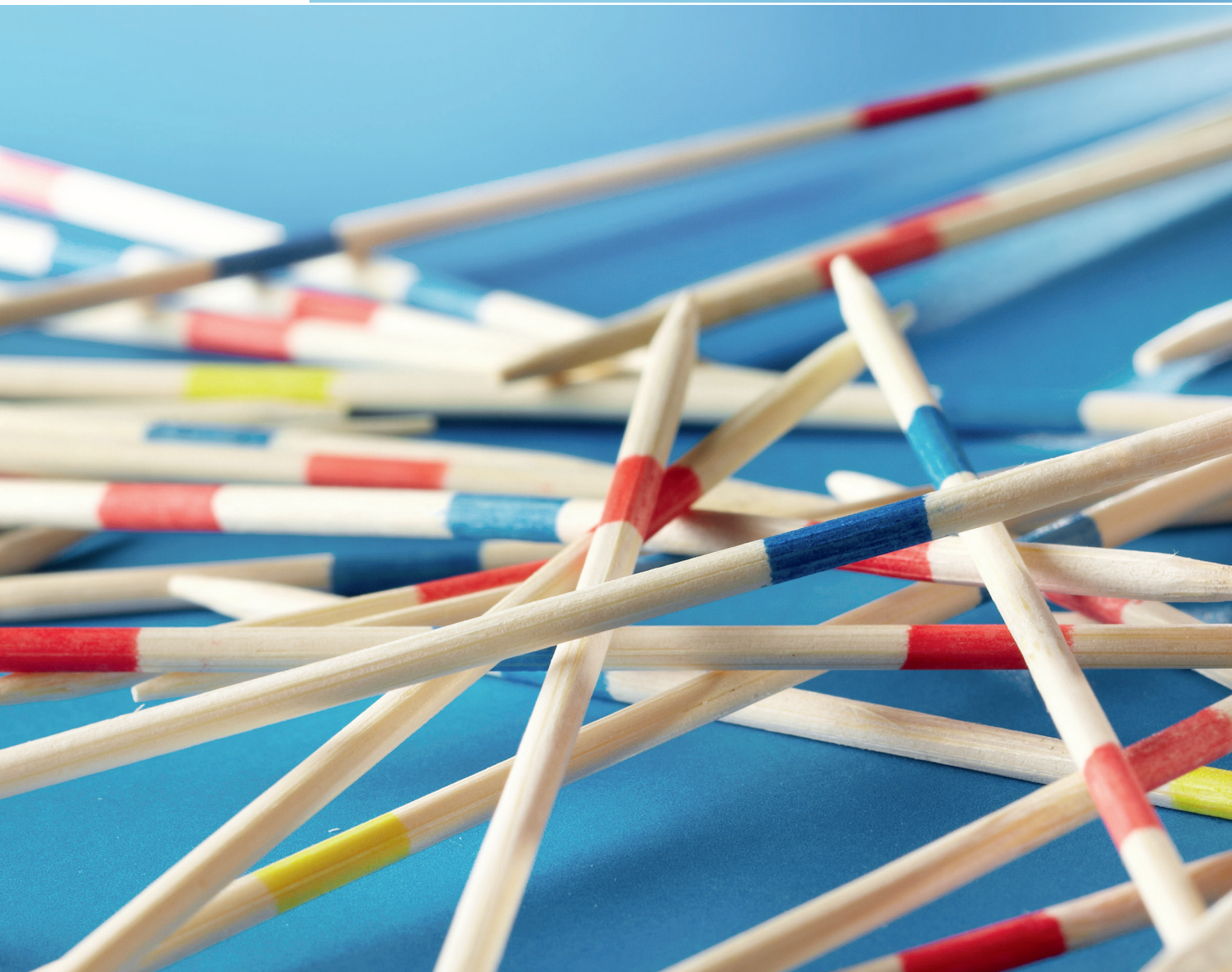


Savings Banks Finance Group

Credit Supply: Together We Are Strong

Helaba Research, May 2019



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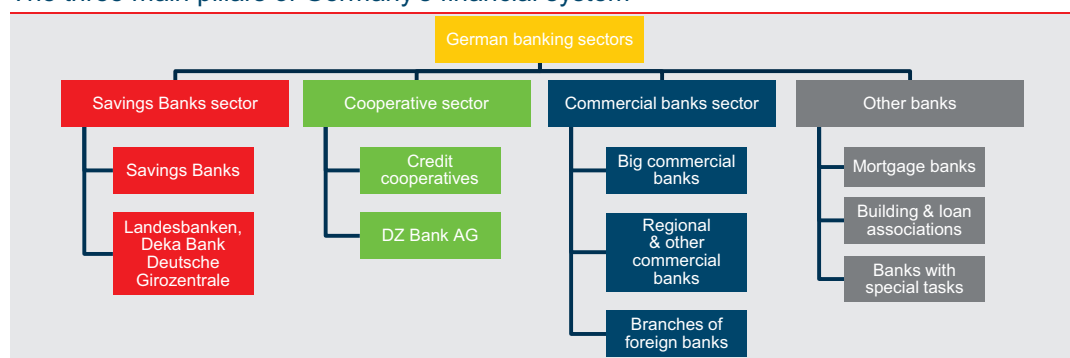


Editorial

Dear readers,

The objective of Mikado, the pick-up sticks game, is to streamline a system while preserving its stability. Germany's financial system was – and still is – faced with similar challenges. Since the financial crisis, a number of financing instruments and business models have proven to be non-viable.

The three main pillars of Germany's financial system



Sources: Deutsche Bundesbank, Helaba Research

What is the situation in Germany today? Germany's financial system has always been characterised by diversity. There are big multinational financial groups, along with specialised banks, medium-sized regional banks and a large number of smaller banks which for the most part cooperate in banking groups. From an economic perspective, it is particularly important for these regionally focussed banks to avoid perceived weaknesses in terms of cost efficiency and at the same time to make use of their close customer relations so as to achieve high allocation efficiency.

Savings Banks and Landesbanken are the key elements of the Savings Banks Finance Group's (S-Finance Group) loan exposure. They play an important role in this context and hold the biggest

market share in corporate finance in Germany. Because of their substantial business volume and the associated value added, they are a strong pillar of the German economy.

In the framework of a possible reorganisation of the Landesbank sector or a realignment of the division of responsibilities within the Savings Banks Finance Group, due consideration should be given to Germany's polycentric economic structure and the role of the S-Finance Group in financing the corporate sector.

My conclusion is that, when you play Mikado, you can usually remove only a few elements of the fragile system without jeopardizing its stability. The same caution should be exercised when restructuring the financial system. However, the processes – which, in the end, are market-driven – should not be artificially obstructed. Instead, these processes should be utilised within the public banking sector, as they will have sustainable economic benefits and help to stabilise the financial system in Germany.

A handwritten signature in blue ink, consisting of a stylized 'H' followed by 'Herbert Grüntker' and a large, sweeping flourish at the end.

Herbert Hans Grüntker
Chief Executive Officer of Helaba

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Summary

Firm roots due to regional ownership

Due to the ownership structure, Savings Banks and Landesbanken are closely connected with the region in which they operate. Because of their limited business area, Savings Banks are particularly dependent on business success in their service area and, hence, they are keenly interested in the development of local businesses. As an important component of the Savings Banks Finance Group, Landesbanken do not operate in biotopes that are protected by government. Since the abolition of guarantor liability and institutional liability, they have been exposed to intense competition in the markets for financial services.

The Savings Banks Finance Group: Firmly anchored in the real economy

Savings Banks and Landesbanken play a strong role as financial intermediaries. By a wide margin, Savings Banks are currently ahead of other categories of banks: they account for a share of 28 % of loans to domestic non-banks, i.e. to Germany's real economy. Credit cooperatives rank second with a share of 19 %. Landesbanken have a respectable market share of 8 % although they are by and large denied access to the volume business with private individuals and SMEs because of the division of labour agreed with the regionally focussed Savings Banks. Although they could be more active in these potential business areas, big commercial banks have a market share of only 13 %. In sum, the 36 %-market share of the S-Finance Group in loans to domestic non-banks is significantly higher than that of commercial banks (29 %).

Backbone of corporate finance

With their corporate credit exposure, Savings Banks played a major role in stabilising Germany's economy during and after the financial crisis. Together with other regional banks, they closed the supply gap: Overall, the volume of corporate loans granted by Savings Banks has increased by two-thirds since the end of 2009. In loans to enterprises, Savings Banks are by far the most important lenders with a share of 26 % (S-Finance Group: 40 %). The market share of big commercial banks has dropped sharply to 12 %. This means that the commercial banking sector has been clearly relegated to second place, with a total market share of 32 %. Among the three major categories of banks, the cooperative sector ranks last in pure loans to enterprises (excluding the self-employed), with a total market share of 13 %.

The self-employed rely on decentralised banks

After the financial crisis, the volume of loans to the self-employed recovered due to the initiative of Savings Banks and credit cooperatives. This is also reflected by the market shares in loans to the self-employed: Savings Banks sector 41 %, credit cooperatives 34 %, and commercial banks 18 %. The exposure of decentralised banks shows how important local decision-makers are, because – more than other groups – the self-employed are likely to include a high proportion of start-up entrepreneurs who need favourable financial support, particularly during the start-up phase of their business.

Decentralised systems: both flexible and stable

Due to their close customer relations, regionally operating banks are in a better position to assess local enterprises and the self-employed and to build up long-term relationships. This is demonstrated by the maturity of the loans granted. Medium-term and long-term loans to enterprises account for 85 % and 91 %, respectively, of the loans granted by Savings Banks, credit cooperatives and Landesbanken. As a rule, Landesbanken and Savings Banks are the only regional focussed banks that are able to provide long-term loans for larger corporates; many cooperative banks ("Volks- und Raiffeisenbanken") do not have enough capital due to their small size. The decentralised S-Finance Group is therefore the backbone of corporate finance in Germany, also when taking sustainability criteria into account.

Guaranteed provision of funds for local and state-level governments

Today, local governments play a more important role than the 16 federal states as borrowers. Local governments bear over 50 % of annual public fixed investments and depend on reliable financing and consulting partners, while the federal government can make use of its placement power in the capital markets owing to its high volumes. As a category of banks, Landesbanken and Savings Banks are by far the largest providers of funds for local governments in Germany, with a share of 45 %. State-level governments are the preferred borrowers of Landesbanken, with a share of 28 %.

Enabling retail customers to own their own homes

Historically, Savings Banks and credit cooperatives have particularly close links with retail customers. Many Savings Banks and credit cooperatives were established to help low-income earners to save money and to grant small loans to pave the way for people to become self-employed or to own their own homes. The market shares of Savings Banks and credit cooperatives are accordingly high, with 29 % and 24 %, respectively. The primary motivation for retail customers to take out a loan is home ownership. This is also the reason for the overall increase in retail loans. While loans to households for home purchases have increased by 27 % since the beginning of 2009, other retail loans have remained almost unchanged.

