FITCH AFFIRMS S- FINANZGRUPPE HESSEN-THUERINGEN AT 'A+'; OUTLOOK STABLE

Fitch Ratings-Frankfurt/London-05 January 2017: Fitch Ratings has today affirmed German S-Finanzgruppe Hessen Thueringen's (SFG-HT) Long-Term Issuer Default Rating (IDR) at 'A+' with a Stable Outlook, Short-Term IDR at 'F1+' and Viability Rating (VR) at 'a+'.

The agency has also affirmed the IDRs of the 50 Sparkassen members of SFG-HT's mutual support scheme and its central institution Landesbank Hessen-Thueringen Girozentrale (Helaba). In addition, Fitch has affirmed Helaba's Derivative Counterparty Rating (DCR) at 'AA-(dcr)' and affirmed the Long-Term and Short-Term Deposit Ratings of the group's member banks including Helaba, at 'AA-' and 'F1+' respectively. The IDR of Helaba's Irish subsidiary Helaba Asset Services has been affirmed at 'A+'.

A full list of the group's rated Sparkassen is available at www.fitchratings.com or via the link above. A full list of rating actions is at the end of this Rating Action Commentary.

KEY RATING DRIVERS
IDRS, VR AND SENIOR DEBT RATING
The IDRs of SFG-HT and its members are based on the SFG-HT's VR. The group's VR is underpinned by its diversified and leading regional franchise in Hessen and Thueringen, which is supplemented by Helaba's role as a central bank and cooperation partner for Sparkassen in the states of North Rhine-Westphalia and Brandenburg.

The group concentrates on retail and SME lending, and its activities are complemented by the domestic and international wholesale banking expertise of Helaba, which acts as the group's central bank and service provider for the Sparkassen. SFG-HT's ratings are closely aligned with those of Sparkassen-Finanzgruppe (SFG; A+/Stable/F1+) because SFG-HT's members are also part of Germany's nationwide savings bank mutual support group.

We expect SFG-HT's risk appetite to remain moderate despite planned stronger loan growth to counter pressure on its profitability and material commercial real estate concentrations in Helaba's loan portfolio. Interest rate risk in the banking book is a key market risk for the group's Sparkassen, mainly driven by increased maturity transformation as sight deposits used to fund longer-term assets have grown.

Helaba's match-funded profile of long-term financing lowers the group's overall vulnerability to interest rate shocks. We believe interest rate risk to be manageable as individual member banks are centrally monitored by the group, and risk controls should enable SFG-HT to detect outliers and require risk-mitigating measures.

The group's asset quality improved further due to the favourable environment for SMEs but also the quality of the group's real estate lending, which forms a significant part of the loan portfolio. Loan impairment charges have remained moderate, but we believe a cyclical trough of non-performing loans has been reached. However, we expect any increase in NPLs to be slow and moderate.

We expect ongoing pressure on SFG-HT's profitability from the persistent low interest rates, but profitability has remained good to date. The group has managed to control operating costs well, but further efficiency gains will be difficult unless the group decides to cut the branch network of its local savings banks significantly, which we do not expect.

SFG-HT's capitalisation and leverage is a rating strength and commensurate with the level of risks the group assumes. The group's funding and liquidity is sound due to its structural excess liquidity. This results from by the Sparkassen's large and stable retail deposits base with a rising share of sight deposits. Helaba's funding and liquidity benefit from a diversified pool of funding sources and access to a wide range of investors including international ones.

The group's sound funding and liquidity underpin the 'F1+' Short-Term IDR, which corresponds to the higher of the two possible Short-Term IDRs for an 'A+' Long-Term IDR.

SUPPORT RATING AND SUPPORT RATING FLOOR

SFG-HT's Support Rating (SR) and Support Rating Floor (SRF) reflect Fitch's view that legislative, regulatory and policy initiatives have substantially reduced the likelihood of sovereign support for EU banks.

The Bank Recovery and Resolution Directive and its bail-in tool came into force in Germany on 1 January 2015 and the Single Resolution Mechanism, providing resolution tools and mechanisms, started on 1 January 2016. As a result, Fitch believes extraordinary sovereign support, while possible, can no longer be relied on.

