liquidity, place funds with wholesale-orientated Landesbanken (either in form of deposits and Schuldscheine or by subscribing to their debt issues). These funding relationships, which are helped by regulatory zero-risk weighting within the Group, can reduce the dependence of Landesbanken (which are typically in lack of retail liquidity) on volatile wholesale market funding. In DBRS view this helps Landesbanken manage through periods of market disruption and can add a level of stability to their funding profile.



Source: Company reports

Customer deposits of EUR 1.2 trillion at end-2016 account for nearly two thirds of Group funding. The stable deposit base of the Sparkassen of EUR 890.1 billion at year-end 2016, up 3.3% from the previous year, provides a solid foundation for the Group. Importantly, the savings banks' customer deposits continued to increase through the financial crisis, growing by close to 16% since year-end 2008. Liquidity at the savings banks is further illustrated by customer deposits exceeding customer loans by EUR 117 billion in 2017 (EUR 121.3 billion at year-end 2016) – leading to a strong loan to deposit ratio of 87.2% (2016: 86.4%). The regulatory liquidity ratio for the savings banks (defined as the ratio between the liquid assets available up to one month and the liabilities callable during this period) has typically been around 2.5% in recent years (2.7% as of Dec 2016). Despite the increased competition versus private sector and foreign banks, the Sparkassen continue to attract deposits via strong brand recognition and customer relationships.

Given their largely wholesale business models, the Landesbanken in aggregate rely much more on market funding. The increased wholesale funding reliance in the Landesbanken sector highlights their vulnerability to market disruption. DBRS notes, however, the rebalancing of the liability structure of Landesbanken after the global financial crisis in favour of deposits from their customer base (intra-group and corporate deposits). Additionally, DBRS notes the strong covered bond franchise of the Landesbanken, which DBRS views as a more stable form of market funding. Cover pools in the Landesbanken sector continue to benefit from wide-ranging CRE finance activities and the traditionally close ties to public sector financing in Germany.

Capitalisation

Grid Grade: Good

DBRS views SFG's capitalisation as good. This considers the overall sound capital and solid underlying earnings of the savings banks, as well as the improved capital position in the Landesbanken sector as well as the more challenging situation at particular Landesbanken.

The Group's aggregated Tier 1 ratio (excluding Landesbausparkassen) improved to 15.6% at the end-2016 (+50bps YoY). The improvements reflect stronger capital ratios in both the Sparkassen and the Landesbanken sectors and a decerase in aggregate risk-weighted assets (RWAs) of the Group by EUR 27 million to EUR 942.7 billion.

The Sparkassen reported an aggregated CET1 ratio of 15.1% at year-end 2016 and a total capital ratio of 16.9%, both improving compared to the prior year. Capitalisation at the savings banks has been supported by high rates of retained earnings in the recent past and slow growth in risk-weighted assets, which DBRS expects to continue in 2018. DBRS notes however the significant impact of intra-group exposures with regulatory zero-risk weighting in the Group (based on SFG's Institution Protection Scheme).

The capital of the savings banks is good and of high loss absorbing quality and is supported by existing silent capital reserves (under 340f HGB) which further strengthen the risk coverage potential of the savings banks sector. However, given the low interest rate environment, which is adding pressure to earnings, some individual saving banks might be challenged to internally generate significant levels of capital. Given the legal structures of the savings banks, raising capital externally is difficult and in the past capital improvement has often been achieved through mergers with stronger institutions.

At the Landesbanken level (including DekaBank), Common Equity Tier 1 ratios increased slightly to 15.3% at end-2016 from 14.5% one year earlier. The development continued to reflect the reduction of risk and deleveraging at the Landesbanken. On absolute terms the equity of Landesbanken decreased from EUR 54.7 billion to EUR 53.5 billion, reflecting the repayment of silent participations, which become gradually ineligible for regulatory capital purposes and are expected to be phased out in the sector by 2022.

Annex: Institution Protection Scheme

DBRS sees the Institution Protection Scheme as a key factor underpinning the floor rating, as it allows for resources of the Group to be made available to all members. Since the Scheme's inception in 1973, no member of Sparkassen-Finanzgruppe has defaulted. However, the Institution Protection Scheme is not equivalent to a cross- guarantee. Creditors and members do not have a legal claim on support from the scheme. Instead, the Scheme is based on mutual support between its members. Therefore, the structure of the system and the ability and willingness of its members to support each other become important components of the strength of the Scheme, and therefore factors considered in the floor ratings.

