FitchRatings

Banks
Universal Commercial Banks
Germany

Sparkassen-Finanzgruppe Hessen-Thueringen

Update

Key Rating Drivers

Regional Retail, Commercial Banking Group: Sparkassen-Finanzgruppe Hessen-Thueringen's (SFG-HT) ratings are underpinned by the strong local retail franchises of the group's savings bank members, which are complemented by the wholesale activities of Landesbank Hessen-Thueringen Girozentrale (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 48 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 Issuer Default Ratings (IDRs) apply to each individual member bank, including Helaba, and are aligned with the group's Viability Rating (VR).

High Interest-Rate Risk: Interest-rate risk is high in the savings 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. This has resulted in significant valuation losses in SFG-HT's security portfolios in 2022, most of which we expect to reverse as bonds mature over the next five years. Fitch views the group's strong deposit franchise, liquidity and capitalisation as sufficient mitigating factors.

Asset Quality to Deteriorate: We expect a deterioration of SFG-HT's impaired loans ratio in 2023 and 2024 as a result of the economic downturn, higher interest rates and inflation, but for it to remain below 3%. Helaba's large exposure to commercial real estate (CRE) leaves it vulnerable to refinancing risk and declining real estate valuations, especially in its CRE developers, office and retail properties sub-portfolios. The saving banks' asset quality benefits from a high share of collateralised lending and a fairly standardised product offering.

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 recover in 2023 driven by a strong growth in net interest margin. We expect the group's 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. SFG-HT's Tier 1 capital ratio remained above 17% at end-2022 despite an increase in RWA and temporary valuation losses. We expect capital generation and RWA optimisation measures to offset most of the expected regulatory RWA inflation and negative rating migration in the commercial real estate and corporate portfolios, maintaining the Tier 1 capital ratio above 16% in the medium term.

Strong Funding and Liquidity: The savings banks' large and sticky 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.

Ratings

Sparkassen-Finanzgruppe Hessen-Thueringen

Long-Term IDR	A+
Short-Term IDR	F1+
Viability Rating	a+
Government Support Rating	ns

Sovereign Risk (Germany)

Long-Term Foreign-Currency IDR	AAA
Long-Term Local-Currency IDR	AAA
Country Ceiling	AAA

Outlooks

Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Local-Currency IDR	Stable

Applicable Criteria

Bank Rating Criteria (September 2023)

Related Research

Fitch Affirms Sparkassen-Finanzgruppe Hessen-Thueringen at 'A+'; Outlook Stable (April 2023)

Sparkassen-Finanzgruppe Hessen-Thueringen Rating Report (May 2023)

Global Economic Outlook (September 2023)

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Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

SFG-HT's, the savings banks' and Helaba's ratings are sensitive to changes in the group's VR. We could downgrade the VR if we expect the group's operating profit/RWA ratio 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 were 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.

SFG-HT's ratings are also sensitive to changes in those of Sparkassen-Finanzgruppe (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

Debt Ratings Classes

Rating level	Landesbank Hessen-Thueringen Girozentrale	Savings banks
Deposit ratings	AA-/F1+	A+/F1+
Senior preferred debt	AA-	
Senior non-preferred debt	A+	
Guaranteed debt	AAA	
Tier 2 debt	A-	

Source: Fitch Ratings

Deposit Ratings and Helaba's Derivative Counterparty Rating and Senior Debt Ratings

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 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.

Helaba's State-Guaranteed Senior Unsecured and Subordinated Notes

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 Non-Guaranteed Subordinated 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.

Significant Changes from Last Review

Helaba: Strong NII Offsets Defaults in CRE Portfolio

Helaba revised upwards its pre-tax profit guidance for 2023 to above EUR700 million after earning pre-tax profit of EUR336 million in 1H23 (1H22: EUR327 million). Net interest income increased 23% yoy to EUR817 million in 1H23, as the falling away of the TLTRO bonus was more than compensated by higher deposit margins, strong demand for retail certificates and the bank's directional treasury position.

Loan impairment charges (LICs) increased 28% to EUR108 million driven by a pick-up in stage 3 provisions (EUR177 million) partially offset by a net release of precautionary stage 1 and stage 2 provisions. The latter was the result of reversals and reductions in allowances for the COVID-19 pandemic and the energy crisis, respectively, which overcompensated additions for risks related to higher interest rates, especially in the CRE sector. Stage 3 provisions originated mainly in Helaba's EUR38.4 billion CRE portfolio, which accounts for more than four times the bank's CET1 capital. Stage 3 loans doubled to EUR1.9 billion (1.5% of gross loans) at end-1H23 (end-2022: 0.8%).

Fifty percent of the CRE portfolio consists of office buildings in Europe and North America, the latter accounting for about a fifth of the office portfolio. Retail properties account for 14% of CRE exposure, with the majority located in Germany. Helaba identified EUR25.2 billion, mostly retail and office CRE loans, as critical at end-1H23, of which EUR3.2 billion were on watchlist, against which it created EUR300 million precautionary provisions for critical sub-portfolios.

Fitch expects Stage 3 inflows in the CRE development, office and retail properties portfolios to continue in 2H23 and 2024 as construction costs surged, valuations are adjusted downwards and loans come up for refinancing. While LICs are likely to be significantly above the historical average, they should not lead to outsized losses in the next two years, due to the portfolio's collateralisation (61% of CRE loans had a loan-to-value ratio below 60% and 26% a loan-to-value ratio between 60% and 70% at end-1H23). For reference, in the adverse scenario of the European Banking Authority's stress test cumulative LICs over the three years from 2023 to 2025 add up to EUR1.8 billion (140bp of end-1H23 gross loans).

