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Research Update:

Outlook On S-Finanzgruppe Hessen-Thueringen Members Now Positive On Improving Capitalization; 'A/A-1' Ratings Affirmed

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Overview

- The consolidated capital ratios of S-Finanzgruppe Hessen-Thuringen (SFHT) have further strengthened, thanks to ongoing earnings retention and moderate loan growth.
- SFHT includes Landesbank Hessen-Thuringen (Helaba) and 49 savings banks in the German states of Hesse and Thuringia.
- We are revising our outlook to positive from stable and affirming the long- and short-term ratings on all the SFHT entities at 'A/A-1'.
- We are affirming the ratings on the grandfathered guaranteed senior subordinated debt issued by Helaba.
- The positive outlook reflects our expectation that our risk adjusted capital ratio could sustainably surpass the 15% threshold over the next 12-24 months, and that this might signal greater overall resilience to periods of stress.

Rating Action

On Aug. 21, 2018, S&P Global Ratings revised its outlook to positive from stable on the 49 savings banks in Hesse and Thuringia and their majority-owned central bank Landesbank Hessen-Thuringen Girozentral (Helaba), which are collectively known as Sparkassen-Finanzgruppe Hessen-Thuringen (SFHT). We affirmed the 'A/A-1' long- and short-term credit ratings on all these entities.

At the same time, we affirmed the 'A-' rating on Helaba's senior subordinated debt, as well as the 'AA' rating on the grandfathered guaranteed senior subordinated debt of Helaba.

Rationale

The revision of the outlook to positive from stable on all of SFHT's members reflects our view that the group's consolidated capitalization continues to strengthen and, even allowing for potential sources of unexpected losses and some lack of fungibility of capital, it could become a greater source of strength to the group. It also reflects that the banks' financial performance will continue to exceed our projections, which would support the buildup of

additional capital.

As of year-end 2017, our consolidated risk adjusted capital (RAC) ratio for SFHT (before adjustments) improved materially to 14.8% from 13.9% a year earlier, also benefitting from lower-than-projected loan growth over the last year.

We acknowledge that the low-interest-rate environment, with ongoing margin pressure, poses significant challenges to Helaba's wholesale-oriented business model, as well as to the savings banks' deposit-funded and branch-based business model. The group reported net income of €926 million for 2017, 11% lower than for 2016. The results would have been even lower, but benefitted from the release of €100 million of credit loss provisions. This equates to a return on equity of about 5%, which is relatively low by global standards, but not inconsistent with the expectations of SFHT's owners.

We forecast that SFHT's preprovision profits will remain under pressure and we expect a gradual reversal of credit loss provisioning requirements to levels more in line with historical numbers. These factors will, in our view, lead to a further, though moderate, decline in net income through 2020. At the same time, with an average annual loan growth of only about 1% since 2013, we expect loan growth to pick up again to about 2%-4% annually over our projection period. Over the last few years, we observed a stagnating customer loan portfolio at Helaba, also driven by high competition in the bank's commercial real estate segments and due to run-down of its shipping portfolio.

In view of the above, we anticipate that aggregate capital levels will continue to improve slightly, but more slowly. We project that SFHT's RAC ratio will remain slightly below the 15% benchmark until 2020. If, on the other hand, our RAC ratio were to improve sustainably above 15%, we would likely revise up our capital and earnings assessment to very strong.

Even if we were to revise this assessment upward, however, we would only raise the ratings if we concluded that the group had meaningfully increased its overall resilience. We note Helaba's and the savings banks' somewhat risk-averse culture, and the relationship-based strategies underpinning its sizable exposure to commercial real estate markets. Nevertheless, we would need to be confident that the group would continue to demonstrate highly favorable asset quality and that revenue growth aspirations, especially in the commercial real estate and corporate finance activities, were not being achieved through a growing risk appetite.

We expect that SFHT's member banks will maintain a strong business focus on Germany, supporting the 'a-' anchor. They also reflect the group's solid aggregate business position, supported by the savings banks' dominant position in regional retail banking and complemented by Helaba's function as its central bank and by its more wholesale-oriented businesses. We look for SFHT, and the nationwide German savings banks sector more broadly, to continue to evolve to meet the changing demands of customers and to leverage technology to support its competitiveness. We also factor in SFHT's refinancing availability

from its large regional retail branch network, close relationships with domestic corporate clients, and funding diversification, courtesy of Helaba.

