FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Sparkassen-Finanzgruppe Hessen Thueringen and Helaba at 'A+'/Negative

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Fitch Ratings - Frankfurt am Main - 07 Aug 2020: Fitch Ratings has affirmed German banking group Sparkassen-Finanzgruppe Hessen Thueringen's (SFG-HT) Long-Term Issuer Default Rating (IDR) at 'A+' with a Negative Outlook, Short-Term IDR at 'F1+' and Viability Rating (VR) at 'a+'.

Fitch has also affirmed the Long-Term IDRs of the 49 savings banks members of SFG-HT's mutual support scheme, and of its central institution, Landesbank Hessen-Thueringen Girozentrale (Helaba) at 'A+'/Negative. Fitch has downgraded the Long-Term Deposit Ratings of the group's savings banks members to 'A+' from 'AA-' and affirmed their Short-Term Deposit Ratings at 'F1+', because it no longer believes that in a resolution event, driven by the Single Resolution Board, the savings banks can benefit from Helaba's large layer of subordinated, senior non-preferred and vanilla senior debt buffer to recapitalise them..

KEY RATING DRIVERS

IDRS, VR, HELABA'S SENIOR UNSECURED AND SENIOR NON-PREFERRED DEBT

SFG-HT is not a legal entity but a network of savings banks in Hessen and Thueringen, whose cohesion is supported by a mutual support scheme and which forms a common economic unit together with Helaba. Fitch assigns group ratings to SFG-HT and its member banks. The IDRs apply to each individual member bank in accordance with Annex 4 of Fitch's Bank Rating Criteria for banking structures backed by mutual support mechanisms and are based on the group's VR.

The group's ratings are underpinned by an integrated business model resulting in stronger cohesion among its members compared with Sparkassen-Finanzgruppe (SFG; A+/Negative/F1+), the nationwide network of savings banks in Germany. It reflects SFG-HT's common business and risk strategy, common risk monitoring, own regional reserve fund and voluntary provision of consolidated IFRS accounts.

Nevertheless, its IDRs and VR are closely aligned with those of SFG because SFG-HT's savings banks members are also part of the German savings banks' nationwide mutual support scheme, which is designed as an institutional protection scheme and recognised by the regulator as a deposit guarantee scheme.

The group enters the economic downturn in 2020 driven by f the coronavirus pandemic from a relative position of strength, given its diversified and strong regional retail franchise, complemented by Helaba's domestic and international wholesale activities, sound asset quality, strong capitalisation and solid deposit-driven funding and liquidity.

The Negative Outlook on SFG-HT's IDRs reflects our view that risks remain skewed to the downside in the medium term, especially if the recession proves deeper or the recovery weaker than Fitch's baseline economic scenario. In this case, SFG-HT's ratings might come under pressure due to deteriorating asset quality, larger credit losses, and weaker revenue generation. This could ultimately result in greater than expected capital erosion, despite our expectation of moderately stronger resilience to the impact of the corona crisis at the savings banks' level. The ultimate impact on SFG-HT's financial profile will also depend on the effectiveness of the government support programmes to the broader economy, the duration of the crisis and the speed and strength of the recovery.

SFG-HT's capitalisation is a rating strength and materially stronger than the German banking sector average. The group's calculated CET1 ratio moderately declined to 18.6% at end-2019, because growth in risk-weighted assets (RWAs), driven by strong loan growth and a one-off asset acquisition at Helaba, outpaced profit retention. We believe the group is well placed to provide financing to its customers through the COVID-19 crisis and absorb the negative impact from the recession. We also believe that the group can remain profitable and continue to build capital under a reasonable stress scenario. A severe stress could lead to losses for SFG-HT, but we do not expect these to be significant .

SFG-HT's appetite for credit risk is low, driven by conservative underwriting standards, strong collateral and an acceptable level of sector and counterparty concentration. We view Helaba's risk appetite as conservative, despite its focus on commercial real estate lending. The group's interest rate risk in the banking book remains high due to unhedged maturity mismatches and makes the group vulnerable to interest rate shocks. However, this is mitigated by Helaba's long-term debt issuance and the savings banks' use of derivatives.

The group's non-performing loan ratio (NPL) dropped below 1.0% at end-2019, helped by Helaba's reported NPL ratio of 0.4%. However, unlike in the previous year, the group reported rising loan impairment charges in 2019, indicating a reversal of the credit cycle prior to the outbreak of the pandemic. Fitch expects SFG-HT's asset quality to deteriorate over the next two years, primarily due to cyclical unsecured consumer finance and the group's corporate/SME lending.

SFG-HT's financial performance improved in 2019 and the group's operating profit/RWA ratio recovered to 1.2% in 2019. However, this was mainly driven by a large swing in the fair value result on financial assets, which we do not expect to be repeated. The group's profitability remains in a longer-term structural decline, similar to most peers, reflecting pressure on net interest income, which is unlikely to be balanced by higher fees. The group showed good cost discipline in 2019 and Helaba launched a restructuring programme including head count reduction. Nevertheless, we expect this year's financial result to be significantly lower, driven by materially higher loan impairment charges.

