Rating Report

Report Date:
28 June 2011

Previous Report:
7 April 2010

Sparkassen-Finanzgruppe

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The Company

Sparkassen-Finanzgruppe is a decentralized group of German public-sector financial institutions with strong market shares in many product categories of banking in Germany.

Recent Actions

30 June 2010
DBRS Rates 410 Members of Sparkassen-Finanzgruppe's Joint Liability Scheme at A (high), Trend Stable

7 April 2010
DBRS Confirms Floor Ratings, Releases Report on Sparkassen-Finanzgruppe

Ratings

Issuer	Debt Rated	Rating	Trend
Sparkassen-Finanzgruppe	Issuer & Senior Long-Term Debt	A (high)	Stable
Sparkassen-Finanzgruppe	Short-Term Instruments	R-1 (middle)	Stable

Rating Rationale

On 28 June 2011, DBRS Inc. (DBRS) confirmed its floor ratings for all members of the joint liability scheme (Haftungsverbund or the Scheme) of Sparkassen-Finanzgruppe (Sparkassen-Finanzgruppe or the Group). The floor ratings are based on the depth and resources of the joint liability scheme, the additional support for the Group's members from their public owners (Träger), as well as broader systemic support. The ratings also consider the underlying earnings potential and the solid franchise of the savings banks and the overall importance of the Group to the German banking sector. Offsetting these rating strengths are the elevated risk profile and weak overall earnings of several Landesbanks that are a significant part of the Group, and the level of competition in the savings banks' core business of German retail banking.

The floor ratings of A (high) for Issuer & Senior Long-Term Debt and R-1 (middle) for Short-Term Instruments apply to each member of Sparkassen-Finanzgruppe's joint liability scheme. The joint liability scheme includes 429 German savings banks, the eight Landesbank Groups, ten public-sector building societies (LBS), the Group's central asset manager DekaBank and other specialised service providers. The floor ratings indicate that each member of the joint liability scheme is rated at least at A (high) / R-1 (middle); however, this does not prevent members from potentially achieving higher individual ratings based on their individual credit assessment. (Continued on page 2)

Rating Considerations

Strengths

(1) Structure of the joint liability scheme, which makes Group resources available to all members of the Group and systemic support for Landesbanks
(2) Underlying earnings potential of Sparkassen-Finanzgruppe
(3) Solid franchise of the savings banks and the overall importance of the Group to the German banking sector

Challenges

(1) Minimising impact from the still uncertain economic environment and still elevated risk and weak performance at the weaker Landesbanks
(2) Managing impact from difficult credit environment on balance sheet and income statement
(3) Defending strong position of savings banks in German retail banking amid intense competition

Financial Information

Sparkassen-Finanzgruppe in EUR millions, unless noted otherwise / EUR Millionen, wenn nicht anders angegeben	31/12/2009 NGAAP	31/12/2008 NGAAP	31/12/2007 NGAAP	31/12/2006 NGAAP	31/12/2005 NGAAP
Total Assets / Bilanzsumme	2,582,782	2,684,968	2,683,358	2,519,019	2,430,095
Equity / Eigenkapital	126,678	115,307	110,050	104,990	100,023
Net Income / Jahresüberschuss nach Steuern	-2319.00	-5,379	2,734	7,676	5,377
Pre-prov op earnings % RWAs / Op Erträge vor Bewertung % Risikoaktiva	n/a	1.19	1.08	1.40	1.31
Post-prov op earnings % RWAs / Op Erträge nach Bewertung % Risikoaktiva	n/a	0.12	0.55	1.08	0.81
Net Interest Margin / Zinsmarge (%)	1.49	1.86	1.34	1.43	1.51
Efficiency Ratio / Kosten-Ertrags-Relation (%)	60.25	64.22	67.03	61.97	64.22
Tier 1 Capital Ratio / Kernkapitalquote (%)	10.12	8.82	8.50	8.36	8.27

Rating Rationale (Continued from page 1)

In DBRS's view, the joint liability scheme of Sparkassen-Finanzgruppe reduces the default risk for each member, because the Scheme makes financial resources available to each member of the Group. As such, the strength and structure of the scheme is a key factor considered in the floor ratings. The joint liability scheme is designed to ensure the solvency and viability of each member, thereby protecting creditors and counterparties. Since the Scheme's inception in 1973, no member has defaulted, which DBRS sees as indicating that the scheme fulfils its function. DBRS recognises, however, that the joint liability scheme has limitations, as it does not amount to a legal cross-guarantee. Moreover, while the combined resources of the joint liability scheme enable it to cope with most stress scenarios, they may be insufficient in a wider systemic crisis. These limitations are factored into the floor ratings.

As mentioned above, the internal support mechanism of Sparkassen-Finanzgruppe is complemented by external support for the Landesbanks, which form part of the Group, thereby adding a level of stability to the floor ratings. During the recent financial crisis, several Landesbanks received support from their public owners in the form of capital injections and other forms of support, such as risk shielding from the federal government. In DBRS's view, these measures reduce the need for additional support from the Group; however, they do not eliminate it. Further, DBRS sees the availability of this support as benefitting the Group, as it lessens the potential burden of the weaker Landesbanks on the Group. Importantly, however, any indication of reduced access to systemic support by the Landesbanks would likely lead to downward pressure on the floor ratings, as it would reduce the financial resources available to the members of Sparkassen-Finanzgruppe.

The floor ratings also consider the overall strong market positions and the solid franchises of the institutions forming Sparkassen-Finanzgruppe, as a whole entity. Together, the Group's members maintain leading positions across many areas of German banking, as demonstrated by the strong combined market shares of c. 43% in business lending, and also a 43% share in retail customer deposits at year-end 2010. The Group continues to see solid lending and deposits activity, especially within the savings banks. The Group's solid combined market share demonstrates its importance in the functioning of the German banking sector. The importance of the Group and the close relationship of its members is illustrated by the increasing levels of cohesion that exists between the savings banks, which allows for cost selling. While DBRS sees the Group's overall franchise strength as benefitting from the solid positioning of the savings banks, certain Landesbanks' franchises have been weakened by noteworthy exposure to volatile capital markets activities. Several of the Landesbanks are undertaking significant restructuring efforts, which if successfully executed, will reduce the overall risk to the Sparkassen-Finanzgruppe and the scheme.

