

Research Update:

S-Finanzgruppe Hessen-Thuringen Outlook To Negative On Weaker Profitability Prospects Amid COVID-19; Ratings Affirmed

April 23, 2020

Overview

- Despite governments' measures to contain the COVID-19 pandemic, European economies, including Germany, face an unprecedented challenge ahead.
- Under our base case of an economic recovery starting in third-quarter 2020, we expect Sparkassen-Finanzgruppe Hessen-Thuringen's (SFHT's) profitability and asset quality to be weaker than we previously envisaged, though we believe it will remain resilient.
- We are therefore affirming our 'A/A-1' ratings on SFHT's member banks but revising our outlooks to negative from stable.
- The negative outlooks mainly reflect banks' sensitivities to industry risk, which we assess as having been on a negative trend in Germany since September 2019.

Rating Action

On April 23, 2020, S&P Global Ratings revised its outlook to negative from stable on the 49 savings banks in the German states of Hesse and Thuringia and their majority-owned central bank Landesbank Hessen-Thuringen Girozentrale (Helaba), collectively known as Sparkassen-Finanzgruppe Hessen-Thuringen (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 preferred debt and our 'AA' rating on its grandfathered guaranteed senior subordinated debt.

Rationale

We believe that SFHT's profitability prospects have deteriorated because we expect the German and eurozone economies to face a recession this year as a result of the COVID-19 pandemic. We also expect that SFHT's scheduled cost-cutting measures could be delayed in light of the

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pandemic. This implies that the group's efficiency will remain only moderate compared to international peers. Finally, we see increasing tail risk to our asset-quality projection given Helaba's sizable exposure to more-cyclical and concentrated segments. Although we expect SFHT to remain resilient, we are revising our outlook on its members to negative from stable.

Previously, our stable outlook was based on successful completion of cost measures to tackle SFHT's sub-par efficiency, which remains weaker than for other 'A' rated banks. We see the risk that anticipated cost-benefits from single-entity programs, including the one announced by Helaba, could be partly delayed and we do not anticipate improvements in the group's consolidated costs over the next two years.

We also believe that the expected cyclical downturn will further weaken SFHT's operating environment; its profitability has already been under pressure in the prolonged low-interest-rate environment. We expect the group's loan book to grow as member banks extend credit to under-stress borrowers, but we do not anticipate margin relief any time soon. We also foresee fee income from credit transactions and asset management being materially lower in 2020 compared to previous years.

We see as positive the group's diversified business mix of the savings banks' strong market positions in regional banking and Helaba's prudent relationship-based strategy. We also acknowledge that the short- to medium-term effects of COVID-19-related disruptions on SFHT's loan book will depend on the success of Germany and other countries' fiscal support policy measures and the length and depth of the domestic and global recessions. However, with exposure of about €30 billion as of year-end 2019, Helaba has significant industry concentration in the international commercial real estate sector. The majority of its exposure is outside Germany, mainly the U.S., the U.K., and France, all of which will face a recession in 2020. We also note SFHT's material exposure to the transport financing segment. We see as positive that average loan-to-value ratios remain fairly conservative and consider Helaba to be risk averse given its sound track record during the 2008 financial crisis. However, we consider material downside risk to our asset quality projection, particularly if the COVID-19 pandemic were to persist beyond third-quarter 2020.

Our base case anticipates lower earnings retention given expected increases in credit-loss provisions over the next two years, and higher RWA inflation from loan growth and increased recognition of nonperforming loans. Overall, we expect the effect on SFHT's capitalization measures to remain moderate. We forecast that our RAC ratio will stay about 12%-13% over the next 18-24 months compared to an estimated 13.6% for year-end 2019.

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. The highly strategic group status of SFHT for German savings banks network (DSGV) today puts a floor on the long-term ratings on individual SFHT savings banks and Helaba at 'A', one notch below DSGV's current GCP at 'a+'. However, we see negative pressure on our GCP assessments for both DSGV and SFHT.

Outlook

The negative outlook acknowledges the challenges that the SFHT group faces in the next 12-24 months from the weakened operating conditions amid the COVID-19 pandemic, combined with already-growing economic and industry risks for the German banking sector.

Downside scenario

We could lower our ratings on SFHT following a negative revision of our view on industry risks in the German banking sector, leading to a change in the anchor for both SFHT and DSGV--the starting point of our ratings--to 'bbb+' from 'a-'.

We could also downgrade the member banks if SFHT's links with DSGV weaken and, at the same time, SFHT's GCP deteriorates below 'a', for instance triggered by a material decline in Helaba's asset quality, especially in commercial real estate and corporate finance, implying a less risk-averse stance than currently.

Upside scenario

We could revise our outlooks to stable if we saw reduced downside risks from the COVID-19 pandemic, combined with a stabilization in the economic and industry risk trends for the German banking industry. We would also look specifically for signs that SFHT's business model and risk profile was going to remain robust and resilient.

Ratings Score Snapshot

| Issuer Credit Rating | A/Negative/A-1 |
|----------------------|-----------------|
| SACP | a |
| Anchor | a- |
| Business Position | Adequate (0) |
| Capital and Earnings | Strong (+1) |
| Risk Position | Adequate (0) |
| Funding and | Average and (0) |
| Liquidity | Adequate |
| Support | 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

Related Research

- Negative Rating Actions Taken On Multiple German Banks On Deepening COVID-19 Downside Risks, April 23, 2020
- How COVID-19 Risks Prompted European Bank Rating Actions, April 23, 2020
- Sparkassen-Finanzgruppe Hessen-Thuringen / Landesbank Hessen-Thuringen Girozentrale, Dec. 10, 2019
- Outlooks On Various German Banks Revised To Negative On Rising Banking Sector Risks; Ratings Affirmed, Sept. 18, 2019
- An Update On How We Rate German Savings Banks, Sept. 26, 2019
- For German Landesbanken In 2019, The Risk Is Down, But Long-Term Questions Remain, Sept. 26, 2019
- Banking Industry Country Risk Assessment: Germany, Oct. 1, 2019

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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