Research Update:

S-Finanzgruppe Hessen-Thueringen Outlook Revised To Stable From Positive On Weaker Capital Forecast; Affirmed At 'A/A-1'

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Overview

- We expect Sparkassen-Finanzgruppe Hessen-Thueringen's (SFHT's) profitability to stay moderate, since interest rates will likely remain low and continue to eat into margins.
- Moreover, SFHT's high cost base has reduced its ability to build up capital through retained earnings, and loan growth at Landesbank Hessen-Thueringen (Helaba) has picked up.
- As a result, we now project our risk-adjusted capital (RAC) ratio for SFHT at about 14% over the next 12-24 months and consider it less likely to improve sustainably above 15% over that period.
- We are therefore revising our outlooks on SFHT's member banks to stable from positive and affirming our 'A/A-1' ratings.
- The stable outlook indicates that we expect SFHT's group credit profile to remain stable and that the group will remain highly strategic to the German savings banks network.

Rating Action

On Aug. 14, 2019, S&P Global Ratings revised its outlook to stable from positive on the 49 savings banks in the German states of Hesse and Thuringia and their majority-owned central bank Landesbank Hessen-Thueringen Girozentrale (Helaba), collectively known as Sparkassen-Finanzgruppe Hessen-Thueringen (SFHT). We affirmed the 'A/A-1' long- and short-term issuer credit ratings on all these entities.

At the same time, we affirmed our 'A-' rating on Helaba's senior subordinated debt and our 'AA' rating on its grandfathered guaranteed senior subordinated debt.

Rationale

We continue to see SFHT as a strong, well-capitalized mutual banking group, but consider a material increase of its capitalization to be unlikely. As of Dec. 31, 2018, our consolidated RAC ratio for SFHT had deteriorated to 13.8% from 14.8% a year earlier, due to lower earnings retention and increased loan growth, mainly at Helaba's commercial real estate (CRE) and corporate finance operations. We now expect our RAC ratio to remain at about 14% over the next 18-24 months and consider it less likely to improve sustainably beyond 15%, which would allow us to revise up our capital and earnings assessment.

SFHT's reported profit before tax of €958 million in 2018, down by about 34% year on year and below our projections. This resulted from the widening of credit spreads and a further decline of market interest rates, while supported by loan growth of about 4%, interest and fee income staying broadly stable. However, the group's profitability also suffers from its large cost base, which increased by 5.5% year on year. We consider last year's rise in costs as permanent and do not anticipate a significant reduction in the short to medium term. We expect the group's cost-to-income ratio to remain at a high 73%-75% until 2021, and the return on equity below 5%, according to our measures, which is low by global standards, but not inconsistent with the expectations of SFHT's owners.

We revised our projection for SFHT's pretax profits downward by about €200 million to €950 million-€1,100 million annually until 2021. The updated figures incorporate our revised interest scenario in which we now anticipate ultra-low rates at least until the second quarter of 2021. This situation presents further challenges to Helaba's wholesale-oriented business model, already experiencing margin pressure in core segments, and to the savings banks' deposit-funded business model. We also anticipate a gradual rise in credit loss provisions, given the signs of economic slowdown in Germany and globally.

Helaba's corporate portfolio returned to growth in 2018, after several years without substantial changes to its size due to intense competition in its important CRE and corporate finance segments and the run-off of legacy portfolios. Increased business volumes and fewer prepayments at Helaba contributed to a 15% increase in our risk-weighted asset (RWA) metric for SFHT. Helaba's CRE and other project finance loans generally attract higher risk weights than most business originated by savings banks. We expect 2%-4% annual growth of SFHT's RWAs over 2019-2021, also considering that Helaba recently acquired a €1.4 billion land transport portfolio.

We anticipate that SFHT's savings banks will maintain their dominant position in regional retail banking, complemented by Helaba's function as the group's central bank and its more wholesale-oriented businesses. We also factor in SFHT's access to refinancing 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 comprise 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). This 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.

Furthermore, we consider SFHT's position within the national German savings banks network (DSGV), whose GCP we assess at 'a+'. We consider SFHT to be a highly strategic subgroup of DSGV, which further supports our 'A' long-term ratings on group members.

Outlook

The outlook is stable because we assume continued stability of SFHT's GCP and are unlikely to change our view of SFHT as highly strategic to the DSGV.

Downside scenario

We could lower our ratings on all SFHT entities if DSGV's GCP or SFHT's links with DSGV weaken and, at the same time, SFHT's GCP deteriorates below 'a'.

While we consider this unlikely, both might occur if, for example, capitalization weakened very substantially at SFHT and across the DGSV network or there were a substantial and sustained weakening of the savings bank sector's competitive position and profitability.

Upside scenario

We could consider an upgrade over the next 12-24 months if earnings generation materially exceeds our projections, such that SFHT's RAC ratio surpasses 15% sustainably. An upgrade would depend on the group maintaining favorable asset quality and Helaba its relatively risk-averse culture, especially in its CRE and corporate finance activities. However, in light of SFHT's diminishing earnings retention capacity compared with projected loan growth, we see a positive rating action as unlikely over the next 18-24 months.

Ratings Score Snapshot

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

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- 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: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating 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

Ratings Affirmed; Outlook Action	
Landesbank Hessen-Thueringen Girozentrale	
Senior Subordinated	A-
Senior Subordinated*	AA
Commercial Paper	A-1

*Grandfathered debt.

Ratings Affirmed; Outlook Action

	To	From
Landesbank Hessen-Thueringen Girozentrale		
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		
Sparkasse Dieburg		
Sparkasse Bensheim		
Sparkasse Battenberg		
Sparkasse Bad Hersfeld-Rotenburg		
Sparkasse Arnstadt-Ilmenau		
Sparkasse Altenburger Land		
Nassauische Sparkasse		
Kyffhaeusersparkasse		

Kreissparkasse Weilburg		
Kreissparkasse Schwalm-Eder		
Kreissparkasse Schluechtern		
Kreissparkasse Saalfeld-Rudolstadt		
Kreissparkasse Saale-Orla		
Kreissparkasse Nordhausen		
Kreissparkasse Limburg		
Kreissparkasse Hildburghausen		
Kreissparkasse Gross-Gerau		
Kreissparkasse Gotha		
Kreissparkasse Gelnhausen		
Kreissparkasse Eichsfeld		
Kasseler Sparkasse		
Frankfurter Sparkasse		
Issuer Credit Rating	A/Stable/A-1	A/Positive/A-1