

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 Thuringen 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+'

Contact:

Primary Analyst

Roger Schneider

Director

+49 69 768076 242

Fitch Deutschland GmbH

Neue Mainzer Strasse 46-50

D-60311 Frankfurt

Secondary Analyst

Lola Yusupova

Associate Director

+49 69 768076 114

Committee Chairperson

Christian Scarafia

Senior Director

+44 20 3530 1012

Media Relations: Elaine Bailey, London, Tel: +44 203 530 1153, Email:

elaine.bailey@fitchratings.com; Rebecca O'Neill, London, Tel: +44 203 530 1697, Email:

rebecca.oneill@fitchratings.com.

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-Thuringen - Rating Action Report

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

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2017 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001