Fitch Affirms S - Finanzgruppe Hessen Thueringen at 'A+' ; Outlook Stable

Link to Fitch Ratings' Report: S - Finanzgruppe - Rating Action Report (https://www.fitchratings.com/site/re/911880)

Fitch Ratings-Frankfurt/London-13 December 2017: Fitch Ratings has affirmed German S-Finanzgruppe Hessen Thueringen's (SFG-HT) Long-Term Issuer Default Rating (IDR) at 'A+' with a Stable Outlook and Viability Rating (VR) at 'a+'.

The agency has also affirmed the IDRs of the 49 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 DCR at 'AA-(dcr)' and 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, which is not part of the group, 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.

The affirmation of the IDRs and VRs primarily reflects SFG-HT's stable and consistent financial performance in a challenging low rate environment, improving capitalisation and asset quality. The group's profile is underpinned by a strong regional retail franchise, solid credit growth and stable property markets reflecting Germany's healthy economic environment.

KEY RATING DRIVERS

IDRS, VR AND SENIOR DEBT

The IDRs of SFG-HT and its members are based on the group's VR. The group's ratings are underpinned by an integrated business model, in which the Sparkassen in Hessen and Thueringen form one economic unit with Helaba. This relationship is set to deepen under the members' strategic commitment. In our view, cohesion in the group is higher than at Sparkassen-Finanzgruppe (SFG; A+/Stable/F1+), as demonstrated by a common risk strategy and provision of aggregated accounts under IFRS standard.

The ratings also benefit from Heleba's tight relationship with Sparkassen in Northrhine-Westfalia and Brandenburg, for which it is the prime cooperation partner. SFG-HT's business model is thus primarily retail driven but benefits from Helaba's wholesale banking expertise.

SFG-HT's ratings are closely aligned with that of SFG because SFG-HT's savings banks members are also part of Germany's nationwide savings bank mutual support group.

We believe that SFG-HT's risk appetite and underwriting standards are moderate, which has resulted in the group's strong asset quality. However, despite interest rate risk moderately declining in 2016 it remains a key risk for the group's savings banks given that the inherent deposit transformation into longer dated loans is an integral part of their business model. For the group as a whole Helaba's match-funded profile of long-term financing lowers overall vulnerability to interest rate shocks.

The group's volume of non-performing loans (NPL) has dropped significantly further with an NPL ratio below 2% at end-2016. This reflects strong consumer fundamentals and healthy SME and corporate balance sheets. Based on Fitch's growth projection for Germany we believe that risk cost will remain low. However, we also take into account concentrations risks in the group triggered by Helaba's more concentrated loan portfolio, primarily with respect to commercial real estate, including foreign exposure and a small shipping portfolio.

SFG-HT's profitability held up well in 2016 despite low interest rates and the group benefited from only a moderate decline in net income (-3%), low risk costs and slightly better fee income. The cost base has been kept well under control, and pre-tax profit amounted to EUR1.6 billion in 2016, up 8% on the previous year. We believe that the low rates will leave a significantly stronger mark on SFG-HT's profit and loss account in 2017 but continued business growth and a friendly credit environment are likely to keep a decline in profits at reasonable levels.

SFG-HT's capitalisation and leverage is a key rating strength. The group reported a fully-loaded CET1-ratio of 19.6% end- 2016 (18.6% at end-2015) driven by a stable and sound internal capital generation. We believe that the group's profitability will allow further strengthening of capital.

The group's funding and liquidity is sound due to the group's structural excess liquidity. This is driven by the Sparkassen's large and stable retail deposits base with continuing inflows of sight deposits. Helaba's funding and liquidity benefit from a diversified pool of funding sources and access to a wide range of domestic and foreign investors. The group's sound funding and liquidity underpins the 'F1+' Short-Term IDR, which corresponds to the higher of the two possible Short-Term IDRs for a 'A+' Long-Term IDR.

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 is possible but cannot be relied upon due to the Bank Recovery and Resolution Directive (which includes a bail-in tool) and the Single Resolution Mechanism's resolution tools and mechanisms.

GUARANTEED SENIOR UNSECURED AND SUBORDINATED NOTES AND OTHER SUBORDINATED NOTES

The 'AAA' rating of Helaba's guaranteed senior unsecured and subordinated debt is based on Fitch's view that the guarantors would honour the statutory grandfathered guarantee by the State of Hessen and the Free State of Thueringen. The rating 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 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.

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 primarily sensitive to a material deterioration of its asset quality, which we believe would only occur in case of 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 normalisation of interest rates and better margin potential that would allow the group to strengthen revenues.

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 material weakening of the overall savings bank sector's credit profile.

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. They are 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 the case of Helaba and deposits for the local savings banks members of the group and Helaba.

A 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. The DCR of Helaba and 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 by way of bail-in of junior and standard senior instruments. Subsequent changes to the resolution regime, which 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 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. While not impossible, in Fitch's opinion, this is highly unlikely.

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 the 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'

49 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. 10 Mar 2017) (https://www.fitchratings.com/site/re/895236)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form (https://www.fitchratings.com/site/dodd-frank-disclosure/1033913)
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