The savings banks' large and growing retail deposit base strongly supports the group's sound funding and liquidity profile. The 'F1+' Short-Term IDR is the higher of two options mapping to a 'A+' Long-Term IDR and reflects the group's 'aa-'score for funding and liquidity. Helaba pursues a strategy of matched funding of new business, and its wholesale funding benefits from an established domestic and international investor base.

GUARANTEED SENIOR UNSECURED AND SUBORDINATED NOTES AND OTHER SUBORDINATED NOTES

The 'AAA' rating of Helaba's guaranteed senior unsecured and subordinated Tier 2 debt is based on Fitch's view of the State of Hessen and the Free State of Thueringen's extremely high ability and propensity to honour their statutory grandfathered guarantee. Fitch believes that the protection provided by the grandfathered guarantee is similar between senior and subordinated debt instruments because the statutory guarantor's liability (Gewaehrtraegerhaftung) does not differentiate between the seniority of various classes of liabilities. In our view, regulatory and EU state aid frameworks do not constrain the level of support for grandfathered debt

Subordinated Tier 2 notes that do not benefit from the guarantee are notched down twice from SFG-HT's VR to reflect Fitch's baseline notching for loss-severity.

DERIVATIVE COUNTERPARTY RATING (DCR), DEPOSIT RATINGS AND HELABA'S SENIOR PREFFERED RATING

Fitch has affirmed Helaba's DCR, deposit ratings and preferred debt ratings at 'AA-', one notch above its Long-Term IDR because of the protection provided by Helaba's sustainable resolution buffers to these preferred creditors. Helaba is subject to a minimum requirement for own funds and eligible liabilities (MREL), and although the bank so far has not publicly expressed it plans to meet this requirement exclusively with senior non-preferred (SNP) and more junior instruments, we expect that the buffer of junior and SNP instruments will continue to comfortably exceed 10% of RWA.

Fitch has downgraded the long-term deposit ratings of SFG-HT's savings banks to 'A+' and affirmed their short-term deposit ratings at 'F1+'. Resolution regimes for European banks have evolved and become clearer and more transparent. We believe the savings banks are now less likely to benefit from Helaba's large layer of subordinated and senior non-preferred debt to recapitalise them if SFG-HT fails. Fitch believes, this is because the authorities appear to favour a 'single point of entry' resolution strategy with a bail-in for Helaba, which does not include the savings banks. As long as SFG-HT is not recognised as one regulatory group including its savings banks members, we believe that it is unlikely that the group's savings banks would be included in a bail-in.

If the need for support arises at savings banks, we believe the mutual support mechanism would ensure this support until the point of failure of the entire group, which is backed by the sector's deposit guarantee scheme that covers all German savings banks and by SFG-HT's own reserve fund. Beyond this point, we do not believe savings banks' depositors would additionally benefit from Helaba's resolution buffers in a way that would justify maintaining the one-notch uplift of the long-term deposit rating of the individual savings banks above their Long-Term IDRs.

HELABA ASSET SERVICES

The IDRs of Helaba Asset Services, which is not a member of SFG-HT's mutual support scheme, are equalised with its parent's IDRs to reflect our view that institutional support would be forthcoming. Helaba Asset Services benefits from a declaration of backing by Helaba, and we believe that Helaba would face reputational risk if Helaba Asset Services defaults on its obligations. Helaba Asset Services' status as a private unlimited company also means that Helaba is fully liable for any shortfall in its assets in case of liquidation.

SUPPORT RATING (SR) AND SUPPORT RATING FLOOR (SRF)

SFG-HT's SR and SRF reflect Fitch's view that extraordinary sovereign support for EU banks is possible but cannot be relied upon due to the Bank Recovery and Resolution Directive and the Single Resolution Mechanism's resolution mechanisms. It is likely that senior creditors will be required to participate in losses, if necessary, instead of or ahead of the group receiving sovereign support.

