FitchRatings

RATING ACTION COMMENTARY

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

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Fitch Ratings - Frankfurt am Main - 30 Jun 2021: Fitch Ratings has revised the Outlook on savings bank group Sparkassen-Finanzgruppe Hessen Thueringen's (SFG-HT) Long-Term Issuer Default Rating (IDR) to Stable from Negative and affirmed the IDR at 'A+', Short-Term IDR at 'F1+' and Viability Rating (VR) at 'a+'. A full list of rating actions is at the end of this rating action commentary.

The revision of the Outlook reflects our expectation that SFG-HT's asset quality will be resilient to the economic fallout of the pandemic as the German government's comprehensive state support to the economy has reduced downside risk. Fitch expects continued pressure on profitability, which is offset by the group's strong capitalisation, funding and liquidity. We have revised the outlook on the German operating environment score to stable from negative to reflect the strengthening economic recovery in Germany, but we still see persistent structural weaknesses in the German banking sector, which will make it challenging for banks to achieve strong profitability.

Feedback

KEY RATING DRIVERS

IDRS AND VR

SFG-HT is not a legal entity but a network of 49 savings banks in Hessen and Thuringia whose cohesion is supported by a mutual support scheme, and which forms a common economic unit together with Landesbank Hessen-Thueringen Girozentrale (Helaba), the group's central institution. 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.

SFG-HT's ratings reflect the group's close integration, which benefits its business model, as well as its strong capitalisation and sound asset quality but also its only moderate profitability.

SFG-HT's capitalisation is a rating strength. Its risk-weighted capital ratios are above the peer average, while its leverage ratio (tangible equity/tangible assets) is also strong but in line with those of its domestic peers, Sparkassen-Finanzgruppe (SFG, the nationwide savings banks group)and Genossenschaftliche FinanzGruppe. Capitalisation can absorb notable rating migration expected to be triggered by the pandemic. Despite its current modest earnings generation, we expect the group to maintain its strong capitalisation from high profit retention.

SFG-HT's low impaired loans ratio reflects its primary banks' conservative underwriting standards, and is helped by government support to SMEs that has contained corporate defaults since the start of the pandemic. Helaba's low Stage 3 loans ratio of only 0.6% at end-2020 also reflects a conservative risk appetite. We expect SFG-HT's impaired loans ratio remained stable in 2020 and will rise moderately this year, but remain within the 1%-2% range by end-2022.

The group's stable operating revenue reflects its strong regional market position, but Helaba's wholesale activities generate weaker and potentially more volatile earnings and SFG-HT's earnings potential is structurally weaker than SFG's and under pressure. SFG-HT's earnings weakened in 2020, mainly driven by Helaba's below average performance, which suffered from a large market volatility-induced negative fair value swing and strong increase in loan impairment charges including a substantial coronavirus-related management buffer. We positively adjust our assessment of profitability for the calculation of risk-weighted assets (RWA) at the primary banks that use the standardised approach, as this moderately inflates RWA compared with similarly rated international peers. Historically, profitability has benefited from the savings banks' resilient and adequate performance.

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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's wholesale funding adds diversity to the group's funding franchise.

SFG-HT's IDRs and VR are at the same level as those of SFG, and Fitch views that there is a strong correlation between the two groups. This is because SFG-HT's savings banks are also part of SFG's nationwide mutual support scheme, which is designed as an institutional protection scheme (IPS) and recognised by the regulator as a deposit guarantee scheme. The IPS also includes Helaba through the Landesbanken's sub-fund.

GUARANTEED NOTES AND SUBORDINATED NOTES

The 'AAA' of Helaba's guaranteed senior unsecured and subordinated Tier 2 debt is 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 statutory grandfathered guarantee. Fitch believes that the protection provided by the guarantee is similar for senior and subordinated debt 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 DEBT RATINGS

Fitch has affirmed Helaba's Derivative Counterparty Rating, 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 minimum requirements for own funds and eligible liabilities, and we expect that the junior and senior non-preferred debt buffer will continue to sustainably exceed 10% of RWA. Helaba's senior unsecured and non-preferred debt are aligned with its IDRs.

The deposit ratings of SFG-HT's savings banks of 'A+'/'F1+' are in line with their IDRs, to reflect insufficient individual junior or senior non-preferred debt buffers to warrant an uplift. The lack of buffer reflects the fact that SFG-HT is not regulated as a single resolution group, which means that in an extremely unlikely scenario where the mutual support mechanisms would fail, the preferred resolution strategy for each individual savings bank would be insolvency procedures.

HELABA ASSET SERVICES

The IDRs of Helaba Asset Services, which is not a member of SFG-HT's mutual support scheme, are aligned with those of its parent, Helaba, to reflect our view that institutional support would be forthcoming. Helaba Asset Services benefits from Helaba's declaration of backing, and we believe Helaba would face reputational risk if Helaba Asset Services defaults on its obligations. Helaba Asset Services is a private unlimited company, which means that Helaba is fully liable for any asset shortfall 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 cannot be relied upon due to the Bank Recovery and Resolution Directive and the Single Resolution Mechanism. 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.

RATING SENSITIVITIES

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

SFG-HT's, the savings banks' and Helaba's ratings are sensitive to changes in the group's VR. An upgrade of the VR would require a material improvement in earnings generation and better cost efficiency, reflecting strengthening of the franchise and business model and lifting the group's operating profit/RWA ratio sustainably above 1.5%, while maintaining low impaired loans ratio and strong capitalisation.

SFG-HT's ratings are also sensitive to changes in SFG's ratings. This is because SFG-HT's savings banks are members of the nationwide mutual support scheme and would be affected by a material change in the savings banks sector's credit profile.

The 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.

The ratings of the non-guaranteed subordinated Tier 2 notes could be upgraded if the VR is upgraded.

Helaba Asset Services' IDRs would be upgraded if SFG-HT's IDRs are upgraded.

An upgrade of the SR and an upward revision of the SRF would require a more positive assessment of the sovereign's propensity to support systemically important banks. In Fitch's opinion, this is highly unlikely.

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

SFG-HT's, the savings banks' and Helaba's ratings could be downgraded if we expect the group's impaired loans ratio to exceed 3% on a sustained basis. This could result from large single credit losses in Helaba's concentrated loan portfolio. The ratings would also come under pressure if profitability weakens and would likely be downgraded if SFG-HT's operating profits/RWA ratio falls below 0.5% on a sustained basis.

SFG-HT's Short-Term IDR is sensitive to changes in the Long-Term IDR and to a revision of the funding and liquidity score below 'aa-'.

The ratings of Helaba's guaranteed debt are primarily sensitive to a downgrade of the guarantors' ratings. The ratings of the non-guaranteed Tier 2 notes are primarily sensitive to changes in SFG-HT's VR.

Helaba's DCR, senior preferred and deposit 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.

Helaba Asset Services' IDRs are primarily sensitive to a change in Helaba's IDRs.

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

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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 is part of 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.

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Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

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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, UK Endorsed
Helaba Asset Services UC	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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Nassauische Sparkasse	EU Issued, UK Endorsed
Sparkasse Altenburger Land	EU Issued, UK Endorsed
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Sparkasse Battenberg (Eder)	EU Issued, UK Endorsed
Sparkasse Bensheim	EU Issued, UK Endorsed

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