Digitalisation and consolidation in the banking sector

The environment for the banking sector is constantly changing. Digitalisation has a particularly strong impact. On the one hand, digitalisation provides huge efficiency gains, e.g. in handling payment transactions. On the other hand, the co-existence of various payment systems and the development of new digital processes entail enormous costs. In the past few decades, there have already been numerous mergers in the banking sector, in particular due to the high cost pressure. At the beginning of 2019, there were 385 Savings Banks – roughly 200 less than in 1999. Despite this consolidation, Savings Banks have the largest branch network in Germany. Today, the branches face very different challenges. To be able to compete successfully with pure-play online banks in future, concepts will be needed that skilfully combine local presence with media competence in order to retain customers.

Differentiation of Savings Banks' regional market positions

In 10 of Germany's 16 federal states, Savings Banks have above-average market shares of 30 % or more. In Bremen, they are even the undisputed regional market leader, with a market share of 55 %. Savings Banks also have above average market shares in the federal states of Saarland, Rhineland-Palatinate and Schleswig-Holstein, where they provide between 37 % and 43 % of the loans to domestic non-banks. North-Rhine Westphalia – Germany's most populous federal state – is also "Savings Banks country", with a market share of 37 %. Competitors are stronger in the federal state of Hesse (because of the financial centre of Frankfurt) and in the city states of Berlin and Hamburg; customer needs are also more demanding there in terms of scope and complexity. Both factors lead to keener competition for Savings Banks and limit their market shares.

S-Finance Group – an important asset for Germany as a federal state

Germany's federal structure is closely linked to the vitality of its protagonists. The country's federal states draw their vitality from regional economic development. The preservation and promotion of regional development requires active local governments and business enterprises, as well as their local credit institutions that provide finance. A strong S-Finance Group creates competition and favourable credit terms. Nevertheless, there have been horizontal and vertical mergers of Savings Banks and Landesbanken in the past. These market-driven processes should be utilised within the public banking sector as they will have sustainable economic benefits and help to stabilise the financial system in Germany. Structural changes in the economy will also pose challenges for banks in the future. Savings Banks and Landesbanken will be able to master these challenges if they jointly develop creative and solid solutions.

1 The Savings Banks Finance Sector – An Asset for Germany

1.1 The Data: Banking statistics of Deutsche Bundesbank

The data used for the overall market and the various categories of banks are based on the monthly and quarterly banking statistics published by Deutsche Bundesbank. As of 1999, the definition of a bank is limited to monetary financial institutions whose business is to receive deposits from the public and to grant credit for their own account and/or to make investments in securities.

Categories of banks
as defined by
Deutsche Bundesbank
(no corporate groups)

While the composition of the categories of banks has changed several times in the course of time, Deutsche Bundesbank has always published only the data applying to the valid definition at a given point in time, without recalculating the absolute figures. This principle also applies to other changes, so that statistical “jumps” may occur in long-term analyses. The definition of categories of banks as used in the present analysis is based on the statistics of Deutsche Bundesbank (as of January 2019), which do not include non-core subsidiaries. The designations used in the study refer to the following banks:

Savings Banks sector

- Landesbanken: 5 Landesbanken (without LBS/subsidiaries); DekaBank Deutsche Girozentrale
- Savings Banks: 380 public-sector Savings Banks, 5 independent Savings Banks

Commercial banks sector

- Big commercial banks: Commerzbank AG, Deutsche Bank AG, DB Privat- und Firmenkundenbank AG, UniCredit Bank AG
- Regional & other commercial banks: 151 banks
- Branches of foreign banks: 111 banks

Cooperative sector

- Credit cooperatives: 850 Volks- und Raiffeisenbanken, 25 other credit institutions of the cooperative sector
- Since the merger of the two regional institutions of credit cooperatives in mid-2016, DZ Bank AG is considered to be a bank with special tasks.

Mortgage banks (13 banks)

Berlin Hyp AG, DZ Hyp AG, Deutsche Hypothekenbank, Deutsche Pfandbriefbank AG, DSK Hyp AG, Düsseldorfer Hypothekenbank AG, Münchener Hypothekenbank eG, Natixis Pfandbriefbank AG, M.M. Warburg & Co Hypothekenbank AG, Calenberger Kreditverein, Ritterschaftliches Kreditinstitut Stade

Building & loan associations

- Private building and loan associations: 12 associations
- Public building and loan associations: 8 Landesbausparkassen (including the Landesbausparkasse, which has been integrated into Helaba)

Banks with special tasks (19 banks)

- Private legal entities: AKA Ausfuhrkredit-GmbH, Clearstream Banking AG, DZ Bank AG, Eurex Clearing AG, KfW IPEX-Bank GmbH, Saarländische Investitionskreditbank AG
- Public legal entities: Hamburgische Investitions- und Förderbank, Investitionsbank Berlin, Investitionsbank des Landes Brandenburg, Investitionsbank Schleswig-Holstein, Investitions- und Strukturbank Rheinland-Pfalz, Kreditanstalt für Wiederaufbau, Landeskreditbank Baden-Württemberg – Förderbank, Landwirtschaftliche Rentenbank, LfA Förderbank Bayern, NRW.BANK, Sächsische Aufbaubank – Förderbank, Thüringer Aufbaubank

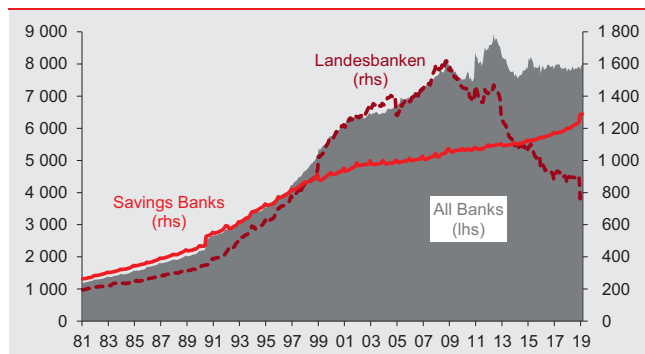
1.2 Substantial total assets

Strong growth
followed by consolidation

During the 1980s, the banks' balance sheets grew at an average rate of 7 % p.a. in Germany. As the banks' capital market focus increased and as the flow of goods and services became more globalised, the trend accelerated considerably in the 1990s. In some cases, balance sheets grew at an annual rate of over 10 %. After the turn of the millennium, the bursting of the "new economy" bubble led to some consolidation which, however, ground to a halt again in mid-2004. This was followed by another period of balance sheet growth (between 2000 and 2008, 4 % on average), which ended with the financial crisis in 2009. Banks had to reduce their total assets to back up the government support measures. As a result of changes in German accounting rules (German GAAP) introduced at the end of 2010, trading portfolio derivatives had to be included in the financial statements, which led to a sharp rise in total assets. In May 2012, the total assets of all German banks taken together reached a peak. Aggregate total assets then declined until the beginning of 2014, mainly due to big commercial banks, Landesbanken, mortgage banks and branches of foreign banks, while the total assets of Savings Banks and credit cooperatives increased steadily.

Landesbanken on course for consolidation

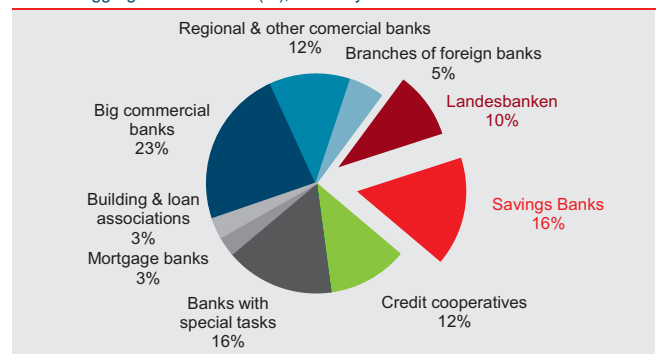
Total assets in EUR billion



Sources: Deutsche Bundesbank, Helaba Research

Savings Banks rank second in total assets

Share of aggregate total assets (%), February 2019



Sources: Deutsche Bundesbank, Helaba Research

Savings Banks and
Landesbanken
are the lead

Until the mid-1990s, the Savings Banks' business performance was largely in line with the performance of the banking sector as a whole. Since their business model is tied to the region in which they operate, Savings Banks subsequently benefited less from certain growth segments. Most Savings Banks were not able to participate in the trend towards disintermediation in the credit markets, while bigger banks also granted fewer loans, but earned commissions from issuing corporate bonds, etc. Savings Banks were hardly involved in international financing transactions, which were highly profitable at the time. Nevertheless, the Savings Banks' business volume continued to grow, albeit at a slower pace. Among the various categories of banks, Savings Banks (along with banks with special tasks) rank second with a share of 16 % in terms of total assets.

Total assets of
big commercial banks
affected by derivatives

Before the financial crisis, Landesbanken grew at above-average rates. While their share of total assets amounted to 15 % in 1991, it increased to 21 % by the end of 2007. The subsequent consolidation of a number of Landesbanken was associated with an above-average reduction of total assets, so that their share had fallen to 10 % by February 2019. Among the various categories of banks, Landesbanken thus rank fourth in terms of total assets. Regardless of ideological discussions about ownership and control structures, Landesbanken still play an important role in Germany's economic reality. The obligation to report trading portfolio derivatives on the balance sheet is likely to depress the share of Landesbanken in total assets, while the share of big commercial banks surged after the change in accounting. This is probably due to their high exposure in this business segment: 18 % of their total assets are generated from derivative financial instruments; derivatives account for a much lower share of the total assets of Landesbanken (5 %). For this reason, total assets are only suitable to provide a rough assessment of the importance of the various categories of banks for the real economy.

1.3 A main pillar in loans to domestic non-banks

Banks are important financial intermediaries

In the German financial system, banks play an important role as intermediaries because lenders and borrowers have historically grown preferences for traditional instruments: non-banks predominantly use loans for financing purposes and deposits for financial investment purposes, although the capital market orientation had slightly increased in the past, at least until the financial crisis. In the statistics, the term “non-banks” comprises enterprises, the self-employed, individuals, and general government.

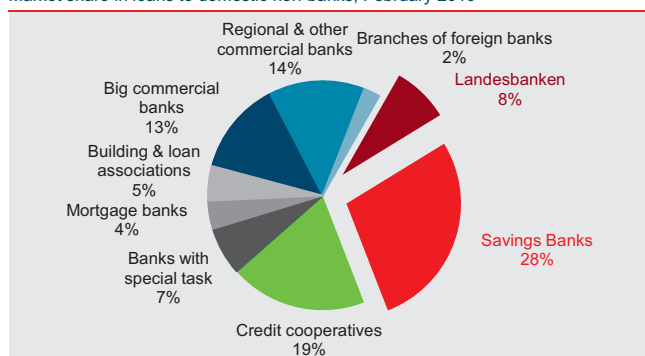
Savings Banks and Landesbanken are active as financial intermediaries to a considerable extent. Leading by a wide margin compared with other categories of banks, Savings Banks currently account for 28 % of loans to domestic non-banks. Credit cooperatives rank second with a share of 19 %. Landesbanken have a respectable market share of 8 % although they are by and large denied access to the volume business with private individuals because of the division of labour agreed with the regionally focussed Savings Banks. Although they could be more active in these potential business areas, big commercial banks have a market share of only 13 %.