The core member banks of SFHT include the 49 regional savings banks and their 69%-owned central bank Helaba. We equalize our ratings on each savings bank and Helaba with our view of SFHT's 'a' group credit profile (GCP). The equalization with the GCP reflects our view that the member savings banks and Helaba are core entities of SFHT, and, as such, would be supported by the group if needed.

Outlook

The positive outlook reflects that we could raise the issuer credit ratings by one notch over the next 12-24 months if we have certainty that SFHT's RAC ratio has demonstrably and sustainably passed the 15% threshold. An upgrade would also require that the group continue to demonstrate favorable asset quality and Helaba keep its risk-averse culture, especially in its commercial real estate and corporate finance activities. We could also raise the ratings if we were to revise upward our view of SFHT's group status within the German savings banks sector. If we were to raise the issuer credit ratings on the SFHT entities, we would expect also raise our issue credit ratings on the senior subordinated instruments, but not the grandfathered 'AA'-rated instruments.

Downside scenario

We could revise the outlook back to stable if we were to see the RAC ratio retreating from, rather than approaching, the 15% threshold, or if we see the improving capitalization being counterbalanced by doubts over the group's exposure to unexpected losses of, for example, the riskier activities undertaken by Helaba.

SFHT's highly strategic group status effectively puts an 'A' floor on the long-term ratings on individual SFHT savings banks and Helaba, given the current 'a+' GCP of the German savings banks' sector. We also assume that the level of cohesion and cooperation within the German savings banks sector will remain high and that the aggregate creditworthiness of the German network of savings banks will remain stable.

A downgrade would require a combination of a weaker assessment of the German savings banks' nationwide network or SFHT's links with it, and of the unsupported GCP of SFHT member banks. While we consider this unlikely, both might occur if profitability were to erode, such that it prevented SFHT or nationwide savings banks from covering their normalized credit losses.

Ratings Score Snapshot

| | To | From |
|-----------------------|-------------------------|-------------------------|
| Issuer Credit Rating | A/Positive/A-1 | A/Stable/A-1 |
| SACP* | a | a |
| Anchor | a- | a- |
| Business Position | Adequate(0) | Adequate(0) |
| Capital and Earnings | Strong(1) | Strong(1) |
| Risk Position | Adequate(0) | Adequate(0) |
| Funding and Liquidity | Average and Adequate(0) | Average and Adequate(0) |
| Support | (0) | (0) |
| ALAC Support | (0) | (0) |
| GRE Support | (0) | (0) |
| Group Support | (0) | (0) |
| Sovereign Support | (0) | (0) |
| Additional Factors | (0) | (0) |

*SACP represents our view of the unsupported group credit profile of SFHT--that is, its intrinsic creditworthiness before considering sources of external support.

Related Criteria

- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Financial Institutions - Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013

- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

Ratings List

Outlook Action; Ratings Affirmed

| | To | From |
|---|----------------|--------------|
| Landesbank Hessen-Thueringen Girozentrale | | |
| Issuer Credit Rating | A/Positive/A-1 | A/Stable/A-1 |
| Senior Subordinated | A- | A- |
| Senior Subordinated* | AA | AA |
| Commercial Paper | A-1 | A-1 |

*Grandfathered debt.

Frankfurter Sparkasse
Wartburg-Sparkasse
Taunus-Sparkasse
Staedtische Sparkasse Offenbach am Main
Stadtsparkasse Schwalmstadt
Stadtsparkasse Grebenstein
Stadtsparkasse Borken
Stadt- und Kreis-Sparkasse Darmstadt
Sparkasse Wetzlar
Sparkasse Werra-Meissner
Sparkasse Waldeck-Frankenberg
Sparkasse Unstrut-Hainich
Sparkasse Starkenburg
Sparkasse Sonneberg
Sparkasse Rhoen-Rennsteig
Sparkasse Odenwaldkreis
Sparkasse Oberhessen
Sparkasse Mittelthueringen
Sparkasse Marburg-Biedenkopf
Sparkasse Laubach-Hungen
Sparkasse Langen-Seligenstadt
Sparkasse Jena-Saale-Holzland
Sparkasse Hanau
Sparkasse Gruenberg
Sparkasse Giessen
Sparkasse Gera-Greiz
Sparkasse Fulda
Sparkasse Dillenburg

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