The Sparkassen-Finanzgruppe's underlying earnings generation ability is factored into the rating, although the losses generated at several of the Landesbanks have negatively affected the overall Group's profitability in the past; this burden is lessening, as losses at these institutions have declined in the past year, as most Landesbanks have returned to a profitable situation in 2010. The solid franchises of the savings banks provide the foundation for relatively stable income generation. In 2009, the most recent year for which aggregate data is available, Sparkassen-Finanzgruppe recorded EUR 17.7 billion of operating earnings before other and non-operating income/expenses and before valuation results (which under German GAAP include losses on loans, securities, and prudential reserves). However, like other financial institutions across the globe, Sparkassen-Finanzgruppe's earnings are vulnerable to market disruption. In 2009, after considering negative valuation results of EUR 11.37 billion mostly due to losses at several Landesbanks, and further market-related losses of EUR 6.1 billion from other and non-operating activities (also mainly at the Landesbanks), the Group recorded an overall pre-tax profit of EUR 0.25 billion. This, however, was an improvement over 2008, in which the Group reported a EUR 3.7 billion pre-tax loss. Importantly, the savings banks have remained profitable throughout the cycle and, in fact, recorded improved pre-tax earnings of EUR 4.9 billion, increasing from EUR 2.2 billion in 2008. For the year 2009, the Group recorded a net loss of EUR 2.3 billion, of which EUR 5.1 billion of the net loss was attributed to the Landesbanks. The Landesbanks also recorded a net loss of EUR 6.7 billion in 2008. Profitability at the savings banks progressed well in 2010 with earnings before tax of EUR 4.1 billion as compared to EUR 2.5 in 2009.

In addition to the earnings volatility introduced through the Landesbanks, the overall risk profile of Sparkassen-Finanzgruppe is negatively affected by the elevated risk exposures of several Landesbanks, which include large structured securities portfolios and corporate lending to higher-risk industries. As discussed above, DBRS recognises that most Landesbanks are in various stages of restructuring, which should result in less risk; however, restructuring is timely and costly. Conversely, credit quality of the savings banks has remained rather resilient. The allowance for loan losses decreased by EUR 1.2 billion to EUR 1.7 billion and is now at the lowest level of the last 10 years.

The Sparkassen-Finanzgruppe's overall satisfactory liquidity and capitalisation are also considered in the ratings. Importantly, DBRS recognises that the strong deposit base and sound liquidity of the savings banks enables them to keep significant deposits with the Landesbanks, which assisted the Landesbanks' liquidity needs in recent years. The Group benefits from the strong, stable deposit franchise of the savings banks, while the wholesale-oriented funding profile of the Landesbanks weakens the overall Group's funding profile. The strong governmental liquidity support offered to the Landesbanks reduced the potential demands on the joint liability scheme during the financial crisis, thereby adding stability to the floor ratings. Capitalisation remains appropriate. Combined, the savings banks and Landesbanks reported a Tier 1 ratio of 10.1% at year-end 2009, up from 8.8% a year earlier.

DBRS views Sparkassen-Finanzgruppe as facing several challenges, which include minimising the impact of the still uncertain global economic environment, as well as managing the impact of the risk exposures and losses at some of the weaker Landesbanks. Longer term, the announced restructuring efforts at some of the Landesbanks will ultimately help achieve this task, as most of the Landesbanks that had enacted restructuring efforts have made significant progress in reducing risks of the business. The ultimate achievement of this challenge would improve the resiliency of the combined Group franchise. Further, the savings banks face the intense competition for retail banking products, maintaining margins and solid profitability in the core German retail banking operations that is a key challenge in this environment. This is particularly important, as the savings banks' solid retail franchise underpins the overall Group's franchise strength. Lastly, as with most financial institutions operating across the globe, the Group needs to manage the ever-changing regulatory environment. While DBRS sees the savings banks as well-positioned given their liquidity and capital positions, the Group, as a whole, including the Landesbanks, faces additional challenges. Nonetheless, given the importance of the Group to the German banking industry, DBRS sees this challenge as one that can be managed in an orderly fashion.

The trend on the floor ratings is Stable, reflecting DBRS's expectation that the support mechanisms will remain intact. Meanwhile, the positive performance of the savings banks and the longer-term expected lowered risk profile of the Landesbanks add stability, as the needs of support continue to be reduced. Given that the structure and strength of the joint liability scheme is a key rating factor, regulatory or other changes that would reduce the availability of support to the Group's members from the joint liability scheme and from external systemic support could negatively affect the support assessment.

Support Assessment (SA)

DBRS's expectation that the members of Sparkassen-Finanzgruppe's joint liability scheme have access to several sources of support is a key factor underpinning the floor ratings. One important source of support is the joint liability scheme, which makes internal resources of the Group available to members facing challenges. While the scheme's resources allow it to support even large savings banks, the scheme's resources may not be sufficient to address a systemic crisis where a large number of savings banks or Landesbanks require support. In a scenario where several Landesbanks faced challenges, DBRS would expect external support from their public owners, as well as systemic support from the federal government, to strengthen the financial resources of the Group's members, if needed. External support would thereby complement the internal support provided by the joint liability scheme. The expectation that such external support is available constitutes a key rating factor, as it stabilises the floor ratings. These considerations are reflected in an SA-2 support assessment for the members of the joint liability scheme.

Rating Consideration Details

Strengths

(1) Structure of the joint liability scheme, which makes Group resources available to all members, and systemic support for Landesbanks

DBRS views the depth of the joint liability scheme and the resources it makes available to all Group members as the key factor underpinning the floor ratings. The joint liability scheme is designed to ensure the viability of each member institution. In DBRS's view, the joint liability scheme, combined with the availability of additional public owner and systemic support, reduces the default probability for each member. Moreover, DBRS sees the substantial support for the Landesbanks from their government owners and the federal government as beneficial for Sparkassen-Finanzgruppe. This support helped safeguard the liquidity and capitalisation of several Landesbanks that faced challenges during the recent financial crisis. DBRS sees systemic support for the Landesbanks as reducing the potential demands on the joint liability scheme and on other members of the Group, which adds a level of stability to the floor ratings.

(2) Underlying earnings potential of Sparkassen-Finanzgruppe

The Group generates sizeable underlying earnings from the strong franchise positions of its members. While consolidated financials for the Group is not available, the savings banks generated a pre-tax income of EUR 4.1 billion for 2010, indeed a solid result. Moreover, all but one of the Landesbanks reported profits for 2010. As such, DBRS expects profitability for the Group to be significantly better than in the past. For 2009, Sparkassen-Finanzgruppe was largely breakeven before tax, largely attributed to the losses generated at the Landesbanks. In 2008, outsized losses at the Landesbanks caused the Group to record a large net loss of EUR 2.3 billion, despite positive contributions from the savings banks and LBS. Going forward, DBRS sees Sparkassen-Finanzgruppe's overall profitability metrics as improving, given the rather successful restructuring of some of the weaker Landesbanks.

