FitchRatings

Fitch Affirms S - Finanzgruppe Hessen Thueringen and Helaba at 'A+'/Stable

Link to Fitch Ratings' Report(s): Fitch Affirms S - Finanzgruppe Hessen Thueringen and Helaba at 'A+'/Stable (https://www.fitchratings.com/site/re/10053604)

Fitch Ratings-Frankfurt/London-27 November 2018: Fitch Ratings has affirmed German banking group S-Finanzgruppe Hessen Thueringen's (SFG-HT) Long-Term Issuer Default Rating (IDR) at 'A+' with a Stable Outlook, and Viability Rating (VR) at 'a+'. Fitch has also affirmed the IDRs of the 49 savings banks members of SFG-HT's mutual support scheme and its central institution, Landesbank Hessen-Thueringen Girozentrale (Helaba).

A full list of rating actions is at the end of this rating action commentary. A full list of the group's rated savings banks is available at www.fitchratings.com or via the link above.

The affirmation reflects SFG-HT's high capitalisation and good asset quality, which is supported by years of strong domestic economic growth as well as healthy corporate and SME balance sheets. The group maintains a solid funding and liquidity position, driven by the savings banks' large retail deposit base. Profitability is sound, although we expect a gradual weakening in the medium term from continued margin pressure. The group's profile is underpinned by its strong regional retail franchise and Helaba's provision of complementary wholesale services and products.

KEY RATING DRIVERS
IDRS, VR AND SENIOR DEBT
The IDRs of SFG-HT and its members are based on the group's VR. The group's ratings are underpinned by its integrated business model, which means that the savings banks in Hessen and Thueringen form a common economic unit with Helaba. Consequently, SFG-HT's cohesion is higher than at Sparkassen-Finanzgruppe (SFG; A+/Stable/F1+) as demonstrated by SFG-HT's common business and risk strategy, common risk monitoring, own regional reserve fund and voluntary provision of consolidated IFRS accounts. The ratings also benefit from a broadened geographical reach because of Helaba's tight relationship with the savings banks in Northrhine-Westfalia and Brandenburg, for which it is the prime cooperation partner.

SFG-HT's 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.

SFG-HT is well capitalised given its fairly low-risk profile, with a fully loaded common equity Tier 1 (CET1) ratio of 20.6% at end-2017 (end-2016: 19.6%), which is well above the German banking sector's average. The capital available in excess over the individual members' undisclosed SREP requirements puts the group in a comfortable position to accommodate its growth objectives while maintaining a solid loss absorbing buffer, even if the German economic environment weakens materially. We expect some regulatory risk-weighted assets (RWA) inflation in the longer term, but this is unlikely to change the group's relative position compared with peers.

The group's non-performing loan (NPL) ratio declined below 1.5% at end-2017 on the back of solid consumer and corporate fundamentals, and we expect these benign conditions to have persisted through 2018. The low NPL ratio also reflects a conservative risk appetite and solid underwriting standards. Our assessment of SFG-HT's asset quality also takes into account Helaba's wholesale business model and in particular its commercial real estate exposure, which results in higher concentration risk than SFG.

The savings banks' high vulnerability to interest rate shocks further increased in 2017 as SFG-HT's overnight deposits grew by almost 10% and with it, the group's asset-liability maturity mismatch. Long-term debt issuance by Helaba in 1Q18 and savings banks' usage of derivative instruments have somewhat mitigated the group's interest rate risk.

SFG-HT's net interest income (NII) declined by 6% in 2017 as the group faces revenue pressure on the back of the low interest rate environment. Fee income benefits moderately from re-pricing of customer services, primarily at the savings banks, and lower expenses in asset management. Fee income has been consistently rising for several years, but it will become increasingly challenging to compensate for the NII erosion.

Therefore, we expect SFG-HT's profit to decline further in the next years. The operating profit/RWA ratio remains healthy (1.4% end-2017), particularly when considering the fact that the savings banks predominantly conservatively apply the standardised approach to assess their RWA.

The savings banks' large and growing retail deposit base supports the group's strong funding and liquidity profile, which underpins the Short-Term IDR of 'F1+', the higher of the two possible Short-Term IDRs for a 'A+' Long-Term IDR. Helaba pursues a strategy of matched funding of new business and its wholesale funding benefits from an established domestic and international investor base.

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 tools and mechanisms.