GUARANTEED SENIOR UNSECURED AND SUBORDINATED NOTES AND OTHER SUBORDINATED NOTES

The 'AAA' rating on Helaba's guaranteed senior unsecured and subordinated debt is based on the statutory grandfathered guarantee by the State of Hessen and the Free State of Thueringen and 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 debt instruments that do not benefit from the grandfathered guarantee are notched down once from SFG-HT's VR to reflect higher loss severity.

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 in the event of a resolution of SFG-HT, which in our opinion would only occur after the sector's institutional protection scheme has failed, SFG-HT's consolidated layer of subordinated and vanilla senior debt is likely to be sufficient to recapitalise member banks, restore viability and prevent default on other "preferred" senior liabilities, including deposits, upon resolution. We do not assign a DCR or Deposit Ratings to SFG HT itself because it is not a legal entity.

HELABA ASSET SERVICES

The IDRs of Helaba Asset Services, which is not a member of the SFG-HT, 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 IDRs and VR are sensitive to a material deterioration of its asset quality, which we believe would only occur if there were a prolonged domestic recession. The group's ratings could also come under pressure if profitability deteriorates materially and weakens internal capital generation, or if a sharp rise in interest rates crystallises losses from exposure to interest rate risk in the banking book. Any upgrade of the VR would require a further strengthening of the group's capitalisation.

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 change of the overall savings bank sector's credit profile. Given the close links between SFG and SFG-HT, SFG-HT's VR would not be rated above SFG's].

DCR AND DEPOSIT RATINGS
Helaba's DCR and the Deposit Ratings of the member banks are primarily sensitive to changes in the group's IDRs. Helaba's DCR is also sensitive to the amount of subordinated and senior vanilla debt buffers relative to the recapitalisation amount likely to be needed to restore viability and prevent default on more senior derivative obligations. In addition, the amount of deposits can affect Helaba's DCR and the Deposit Ratings of local savings banks members.

Strong short-term volatility or long-term inflation of risk-weighted assets as a direct result of the implementation of more stringent regulatory requirements could materially increase the debt buffer needed to recapitalise the banks upon failure and justify the uplift.

The DCR of Helaba and the Deposit Ratings of the member banks are also sensitive to increases in the banks' individual Pillar 2 regulatory requirements as we assume that these determine the level to which the banks would have to be recapitalised upon resolution.

Furthermore, the DCR of Helaba and Deposit Ratings of the member banks are sensitive to Fitch's assumptions regarding the individual points of non-viability at which the regulator is likely to require a recapitalisation through bail-in of junior and standard senior instruments. Subsequent changes to the resolution regime that may alter the hierarchy of the various instruments in resolution could also trigger a change in the DCR and Deposit Ratings.

SUPPORT RATING AND SUPPORT RATING FLOOR
An upgrade of the SR and an 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. This is highly unlikely, although not impossible.

GUARANTEED SENIOR UNSECURED AND SUBORDINATED NOTES AND OTHER SUBORDINATED NOTES
The rating of Helaba's guaranteed senior unsecured and subordinated debt is primarily sensitive to a change in Fitch's view of the creditworthiness of the guarantor. The ratings of subordinated debt instruments that do not benefit from the grandfathered guarantee are primarily sensitive to changes in SFG-HT's VR, from which they are notched.

HELABA ASSET SERVICES
Helaba Asset Services IDRs are equalised with Helaba's IDRs 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+'
Viability Rating 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+'
Senior debt affirmed at 'A+'/'F1+'
Subordinated debt affirmed at 'A'
Senior and subordinated guaranteed obligations affirmed at 'AAA'
Long-term deposits affirmed at 'AA-'
Short-term deposits affirmed at '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'

50 savings banks:
IDRs affirmed at 'A+' and 'F1+'; Outlook Stable
Long-term deposits affirmed at 'AA-'
Short-term deposits affirmed at 'F1+'

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Additional information is available on www.fitchratings.com.

Applicable Criteria
Global Bank Rating Criteria (pub. 25 Nov 2016)
https://www.fitchratings.com/site/re/891051
Global Non-Bank Financial Institutions Rating Criteria (pub. 15 Jul 2016)
https://www.fitchratings.com/site/re/884128

Related Research

S-Finanzgruppe Hessen-Thueringen - Rating Action Report

https://www.fitchratings.com/site/re/892752