Savings Banks and Landesbanken with strong lending business

On average, loans to non-banks account for 44 % of total assets in the banking sector. Banks with a strong regional focus attach much greater importance to the lending business. Loans to non-banks account for 66 % of the total assets of Savings Banks and for 63 % of the total assets of credit cooperatives. Since Savings Banks take precedence within the S-Finance Group in loans to private individuals and SMEs, the share of Landesbanken (43 %) is per se lower, but close to average. The big commercial banks' share is significantly lower (28 %). The analysis of the balance sheet structure has shown that Landesbanken, along with Savings Banks, constitute the German banking system's credit supply backbone and, hence, are closely linked to what is referred to as the “real economy”.

Savings Banks Finance Group is number one in lending ...

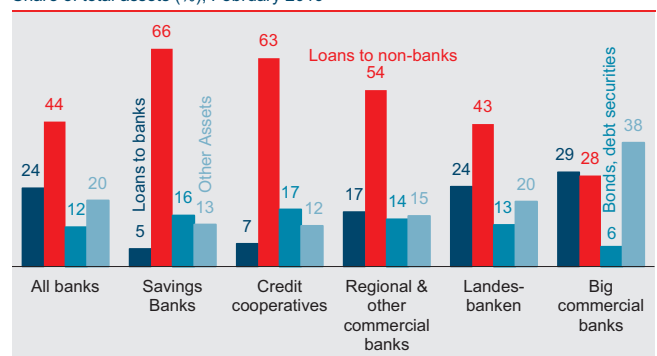
Market share in loans to domestic non-banks, February 2019



Sources: Deutsche Bundesbank, Helaba Research

... with an asset structure focussed on loans

Share of total assets (%), February 2019



Sources: Deutsche Bundesbank, Helaba Research

The fact that loans to banks account for a relatively high share of the total assets of Landesbanken has to do with their position as members of the S-Finance Group together with Savings Banks. This close cooperation is reflected not only in the interbank business with Savings Banks, but also in common financing projects in the joint loans business.

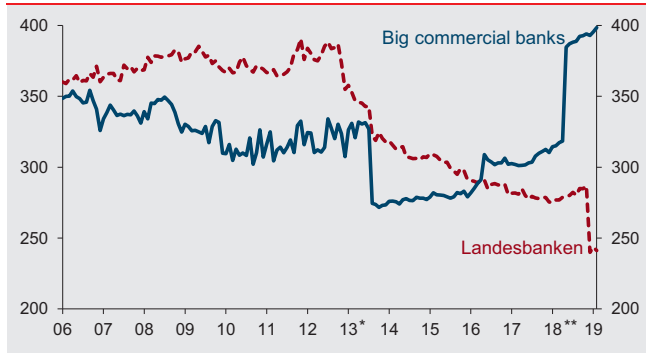
Loan portfolio increases slightly

Developments in the past few years, however, have shown that the necessary consolidation has led to a reduction of the lending business for many Landesbanken. The big commercial banks reduced non-core activities such as public-sector finance and commercial real estate finance. On the other hand, banks that are mainly regionally focussed – i.e. Savings Banks, credit cooperatives, as well as regional and other commercial banks – continuously expanded their business with domestic non-banks, so that, overall, the loan portfolio has remained largely stable. However, the abrupt drop in loans to non-banks in September 2013 was due to reclassification: Eurex Clearing AG was granted the status of a bank and therefore dropped out of the segment of

non-banks. This affected in particular the lending business of big commercial banks, banks with special tasks, Landesbanken, regional and other commercial banks, as well as the regional institutions of credit cooperatives. Another reclassification (merger of Deutsche Postbank AG with Deutsche Bank Privat- und Geschäftskunden AG) led to an abrupt increase in lending by big commercial banks in 2018.

Consolidation of Landesbanken in lending business

Loans (excluding securities) to domestic non-banks, in EUR billion



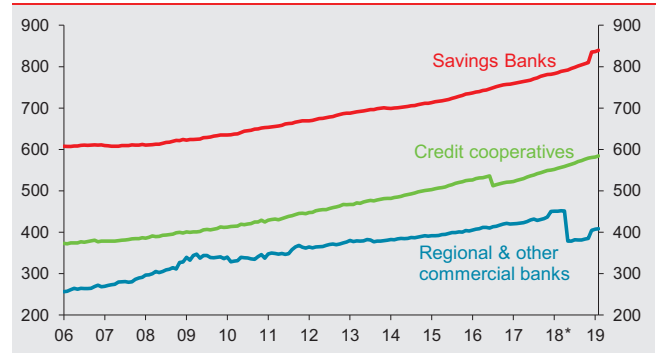
*September 2013: Change in status of Eurex Clearing AG: from enterprise to bank

**June 2018: Merger of Deutsche Postbank AG with Deutsche Bank Privat- und Geschäftskunden AG; November 2018: HSH Nordbank and LBB exit Landesbank sector

Sources: Deutsche Bundesbank, Helaba Research

Regional banks have stabilizing effect

Loans (excluding securities) to domestic non-banks, in EUR billion



*June 2018: Merger of Deutsche Postbank AG with Deutsche Bank Privat- und Geschäftskunden AG; November 2018: LBB is categorised as Savings Bank

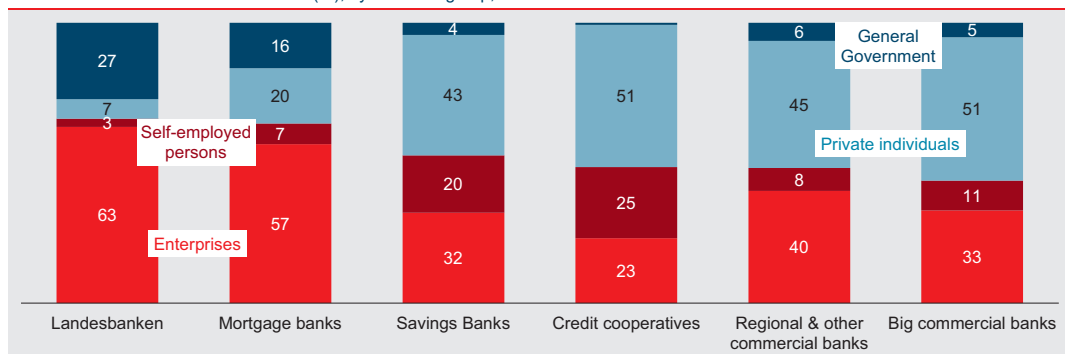
Sources: Deutsche Bundesbank, Helaba Research

S-Finance Group
with focus on
corporate finance

The priorities of Landesbanken become obvious when their loan portfolios are analysed. Enterprises are the main borrowers: Landesbanken make 63 % of their loans to domestic non-banks to them, and another 3 % are granted to the self-employed. No other category of banks has a similarly high share. Savings Banks are also extremely active in these business segments. Financing provided to business enterprises and the self-employed accounts for 32 % and 20 %, respectively, of their loan portfolio. Big commercial banks have a share of 33 % in loans to enterprises plus a share of 11 % in loans to the self-employed.

Clear focus of Savings Banks and Landesbanken

Shares of loans to domestic non-banks (%), by borrower group, December 2018



Sources: Deutsche Bundesbank, Helaba Research

Credit cooperatives
with focus on
the self-employed

Credit cooperatives, which traditionally have close relations with the self-employed, are least active in loans to enterprises. However, the fact that cooperative banks are underrepresented in this segment may also be due to their relative size. There are a total of 875 credit cooperatives, whose total assets amount to EUR 1.1 billion on average. For the 385 Savings Banks, the average amounts to EUR 3.3 billion. The low equity base can therefore be a bottleneck for local credit cooperatives. While the central institution of cooperatives has increased its corporate finance capacity and can therefore provide better support to credit cooperatives, it is unlikely that they will match the capacity of Savings Banks and Landesbanken. Before their merger in mid-2016, the two remaining regional institutions had a market share of just below 2 % in loans to enterprises and the self-employed.

General government
as an important borrower

Loans to general government play the second largest role for Landesbanken. With a share of 27 %, they account for the highest weight in the borrower structure among the various categories of banks. They are followed by mortgage banks which, because of their business model, are also particularly active as lenders for the public sector.

Overall, the loan portfolio of Savings Banks and Landesbanken clearly shows that, without public sector banks, the financing options of enterprises as well as local and state-level governments would be limited. A strong S-Finance Group creates competition in the banking sector, and customers in all segments benefit from the favourable credit terms.

1.4 International business: Division of labour within the Savings Banks Finance Group

Foreign loans
reflect globalisation

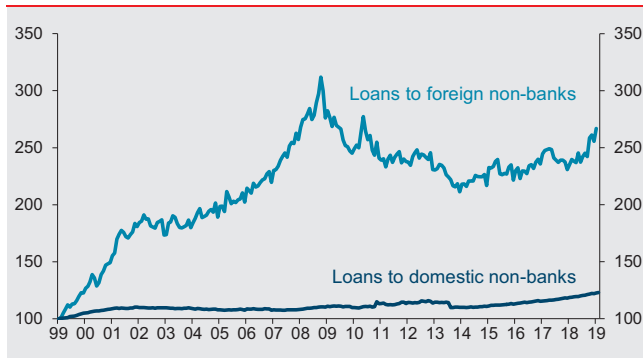
In the years prior to the financial crisis, loans to foreign non-banks grew more rapidly than other loans: Their volume tripled in the period from 1999 to 2008. From 2009 to 2013, the loan portfolio decreased by 30 %, most likely due to the financial, economic and debt crisis in many countries. After passing this trough, loans to foreign non-banks increased with certain fluctuations (+9 %). Since 2013, the volume of loans to domestic non-banks has increased by approx. 7 %, following a period of extremely low growth. This means that there has been more of a focus on domestic markets again, without losing sight of international diversification.

International exposure
of Landesbanken
returns to stability

Landesbanken have followed this general market trend: after the period of strong growth, the international business was downsized by nearly 30 % as of 2008. The consolidation in the Landesbanken sector also affected the volume of loans to domestic non-banks, which decreased by 27 %. However, it makes sense for Landesbanken to continue to pursue their international business in order to ensure the Savings Banks' integration into nationwide and international banking relations. This enables Savings Banks to support and advise corporate clients who venture abroad to develop new business opportunities.

Market segment of foreign loans returning to normal

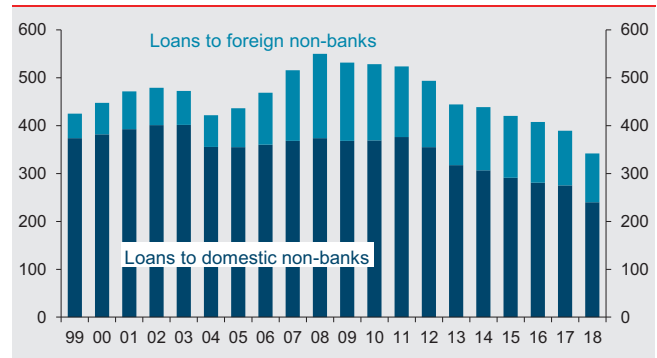
Loans to non-banks (excluding securities); January 1999 = 100



Sources: Deutsche Bundesbank, Helaba Research

Landesbanken: Reduction of international business

Landesbanken: Loans to non-banks in EUR billion, December



Sources: Deutsche Bundesbank, Helaba Research

Savings Banks with focus
on domestic markets

In turn, Savings Banks deal more intensively with their local customers' requests for loans and have a very low share of loans to foreigners (2 %) in line with their specialisation. However, they also do not refrain from meeting requests for loans to foreign non-banks. The relevant loan volume doubled from 2008 to 2018. Overall, however, the international credit exposure within the S-Finance Group is lower than that of private commercial banks (with loans to foreign non-banks amounting to 10 % compared with 20 % for private commercial banks). This means that the regional roots of public-sector banks are intact.