(3) Solid franchise of the savings banks and overall importance of the Group to the German banking sector

The solid franchise of the savings banks positively affects the overall franchise strength of Sparkassen-Finanzgruppe. The savings banks have particularly strong positions in transactional accounts, savings deposits and retail lending in Germany, with market share in excess of 40% in some products. In addition to generating relatively stable earnings, the solid market share illustrates the overall importance of the Group to the German banking sector. The dense network of the savings banks, with 15,685 branch locations, makes them key providers of financial services in Germany. Further illustrating the critical role of the savings banks is their mandate under public law to promote savings and improve access to banking services in the communities they serve. The franchise strength of the savings banks is also reflected in their EUR 768 billion of customer liabilities (including certificated liabilities) at year-end 2010, which underpins their sound funding profile.

Challenges

(1) Minimising impact of the still uncertain global economic environment and the risk exposures at several Landesbanks

While the impact continues to be reduced, the financial crisis has particularly impacted four Landesbanks, causing large losses and necessitating substantial support measures. Most of this support came from the public owners of the Landesbanks and partly from the German Financial Markets Stabilisation Fund (SoFFin); however, the savings banks and the joint liability scheme also committed capital support and gave risk guarantees. The savings banks continue to support the liquidity of Landesbanks, by keeping large amounts of deposits at the Landesbanks. The extensive restructuring efforts undertaken at several Landesbanks will help the Group in managing this challenge.

Moreover, given the still muted and uneven global economic recovery and the uncertainties at several peripheral Euro zone sovereigns, DBRS sees the savings banks as facing uncertainties regarding credit costs. While DBRS recognises that credit costs were down significantly in 2010, continuation of this trend may be difficult should the economic recovery falter. As the leading lenders to small and medium-sized enterprises (SMEs) in Germany, the savings banks are exposed to credit quality deterioration in this segment.

(2) Defending strong position of savings banks in German retail banking amid intense competition
As the market leader in many areas of German retail banking, the savings banks continue to face strong competition. Defending their strong retail position poses an important task, as this franchise underpins the strength of Sparkassen-Finanzgruppe overall. Competitive pressure is intense, as the financial crisis has led many banks to re-focus on traditional deposit-gathering and retail lending activities. Although the net interest spread for the savings banks improved slightly in 2010 after several years of gradual decline, DBRS expects that competitive pressure will continue to constrain margins. Nonetheless, DBRS recognises the increase in deposits and the increased level of lending volumes at the savings banks, which in DBRS's view, illustrates the strength of the franchise and the safety of the Sparkassen name.

(3) Managing the impact of the ever-changing regulatory environment.
Like all other financial institutions operating across the globe, the savings banks face uncertainties regarding the ever-changing regulatory environments. While DBRS views the savings banks themselves as well-positioned to meet future repertory changes, as we understand them today, the Group and its entirety may be more challenged. Nonetheless, with the success of many of the restructuring efforts at the Landesbanks, and the increased capital generated at these institutions, DBRS sees the Group as well-positioned to meet this challenge.

Rating Drivers

Factors with Positive Rating Implications
Given the level of the ratings and DBRS's floor concept, upward rating momentum would be unlikely short of an external event. Nonetheless, DBRS views positively its solid earnings and balance sheet management at the Group level, and the de-risking at Landesbank level.

Factors with Negative Rating Implications
Negative ratings pressure would result from indications that the Landesbanks' access to support from their public owners and the federal government was reduced. Downward ratings momentum could also be caused by a weakening of the savings banks' franchise and their underlying earnings ability, and by further outsized losses at the Landesbanks that weaken the overall Group's financial resources. Changes to the joint liability scheme that reduce the availability of support to its members would cause downward ratings pressure.

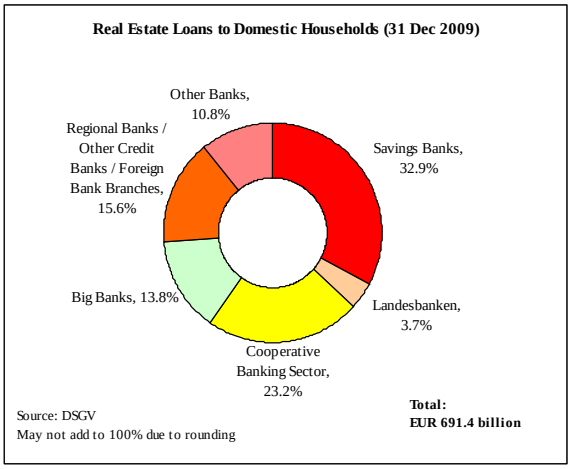
Franchise Strength - Description of Operations

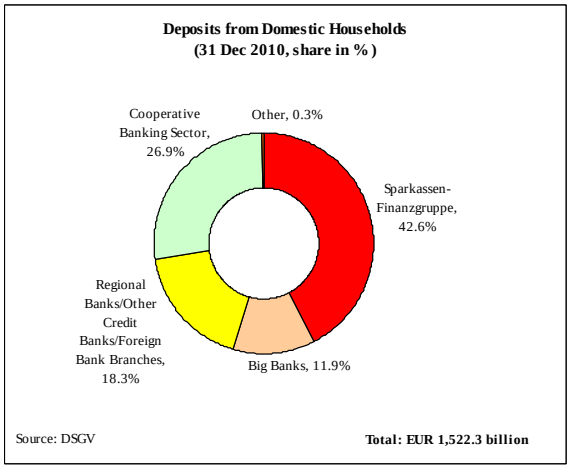
Together, the members of Sparkassen-Finanzgruppe's joint liability scheme form one of the largest financial Groups globally, with total aggregated assets of EUR 2.6 trillion as of year-end 2010. Sparkassen-Finanzgruppe primarily comprises three constituent Groups with distinct franchises – the German savings banks, the Landesbanks and the public-sector building societies (Landesbausparkassen, or LBS). 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 Landesbanks negatively affects the overall Group.

The 429 German savings banks as of 31 December 2010 have a strong, relatively stable franchise, which, as discussed above, is a key rating consideration. With EUR 1083 billion in total assets, and over EUR 767.8 billion customer deposits (including certificated liabilities) at year-end 2010, the savings banks enjoy leading market positions across a wide range of financial services provided to retail customers and SMEs in Germany. The public owners (Träger) of most savings banks are the municipalities and the regions in which they operate.