The Scheme comprises a system of connected support funds, including 11 regional savings banks support funds, plus one support fund each for the Landesbanken and the LBS. If a decision has been made to support a member, such support is initially provided by the regional support fund to which the institution belongs. If a savings bank requires support that exceeds the resources of its regional support fund, then in the next step the resources of all 11 savings banks support funds can be activated. If this still proves insufficient, then the resources of the whole Institution Protection Scheme can be utilized, requiring a 75% majority vote. However, the decentralised structure of the system could pose a challenge in DBRS's view, as it increases the number of steps that are needed to leverage the full resources of the system and could lead to a delay in the provision of timely support.

The mechanisms of the Institution Protection Scheme are available to strengthen and restructure savings banks that face challenges. In DBRS's opinion, these cases, while generally involving smaller support amounts, help ensure the ability of the system to function smoothly. With the exception of the Landesbanken, most support cases of the Institution Protection Scheme have involved small institutions. Sparkassen-Finanzgruppe reports that 90% of all support cases at the Sparkasse level can be handled by the challenged member's regional support fund alone, without additional resources from the system of support funds. Yet, DBRS recognises that the combined resources of the Institution Protection Scheme are not sufficient, nor was the Scheme designed, to address a wider systemic crisis or the possible burden of larger and less risk averse Landesbanken should complementary support from its public-sector owners prove unavailable. This is viewed as a weakness that negatively affects the floor ratings. In the past, examples of important support for the Landesbanks has included assistance from their public owners, from the central German government, and from regional support funds that savings banks and Landesbanken have established. The administrators of the support funds can use their discretion to require additional support from the public owners of a challenged member and to effect management and business strategy changes to ensure a successful restructuring and protect the Scheme's funds. Member contributions to the Scheme are risk- based, providing an incentive for members to exercise prudent risk management.

The Deposit Guarantee Act in Germany was introduced in July 2015 and transposed relevant EU directives into German national law. This development mandated modifications to the Group's Institution Protection Scheme (formerly known as Joint Liability Scheme). The changes essentially entailed the implementation of i) early intervention rights for the IPS in order to stabilise ailing members at the early stages of financial distress, ii) a significant increase of rescue funds available to the IPS, which are also available for preventive support measures, iii) the inclusion of non-cash support elements (e.g. guarantees). Additionally, the IPS has been enhanced by new governing and reporting structures within the Group, as well as investment in personnel, procedures and technology targeted to ensure that customers can be timely refunded the guaranteed amount of € 100,000 per depositor per institution. The Sparkassen-Finanzgruppe's Institution Protection Scheme has been officially recognised by the German regulator as a deposit guarantee scheme under the Deposit Guarantee Act. The Institution Protection Scheme serves therefore a mixed purpose as both a rescue scheme and a deposit guarantee scheme with common financial resources which are not mutually ring-fenced.

As mentioned the Sparkassen-Finanzgruppe is taking steps to strengthen the pre-funding of resources available for the Institution Protection Scheme, something DBRS will continue to evaluate. The recent changes in the regulatory environment with the implementation of the European Bank Recovery and Resolution Directive (BRRD) in Germany in 2015 mean that the likelihood of state support has decreased and any form of state intervention, such as has been previously made available to the Landesbanken during the global financial crisis in 2008, has to be guided by the rules of the BRRD directive. This means that public owners (German federal states) are prohibited from providing emergency support to distressed Landesbanken. DBRS has in September 2015 removed the systemic support considerations from the floor rating of the SFG and the rating no longer incorporates uplift for broader systemic support. The removal of the one notch of systemic support reflected DBRS's view that there is less certainty about the likelihood of timely systemic support. This is reflected in an SA3 support assessment for the Sparkassen Finanzgruppe.

DBRS notes that the members of the Institution Protection Scheme have strong incentives to support each other, which is critical to ensure the functioning of the system, due to the lack of a legally binding cross-guarantee. A default by any member would cause reputational damage for the overall Group. Customers and counterparties may not differentiate between Group members and may view a default by any one member as a sign of weakness for the overall Group. This reputational link is furthered by the common "Sparkassen" brand and the red "S" logo shared by all savings banks. Similarly, most Landesbanken carry the "Landesbank", or short "LB", brand in their name, and all public-sector building societies share the "LBS" brand. The cost of such reputational damage likely outweighs the costs of providing the support mechanism in most stress cases.