1.5 Backbone of corporate finance

According to analyses carried out by Deutsche Bundesbank, German enterprises had an average equity ratio of 21 % in 1999. Since then, the ratio of equity to total assets has improved steadily, most recently amounting to approx. 30 %. Progress has been observed in particular in the segment of small and medium-sized enterprises, which have improved their equity ratio from 9 % to 28 % in the same period of time. While this means that German enterprises have become less dependent on loans to meet their financing needs, bank loans continue to be the most important financing instrument by far in Germany. If loan finance was not available to enterprises on a sufficient scale and at reasonable cost, investment which is important for Germany's economic growth could not be financed.

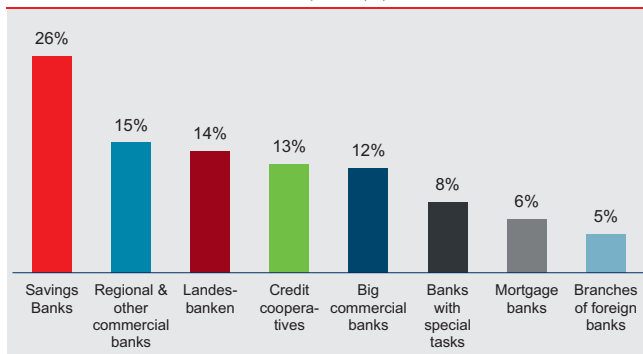
Savings Banks with high growth rates in loans to corporate clients

From 1999 to the beginning of 2009, the volume of loans to domestic enterprises increased by 36 %. The economic crisis then led to a temporary decline which, because of its limited scale, was probably more an indication of a weakness in demand than of a credit crunch. Subsequently, commercial banks were particularly hesitant about granting loans. Savings Banks and credit cooperatives stepped in to close the supply gap: Overall, the volume of corporate loans granted by Savings Banks has increased by 67 % since the end of 2009, while the lending volume of the other regionally focussed banks such as credit cooperatives as well as regional and other commercial banks has risen by 100 % and 66 %, respectively. Because of their consolidation requirements, Landesbanken had to adopt a cautious approach. The regrouping of HSH Nordbank and LBB led to another decline, so that the volume of corporate loans granted by Landesbanken has recently ranged around one-third below the level at the end of 2009.

As formerly important providers of finance for business, big commercial banks were barely active in this long-term growth market: The volume of corporate loans granted by big commercial banks is 6 % below the level of 2009. However, the abrupt drop in corporate loans in September 2013 is due to the reclassification cited above. Eurex Clearing AG was granted the status of a bank and therefore dropped out of the segment of corporate loans. This affected big commercial banks in particular, which accounted for half of the regrouped loan volume. Hence, the development of corporate finance provided by big commercial banks is overstated; it is probably slightly positive.

S-Finance Group: Market leader in corporate loans ...

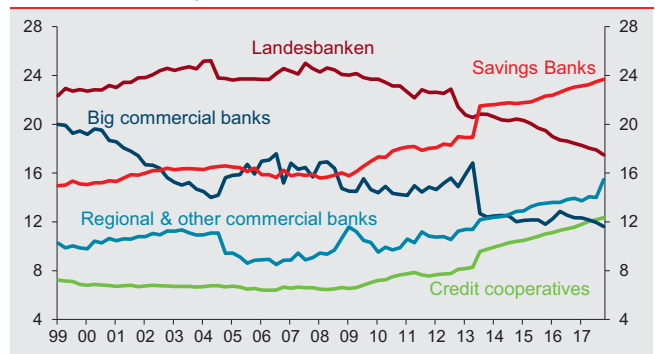
Market share in loans to domestic enterprises (%), December 2018



Sources: Deutsche Bundesbank, Helaba Research

... despite consolidation of Landesbanken

Loans to domestic enterprises in EUR billion



*September 2013: Change in status of Eurex Clearing AG from enterprise to bank

**November 2018: HSH Nordbank and LBB exit Landesbank sector

Sources: Deutsche Bundesbank, Helaba Research

Enterprises and the self-employed rely on decentralised banks

With their corporate credit exposure, Savings Banks played a major role in stabilising the economy during and after the financial crisis. In loans to enterprises, Savings Banks are by far the most important lenders with a share of 26 % (S-Finance Group: 40 %). The market share of big commercial banks, which used to be 20 %, has dropped to only 12 %. This means that the commercial banking sector has been clearly relegated to second place, with a total market share of

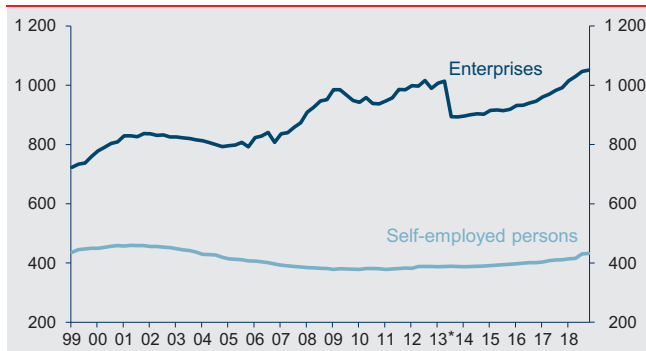
32 %. Among the three major categories of banks, the cooperative sector ranks lowest in pure loans to enterprises (excluding the self-employed), with a total market share of 13 %.

The self-employed: customers of Savings Banks and credit cooperatives

Unlike pure loans to enterprises, loans to the self-employed did not recover during the upswing that lasted until 2008. Compared with the peak level in June 2001, the loan volume fell by as much as 17 % until 2008. However, this decline is not due to local banks but to big commercial banks. After the financial crisis, the volume of loans to the self-employed recovered somewhat by 14 %, owing to the initiative of Savings Banks and credit cooperatives. Landesbanken are barely active in the customer segment of the self-employed because this segment is a primary business area of Savings Banks within the S-Finance Group.

The self-employed have a hard time

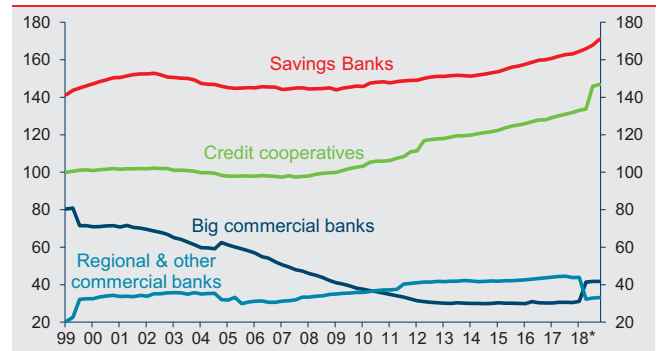
Loans to domestic enterprises and the self-employed in EUR billion



* September 2013: Change in status of Eurex Clearing AG from enterprise to bank
Sources: Deutsche Bundesbank, Helaba Research

Local banks support the self-employed

Loans to domestic the self-employed in EUR billion



* June 2018: Merger of Deutsche Postbank AG with Deutsche Bank Privat- und Geschäftskunden AG
Sources: Deutsche Bundesbank, Helaba Research

The exposure of decentralised credit cooperatives and Savings Banks shows how important local decision-makers are because, more than other groups, the self-employed are likely to include a high proportion of start-up entrepreneurs who need favourable financial support, in particular during the start-up phase of their business. This is also reflected by the market shares in loans to the self-employed: Savings Banks sector 41 %, credit cooperatives 34 %, and commercial banks 18 %.

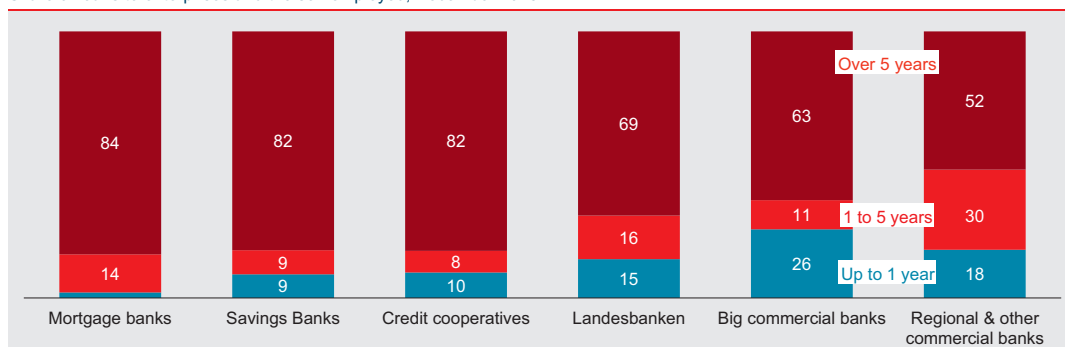
Indispensable for long-term commitments

Corporate finance: focussed on long-term loans

In the business of making loans to enterprises and the self-employed, close customer relations continue to play an important role. Regionally operating banks can better assess their local borrowers and build up a long-term relationship. This is demonstrated by the maturity of the loans granted. Medium-term and long-term loans, which are crucial for enterprises and the self-employed, account for a share of between 85 and 91 % of the loans granted by Savings Banks, credit cooperatives, and Landesbanken. The share of medium-term and long-term loans is highest for mortgage banks because of their specialisation. In the other categories of banks, the share of medium-term and long-term loans is lower, ranging between 74 % and 82 %.

Local banks with longer-term commitments

Share of loans to enterprises and the self-employed, December 2018



Sources: Deutsche Bundesbank, Helaba Research

As a rule, Landesbanken and/or Savings Banks are the only regional focussed banks that are able to provide long-term loans for larger corporates because many cooperative banks (“Volks- und Raiffeisenbanken”) do not have enough capital due to their small size. The decentralised S-Finance Group is therefore the backbone of corporate finance in Germany, also when taking sustainability criteria into account.

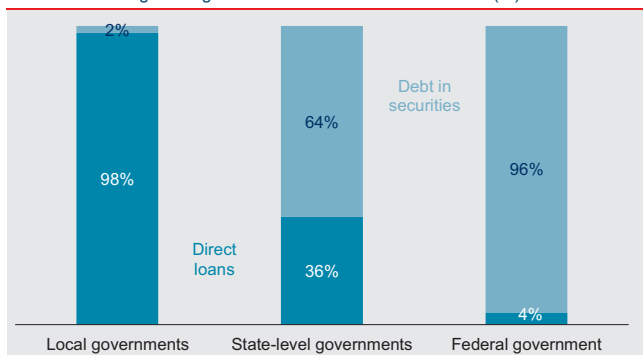
1.6 Guaranteed funding of local and state-level governments

Local governments
rely on loans
for financing purposes

Germany’s federal government can efficiently obtain finance from the capital markets and does so nearly exclusively. The opposite is true for local governments, which rely almost completely on direct loans to finance their local budgets. The 16 state-level governments use a “mixed calculation”, however, with a leaning towards a stronger focus on capital markets. Sufficient supply of traditional loans is likely to remain the precondition for a sustainable provision of finance for state-level and local governments, while the federal government can make use of its placement power in the capital markets because of the high volumes involved. For this reason, the federal government only accounts for a low percentage of loans to general government today. However, since the establishment of FMS Wertmanagement, the federal government has also had direct borrower-lender relationships with the banking sector.

