FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Sparkassen-Finanzgruppe Hessen-Thueringen at 'A+'; Outlook Stable

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Fitch Ratings - Paris - 09 Apr 2024: Fitch Ratings has affirmed Sparkassen-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 Landesbank Hessen-Thueringen Girozentrale's (Helaba) 'A+' Long-Term IDR with a Stable Outlook. A full list of rating actions is below.

Fitch has withdrawn the ratings of one savings bank following its merger with another member of the group. A full list of rated SFG-HT members is available at www.fitchratings.com.

KEY RATING DRIVERS

Regional Retail, Commercial Banking Group: SFG-HT's ratings are underpinned by the strong local retail franchises of the group's savings bank members, which are complemented by the wholesale activities of Helaba, the group's central institution. The ratings also reflect the close integration of SFG-HT's members, and the group's sound asset quality, strong capitalisation and improved profitability.

Strong Mutual Support: SFG-HT is not a legal entity but a network that comprises 48 savings banks in Hesse and Thuringia as well as Helaba, and forms an economic unit whose cohesion is supported by a mutual support scheme. SFG-HT's IDRs apply to each individual member bank (including Helaba) and are aligned with the group's VR.

Conservative Risk Profile: SFG-HT's risk profile has been sound, reflecting prudent underwriting standards, a high share of collateralised lending and a fairly standardised product offering. Interest rate risk persists due to structural unhedged asset-liability mismatch but has moderated because the rise in interest rates stopped. SFG-HT's large exposure to commercial real estate (CRE), mainly through Helaba, leaves it vulnerable to the current CRE downturn.

Sound but Deteriorating Asset Quality: SFG-HT's asset quality deteriorated in 2023 due to pressure on Helaba's CRE portfolio. We expect SFG-HT's impaired loans ratio to deteriorate further in 2024 as a result of the economic downturn and ongoing stress in the CRE market, but for it to remain below 3%. SFG-HT's asset quality benefits from a high share of collateralised lending and a fairly standardised product offering, which is a mitigating factor.

Sound, Improved Profitability: The group's operating profit increased significantly to about 1.6% of risk-weighted assets (RWAs) due to higher net interest margins and valuation gains on securities after interest rate induced valuation losses in 2022. Fitch expects profitability to decline in 2024 due to a repricing of the deposit base and elevated loan impairment charges.

Strong Capitalisation: SFG-HT's capitalisation is a rating strength. Based on Fitch's estimates, SFG-HT's common equity Tier 1 (CET1) ratio increased in 2023 thanks to higher net income and reduced RWAs at Helaba, to above 18%. We expect healthy internal capital generation to strengthen SFG-HT's capital reserves and maintain its CET1 capital ratio above 16% in the medium term.

Strong Funding and Liquidity: The savings banks' large and granular retail deposit base underpins the group's strong funding and liquidity profile. The 'F1+' Short-Term IDR is the higher of two options mapping to the 'A+' Long-Term IDR and reflects the group's 'aa-' score for funding and liquidity. Helaba diversifies the group's funding profile by providing access to international unsecured and secured funding markets.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

We could downgrade the ratings if we expect the group's operating profit/RWAs ratio to durably fall below 0.7% and its impaired loans ratio to durably exceed 3%. This could result from large single losses in Helaba's concentrated loan portfolio, notably in its large CRE exposure. The Short-Term IDRs are sensitive to changes in the Long-Term IDR and to a revision of the funding and liquidity score to below 'aa-'.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

An upgrade would require a material improvement in SFG-HT's business profile, which Fitch does not currently expect. A materially stronger business profile would need to materialise from significantly higher earnings generation and better cost efficiency on a sustained basis, while having a low impaired loans ratio and strong capitalisation.

In addition, SFG-HT's ratings are also sensitive to changes in those of Sparkassen-Finanzgruppe (Sparkassen; SFG A+/Stable), the nationwide savings bank network. 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.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

Helaba's Derivative Counterparty Rating (DCR), deposit ratings and senior preferred debt ratings are one notch above the bank's Long-Term IDR because of the protection provided by its sustainable resolution buffers to these preferred creditors. Helaba forms a resolution group that does not include SFG-HT's savings banks (except Frankfurter Sparkasse, of which Helaba owns 100%). Helaba is subject to minimum requirements for own funds and eligible liabilities, and we expect that the bank's junior and senior non-preferred debt buffer will continue to sustainably exceed 10% of its RWAs. Helaba's senior unsecured and senior non-preferred debt ratings are aligned with its IDRs for the same reason.