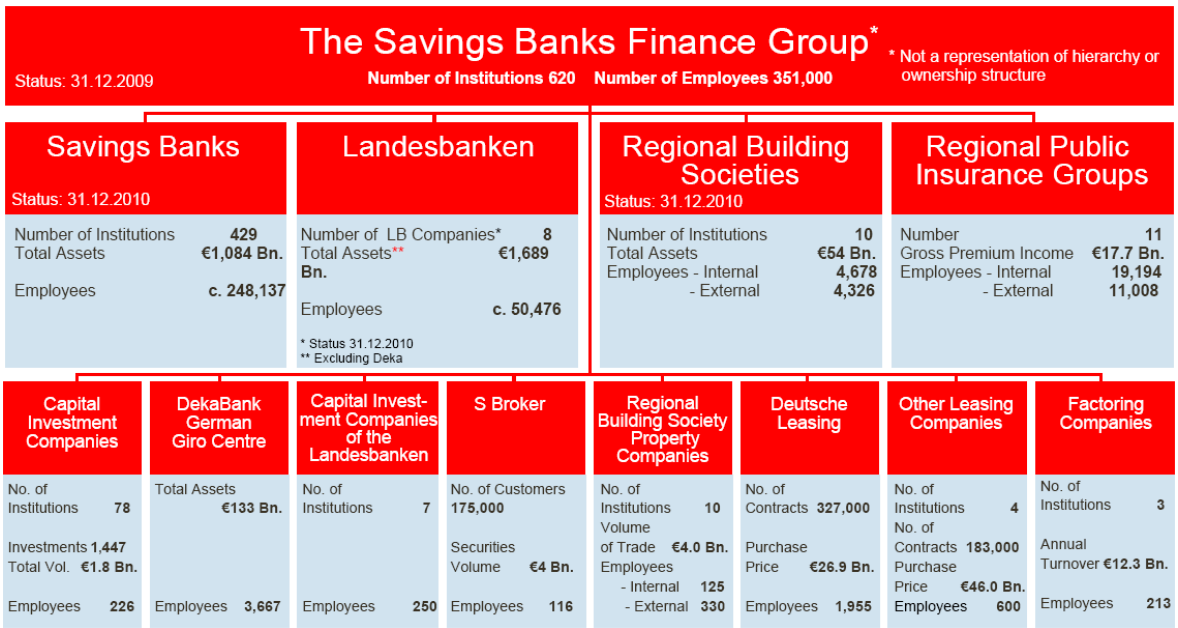
The strong combined position of the member institutions of Sparkassen-Finanzgruppe in German banking is demonstrated by their market share in core products, with a combined 43% share in retail customer deposits (including LBS) and also 43% in business lending at year-end 2010. The savings banks had EUR 227 billion in domestic residential real estate loans at year end 2009, comprising a sizeable 32.9% market share, whilst the Landesbanks have an additional EUR 26 billion in real estate loans to domestic households, or 3.7% of

the total. The members of Sparkassen-Finanzgruppe also have strong customer deposit franchises. At the savings bank level, deposits from households totalled EUR 593.9 billion at 31 December 2009, representing a market share of 40.4%. The Landesbanks had EUR 37 billion in customer deposits or 2.5% market share in customer deposits.





The eight Landesbank Groups are mostly active in wholesale banking. The Landesbanks are important lenders to medium- to large-sized corporations and public-sector entities in their domestic regions. The Landesbanks are also significant participants in international loan syndication, money markets, securitisation and asset-based financing; however, the current restructuring at several Landesbanks will significantly change their profiles. Most Landesbanks are jointly owned by the states in which they are headquartered (reflecting their origin as state banks) and regional savings banks associations. However, the savings banks' stakes in two Landesbanks have been diluted, after they did not participate in recent capital injections. The franchises of the Landesbanks vary. Some Landesbanks have successfully developed more diverse franchises; however, in aggregate the Landesbanks are more vulnerable to market dislocations than the savings banks.



The ten regionally-focused public-sector building societies (LBS) that also form part of Sparkassen-Finanzgruppe have a combined market-leading position in home savings and loans products which are mainly distributed by the savings banks. They are mostly owned by regional savings banks associations and Landesbanks. Other members of the joint liability scheme of Sparkassen-Finanzgruppe include DekaBank,

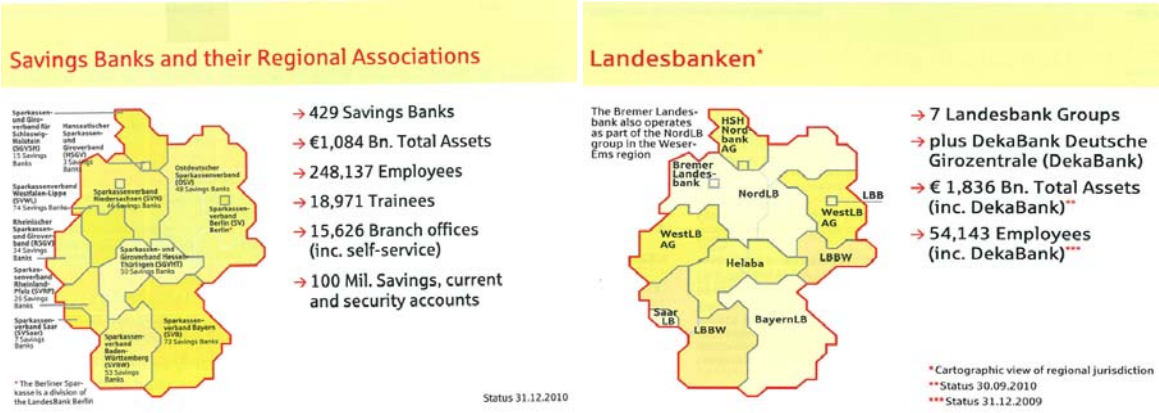
the central asset manager of Sparkassen-Finanzgruppe, and other smaller providers of specialised financial products. DekaBank is the third largest mutual funds manager in Germany, providing key asset management products that the savings banks offer to their retail customers. The broader Sparkassen-Finanzgruppe 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 joint liability scheme and therefore do not benefit from DBRS's floor ratings.

