FitchRatings

RATING ACTION COMMENTARY

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

Tue 18 Apr, 2023 - 1:28 PM ET

Fitch Ratings - Frankfurt am Main - 18 Apr 2023: Fitch Ratings has affirmed Sparkassen-Finanzgruppe Hessen-Thueringen's (SFG-HT) Long-Term Issuer Default Rating (IDR) at 'A+' with a Stable Outlook and Viability Rating (VR) at 'a+'. Fitch has also affirmed Landesbank Hessen-Thueringen Girozentrale's (Helaba) 'A+' Long-Term IDR with a Stable Outlook. A full list of rating actions is below.

KEY RATING DRIVERS

Regional Retail, Commercial Banking Group: SFG-HT's ratings are underpinned by the strong local retail franchises of the group's savings bank members, which are complemented by the wholesale activities of Helaba, the group's central institution. The ratings also reflect the close integration of SFG-HT's members, and the group's sound asset quality, strong capitalisation and moderate recurring profitability.

Strong Mutual Support: SFG-HT is not a legal entity but a network that comprises 49 savings banks in Hesse and Thuringia as well as Helaba, and forms a common economic unit whose cohesion is supported by a mutual support scheme. SFG-HT's IDRs apply to each individual member bank (including Helaba) and are aligned with the group's VR.

High Interest-Rate Risk: Interest-rate risk is high in the local banks' loan books and securities portfolios due to their asset/liability duration mismatches, a high share of fixed-rate lending and absence of widespread use of interest-rate hedging. However, Fitch views the group's strong deposit franchise, liquidity and capitalisation as sufficient mitigating factors.

Sound Asset Quality: We expect SFG-HT's impaired loans ratio to deteriorate modestly in 2023 as a result of the economic downturn, rising interest rates and inflation, but for it to remain below 2% in the medium term. SFG-HT's asset quality benefits from prudent underwriting standards, a high share of collateralised lending and a fairly standardised product offering. The group's large exposure to commercial real estate leaves it vulnerable to a real estate crisis, which is mitigated by strong collateralisation based on conservative valuations.

Resilient Pre-Impairment Profitability: The group's operating revenue is stable and benefits from the savings banks' strong regional market position, complemented by Helaba's low-margin wholesale activities. Fitch expects SFG-HT's profitability to have declined significantly in 2022 due to temporary valuation losses in the local banks' security portfolios. We expect profitability to recover in 2023 and the group's four-year average operating profit to remain at about 0.8% of its risk-weighted assets (RWAs) through the cycle.

Strong Capitalisation: SFG-HT's capitalisation is a rating strength. Based on Fitch's estimates, SFG-HT's common equity Tier 1 (CET1) ratio moderately declined at end-2022 due to an increase in RWA and temporary valuation losses, but should remain close to 17%. We expect healthy capital generation to strengthen SFG-HT's capital reserves and maintain its CET1 capital ratio above 16% in the medium term.

Strong Funding and Liquidity: The savings banks' large and granular retail deposit base underpins the group's strong funding and liquidity profile. The 'F1+' Short-Term IDR is the higher of two options mapping to the 'A+' Long-Term IDR and reflects the group's 'aa-' score for funding and liquidity. Helaba diversifies the group's funding profile by providing access to the international unsecured and secured funding markets.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

The ratings of SFG-HT, the savings banks and Helaba are sensitive to changes in the group's VR. We could downgrade the VR if we expect the group's operating profit/RWAs to durably fall below 0.5% and its impaired loans ratio to durably exceed 3%. This could result from large single losses in Helaba's concentrated loan portfolio, notably in its large commercial real estate exposure. SFG-HT's Short-Term IDR is sensitive to changes in the Long-Term IDR and to a revision of the funding and liquidity score below 'aa-'.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

The ratings would be upgraded if the group's VR was upgraded. An upgrade of the VR would require a material improvement in earnings generation and better cost efficiency and lifting the group's operating profit/RWAs ratio above 1.5% on a sustained basis, while maintaining a low impaired loans ratio and strong capitalisation.

In addition, SFG-HT's ratings are also sensitive to changes in those of Sparkassen-Finanzgruppe (Sparkassen; A+/Stable), the nationwide savings bank network. This is because SFG-HT's savings banks are also part of the savings banks' nationwide mutual support mechanism, and would be affected by a material change of the overall savings bank sector's credit profile.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

Helaba's Derivative Counterparty Rating (DCR), deposit ratings and senior preferred debt ratings are one notch above the bank's Long-Term IDR because of the protection provided by its sustainable resolution buffers to these preferred creditors. Helaba forms a resolution group that does not include SFG-HT's savings banks (except for Frankfurter Sparkasse, of which Helaba owns 100%). Helaba is subject to minimum requirements for own funds and eligible liabilities, and we expect that the bank's junior and senior non-preferred debt buffer will continue to sustainably exceed 10% of its RWAs. Helaba's senior unsecured and senior non-preferred debt ratings are aligned with its IDRs for the same reason.

The deposit ratings of SFG-HT's savings banks are in line with their IDRs because each savings bank's junior and senior non-preferred debt buffers, when available, are insufficient to warrant a rating uplift. We do not expect the savings banks to build up significant buffers because SFG-HT is not regulated as a single resolution group. This means that in a highly unlikely scenario where the mutual support mechanism would fail to protect its members' viability, the preferred resolution strategy for each savings bank would be insolvency procedures.