Sparkassen-Finanzgruppe In EUR Millions	31/12/2016 NGAAP		31/12/2015 NGAAP		31/12/2014 NGAAP		31/12/2013 NGAAP		31/12/2012 NGAAP		31/12/2011 NGAAP	
Balance Sheet												
Cash and deposits with central banks	50,869	2.40%	30,837	1.43%	26,041	1.16%	23,120	1.02%	39,910	1.64%	30,968	1.21%
Lending to/deposits with credit institutions	265,222	12.52%	294,241	13.64%	338,108	15.01%	371,863	16.42%	408,768	16.84%	500,605	19.49%
Financial securities	447,240	21.11%	475,162	22.02%	502,051	22.29%	510,326	22.54%	508,610	20.96%	533,169	20.76%
- Trading portfolio	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
- At fair value	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
- Available for sale	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
- Held-to-maturity	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
- Other	447,240	21.11%	475,162	22.02%	502,051	22.29%	510,326	22.54%	508,610	20.96%	533,169	20.76%
Financial derivatives instruments	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
- For hedging purposes	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
- Other	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Gross lending to customers	1,204,587	56.85%	1,192,957	55.29%	1,186,005	52.67%	1,179,018	52.07%	1,215,967	50.11%	1,227,933	47.81%
- Loan loss provisions	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Insurance assets	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Investments in associates/subsidiaries	25,037	1.18%	25,730	1.19%	27,620	1.23%	30,285	1.34%	33,523	1.38%	34,970	1.36%
Fixed assets	12,319	0.58%	12,596	0.58%	12,206	0.54%	12,361	0.55%	12,530	0.52%	12,342	0.48%
Goodwill and other intangible assets	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Other assets	113,491	5.36%	126,168	5.85%	159,852	7.10%	137,344	6.07%	207,449	8.55%	228,288	8.89%
Total assets	**2,118,765**	**100.00%**	**2,157,691**	**100.00%**	**2,251,882**	**100.00%**	**2,264,317**	**100.00%**	**2,426,757**	**100.00%**	**2,568,275**	**100.00%**
Total assets (USD)	2,565,873		2,613,013		2,727,082		3,119,355		3,200,260		3,335,422	
Loans and deposits from credit institutions	371,418	17.53%	408,855	18.95%	452,892	20.11%	475,006	20.98%	491,964	20.27%	550,774	21.45%
Deposits from customers	1,211,165	57.16%	1,192,944	55.29%	1,166,101	51.78%	1,151,077	50.84%	1,177,587	48.53%	1,176,565	45.81%
- Demand	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
- Time and savings	1,211,165	57.16%	1,192,944	55.29%	1,166,101	51.78%	1,151,077	50.84%	1,177,587	48.53%	1,176,565	45.81%
Issued debt securities	203,340	9.60%	204,104	9.46%	247,959	11.01%	275,714	12.18%	322,494	13.29%	368,272	14.34%
Financial derivatives instruments	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
- For hedging purposes	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
- Other	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Insurance liabilities	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Other liabilities	151,470	7.15%	174,772	8.10%	203,719	9.05%	183,586	8.11%	260,631	10.74%	303,969	11.84%
-Financial liabilities at fair value through P/L	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Subordinated debt	21,473	1.01%	22,009	1.02%	29,518	1.31%	29,884	1.32%	30,604	1.26%	36,731	1.43%
Hybrid Capital	1,957	0.09%	2,149	0.10%	2,350	0.10%	2,651	0.12%	3,106	0.13%	4,137	0.16%
Equity	157,943	7.45%	152,858	7.08%	149,344	6.63%	146,399	6.47%	140,371	5.78%	127,827	4.98%
Total liabilities and equity funds	**2,118,765**	**100.00%**	**2,157,698**	**100.00%**	**2,251,882**	**100.00%**	**2,264,317**	**100.00%**	**2,426,757**	**100.00%**	**2,568,275**	**100.00%**
Income Statement												
Interest income	53,792		61,433		66,739		72,058		86,219		97,191	
Interest expenses	-22,979		-28,807		-34,100		-39,394		-52,766		-61,657	
Net interest income and credit commissions	30,813	77.11%	32,626	80.47%	32,639	83.34%	32,664	80.54%	33,453	80.69%	35,534	83.77%
Net fees and commissions	8,049	20.14%	7,589	18.72%	7,123	18.19%	6,802	16.77%	6,837	16.49%	7,293	17.19%
Trading / FX Income	1,041	2.61%	516	1.27%	121	0.31%	1,359	3.35%	726	1.75%	-539	-1.27%
Net realised results on inv securities (AFS)	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Net results from other fin instr at fair value	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Net income from insurance operations	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Results from ass/subs accounted at equity	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Other operating income (incl. dividends)	58	0.15%	-188	-0.46%	-720	-1.84%	-269	-0.66%	441	1.06%	133	0.31%
Total operating income	39,961	100.00%	40,543	100.00%	39,163	100.00%	40,556	100.00%	41,457	100.00%	42,421	100.00%
Staff costs	-16,163	59.12%	-16,772	59.79%	-16,223	59.95%	-15,628	58.54%	-15,617	59.22%	-15,000	57.64%
Other operating costs	-11,176	40.88%	-11,279	40.21%	-10,840	40.05%	-11,069	41.46%	-10,753	40.78%	-11,024	42.36%
Depreciation/amortisation	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Total operating expenses	-27,339	100.00%	-28,051	100.00%	-27,063	100.00%	-26,697	100.00%	-26,370	100.00%	-26,024	100.00%
Pre-provision operating income	12,622		12,492		12,100		13,859		15,087		16,397	
Loan loss provisions	-2,985		-1,052		-1,483		-3,237		-58		6,266	
Post-provision operating income	9,637		11,440		10,617		10,622		15,029		22,663	
Impairment on (in)tangible assets	0		0		0		0		0		0	
Net gains/losses on (in)tangible assets	0		0		0		0		0		0	
Other non-operating items	-4,446		-4,830		-7,040		-5,780		-9,527		-17,551	
Pre-tax income	5,191		6,610		3,577		4,842		5,502		5,112	
Taxes	-3,499		-3,723		-3,386		-3,227		-3,409		-3,488	
Minority interest	0		0		0		0		0		0	
Net income	**1,692**		**2,887**		**191**		**1,615**		**2,093**		**1,624**	
Net income (USD)	2,049		3,496		231		2,225		2,760		2,109	