Joint Liability Scheme

DBRS sees the joint liability scheme as a key factor underpinning the floor rating, as it makes resources of the Group available to all members. Since the scheme's inception in 1973, no member of Sparkassen-Finanzgruppe has defaulted. The joint liability scheme is not tantamount to a cross-guarantee, which negatively affects the floor ratings. 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 Landesbanks and the LBS. If a decision has been made to support a member, such support is initially provided by that 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 joint liability scheme can be utilised. 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.

In support cases, the mechanisms of the joint liability 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 Landesbanks, most support cases of the joint liability scheme involve small institutions. 90% of all support cases can be handled by the challenged member's regional support fund alone, without additional resources from the system of support funds. DBRS recognises, however, that the combined resources of the joint liability scheme are not sufficient, nor was the Scheme designed, to address a wider systemic crisis. This is viewed as a weakness that negatively affects the floor ratings. However, as discussed above, this weakness is partly mitigated by the access to additional sources of external support that the members of Sparkassen-Finanzgruppe enjoy, most importantly from their public owners, from the federal German government, and from regional support funds that savings banks and Landesbanks 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 for prudent risk management.

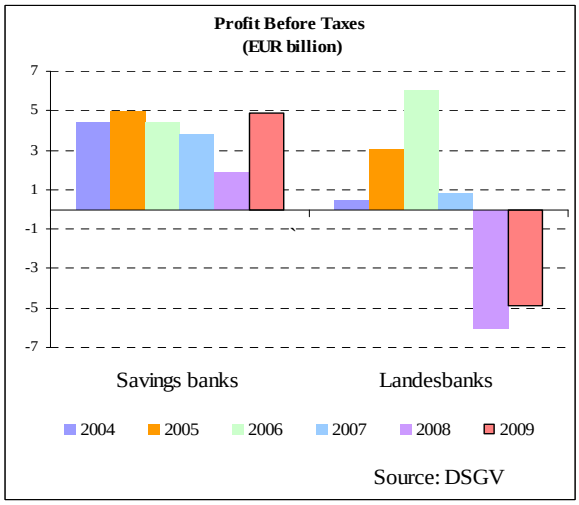


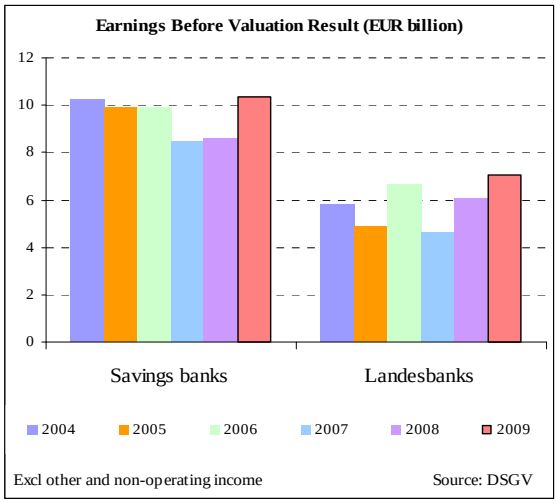
DBRS notes that the members of the joint liability scheme have strong incentives to support each other, which is critical to ensure the functioning of the system, due to the lack of a legally binding cross-guarantee. A default by any member would cause reputational damage for the overall Group. Customers 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 used by all savings banks. Similarly, most Landesbanks 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 utilising the support mechanism in most stress cases.

In addition, DBRS sees strong economic incentives for the Scheme's members to support each other. Savings banks that run into difficulties typically have strong market positions, which constitute a franchise value for Sparkassen-Finanzgruppe. In addition, the significant joint business that the Group members conduct with each other creates an economic incentive to provide support. The savings banks are also major shareholders of most Landesbanks, creating an economic incentive to support them. For those Landesbanks where the savings banks no longer own substantial interests, the economic incentive to provide support has declined; however, this has been replaced by support from the state owners of these Landesbanks.

Earnings Power

Although Sparkassen-Finanzgruppe has sizeable earnings potential, the Group's net performance has been negatively affected by the earnings volatility and losses generated at several Landesbanks. In 2009, the most recent year for which aggregate data is available, the overall Group generated a sizeable EUR 17.7 billion of operating earnings before other and non-operating income/expenses and valuation results (which under German Commercial Code (HGB) includes losses on loans, securities and prudential reserves). For the year ending 31 December 2009, the Group generated a net loss of EUR 2.3 billion, of which EUR 5.1 billion were attributed to the Landesbanks and a positive EUR 2.7 billion was attributed to net income at the tax from the savings banks. Profitability at the savings banks progressed well in 2010 with earnings before tax of EUR 4.1 billion as compared to 2.5 billion in 2009. Importantly, the operating earnings before valuation result for Sparkassen-Finanzgruppe continue show solid momentum, reflecting higher net interest income, which was helped by volume growth and slightly improved yields, and good cost control. However, as discussed earlier, the EUR 11.4 billion of valuation losses and EUR 6.1 billion of other and non-operating expenses led to a net loss of EUR 2.3 billion for the Sparkassen-Finanzgruppe in 2009. Both the valuation loss and non-operating expenses were largely driven by several Landesbanks which were particularly affected by the financial crisis.





The Savings banks generate relatively stable underlying earnings, which positively affect the overall Group's earnings profile, and thereby support the ratings. To this end, the savings banks reported net pre-tax profit of EUR 4.1 billion in 2010, increasing from EUR 2.5 in 2009. The 2010 result showed an increased interest income and lower credit costs. DBRS sees the overall performance of the savings banks as demonstrating their ability to generate positive earnings through a variety of financial conditions.

While aggregated data for the Landesbanks is not yet available, given the individual results reported to date, DBRS expects much improved aggregated results. DBRS notes that most Landesbanks either remained profitable or returned to profitability in 2010. The weaker Landesbanks benefitted from their restructuring efforts, de-risking the balance sheets, and risk shields provided by their public owners. DBRS notes that there is still a large difference in underlying earnings ability and long term viability between the Landesbanks. In 2009, the Landesbanken reported a net loss before taxes of EUR 4.9 billion which negated the positive results of the Sparkassen. This was on the heels of a EUR 6.1 billion aggregate loss for the Landesbanks in 2009, which led Sparkassen-Finanzgruppe to record a large overall loss. The negative performance of the Landesbanks is partly offset by the substantial support from their public owners. In the longer run, however, DBRS expects that the Landesbanks' earnings volatility will be greatly reduced by the restructuring efforts currently underway. However, additional time is needed.

