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RATING ACTION COMMENTARY

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

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Fitch Ratings - Frankfurt am Main - 09 Apr 2024: Fitch Ratings has affirmed Genossenschaftliche FinanzGruppe (GFG), its central institution DZ BANK AG Deutsche Zentral-Genossenschaftsbank (DZ BANK) and about 700 primary bank members of GFG's mutual support scheme, at their 'AA-' Long-Term Issuer Default Ratings (IDRs) with a Stable Outlook. GFG's Viability Rating (VR) has been affirmed at 'aa-'.

A full list of rating actions for all rated members of GFG is available below.

Fitch has withdrawn the ratings of 40 local cooperative banks because they no longer exist as separate entities following their merger with other members of the group.

KEY RATING DRIVERS

Leading German Retail and Commercial Group: GFG's ratings reflect the group's leading and highly diversified business profile, strong risk-adjusted capitalisation, low leverage, sound asset quality, a record of profitability that is considerably better than most German peers', as well as its outstanding funding profile by international standards. GFG's VR is one notch above the implied VR, reflecting the high importance of its strong business profile for the rating.

Mutual Support Mechanism: GFG is not a legal entity, but a cooperative banking network whose cohesion is ensured by an institutional protection scheme (IPS) 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 and its subsidiaries.

Diversified Business Model: GFG's domestically-focused, stable universal banking business model has delivered stable profits over several economic cycles. It is based on its local banks' strong domestic retail and small SME banking franchise interlinked and supported by DZ BANK group's product providers. The latter includes domestic market leaders in insurance, asset management, real estate, as well as DZ BANK's capital-market business. The business model benefits from a strong strategic alignment between DZ BANK and the local banks with intensified cooperation and cross-selling across GFG.

Conservative Risk Appetite: GFG's risk profile largely reflects the group's cooperative nature with a contained risk appetite. It is underpinned by granular credit exposures based on sound underwriting standards at primary banks, conservative securities portfolios and the benefit of liquidity pooling and transmission through DZ BANK.

DZ BANK's market risk is low and results from modest capital-market activities. GFG's decentralised risk- management structure provides adequate and effective risk controls. Unhedged interest-rate risk at the primary banks is high, resulting from asset/liability duration mismatches, which is a weakness.

Sound Asset Quality; Deterioration Ahead: GFG's sound asset quality remained resilient in 2023 including at the group's central institution despite macro-economic challenges. We expect impaired loans to modestly increase in the next two years, to up to 2% of gross loans due to rising insolvencies in the group's SME and commercial real-estate portfolios.

Resilient Underlying Profitability: GFG's operating profit recovered in 2023 to about 1.7% of its risk-weighted assets (RWAs), driven by reversals of temporary valuation losses (in 2022 from higher interest rates) on the banks' securities portfolios. In addition, the group benefited from higher net interest margins due to slow deposit repricing and healthy business volumes. In 2024 we expect lower operating profit, at about 1.3% of RWAs, due to primarily higher loan impairment charges, but also moderate credit growth and further deposit repricing.

Sound Capitalisation: The local banks and DZ BANK are both well-capitalised, and GFG's leverage ratio is high by international standards. We expect GFG's common equity Tier 1 (CET1) ratio to remain above 15% in the medium term, supported by traditionally high profit retention and slower loan growth than in previous years.

Very Stable Funding: The local banks are predominantly funded by granular, mostly price-insensitive domestic retail deposits, and their structurally large excess liquidity covers most of DZ BANK's short-term funding needs. Primary banks' customer deposit base was largely stable in 2023 despite a notable shift towards time deposits.

DZ BANK provides GFG with reliable access to wholesale markets as a frequent issuer of unsecured debt and the largest German covered bond issuer with an established and geographically diversified investor base.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

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

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

An upgrade of GFG's and of its members' ratings is unlikely given the already high ratings and in light of significant economic and financial uncertainties. In addition to a domestic environment that would allow higher lending margins, an upgrade would also require greater cost efficiency, which is likely to necessitate further streamlining of the group's structure, especially at the local banks beyond the current merger activity, as well as better asset quality and higher capitalisation.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

GFG's and its members' Short-Term IDRs of 'F1+' map to their Long-Term IDR of 'AA-'.