Sparkassen-Finanzgruppe In EUR Millions	31/12/2016 NGAAP	31/12/2015 NGAAP	31/12/2014 NGAAP	31/12/2013 NGAAP	31/12/2012 NGAAP	31/12/2011 NGAAP
Off-balance sheet and other items						
Asset under management	n/a	n/a	n/a	n/a	n/a	n/a
Derivatives (notional amount)	n/a	n/a	n/a	n/a	n/a	n/a
BIS Risk-weighted assets (RWA)	n/a	n/a	n/a	n/a	n/a	n/a
No. of employees (end-period)	n/a	n/a	n/a	n/a	341,200	345,600
Earnings and Expenses						
Earnings						
Net interest margin [1]	1.59%	1.64%	1.60%	1.56%	1.52%	1.55%
Pre-provision earning capacity (total assets basis) [2]	0.59%	0.57%	0.54%	0.59%	0.60%	0.63%
Pre-provision earning capacity (risk-weighted basis) [3]	n/a	n/a	n/a	n/a	n/a	n/a
Pre-provision earning capacity by employee	n/a	n/a	n/a	n/a	44,217	47,445
Post-provision earning capacity (total assets basis)	0.45%	0.52%	0.47%	0.45%	0.60%	0.88%
Post-provision earning capacity (risk-weighted basis)	n/a	n/a	n/a	n/a	n/a	n/a
Expenses						
Efficiency ratio (operating expenses / operating income)	68.41%	69.19%	69.10%	65.83%	63.61%	61.35%
All inclusive costs to revenues [4]	79.54%	81.10%	87.08%	80.08%	86.59%	102.72%
Operating expenses by employee	n/a	n/a	n/a	n/a	77,286	75,301
Loan loss provision / pre-provision operating income	23.65%	8.42%	12.26%	23.36%	0.38%	-38.21%
Provision coverage by net interest income	1032.26%	3101.33%	2200.88%	1009.08%	n/m	-567.09%
Profitability Returns						
Pre-tax return on Tier 1 (excl. hybrids)	n/a	n/a	n/a	n/a	n/a	n/a
Return on equity	1.83%	1.89%	0.13%	1.10%	1.49%	1.27%
Return on average total assets	0.13%	0.13%	0.01%	0.07%	0.08%	0.06%
Return on average risk-weighted assets	n/a	n/a	n/a	n/a	n/a	n/a
Dividend payout ratio [5]	n/a	n/a	n/a	n/a	n/a	n/a
Internal capital generation [6]	n/a	n/a	n/a	n/a	n/a	n/a
Growth						
Loans	0.97%	0.59%	0.59%	-3.04%	-0.97%	1.12%
Deposits	1.53%	2.30%	1.31%	-2.25%	0.09%	1.02%
Net interest income	-5.56%	-0.04%	-0.08%	-2.36%	-5.86%	0.78%
Fees and commissions	6.06%	6.54%	4.72%	-0.51%	-6.25%	1.42%
Expenses	-2.54%	3.65%	1.37%	1.24%	1.33%	-0.47%
Pre-provision earning capacity	1.04%	3.24%	-12.69%	-8.14%	-7.99%	-3.79%
Loan-loss provisions	n/a	n/a	n/a	n/a	-100.93%	n/a
Net income	-41.39%	1411.52%	-88.17%	-22.84%	28.88%	-46.89%
Risks						
RWA % total assets	n/a	n/a	n/a	n/a	n/a	n/a
Impaired loans (net of LLPs) % pre-provision operating income [7]	n/a	n/a	n/a	n/a	n/a	n/a
Impaired loans (net of LLPs) % equity	n/a	n/a	n/a	n/a	n/a	n/a
Liquidity and Funding						
Customer deposits % total funding	67.01%	65.26%	61.49%	59.59%	58.22%	55.18%
Total wholesale funding % total funding [8]	32.99%	34.74%	38.51%	40.41%	41.78%	44.82%
- Interbank % total funding	20.55%	22.37%	23.88%	24.59%	24.32%	25.83%
- Debt securities % total funding	11.25%	11.17%	13.07%	14.27%	15.94%	17.27%
- Subordinated debt % total funding	1.19%	1.20%	1.56%	1.55%	1.51%	1.72%
Short-term wholesale funding % total wholesale funding	62.29%	64.39%	62.01%	60.85%	58.22%	57.63%
Liquid assets % total assets	36.03%	37.09%	38.47%	39.98%	39.45%	41.46%
Net short-term wholesale funding reliance [9]	-28.91%	-28.83%	-29.83%	-31.66%	-31.67%	-34.18%
Adjusted net short-term wholesale funding reliance [10]	-28.91%	-28.83%	-29.83%	-31.66%	-31.67%	-34.18%
Customer deposits % gross loans	100.55%	100.00%	98.32%	97.63%	96.84%	95.82%
Capital [11]						
Tier 1 (As-reported)	15.10%	15.10%	14.60%	14.60%	13.10%	11.50%
Total Capital	n/a	n/a	n/a	n/a	n/a	n/a