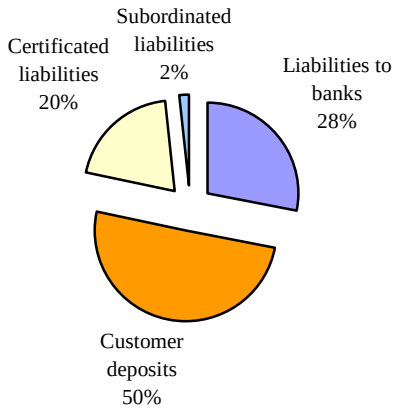
Positively, the savings banks recorded improved net interest income in 2009. Net interest income increased by 7.7% to EUR 36.7 billion; the improvement followed several years of declining spreads and partly reflected the steep yield curve and a shift towards shorter-term customer deposits and longer loan maturities. DBRS expects interest margins for the savings banks to remain under pressure from intense competition for deposits. The Landesbanks generate relatively low interest spreads, on average, reflecting relatively narrow spreads on their large corporate lending and securities and the cost of their wholesale funding.

Cost efficiency for Sparkassen-Finanzgruppe is relatively low in an international context. The expense ratio reflects the Group's decentralised structure with multiple legally independent entities. DBRS recognises that efforts by the savings banks to centralise back-office functions in recent years have started to show results, with the cost-income ratio declining for two consecutive years, albeit to a still-high 60.6% but has improved from 63% in 2009.

Funding and Liquidity

DBRS views the liquidity and funding position of Sparkassen-Finanzgruppe as satisfactory, as the Group benefits from the strong deposit franchise of the savings banks. Although the savings banks benefit from their strong deposit-gathering ability, the Landesbanks are largely wholesale-funded, which in turn weakens the overall Group's funding profile. Reflecting the combination of the strong deposit base of the savings banks and the wholesale-oriented funding profile of the Landesbanks, Sparkassen-Finanzgruppe overall had a noteworthy wholesale funding reliance of 50% of total funding at year-end 2009. Customer deposits of EUR 1.2 trillion accounted for the remaining 50% of Group funding.

Sparkassen-Finanzgruppe Funding EUR bill (31/12/09)



Total: EUR 2,308 billion Source: DSGV

The savings banks' stable liabilities to customers of EUR 768 billion (including certificated liabilities) at year-end 2010, provide the foundation for a funding profile. Importantly, the savings banks' customer liabilities demonstrated stable performance through the financial crisis, growing by 6.8% since year-end 2007. Liquidity at the savings banks is further illustrated by liabilities to customers exceeding customer loans by EUR 107 billion at year-end 2010. The liquidity ratio according to regulation is 2.5%, which is significantly above the 1% minimum requirements.

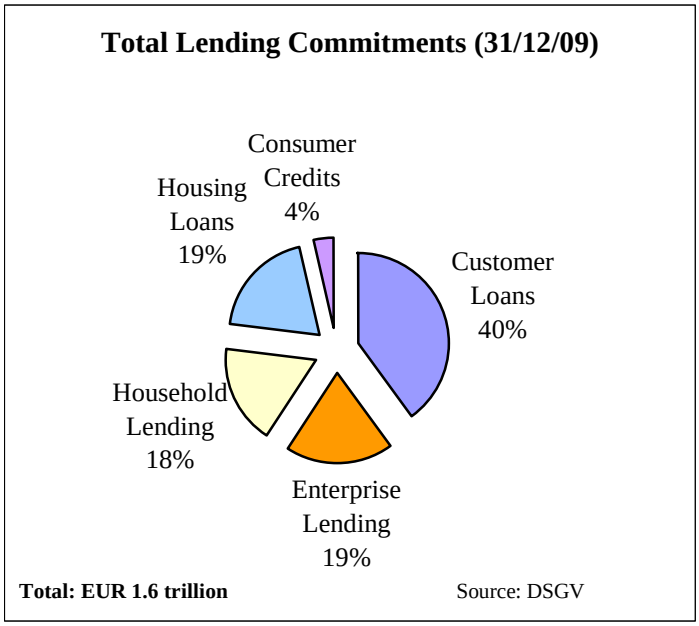
Given their largely wholesale business models, the Landesbanks in aggregate rely much more on market funding. The funding pressures for some Landesbanks highlight the vulnerability to market disruption. Importantly, to relieve the funding stress and safeguard each Landesbank's funding ability through the crisis, the state owners and the federal government promptly announced debt guarantees for the Landesbanks. As market conditions have normalised, the Landesbanks have returned unutilised guarantees.

DBRS recognises that several Landesbanks have relatively stable funding relationships with savings banks that keep a portion of their excess deposits with them. These funding relationships helped several Landesbanks manage through the recent period of market disruption, adding a level of stability to their funding profile.

One factor that will add to the funding needs for Landesbanks in coming years is the large amount of maturing debt that was issued under explicit state guarantees before July 2005. This debt will have to be replaced with unguaranteed funding. On the other hand, ongoing asset reduction efforts at most Landesbanks will have an offsetting effect on funding needs in the near to medium term. DBRS expects that the Landesbanks would weather any renewed disruption in funding markets, helped by the availability of systemic support that was demonstrated in the recent financial crisis.

Risk Profile

The risk profile of Sparkassen-Finanzgruppe has improved over the past year given the various risk reduction measures undertaken at the weaker Landesbanks. Nonetheless, there is still elevated exposure at several Landesbanks. This somewhat outweighs the overall sound risk profile of the savings banks; however, the restructuring and de-risking efforts has reduced this drag on the Group. As such, in the longer term, DBRS sees the overall risk profile benefitting from the restructuring efforts at some of the Landesbanks.



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 with the country. Moreover, the exposures in the aggregate loan portfolio of the savings banks are highly granular. Further, the Group has sizeable exposures to business lending, which amounted to EUR 320 billion or 49% of total receivables at year-end 2010. Given the nature of business lending and the overall vulnerability of SMEs to the economic cycle, DBRS views this portfolio as increasing the overall risk profile of the Group. Yet, the Group's large real estate lending to private customers and loans to public authorities have performed well through past economic cycles, adding a level of stability to overall credit quality. Real estate loans to private customers amounted to approximately EUR 230 billion, or 24% of the total book) at year-end 2010, while loans to public authorities (mainly domestic) stood at EUR 142.4 billion. Further, Sparkassen-Finanzgruppe's lending to private individuals (excluding real estate) moderates the risk profile, given the high barriers to personal bankruptcy filings in Germany and the long track record of the savings banks (which account for most private loans) in lending to their local customers.