Capital market finance for federal & state-level govts.

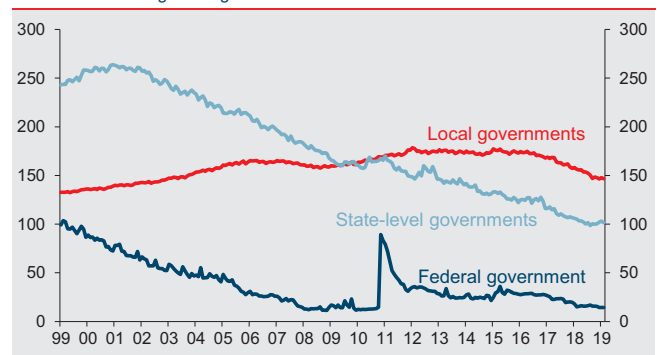
Debt structure of general government as of 31 December 2017 (%)



Sources: Statistisches Bundesamt, Helaba Research

Local governments with highest borrowing needs

Loans to domestic general government in EUR billion

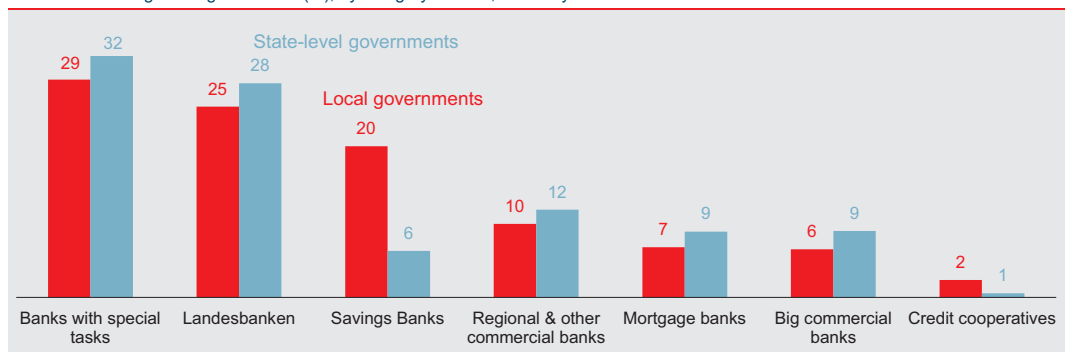


Sources: Deutsche Bundesbank, Helaba Research

State-level and local governments are the main user of loans in the public-sector. Local governments currently play an even bigger role than state-level governments in the demand for loans. Local governments bear over 50 % of the annual cost of public fixed investments and therefore depend on reliable financing and consulting partners. However, the stable economic situation in recent years has had a positive impact in the form of rising tax revenues, so that the local governments’ demand for loans has been declining for some time now.

S-Finance Group: Most important provider of funds for local governments

Share of loans to general government (%), by category of bank, February 2019



Sources: Deutsche Bundesbank, Helaba Research

46 % of loans to local governments are granted by Landesbanken and Savings Banks

Due to their focus, banks with special tasks, which also include regional and national development banks, account for the highest share of finance provided by the banking sector to state-level and local governments. As a category of banks, Landesbanken and Savings Banks are, by far, the main providers of funds for local governments in Germany, with a share of 45 %. State-level governments are the preferred borrowers of Landesbanken, with a share of 28 %.

1.7 Enabling retail customers to own their own homes

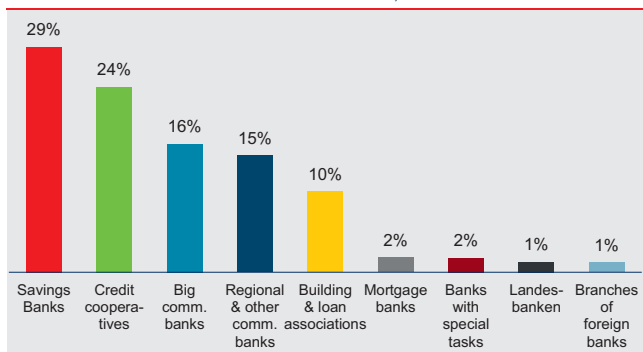
Along with enterprises, private individuals are the main customers of Savings Banks, regional banks and other commercial banks, credit cooperatives, and big commercial banks. They receive between 42 % and 51 % of the domestic lending volume. Even in banks whose business model is less focussed on the retail business, retail customers account for between 7 % and 23 % of loans. Building and loan associations have the highest share of retail customers (86 %) because they are their core customers.

Savings Banks and credit cooperatives are historically important for retail customers

Historically, Savings Banks and credit cooperatives have particularly close links with retail customers. Many Savings Banks and credit cooperatives were established to help low-income earners to save money and to grant small loans to pave the way for people to become self-employed or to own their own homes. Accordingly, Savings Banks and credit cooperatives have high market shares in retail loans (28 % and 24 %, respectively). Along with regional and other commercial banks, they are responsible for the increase in retail lending, which has risen by 22 % since the financial crisis.

Savings Banks: Market leader in retail loans

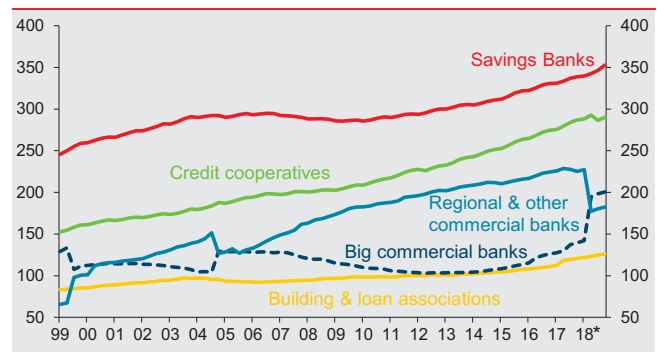
Market share of loans to domestic retail customers, December 2018



Sources: Deutsche Bundesbank, Helaba Research

Regionally focussed bank preferred

Loans to retail customers in EUR billion

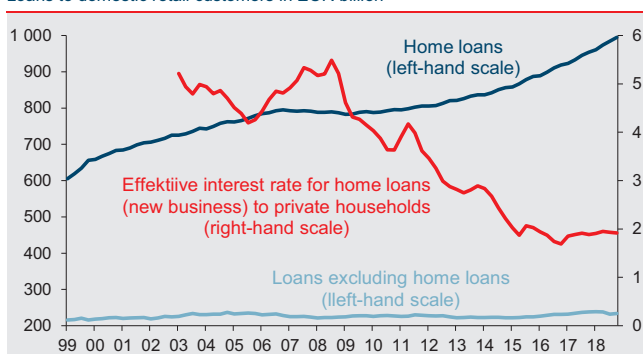


* June 2018: Merger of Deutsche Postbank AG with Deutsche Bank Privat- und Geschäftskunden AG
Sources: Deutsche Bundesbank, Helaba Research

The primary motivation for retail customers to take out a loan is to build or purchase a home. This is also the reason for the overall increase in retail loans. While loans to households for home purchases have increased by 27 % since the beginning of 2009, other retail loans have all but stagnated (+4 %).

Retail loans: driven by housing construction ...

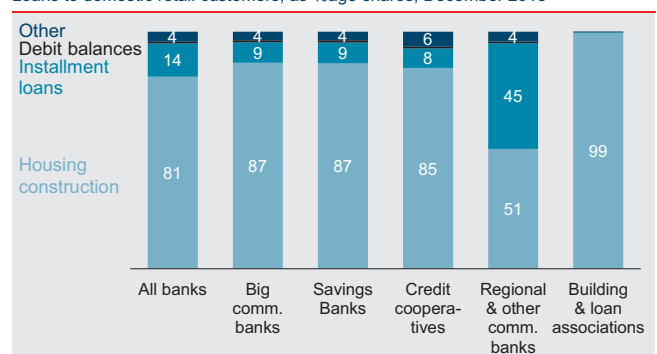
Loans to domestic retail customers in EUR billion



Sources: Deutsche Bundesbank, Helaba Research

... in all categories of banks

Loans to domestic retail customers, as %age shares, December 2018



Sources: Deutsche Bundesbank, Helaba Research

In all categories of banks with a significant retail business, home loans account for between 51 % and 87 %. The average share amounts to 81 %. At the beginning of the 1990s, the average share of home loans amounted to approx. 65 %. Since then, interest rates have fallen sharply, which has significantly facilitated home purchases and generated a sustained upward trend.

Instalment loans:
domain of regional and
other commercial banks

Instalment loans are the second most important type of loan, accounting for a share of 14 %. Regional and other commercial banks, which also include the credit institutions of car manufacturers, are particularly active in this field. On the other hand, debit balances on wage and salary accounts only play a minor role in the retail banking business. Since the interest on the short-term provision of money is relatively high, this is for the customers benefit. A solid financial status in debit and credit balances is an objective that all banks should pursue in the retail banking business.

2 Economic Structures in Germany Call for Suitable Solutions

2.1 Loans by sector: service providers are predominant

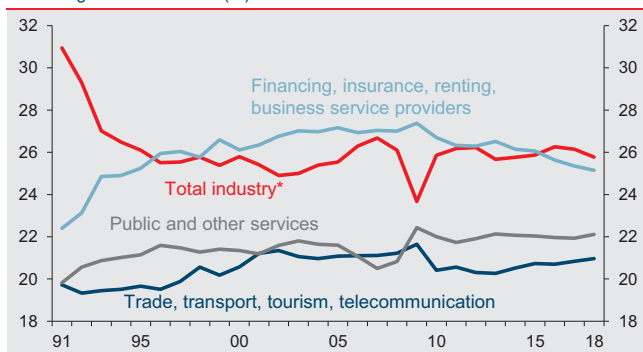
Which sectors are the main borrowers? Before answering this question, Germany's economic structure should be briefly discussed because the relative importance of the various sectors has shifted considerably in recent years. This has also had an impact on the sectoral structure of the loan portfolio.

Share of manufacturing
sector has diminished,
service sector has grown

Germany's economic structure underwent significant changes until the mid-1990s. The relative importance of the manufacturing sector (excluding construction) decreased substantially: its share of the gross value added fell from 31 % in 1991 to 26 % within a period of four years. After the beginning of the new millenium, the manufacturing-driven business cycle had once again strengthened the manufacturing sector; however, this trend did not continue in the aftermath of the financial and economic crisis. On the other hand, the finance, renting and business activities sector expanded almost without interruption, from 22 % in 1991 to 27 % in 2009. With the onset of the economic and financial crisis, the service sectors dominated by private enterprise lost some of their relative importance as the significance of state-dominated public and other service providers grew.