The 'AAA' rating on Helaba's guaranteed senior unsecured and subordinated Tier 2 debt are based on Fitch's view of the State of Hesse and the Free State of Thuringia's extremely high ability and propensity to honour their grandfathered statutory guarantor's liability (*Gewaehrtraegerhaftung*). Fitch believes that the senior and subordinated instruments are similarly protected because the guarantee does not differentiate between seniorities. In our view, the regulatory and EU state aid frameworks do not constrain support for grandfathered debt.

Helaba's subordinated Tier 2 notes that do not benefit from the state guarantee are notched down twice from SFG-HT's VR to reflect Fitch's baseline notching for loss-severity and the assumption that extraordinary support from SFG-HT would be forthcoming to support these junior instruments, if needed, even though junior instruments are not formally covered by the group's mutual support scheme.

No Sovereign Support Assumed: SFG-HT's Government Support Rating (GSR) reflects Fitch's view that the EU's resolution framework is likely to require senior creditors participating in losses, if necessary, instead or ahead of a bank receiving sovereign support.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

Helaba's DCR and senior debt ratings as well as all members' deposit ratings are sensitive to a change in the group's IDRs. In addition, we could downgrade Helaba's DCR and long-term senior preferred debt and deposit ratings if we expect Helaba's junior and senior non-preferred debt buffer to durably fall below 10% of its RWA. The long-term deposit ratings of SFG-HT's savings banks could also be upgraded if all members of SFG-HT become regulated as a single resolution group with bail-in as the preferred resolution strategy.

Helaba's guaranteed senior unsecured and subordinated Tier 2 debt ratings are primarily sensitive to a weakening of the guarantors' ability to provide support as assessed by Fitch. The ratings of Helaba's non-guaranteed Tier 2 notes are primarily sensitive to a change in SFG-HT's VR.

SFG-HT's GSR is at the lowest level on Fitch's rating scale. Therefore, it cannot be downgraded.

We would upgrade SFG-HT's GSR only if we see rising propensity from the sovereign to support systemically important banks, which is highly unlikely in the current regulatory environment.

SUBSIDIARIES & AFFILIATES: KEY RATING DRIVERS

The IDRs of Helaba Asset Services UC, which is not a member of SFG-HT's mutual support scheme, are aligned with those of its parent, Helaba, to reflect our view that shareholder support would be forthcoming. This is reflected in Helaba Asset Services' Shareholder Support Rating (SSR) of 'a+'. Helaba Asset Services benefits from Helaba's declaration of backing, and we believe Helaba would face significant reputational risk if Helaba Asset Services defaults on its obligations. Helaba Asset Services is a private unlimited company, which means that Helaba is fully liable for any asset shortfall in case of liquidation.

SUBSIDIARIES AND AFFILIATES: RATING SENSITIVITIES

Helaba Asset Services' IDRs and SSR are primarily sensitive to a change in Helaba's IDRs.

VR ADJUSTMENTS

The earnings & profitability score of 'a-' has been assigned above the category implied score of 'bbb' due to the following adjustment reason: risk-weight calculation (positive).

The funding & liquidity score of 'aa-' has been assigned above the category implied score of 'a' due to the following adjustment reason: deposit structure (positive).

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

Helaba's grandfathered state-guaranteed senior unsecured and Tier 2 subordinated notes are linked to Fitch's assessment of State of Hesse's and the Free State of Thueringen creditworthiness and, by extension, to Germany's ratings.

Helaba Asset Services' ratings are derived from Helaba's IDRs.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Markus Glabach
Director
Primary Rating Analyst
+49 69 768076 195
markus.glabach@fitchratings.com
Fitch Ratings – a branch of Fitch Ratings Ireland Limited
Neue Mainzer Strasse 46 - 50 Frankfurt am Main D-60311

Marco Diamantini
Director
Secondary Rating Analyst
+49 69 768076 114
marco.diamantini@fitchratings.com

Olivia Perney
Managing Director
Committee Chairperson
+33 1 44 29 91 74
olivia.perney@fitchratings.com

MEDIA CONTACTS

Peter Fitzpatrick
London
+44 20 3530 1103
peter.fitzpatrick@thefitchgroup.com

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

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APPLICABLE CRITERIA

Non-Bank Financial Institutions Rating Criteria (pub. 31 Jan 2022) (including rating assumption sensitivity)

Bank Rating Criteria (pub. 07 Sep 2022) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Frankfurter Sparkasse	EU Issued, UK Endorsed
Helaba Asset Services UC	EU Issued, UK Endorsed
Kasseler Sparkasse	EU Issued, UK Endorsed
Kreissparkasse Eichsfeld	EU Issued, UK Endorsed
Kreissparkasse Gelnhausen	EU Issued, UK Endorsed
Kreissparkasse Gotha	EU Issued, UK Endorsed
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Kreissparkasse Schluechtern	EU Issued, UK Endorsed
Kreissparkasse Schwalm-Eder	EU Issued, UK Endorsed
Kreissparkasse Weilburg	EU Issued, UK Endorsed
Kyffhaeusersparkasse Artern-Sondershausen	EU Issued, UK Endorsed
Nassauische Sparkasse	EU Issued, UK Endorsed
Sparkasse Altenburger Land	EU Issued, UK Endorsed
Sparkasse Arnstadt-Ilmenau	EU Issued, UK Endorsed
Sparkasse Bad Hersfeld-Rotenburg	EU Issued, UK Endorsed
Sparkasse Battenberg (Eder)	EU Issued, UK Endorsed
Sparkasse Bensheim	EU Issued, UK Endorsed

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