Historically, DBRS viewed the highest credit risk for Sparkassen-Finanzgruppe in the corporate loan portfolios of several Landesbanks. While the financial crisis in 2008 primarily affected their securities portfolios, the subsequent recession and current period of still uncertain economic direction may put pressure on credit quality. While DBRS recognises large differentials in credit performance between the Landesbanks, and the sizeable de-risking and restructuring that has taken place since the crisis, DBRS still views this as a risk to the Group.

Notwithstanding, as discussed above, the savings banks are exposed to the economic cycle through the businesses' and sole proprietors' (SMEs) loan books. Performance continues to be within DBRS's expectations, and 2010 results indicated improved credit performance. Nonetheless, performance may falter, if the still-fragile economic situation deteriorates. The savings banks' aggregate lending to businesses and sole proprietors is diversified across sectors, with the broad services sector accounting for the largest portion at 56% of total business lending at year-end 2008, followed by the also broad sectors automotive (14%) and manufacturing (12%). 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 and centralised software and credit scoring systems.

DBRS notes that the savings banks have recorded significantly lower credit losses in 2010. While we recognise this positive direction, the still uncertain environment causes us to pause. Notwithstanding, given

the loss mitigation efforts taken by the savings banks, and the reduced risk profile of most of the Landesbanks, DBRS sees credit risk of the Group as significantly lower than it was in the past.

Capitalisation: Structure and Adequacy

DBRS views Sparkassen-Finanzgruppe's overall capitalisation as sufficient. This view considers the overall sound capital and solid underlying earnings of the savings. The savings banks reported a Tier 1 ratio of 9.9% at year end 2010 and a total capital ratio of 15.1% at year end 2010, both increasing from a year before. For the Group combined, the Tier 1 capital was 10.1% at year end 2009, improved in recent years, driven by consistent internal capital generation at the savings banks, reduction on RWAs, and capital injections for the Landesbanks.

The savings banks have increased their regulatory capitalisation in recent years largely through earnings retention and additions to prudential reserves. Internal capital generation and slow growth in risk-weighted assets (RWAs) led to consistent increases in the savings banks' Tier 1 ratio. The capital of the savings banks is of solid quality. Almost all their Tier 1 capital of EUR 55 billion at year-end 2009 consisted of subscribed capital, open reserves and prudential reserves, with only a small contribution from hybrids (silent participations).

Capital resources at the Landesbanks are viewed as weaker and of lower quality, which dilutes the capital strength of Sparkassen-Finanzgruppe overall. The Landesbanks had a combined Tier 1 ratio of 8.3% at year-end 2008 (the latest year for which aggregate data is available), down from 8.43% at year-end 2007. The year-on-year decline mainly reflected the aggregate net loss recorded for the Landesbanks. To ensure compliance with minimum capital standards throughout the financial crisis, the state owners and SoFFin committed EUR 36.3 billion in risk guarantees and EUR 21 billion in capital to the Landesbanks. As discussed, ongoing government support partly mitigates the weak capitalisation of several Landesbanks.

The quality of capital at the Landesbanks is diluted by the high contribution from silent participations to Tier 1 capital. Silent participations are subject to non-payment of interest and to write-downs under certain conditions. However, any written-down amounts are written back in subsequent years, provided that the issuer generates sufficient earnings. Several Landesbanks have utilised the non-payment and write-down features of their silent participations and other hybrids (such as profit participation rights, which are part of Tier 2 capital) in recent periods.

Sparkassen-Finanzgruppe
Report Date:
28 June 2011

Financial Information

Sparkassen-Finanzgruppe	31/12/2009	31/12/2008	31/12/2007	31/12/2006	31/12/2005
	€	€	€	€	€
In EUR Millions	**NGAAP**	**NGAAP**	**NGAAP**	**NGAAP**	**NGAAP**
Balance Sheet					
Cash and deposits with central banks	31,572	32,986	27,729	25,832	25,704
Lending to/deposits with credit institutions	615,887	731,111	788,376	693,883	687,047
Financial securities	599,251	572,299	580,774	573,160	533,598
- Trading portfolio	n/a	n/a	n/a	n/a	n/a
- At fair value	n/a	n/a	n/a	n/a	n/a
- Available for sale	n/a	n/a	n/a	n/a	n/a
- Held-to-maturity	n/a	n/a	n/a	n/a	n/a
- Other	599,251	572,299	580,774	573,160	533,598
Financial derivatives instruments	n/a	n/a	n/a	n/a	n/a
- For hedging purposes	n/a	n/a	n/a	n/a	n/a
- Other	n/a	n/a	n/a	n/a	n/a
Gross lending to customers	1,200,470	1,207,665	1,160,191	1,111,828	1,077,586
- Loan loss provisions	n/a	n/a	n/a	n/a	n/a
Insurance assets	n/a	n/a	n/a	n/a	n/a
Investments in associates/subsidiaries	41,722	49,559	48,407	41,812	42,796
Fixed assets	12,993	13,389	13,946	14,729	14,905
Goodwill and other intangible assets	n/a	n/a	n/a	n/a	n/a
Other assets	80,887	77,959	63,935	57,775	48,459
Total assets	**2,582,782**	**2,684,968**	**2,683,358**	**2,519,019**	**2,430,095**
Total assets (USD)	3,701,695	3,784,999	3,918,508	3,325,785	2,877,864
Loans and deposits from credit institutions	649,465	754,127	829,671	737,121	682,737
Deposits from customers	1,160,141	1,146,261	1,067,457	1,025,738	997,991
- Demand	n/a	n/a	n/a	n/a	n/a
- Time and savings	1,160,141	1,146,261	1,067,457	1,025,738	997,991
Issued debt securities	458,371	482,621	496,983	480,092	492,008
Financial derivatives instruments	n/a	n/a	n/a	n/a	n/a
- For hedging purposes	n/a	n/a	n/a	n/a	n/a
- Other	n/a	n/a	n/a	n/a	n/a
Insurance liabilities	n/a	n/a	n/a	n/a	n/a
Other liabilities	140,872	135,007	167,483	158,528	144,638
Subordinated debt	39,827	41,220	11,714	12,550	12,698
Hybrid Capital	7,428	10,425	n/a	n/a	n/a
Equity	126,678	115,307	110,050	104,990	100,023
Total liabilities and equity funds	**2,582,782**	**2,684,968**	**2,683,358**	**2,519,019**	**2,430,095**
Income Statement					
Interest income	109,816	148,835	145,665	130,938	123,744
Interest expenses	-73,134	-114,774	-112,887	-97,490	-89,814
Net interest income and credit commissions	36,682	34,061	32,778	33,448	33,930
Net fees and commissions	7,028	8,100	8,296	8,050	7,552
Trading / FX Income	1,131	-1,478	-1,576	1,186	421
Net realised results on inv securities (AFS)	n/a	n/a	n/a	n/a	n/a
Net results from other fin instr at fair value	n/a	n/a	n/a	n/a	n/a
Net income from insurance operations	n/a	n/a	n/a	n/a	n/a
Results from ass/subs accounted at equity	n/a	n/a	n/a	n/a	n/a
Other operating income (incl. dividends)	-263	1,238	1,202	1,483	200
Total operating income	44,578	41,921	40,700	44,167	42,103
Staff costs	-15,740	-15,553	-15,425	-16,285	-15,847
Other operating costs	-11,119	-11,367	-11,857	-11,084	-11,192
Depreciation/amortisation	0	0	n/a	n/a	n/a
Total operating expenses	-26,859	-26,920	-27,282	-27,369	-27,039
Pre-provision operating income	17,719	15,001	13,418	16,798	15,064
Valuation result	-11,369	-13,508	-6,571	-3,918	-5,723
Post-provision operating income	6,350	1,493	6,847	12,880	9,341
Impairment on (in)tangible assets	0	0	0	0	0
Net gains/losses on (in)tangible assets	0	0	0	0	0
Other non-operating items	-6,103	-5,125	-2,157	-2,297	-1,184
Pre-tax income	247	-3,632	4,690	10,583	8,157
Taxes	-2,566	-1,747	-1,961	-2,907	-2,780
Minority interest	0	0	0	0	0
Net income	**-2,319**	**-5,379**	**2,734**	**7,676**	**5,377**
Net income (USD)	-3,324	-7,583	3,985	10,134	6,368

