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Research

Ratings on DZ Bank AG and Various Cooperative Banks Affirmed; Outlook Negative

Publication Date: 27-Aug-2003
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FRANKFURT (Standard & Poor's) Aug. 27, 2003--Standard & Poor's Ratings Services said today it affirmed its 'A-' long-term counterparty credit and senior unsecured debt ratings and its 'A-2' short-term ratings on DZ Bank AG Deutsche Zentral-Genossenschaftsbank (DZ Bank) and on its subsidiaries, Deutsche Genossenschafts-Hypothekenbank AG, DZ Bank International S.A., and DZ Bank Ireland PLC. The outlooks are negative.

At the same time, Standard & Poor's affirmed its 'A-' long-term counterparty credit and senior unsecured debt ratings and its 'A-2' short-term ratings on Westfälische Landschaft Bodenkreditbank AG and its 'BBB+' long-term and its 'A-2' short-term ratings on DVB Bank AG and VR Leasing AG. The outlooks are negative.

"The ratings on DZ Bank and rated member banks of the cooperative banking sector are based on the German cooperative banking sector's system of solidarity and its comprehensive protective scheme, which has prevented insolvencies of member institutions for more than 60 years, and reflect Standard & Poor's view of the sector as a single economic group," said Standard & Poor's credit analyst Stefan Best. In 2002, the protective scheme also supported DZ Bank and member banks to avoid reputational risks related to real estate investment funds sold to their customers. The ratings are also based on the sector's important market position--particularly in the domestic retail banking market--the sector's stable funding sources, overall sound capitalization, and signals a recovery of the local banks' performance in 2002.

"The ratings are constrained, however, by the sector's steadily declining core profitability levels after risk on a consolidated basis and its deteriorating asset quality, which has put strains on both earnings and the sector's protective scheme due to the problems at a large number of the cooperative sector's member banks," said Mr. Best. This included DZ Bank in 2002, as the largest member, whose very weak financial profile is also a key negative factor in Standard & Poor's assessment of the sector's financial strength. Initiatives have been implemented to improve credit risk management of DZ Bank and member banks. The sector's slow progress in implementing planned restructuring initiatives designed to maintain its still solid market position in light of the fundamental structural problems of the German banking industry, and sluggishness in reducing its unfavorable cost-to-income ratios are also constraining factors.

The ratings continue to reflect Standard & Poor's expectation that the merger and the concomitant restructuring of DZ Bank will eventually strengthen its business ties with other members and gradually improve DZ Bank's weak financial profile, and that the sector's proven commitment to support member banks in times of stress will be maintained. DZ Bank's very high loan-loss provisions between 2000 and 2002, however, required substantial efforts to absorb these losses and have considerably strained its financial strength.

DZ Bank's key challenges over the next three years will be the management of its restructuring and integration process and the development of a common corporate culture. In particular, DZ Bank will have to prove that its revised strategy is appropriate for its resources and its ability to absorb unexpected losses. With low profitability and capital levels, the bank's solution to its bad loans, cost cutting, and strategic reorientation--aimed at downsizing and focusing on core activities and markets--will be crucial.

The outlook reflects Standard & Poor's concerns about the risk of further negative implications of the

recession-plagued domestic economic environment on the member banks' earnings and the sector's protective scheme, which has also been under strain as the amount of funds required to support troubled member institutions have remained at high levels. It also mirrors DZ Bank's weak financial profile and uncertainties about the length of its recovery process.

"The cooperative banking sector faces the challenge of successfully implementing its planned restructuring initiatives and optimizing synergies in the sector as further erosion of the member banks' financial strength could have negative rating implications," said Mr. Best.

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