Sector structure is changing

Share of gross value added (%)

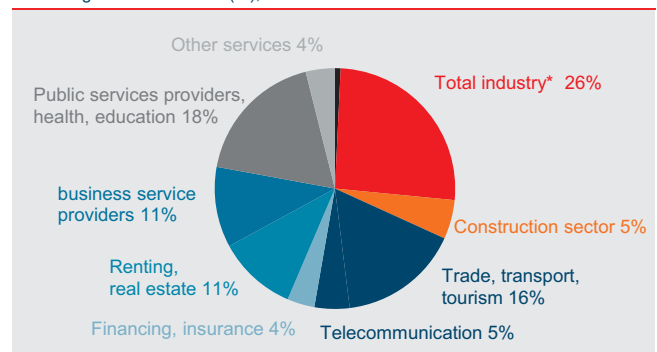


* excluding construction sector

Sources: Statistisches Bundesamt, Helaba Research

Service providers generate 70 % of value added

Share of gross value added (%), 2018



* excluding construction sector

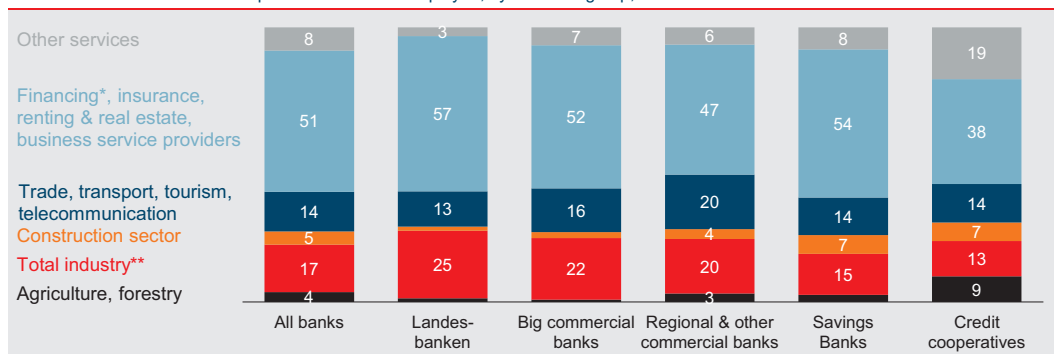
Sources: Statistisches Bundesamt, Helaba Research

This macroeconomic shift is reflected in the structure of borrowers. The share of industrial loans fell by half in the past forty years and now amounts to 17 %. Industrial loan exposures are above average for Landesbanken, big commercial banks as well as regional and other commercial banks,

with shares of between 20 % and 25 % of the corporate loans granted by the category of bank concerned. The bulk of loans is now granted to service providers, which also account for approx. 70 % of the gross value added. This may come as a surprise in an industrialised country like Germany; however, a large number of the service providers are geared towards the manufacturing sector.

Manufacturing sector less important as borrower

Share of loans to domestic enterprises and the self-employed, by borrower group, December 2018



* excluding MFI, i.e. excluding banks **excluding Construction sector

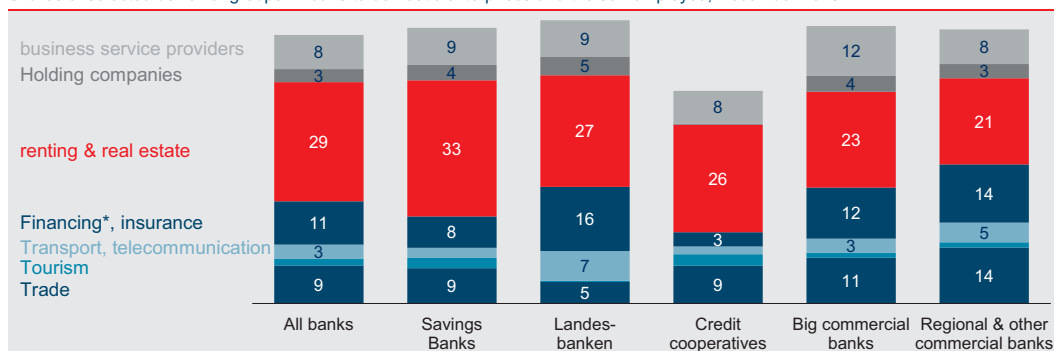
Sources: Deutsche Bundesbank, Helaba Research

Savings Banks in demand
as lenders for SMEs

The sector mix of the Savings Banks' loan portfolios is close to average in the banking sector, although Savings Banks have a strong impact on the average, with their high market share in loans to enterprises and the self-employed (30 %). Because of the division of labour within the S-Finance Group, Landesbanken have below-average lender-borrower relationships with enterprises in the construction and agricultural sectors, most of which are small. The same applies to big commercial banks, which are less active in this business segment because of their size and the relative concentration of their branch network. With their local presence and their precise knowledge of local conditions, Savings Banks and credit cooperatives can score points in economic sectors with many small and medium-sized enterprises.

Renting & real estate with highest demand for loans

Shares of selected borrower groups in loans to domestic enterprises and the self-employed, December 2018



* excluding MFI, i.e. excluding banks

Sources: Deutsche Bundesbank, Helaba Research

Real estate and
residential housing sector
is an important borrower

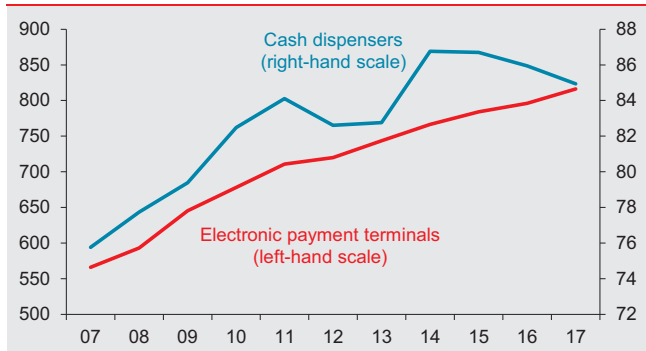
In the tertiary sector, the importance of the domestic real estate industry cannot be overstated. With a share of 29 %, renting & real estate is the most important borrower in the corporate sector. Savings Banks, Landesbanken and credit cooperatives hold the highest market shares because, on the one hand, real estate financing is part of their core business; on the other hand, they have close ties with regional housing companies and associations, some of which are in fact subsidiaries.

2.2 Digitalisation and consolidation in the banking sector

Changing economic structures do not only have an impact on borrowers, but also on the banks themselves. Digitalisation provides huge efficiency gains in handling payment transactions. Payment systems have been and will be developed to promote paperless and cashless payment transactions. In the period from 2007 to 2014, the number of cash dispensers (ATM) initially increased by 11,000 to just under 87,000. Subsequently, their number decreased to less than 85,000 by the year 2017. On the other hand, electronic payment terminals became more and more widespread. Their number increased by 250,000 to approx. 816,000 devices in the same period of time.

Operation of various payment systems

Devices in '000s

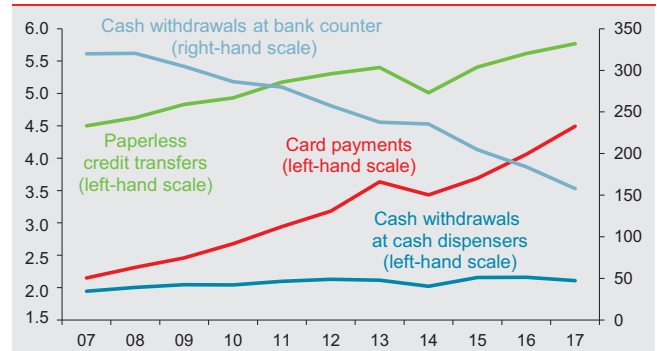


Sources: Deutsche Bundesbank, Helaba Research

Card payments are replacing cash

Transactions in billions

Transactions in millions



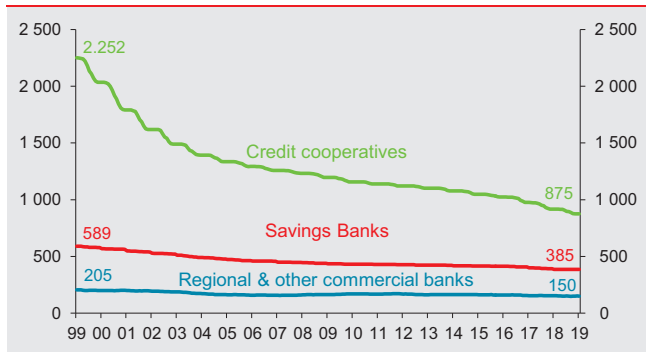
Sources: Deutsche Bundesbank, Helaba Research

Payment practices
are changing

The different payment options also varied widely in terms of the development of their use. Cash withdrawals at cash dispensers remained largely unchanged over the entire period. On the other hand, the popularity of card payments increased significantly. Overall, cash dispensers are less popular because cards permit on-site payments almost everywhere.

Consolidation is progressing in the banking sector ...

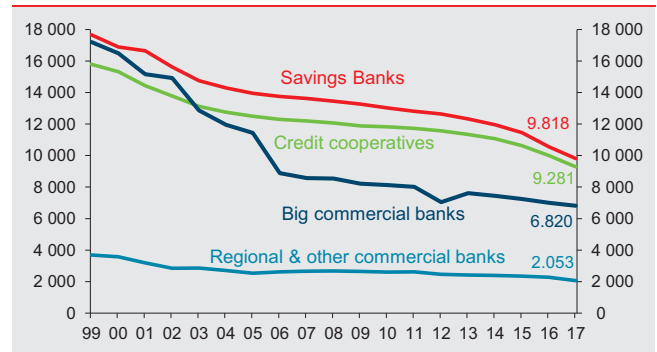
Number of banks



Sources: Deutsche Bundesbank, Helaba Research

... associated with a declining number of branches

Number of branches



Sources: Deutsche Bundesbank, Helaba Research

However, solutions – once established – are rarely completely abolished when lower-cost alternatives are introduced. The co-existence of various payment systems as well as the development of new digital processes entail enormous costs for the individual bank. In the past few decades, there have already been many mergers in the banking sector, in particular due to high cost pressure. This led to changes in the number of banks and their branches: The decline was particularly strong in the cooperative sector, where the number of banks dropped by nearly 1,400 to 875 over the past twenty years. The initial number of banks was much lower for Savings Banks. Nevertheless, there were also mergers in the Savings Banks sector. At the beginning of 2019, there were 385 Savings Banks – roughly 200 fewer banks than in 1999. The number of Landesbanken fell from twelve to five.

Digitalisation calls for new
customer retention
concepts

Despite this consolidation, the Savings Banks' network of approx. 9,800 branches is larger than that of any other category of bank. The employees in the branches are challenged in different ways. Due to digitalisation, the relationship between customers and their advisers is no longer as close because both meet much less frequently. Social media on the web mainly appeal to young people who are used to shopping without shop assistants, travelling without travel agents, and finding information without books. Their mostly positive experience has built trust in digital services, which make personal contact appear superfluous. To be able to compete successfully with pure-play online banks, concepts are needed that skilfully combine local presence with media competence in order to retain customers – because today's children, adolescents and young adults will be tomorrow's entrepreneurs, investors and borrowers.