Sparkassen-Finanzgruppe
Report Date:
28 June 2011

Sparkassen-Finanzgruppe	31/12/2009	31/12/2008	31/12/2007	31/12/2006	31/12/2005
	€	€	€	€	€
In EUR Millions	NGAAP	NGAAP	NGAAP	NGAAP	NGAAP
Off-balance sheet and other items					
Asset under management	n/a	n/a	n/a	n/a	n/a
Derivatives (notional amount)	n/a	n/a	n/a	n/a	n/a
BIS Risk-weighted assets (RWA)	n/a	1,253,724	1,266,523	1,214,258	1,179,981
No. of employees (end-period)	366500	377,229	377,441	371,323	376,248
Earnings and Expenses					
Earnings					
Net interest margin [1]	1.49%	1.86%	1.34%	1.43%	1.51%
Pre-provision earning capacity (total assets basis) [2]	0.67%	0.78%	0.53%	0.69%	0.65%
Pre-provision earning capacity (risk-weighted basis) [3]	n/a	1.19%	1.08%	1.40%	1.31%
Pre-provision earning capacity by employee	48,347	39,766	37,691	45,400	39,958
Post-provision earning capacity (total assets basis)	0.24%	0.08%	0.27%	0.53%	0.40%
Post-provision earning capacity (risk-weighted basis)	n/a	0.12%	0.55%	1.08%	0.81%
Expenses					
Efficiency ratio (op expenses / op income)	60.25%	64.22%	67.03%	61.97%	64.22%
All inclusive costs to revenues [4]	73.94%	76.44%	72.33%	67.17%	67.03%
Operating expenses by employee	73,285	71,362	76,635	73,970	71,721
Loan loss provision / pre-provision operating income	64.16%	90.05%	48.97%	23.32%	37.99%
Provision coverage by net interest income	322.65%	252.15%	498.83%	853.70%	592.87%
Profitability Returns					
Pre-tax return on Tier 1 (excl. hybrids)	n/a	n/a	n/a	n/a	n/a
Return on equity	-1.83%	-4.66%	2.48%	7.31%	5.38%
Return on average total assets	-0.09%	-0.28%	0.11%	0.32%	0.23%
Return on average risk-weighted assets	n/a	-0.43%	0.22%	0.64%	0.47%
Dividend payout ratio [5]	n/a	n/a	n/a	n/a	n/a
Growth					
Loans	-0.60%	4.09%	4.35%	3.18%	1.45%
Deposits	1.21%	7.38%	4.07%	2.78%	4.00%
Net interest income	7.70%	3.76%	-2.00%	-1.42%	-0.45%
Fees and commissions	-13.21%	-2.35%	3.06%	6.59%	3.58%
Expenses	-0.22%	-1.34%	-0.32%	1.22%	2.60%
Pre-provision earning capacity	18.13%	8.42%	-20.12%	11.51%	-7.17%
Loan-loss provisions	n/a	103.50%	67.71%	-31.54%	-14.91%
Net income	-57.06%	-174.73%	-64.45%	42.76%	163.57%
Risks					
RWA% total assets	n/a	46.69%	47.20%	48.20%	48.56%
Credit Risks					
Impaired loans % gross loans	n/a	n/a	n/a	n/a	n/a
Loss loan provisions % impaired loans	n/a	n/a	n/a	n/a	n/a
Impaired loans (net of LLPs) % pre-provision op inc [7]	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
Liquidity and Funding					
Customer deposits % total funding	50.27%	47.28%	44.37%	45.48%	45.67%
Total wholesale funding % total funding [8]	49.73%	52.72%	55.63%	54.52%	54.33%
- Interbank % total funding	28.14%	31.11%	34.49%	32.68%	31.24%
- Debt securities % total funding	19.86%	19.91%	20.66%	21.29%	22.51%
- Subordinated debt % total funding	1.73%	1.70%	0.49%	0.56%	0.58%
Customer deposits % gross loans	96.64%	94.92%	92.01%	92.26%	92.61%
Capital [11]					
Tier 1	10.12%	8.82%	8.50%	8.36%	8.27%
Total Capital	14.80%	13.47%	13.24%	13.22%	13.19%

[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.

* Interim information is annualised where needed.

Ratings History

Issuer	Debt Rated	Current	2010	2009	2008
Sparkassen-Finanzgruppe	Issuer & Senior Long-Term Debt	A (high)	A (high)	A (high)	A (high)
Sparkassen-Finanzgruppe	Short-Term Instruments	R-1 (middle)	R-1 (middle)	R-1 (middle)	R-1 (middle)

Notes:
All figures are in Euros unless otherwise noted.

For the definition of Issuer Rating, please refer to Rating Definitions under Rating Policy on www.dbrs.com.

Issuer ratings apply to all general senior unsecured obligations of the issuer in question.