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 that the guarantors would honour the statutory grandfathered guarantee by the State of Hessen and the Free State of Thueringen. The rating reflects Fitch's view of the creditworthiness of the states, underpinned by the stability of the German solidarity system linking the states' creditworthiness to that of the Federal Republic of Germany (AAA/Stable).

Subordinated Tier 2 notes that do not benefit from the grandfathered guarantee are notched down once from SFG-HT's VR to reflect higher loss severity.

DERIVATIVE COUNTERPARTY RATING (DCR) AND DEPOSIT RATINGS
The Deposit Ratings of SFG-HT's member banks and Helaba's DCR are one notch above SFG-HT's Long-Term IDR. This reflects our view that SFG-HT's consolidated layer of subordinated and vanilla senior debt is likely to be maintained above 8% of group RWA and will therefore be sufficient to recapitalise member banks, restore viability and prevent default on other senior preferred liabilities, including deposits, upon resolution. Given the absence of SFG-HT-wide capital requirements, and given that member banks' individual SREP requirements are not disclosed, we assume a buffer of at least 8% of consolidated (SFG-HT) RWA should be sufficient to restore the group's viability in a resolution.

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 its parent would face reputational risk if Helaba Asset Services were to default on its obligations. Helaba Asset Services' status as a private unlimited company also means that its owner is fully liable for any

shortfall in its assets in case of liquidation.

RATING SENSITIVITIES
IDRS, VR AND SENIOR DEBT
SFG-HT's ratings are primarily sensitive to a material deterioration in its profitability, which could be triggered by rising loan loss provisions, particularly from a weakening of the real estate sector. A sharp rise in interest rates could crystallise losses from the group's exposure to interest rate risk. Conversely, sustainably improving profitability could lead to an upgrade.

SFG-HT's VR and IDRs are also sensitive to changes in SFG's IDRs and VR as SFG-HT is part of the savings banks' nationwide mutual support mechanism and would therefore be affected by a material weakening of the overall savings bank sector's credit profile.

DCR AND DEPOSIT RATINGS
The Deposit Ratings of the member banks and Helaba's DCR are primarily sensitive to changes in SFG-HT's IDRs. They are also sensitive to a potential reduction in the volume of consolidated buffers of subordinated and senior vanilla debt below 8% of SFG-HT's RWAs. Regulation-driven long-term RWA inflation could also increase the size of the debt buffer needed to recapitalise the banks upon failure.

SUPPORT RATING AND SUPPORT RATING FLOOR
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.

GUARANTEED SENIOR UNSECURED AND SUBORDINATED NOTES AND OTHER SUBORDINATED NOTES
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. The ratings of subordinated Tier 2 notes that do not benefit from the grandfathered guarantee are primarily sensitive to the changes in SFG-HT's VR.

HELABA ASSET SERVICES
Helaba Asset Services IDRs are equalised with and primarily sensitive to any change in Helaba's IDRs.

The rating actions are as follows:

SFG-HT
Long-Term IDR affirmed at 'A+'; Outlook Stable
Short-Term IDR affirmed at 'F1+'
VR affirmed at 'a+'
Support Rating affirmed at '5'
Support Rating Floor affirmed at 'No Floor'

Helaba
Long-Term IDR affirmed at 'A+'; Outlook Stable
Short-Term IDR affirmed at 'F1+'
Non-guaranteed senior debt affirmed at 'A+'/'F1+'
Non-guaranteed subordinated Tier 2 debt affirmed at 'A'
Guaranteed senior and subordinated Tier 2 notes affirmed at 'AAA'
Deposit Ratings affirmed at 'AA-'/'F1+'
Derivative Counterparty Rating affirmed at 'AA-'(dcr)

Helaba Asset Services

Long-Term IDR affirmed at 'A+'; Outlook Stable
Short-Term IDR affirmed at 'F1+'
Support Rating affirmed at '1'

49 savings banks members of SFG-HT's mutual support scheme
IDRs affirmed at 'A+'/'F1+'; Outlook Stable
Deposit Ratings affirmed at 'AA-'/'F1+'

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Additional information is available on www.fitchratings.com

Applicable Criteria

Bank Rating Criteria (pub. 12 Oct 2018) (https://www.fitchratings.com/site/re/10044408)
Non-Bank Financial Institutions Rating Criteria (pub. 12 Oct 2018)
(https://www.fitchratings.com/site/re/10044407)

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