[1] (Net interest income + dividends)% average interest earning assets.
[2] Pre-provision operating income % average total assets.
[3] Pre-provision operating income % average total risk-weighted assets.
[4] (Operating & non-op. costs) % (op. & non-op. revenues)
[5] Paid dividend % net income.
[6] (Net income - dividends) % shareholders' equity at t-1.
[7] We take into account the stock of LLPs in this ratio.
[8] Whole funding excludes corporate deposits.
[9] (Short-term wholesale funding - liquid assets) % illiquid assets
[10] (Short-term wholesale funding - liquid assets - loans maturing within 1 year) % illiquid assets
[11] Capital ratios of Interim results exclude profits for the year

Rating Methodology

The applicable methodology is the Global Methodology for Rating Banks and Banking Organisations (May 2017), which can be found on our website under Methodologies.

Ratings

Issuer	Debt	Rating	Rating Action	Trend
Sprarkassen-Finanzgruppe	Long-Term Issuer Rating	A	Trend Changed	Positive
Sprarkassen-Finanzgruppe	Short-Term Issuer Rating	R-1 (low)	Trend Changed	Positive
Sprarkassen-Finanzgruppe	Long-Term Senior Debt	A	Trend Changed	Positive
Sprarkassen-Finanzgruppe	Short-Term Debt	R-1 (low)	Trend Changed	Positive

Rating History

Debt	Current	2017	2016	2015	2014
Long-Term Issuer Rating	A	-	-	-	-
Short-Term Issuer Rating	R-1 (low)	-	-	-	-
Long-Term Senior Debt	A	A	A	A	A (high)
Short-Term Debt	R-1 (low)	R-1 (low)	R-1 (low)	R-1 (low)	R-1 (middle)

Previous Action(s)

- DBRS Confirms Sparkassen Group at ‘A’, Trend now Positive, March 27, 2018.
- DBRS Rates 383 Members of Sparkassen Group at A, Trend Pos, March 27, 2018.

Previous Report

- Sparkassen-Finanzgruppe, Rating Report, April 28, 2017

Note:
All figures are in Euros unless otherwise noted.

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