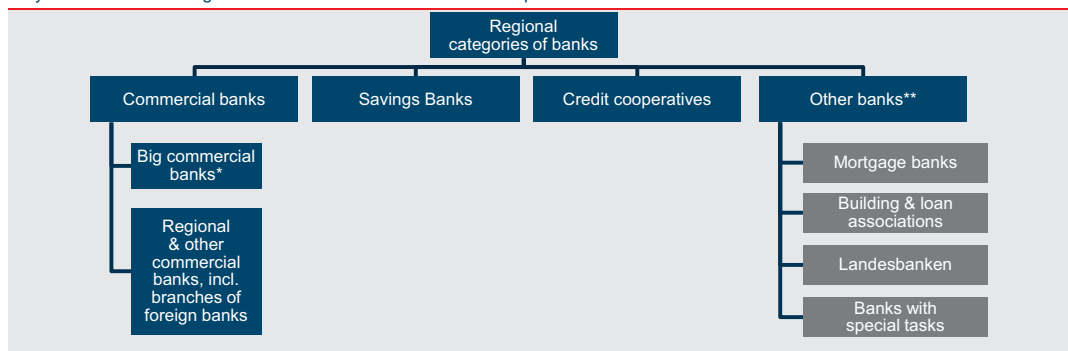
2.3 Differentiation of Savings Banks' regional market positions

Other definition of
categories of banks
at level of federal states

In the regional banking statistics, the regional categorisation is based on the domicile of the establishments (branches) and not on the domicile of customers. The only exception is Deutsche Postbank, whose customer relationships have been allocated to the various federal states on the basis of post codes since 2005. The results of regional statistics presented below are therefore not identical with the loans granted to bank customers in the federal states concerned. This applies in particular to banks operating nationwide without branch networks, such as direct banks – most of which are included in regional and other commercial banks – whose entire retail business is allocated to the federal state in which the bank concerned has its domicile. To minimise such distortions, some banks that operate nationwide are not included in the regional statistical data regarding the federal state in which a bank has its domicile.

Categories of banks as defined in regional statistics of Deutsche Bundesbank

Only the data for the categories of banks in the dark blue fields are published!



* Deutsche Postbank AG: Categorisation of customer relationships based on post codes ** excluding Kreditanstalt für Wiederaufbau (KfW), AKA, Ausfuhrkredit-GmbH, Landwirtschaftliche Rentenbank, DekaBank, DZ BANK AG, IKB Deutsche Industriebank AG.
Sources: Deutsche Bundesbank, Helaba Research

In addition, there are other deviations with regard to the composition of categories of banks at regional level. Regional and other commercial banks also include branches of foreign banks. For data privacy reasons, Landesbanken are not separately reported; otherwise, it would be possible to draw conclusions with regard to specific banks at the level of federal states. Hence, the aggregate "Other banks" contains an "assortment" of Landesbanken, mortgage banks, building and loan associations, as well as banks with special tasks.

Breakdown of loans
by federal state

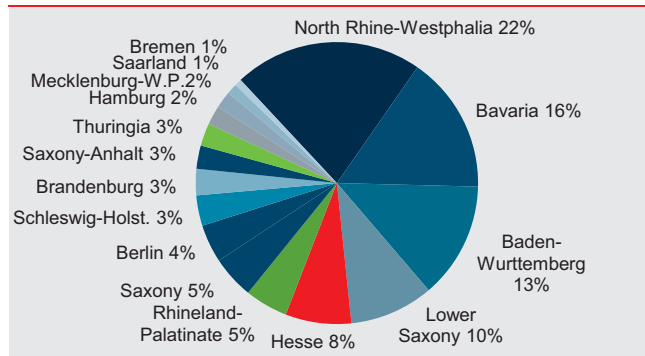
Before addressing the market positions of Savings Banks in Germany's various federal states, it is important to have an overview of the regional breakdown of loans in general. Population size and the gross domestic product can serve as yardsticks because Germany's federal states vary widely in terms of these two criteria. The four largest federal states (North-Rhine Westphalia, Bavaria, Baden-Württemberg, and Lower Saxony) and the smaller federal states have largely matching shares in relation to the number of inhabitants and lending volumes. Most of the variations can be explained by differences in economic strength. The State of Hesse is an exception. This is due to the fact that Frankfurt is a financial centre which is the domicile of many banks operating

Special case: Hesse

nationwide with a branch network, which considerably distorts the distribution. In many banks, most of the large loans and complex financing transaction are handled at the headquarters in Frankfurt. With reference to the category of commercial banks, this means that roughly one-quarter of their domestic loans to non-banks are handled in Frankfurt. Overall, the State of Hesse accounts for 13 % of domestic loans to non-banks, while its inhabitants represent only 8 % of Germany's population.

Population size does not fully explain ...

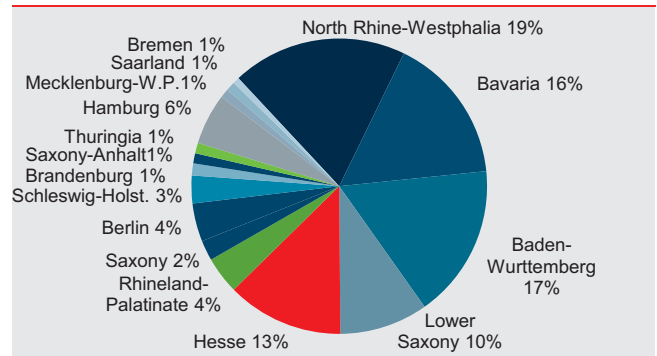
Share of Germany's population (%), 2018



Sources: Deutsche Bundesbank, Helaba Research

... the regional breakdown of loans

Shares of loans to domestic non-banks (%), December 2018

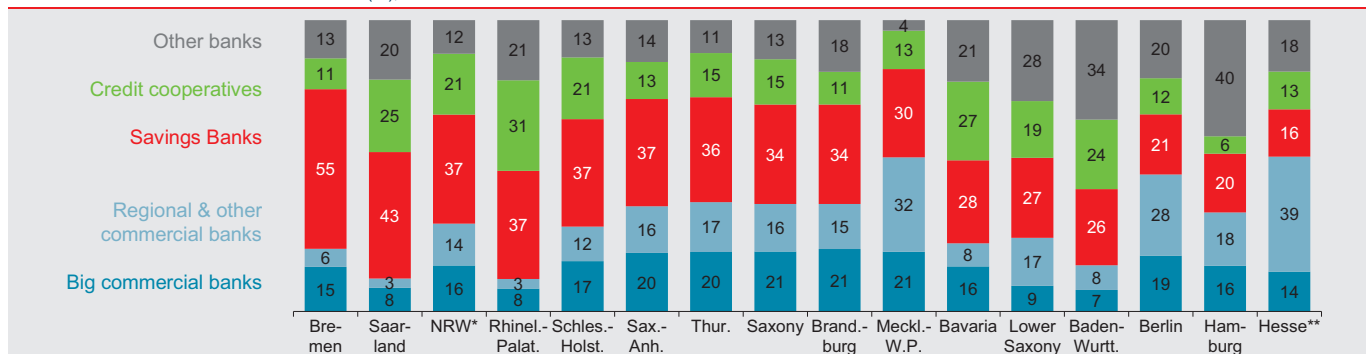


Sources: Deutsche Bundesbank, Helaba Research

The high concentration of lending activities by private banks in the financial centre of Frankfurt also explains the commercial banks' very high market share of over 50 % in the State of Hesse. This is also the reason why the market share of Savings Banks in Hesse (16 %) is biased downwards. However, the presence of competitors is stronger in Frankfurt and in the city states of Berlin and Hamburg, and customer needs are also more demanding in terms of their scope and complexity – both factors lead to keener competition facing Savings Banks and credit cooperatives in these regional markets.

Savings Banks have market shares of 30 % or more in 10 of 16 federal states

Market shares in loans to domestic non-banks (%), December 2018



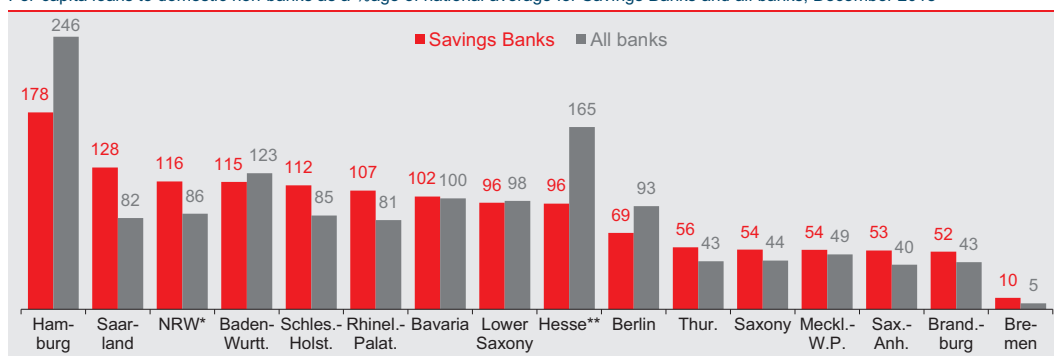
* North Rhine-Westphalia ** As a financial centre, Frankfurt is the domicile of many banks operating nationwide, which distorts the market shares to the disadvantage of Savings Banks in the State of Hesse because the bulk of large exposures are handled in headquarters. Sources: Deutsche Bundesbank, Helaba Research

Savings Banks with very high market shares in some regions

Apart from this, Savings Banks have above-average market shares of 30 % or more in 10 of Germany's 16 federal states. In Bremen, Savings Banks are the undisputed regional market leader, with a market share of 55 %. Savings Banks also have above-average market shares in the federal states of Saarland, Rhineland-Palatinate and Schleswig-Holstein, where they provide between 37 and 43 % of the loans to domestic non-banks. North-Rhine Westphalia – Germany's most populous federal state – is also "Savings Banks country", with a market share of 37 %. Here, the Savings Banks' per-capita lending volume is 16 % above the national average of Savings Banks in Germany. At the same time the average per-capita lending volume of all banks is 14 % below their national average.

Credit supply by Savings Banks in most cases higher than the average for banks

Per-capita loans to domestic non-banks as a %age of national average for Savings Banks and all banks, December 2018



* North Rhine-Westphalia ** As a financial centre, Frankfurt is the domicile of many banks operating nationwide, which distorts the market shares to the disadvantage of Savings Banks in the State of Hesse because the bulk of large exposures are handled in these headquarters.

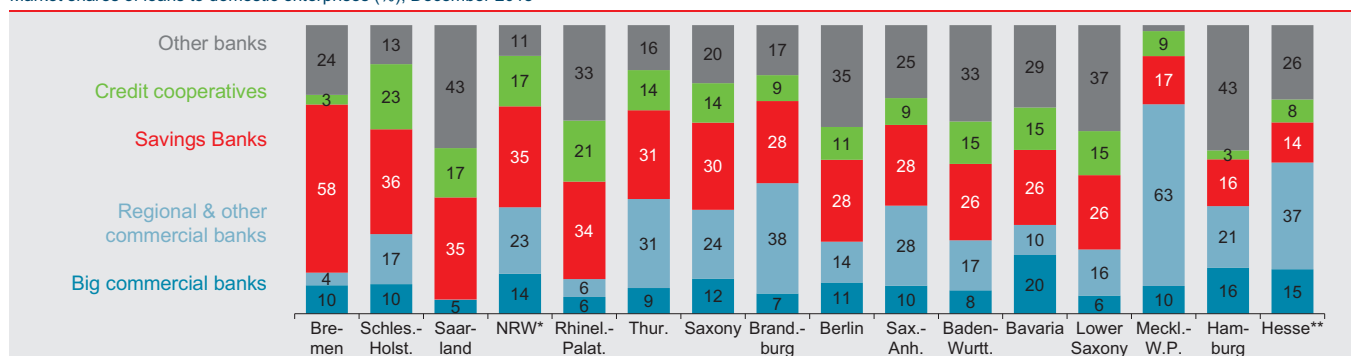
Sources: Deutsche Bundesbank, Helaba Research

Savings Banks with above-average loans per inhabitant

In former East Germany, per-capita lending is low, ranging between 40 and 49 % of the national average. Savings Banks are also more active in these federal states: their lending volumes amount to between 52 % and 56 % of the Savings Banks' national average. However, this situation does not reflect an undersupply of credit; instead, it is more due to a lack of demand. Enterprises in former East Germany are often part of corporate groups which have their domiciles in the old federal states in the western part of Germany, so that financing transactions are therefore concluded with the banks located there. In addition, the population in Germany's eastern federal states is somewhat older on average, which reduces the need for financing.