The deposit ratings of SFG-HT's savings banks are in line with their IDRs because each savings bank's junior and senior non-preferred debt buffers, when available, are insufficient to warrant a rating uplift. We do not expect the savings banks to build up significant buffers because SFG-HT is not regulated as a single resolution group. This means that in a highly unlikely scenario where the mutual support mechanism would fail to protect its members' viability, the preferred resolution strategy for each savings bank would be insolvency procedures.

The 'AAA' ratings on Helaba's guaranteed senior unsecured and subordinated Tier 2 debt are based on Fitch's view of the State of Hesse and the Free State of Thuringia's extremely high ability and propensity to honour their grandfathered statutory guarantor's liability (Gewaehrtraegerhaftung). Fitch believes that the senior and subordinated instruments are similarly protected because the guarantee does not differentiate between seniorities. In our view, the regulatory and EU state aid frameworks do not constrain support for grandfathered debt.

Helaba's subordinated Tier 2 notes that do not benefit from the state guarantee are notched down twice from SFG-HT's VR to reflect Fitch's baseline notching for loss-severity and the assumption that extraordinary support from SFG-HT would be forthcoming to support these junior instruments, if needed, even though junior instruments are not formally covered by the group's mutual support scheme.

SFG-HT's Government Support Rating (GSR) reflects Fitch's view that the EU's resolution framework is likely to require senior creditors participating in losses, if necessary, instead or ahead of a bank receiving sovereign support.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

Helaba's DCR and senior debt ratings as well as all members' deposit ratings are sensitive to changes to the group's IDRs. In addition, we could downgrade Helaba's DCR and long-term senior preferred debt and deposit ratings if we expect Helaba's junior and senior nonpreferred debt buffer to durably fall below 10% of its RWAs. The long-term deposit ratings of SFG-HT's savings banks could also be upgraded if all members of SFG-HT become regulated as a single resolution group with bail-in as the preferred resolution strategy.

Helaba's guaranteed senior unsecured and subordinated Tier 2 debt ratings are primarily sensitive to a weakening of the guarantors' ability to provide support as assessed by Fitch. The ratings of Helaba's non-guaranteed Tier 2 notes are primarily sensitive to a change in SFG-HT's VR.

SFG-HT's GSR is at the lowest level on Fitch's rating scale. Therefore, it cannot be downgraded.

We would upgrade SFG-HT's GSR only if we see rising propensity from the sovereign to support systemically important banks, which is highly unlikely in the current regulatory environment.

VR ADJUSTMENTS

The earnings & profitability score of 'a-' has been assigned above the 'bbb' implied category score due to the following adjustment reason: risk-weight calculation (positive).

The funding & liquidity score of 'aa-' has been assigned above the 'a' implied category score due to the following adjustment reason: deposit structure (positive).

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

Helaba's grandfathered state-guaranteed senior unsecured and Tier 2 subordinated notes are linked to Fitch's assessment of State of Hesse's and the Free State of Thueringen creditworthiness and, by extension, to Germany's ratings.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 15 Mar 2024) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Frankfurter Sparkasse	EU Issued, UK Endorsed
Kasseler Sparkasse	EU Issued, UK Endorsed
Kreissparkasse Eichsfeld	EU Issued, UK Endorsed
Kreissparkasse Gelnhausen	EU Issued, UK Endorsed
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Kreissparkasse Weilburg	EU Issued, UK Endorsed
Kyffhaeusersparkasse Artern-Sondershausen	EU Issued, UK Endorsed
Landesbank Hessen-Thueringen Girozentrale	EU Issued, UK Endorsed
Nassauische Sparkasse	EU Issued, UK Endorsed
Sparkasse Altenburger Land	EU Issued, UK Endorsed
Sparkasse Arnstadt-Ilmenau	EU Issued, UK Endorsed
Sparkasse Bad Hersfeld-Rotenburg	EU Issued, UK Endorsed
Sparkasse Battenberg (Eder)	EU Issued, UK Endorsed
Sparkasse Bensheim	EU Issued, UK Endorsed

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