Additional ESG Commentary

The highest level of ESG credit relevance is a score of '3'. SFG-HT's governance structure is not a rating driver and is not constrained by SFG's score of '4' for group structure, even though SFG-HT's savings banks are also part of the nationwide savings banks organisation. This is because SFG-HT statutorily operates as one economic unit, which is a key pillar of its corporate culture. This commitment makes its decision making processes more effective and fosters a materially stronger cohesion than within SFG. The score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on SFG-HT, either due to their nature or to the way in which they are being managed by the entity

RATING SENSITIVITIES

IDRS, VR, HELABA'S SENIOR UNSECURED AND SENIOR NON-PREFERRED DEBT

The IDRs, senior unsecured debt and Helaba's senior non-preferred ratings are sensitive to changes in the group's VR. SFG-HT's ratings are also sensitive to changes in those of SFG. This is because SFG-HT's savings banks are also part of the savings banks' nationwide mutual support mechanism, and would be affected by a material change of the overall savings bank sector's credit profile.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

SFG-HT's ratings could be affirmed and the Outlook revised to Stable if COVID-19 disruptions are short-lived, and the group manages to maintain adequate asset quality. Fitch believes that the measures taken by the German government to support retail customers and the corporate sector should indirectly support SFG-HT's asset quality and ultimately its viability. Profitability pressure from an extended period of low interest rates makes an upgrade unlikely in the short term.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

SFG-HT's ratings could be downgraded if the economic disruptions caused by the pandemic intensify, making a swift economic recovery in 2021 and 2022 less likely. In this case, SFG-HT's ratings could come under pressure from elevated credit losses triggered by a severe deterioration in asset quality and weaker revenue generation, ultimately resulting in greater than expected capital erosion.

The Short-Term IDR is also sensitive to our assessment of the group's funding and liquidity and could be downgraded if SFG-HT's funding and liquidity score drop below 'aa-'.

GUARANTEED SENIOR UNSECURED AND SUBORDINATED NOTES AND OTHER SUBORDINATED NOTES

Factors that could, individually or collectively, lead to negative rating action/downgrade

The rating of Helaba's guaranteed senior unsecured and subordinated Tier 2 debt is primarily sensitive to a change in Fitch's view of the creditworthiness of the guarantor. A downgrade of the guarantors would trigger a downgrade of the guaranteed instruments. The ratings of the subordinated Tier 2 notes that do not benefit from the guarantee are primarily sensitive to the changes in SFG-HT's VR, from which they are notched.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

The ratings of the guaranteed bonds are 'AAA', which is the highest level on Fitch's scale. The ratings cannot be upgraded.

The ratings of subordinated Tier 2 notes that do not benefit from the guarantee could be upgraded if the notes meet the specific conditions under our criteria for applying a reduced notching or if the VR was upgraded.

DCR, DEPOSIT RATINGS AND HELABA'S SENIOR PREFFERED RATING

Factors that could, individually or collectively, lead to negative rating action/downgrade

The Deposit Ratings of the savings bank members, and Helaba's DCR and senior non-preferred debt rating are primarily sensitive to changes in SFG-HT's IDRs.

Helaba's ratings are also sensitive to a reduction of its consolidated buffers of subordinated and senior non-preferred debt to below 10% of its RWA. Regulation-driven long-term RWA inflation could also weigh on the rating uplift if it is not accompanied by an increase in the size of the debt buffer.

Factors that could, individually or collectively, lead to positive rating action/upgrade

The deposit ratings of the savings bank members could be upgraded if all members of SFG-HT become subject to a common resolution regime with bail-in as the preferred resolution strategy, and if the group fulfils its MREL requirements with senior non-preferred or more junior debt, or if the debt buffer at Helaba sustainably remains above 10% of the resolution group's RWAs.

HELABA ASSET SERVICES

Factors that could, individually or collectively, lead to negative rating action/downgrade

Helaba Asset Services' IDRs are equalised with and primarily sensitive to a change in Helaba's IDRs. A cancellation of Helaba's declaration of backing would trigger a widening of the support notching.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Helaba Asset Services IDRs are already equalised with the parent. A higher rating is therefore unlikely.

SUPPORT RATING AND SUPPORT RATING FLOOR

Factors that could, individually or collectively, lead to negative rating action/downgrade

The SR and SRF are already at the lowest possible levels.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade of the SR and upward revision of the SRF would be contingent on a positive change in Fitch's view of the sovereign's propensity to support its systemically important banks. While not impossible, in Fitch's opinion, this is highly unlikely.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and

worst-case scenario credit ratings, visit
[https://www.fitchratings.com/site/re/10111579]

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

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

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

Landesbank Hessen-Thueringen Girozentrale (Helaba) is part of Sparkassen-Finanzgruppe Hessen-Thueringen (SFG-HT). SFG-HT is not a legal entity but a network of savings banks in Hessen and Thueringen whose cohesion is supported by a mutual support scheme and which forms a common economic unit together with Helaba. Fitch assigns "group" ratings to SFG-HT and its member banks.

Helaba Asset Services is a subsidiary of Helaba.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Non-Bank Financial Institutions Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)

Bank Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Frankfurter Sparkasse	EU Issued
Kasseler Sparkasse	EU Issued
Kreissparkasse Eichsfeld	EU Issued
Kreissparkasse Gelnhausen	EU Issued
Kreissparkasse Gotha	EU Issued
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Nassauische Sparkasse	EU Issued
Sparkasse Altenburger Land	EU Issued
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Structured Finance: Covered Bonds Structured Finance Banks Europe

Germany Ireland