Savings Banks' share of pure corporate lending business is somewhat lower than ...

Market shares of loans to domestic enterprises (%), December 2018



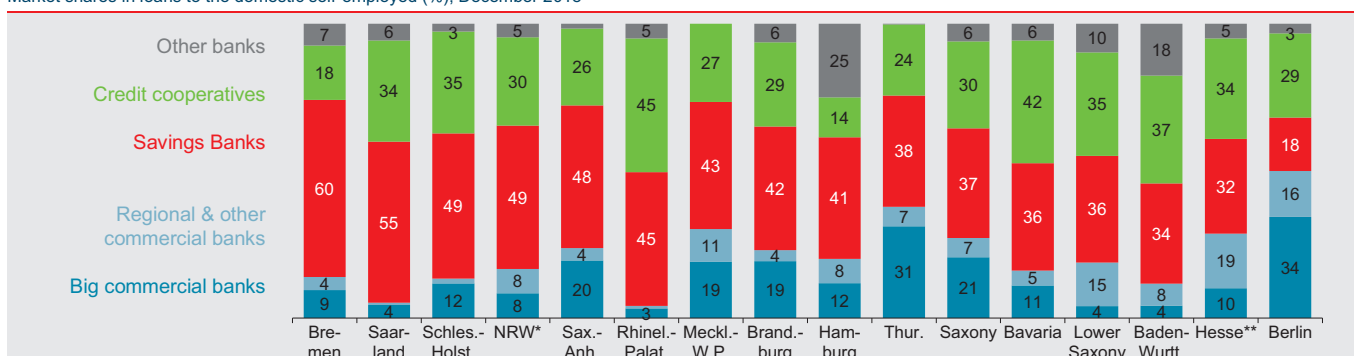
* North Rhine-Westphalia ** As a financial centre, Frankfurt is the domicile of many banks operating nationwide, which distorts the market shares to the disadvantage of Savings Banks in the State of Hesse because the bulk of large exposures are handled in these headquarters. Sources: Deutsche Bundesbank, Helaba Research

Enterprises and the self-employed are important customer groups

At the level of the federal states, the Savings Banks' main competitors in the corporate banking business are for the most part regional & other commercial banks. However, their market share is rarely higher than that of Savings Banks. The situation is different with regard to the self-employed.

... in lending to the self-employed

Market shares in loans to the domestic self-employed (%), December 2018

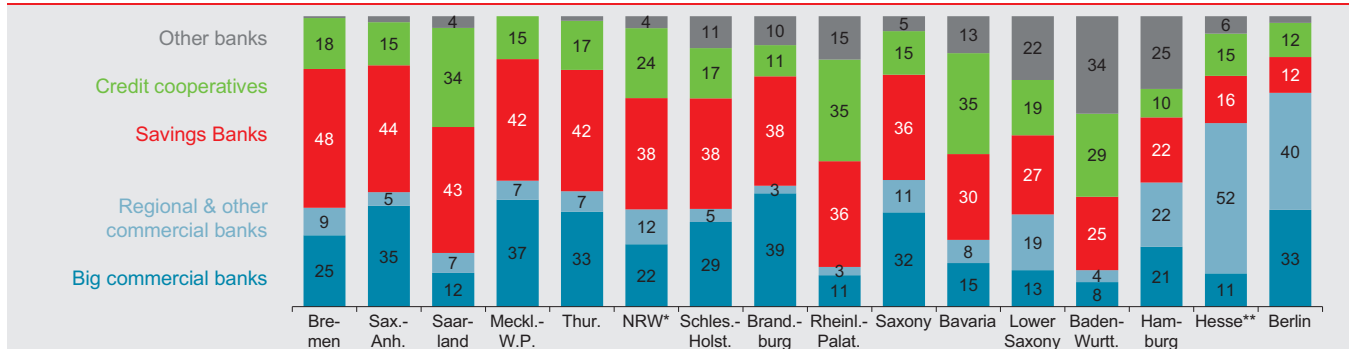


* North Rhine-Westphalia ** As a financial centre, Frankfurt is the domicile of many banks operating nationwide, which distorts the market shares to the disadvantage of Savings Banks in the State of Hesse because the bulk of large exposures are handled in these headquarters. Sources: Deutsche Bundesbank, Helaba Research

In four federal states, Savings Banks provide over 40 % of the loans to the self-employed, and in another five federal states, they account for as much as approx. 50 % or more of the loans to the self-employed. However, credit cooperatives are also very active, with market shares of up to 45 % (in Rhineland-Palatinate).

Retail customers make intensive use of loans provided by Savings Banks

Market shares in loans to domestic retail customers (%), December 2018



* North Rhine-Westphalia **As a financial centre, Frankfurt is the domicile of many banks operating nationwide, which distorts the market shares to the disadvantage of Savings Banks in the State of Hesse because the bulk of large exposures are handled in these headquarters. Sources: Deutsche Bundesbank, Helaba Research

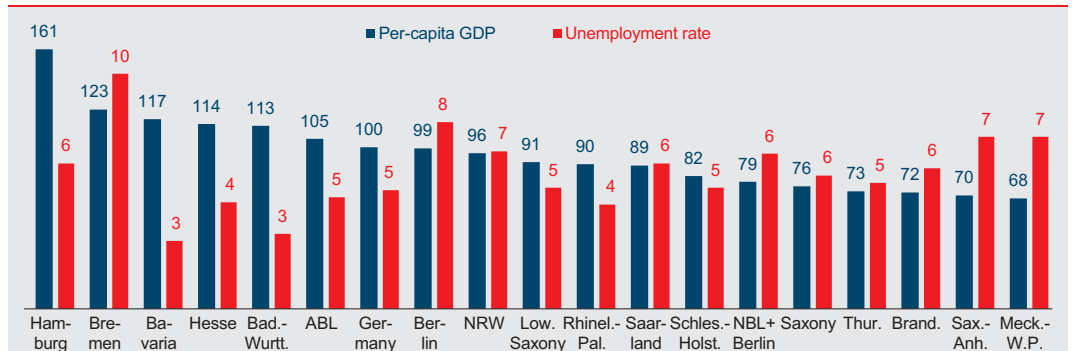
Good starting position for retail banking business

Retail customers, whose primary interest as borrowers is to finance home ownership, are welcome in all categories of banks, since this kind of borrowing transaction is backed by immovable collateral, whose valuation has increased in recent years. In Germany, housing finance is mainly based on long-term fixed-interest loans. The risks are also manageable because the labour market situation has improved significantly; many federal states are close to full employment. In loans to individuals, Savings Banks have market shares of 30 % or more in eleven federal states.

Regional economic strength and labour market

Per-capita GDP as a %age of national average, 2018

Unemployment rate as a %age of total civilian workforce, April 2019



Sources: Arbeitskreis VGR der Länder, Bundesagentur für Arbeit, Helaba Research

3 Conclusion: The S-Finance Group supports Germany's federalism

Savings Banks and Landesbanken strengthen Germany's federal structure

There is no doubt that Germany is a country with a federal structure. However, how should Germany's federalism be practised? Germany's federal structure is directly linked to the vitality of its 16 federal states. In this context, state-level governments and local governments play an important role, for example in providing physical and intellectual infrastructure. The financing of relevant projects is supported in particular by the public banking sector. More than other banks, Savings Banks – whose business area is limited by the regional principle – are dependent on their regional business success and, hence, they are keenly interested in the development of local businesses.

Savings Banks and Landesbanken are therefore essential components for securing Germany's economic future and development, both from a national and regional perspective.

Legal framework of the Savings Banks in Germany*

The German regulatory regime applies equally to all banks, including Savings Banks. However, the legal framework of the Savings Banks has a number of special features:

- Savings Banks were established to provide all citizens with the opportunity to deposit their savings safely. This founding mission has evolved over time and was laid down by law as a so-called **public mandate**, including the obligation:
 - to ensure non-discriminatory provision of financial services to all citizens and particularly to small and medium-sized enterprises in the region,
 - to strengthen competition in banking business (even in rural areas),
 - to promote savings,
 - to sponsor a broad range of social commitments.
- **Public legal form:** Initially, Savings Banks were founded by citizens; their structure was reminiscent of private foundations. Later, they were founded predominantly by municipalities and were integrated into the local government organisations. This legal structure was replaced in 1931. Since then, Savings Banks have operated under market conditions as legally and economically independent institutions under public law.
- Savings Banks in Germany operate under "**municipal trusteeship**". Their "responsible public bodies" are the municipalities, but they are not state-owned banks. They are fully independent in their day-to-day business and run by licensed bankers.
- Savings Banks only service a clearly defined business area, which is specified as the administrative region of the municipality or district in which they were founded. The **regional principle** is laid down by law.

*Source: Deutscher Sparkassen- und Giroverband, "Inside the Savings Banks Finance Group", p. 12-13, 2018

Close ties with
home region

As a result of their legal structure, the S-Finance Sector has stronger links to a given home region than, for example, the branch of an internationally operating big bank. In corporate finance and in the provision of finance to local and state-level governments, Landesbanken and Savings Banks achieve above-average market shares due to their physical proximity to their customers. Close customer ties are important, especially in light of Germany's polycentric economic structure. Whenever the risk-bearing capacity of Savings Banks is exceeded because of their size, the Landesbanken will become active. For the business model of local Savings Banks, the existence of Landesbanken – which are complementary to them – remains an essential prerequisite. However, they are not a homogeneous group. In addition to the intensification observed in the Group business with Savings Banks, Landesbanken – whose business priorities are influenced by regional specificities – are increasingly developing distinct identities.

As a group of banks, Landesbanken – in close cooperation with Savings Banks – form a large and complex economic structure that has evolved over a long period of time. In the framework of a possible reorganisation of the Landesbank sector or a realignment of the division of responsibilities within the Savings Banks Finance Group, due consideration should be given to Germany's polycentric economic structure and the role of the S-Finance Group in financing the corporate sector. With this in mind, it is important to keep as many credit channels open as possible in order to meet regional requirements.

Savings Banks and
Landesbanken
meet challenges

Nevertheless, there has already been a series of both horizontal and vertical mergers of Savings Banks and Landesbanken in the past. These processes – which, in the end, are market-driven – should not be obstructed. Instead, they should be utilised within the public banking sector as they will have sustainable economic benefits and help to stabilise the financial system in Germany. Structural changes in the national economy will also pose challenges for banks in the future. Savings Banks and Landesbanken will be able to master these challenges if they jointly develop creative and solid solutions. ■

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