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

The deposit ratings of Deutsche Apotheker- und Aerztebank and of the local cooperative banks are aligned with GFG's IDRs due to the absence of sustainable significant resolution debt buffers at these entities. Each local bank is regulated individually as a less significant institution. Consequently, the German regulator's preferred resolution strategy for these banks consists of standard insolvency procedures, as opposed to the preferred bail-in resolution strategy for the DZ BANK group and Muenchener Hypothekenbank, each of which is directly under the authority of the European Single Resolution Board (SRB) and follows a single-point-of-entry approach. Therefore, the predominantly deposit-funded local banks have no incentive to build up resolution buffers. This is also the case for Deutsche Apotheker- und

Aerztebank, which is directly under the authority of the SRB, but is currently not required to maintain resolution buffers in excess of its capital requirements.

The ratings of the subordinated Tier 2 and additional Tier 1 notes (AT1) issued by DZ BANK and its subsidiaries are two and four notches below GFG's VR, respectively, which is the standard notching for this type of instruments under Fitch's criteria. We use the VR of GFG as the 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.

No Government Support Assumed: 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 ahead of the group receiving sovereign support.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

GFG's members' long-term debt and deposit ratings are sensitive to a change of GFG's Long-Term IDR. We could also downgrade DZ BANK's DCR and DZ BANK's and its subsidiaries' long-term senior preferred debt and deposit ratings and Muenchener Hypothekenbank's long-term deposit rating if we no longer expect them to maintain senior non-preferred and junior debt buffers above 10% of the banks' respective RWAs on a sustained basis.

The ratings of the subordinated Tier 2 notes issued by DZ BANK and its subsidiaries are sensitive to a change in GFG's VR.

DZ BANK'S AT1 notes' rating would be downgraded if GFG's VR is downgraded. In addition, the notes could be downgraded if non-performance risk increases relative to the risk captured in GFG's VR, for example if the BVR rules out the possibility of coupon payments if DZ BANK receives extraordinary support from the mutual support scheme, or if DZ BANK's buffer over coupon omission triggers declines below 100bp. An upgrade of the AT1 notes would require an upgrade of GFG's VR.

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

SUBSIDIARIES & AFFILIATES: KEY RATING DRIVERS

DZ BANK subsidiaries' issuer and debt ratings are aligned with those of DZ Bank.

SUBSIDIARIES AND AFFILIATES: RATING SENSITIVITIES

DZ BANK subsidiaries' issuer and debt ratings are sensitive to a change in DZ BANK's issuer or debt ratings.

VR ADJUSTMENTS

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

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

The capitalisation and leverage score of 'aa-' is above the 'a' implied category score due to the following adjustment reason: leverage and risk-weight calculation (positive).

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

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

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

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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FITCH RATINGS ANALYSTS

Roger Schneider
Director
Primary Rating Analyst
+49 69 768076 242
roger.schneider@fitchratings.com

Fitch Ratings – a branch of Fitch Ratings Ireland Limited
Neue Mainzer Strasse 46 - 50 Frankfurt am Main D-60311

Justus Roppertz
Senior Analyst
Secondary Rating Analyst
+49 69 768076 232
justus.roppertz@fitchratings.com

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

MEDIA CONTACTS

Peter Fitzpatrick
London
+44 20 3530 1103
peter.fitzpatrick@thefitchgroup.com

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 15 Mar 2024) (including rating assumption sensitivity)

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Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

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Bank fuer Sozialwirtschaft AG	EU Issued, UK E
Bank Im Bistum Essen eG	EU Issued, UK E
Bankhaus RSA eG	EU Issued, UK E
Bausparkasse Schwaebisch Hall AG	EU Issued, UK E
Bayerische BodenseeBank -Raiffeisen- eG	EU Issued, UK E
BBBank eG	EU Issued, UK E
Bensberger Bank eG	EU Issued, UK E
Berliner Volksbank eG	EU Issued, UK E
Bernhauser Bank eG	EU Issued, UK E
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Brandenburger Bank Volksbank-Raiffeisenbank eG	EU Issued, UK E

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch’s website.

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