Savings Banks Contain Deposit Outflows

The balance sheet of SGF-HT's savings banks declined 3.2% to EUR151.3 billion in 1H23. This was mainly driven by a reduction of interbank assets and liabilities, reflecting the redemption of part of SFG-HT's outstanding central bank tenders (TLTRO), in combination with a EUR2.8 billion (2.3%) outflow of customer deposits. The latter is broadly in line with the 1.9% deposit outflow for savings banks nationwide. Gross loans increased 0.6% to EUR93.3 billion, broadly in line with the savings banks nationally, despite a 57% decline yoy in new retail mortgage lending business. We expect loan volumes to remain broadly stable until year-end, while the deposit outflow is likely to continue. Nevertheless, SFG-HT's savings banks' liquidity remains strong and above the long-term average. Their capitalisation also remains sound with a common equity Tier 1 ratio of 17.4% at end-1H23.

SFG-HT's savings banks expect their operating profit to increase to EUR1.4 billion in 2023 after a EUR141 million operating loss booked in 2022. The latter was mainly driven by EUR1.3 billion valuation losses in the savings banks liquidity portfolios as a result of rising interest rates, which we do not expect to recur in 2023. The savings banks also expect operating profit before impairments and valuation adjustments to grow 28% yoy to EUR1.5 billion in 2023 driven by slow repricing of deposits and strong securities sales to retail clients only partly offset by cost inflation. We view this as plausible.

Ratings Navigator

Sparkassen-Finanzgruppe Hessen-Thueringen

ESG Relevance:

Banks
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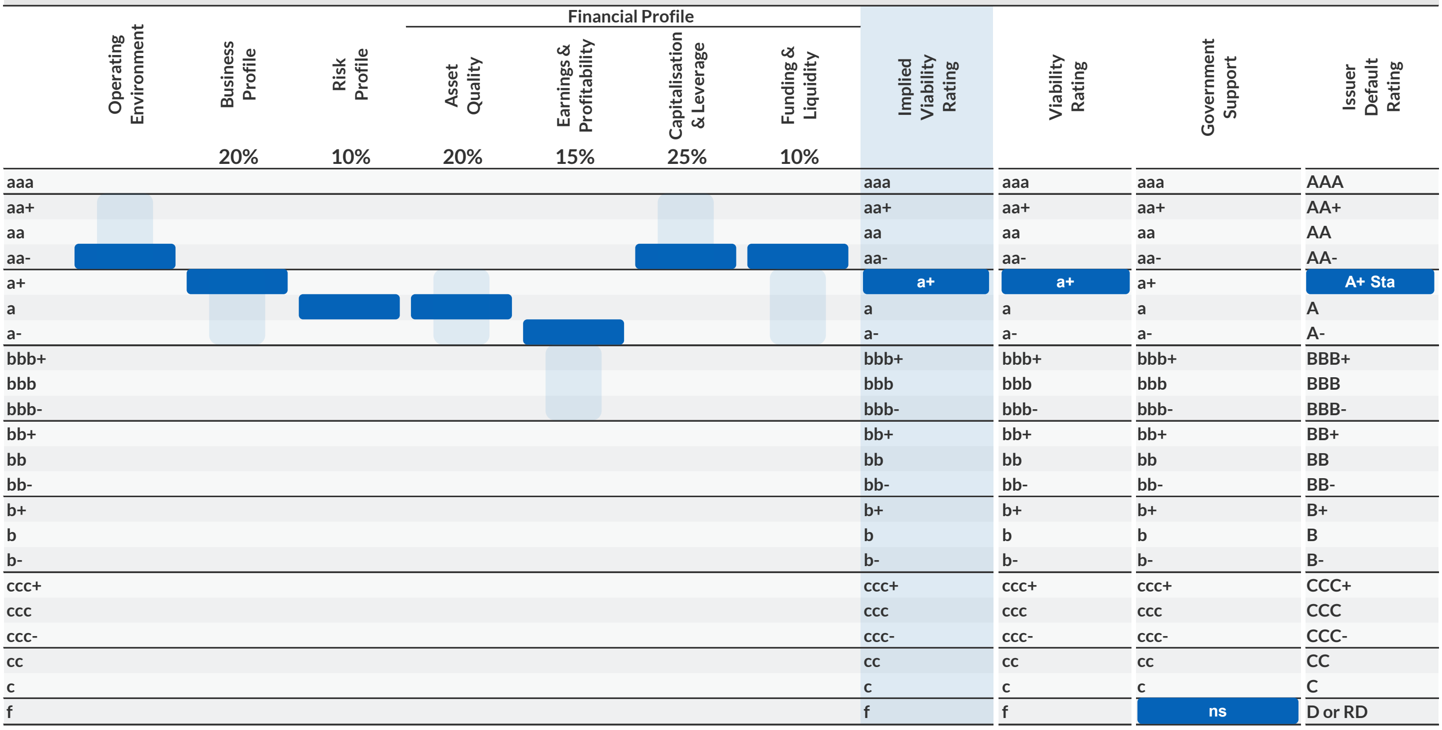

The Key Rating Driver (KRD) weightings used to determine the implied VR are shown as percentages at the top. In cases where the implied VR is adjusted upwards or downwards to arrive at the VR, the KRD associated with the adjustment reason is highlighted in red. The shaded areas indicate the benchmark-implied scores for each KRD.

VR - Adjustments to Key Rating Drivers

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).

Financials

Summary Financials and Key Ratios

	31 Dec 22		31 Dec 21	31 Dec 20	31 Dec 19
	Year end (USDm) Audited - unqualified	Year end (EURm) Audited - unqualified	Year end (EURm) Audited - unqualified	Year end (EURm) Audited - unqualified	Year end (EURm) Audited - unqualified
Summary income statement					
Net interest and dividend income	3,622	3,396	2,970	2,895	2,935
Net fees and commissions	1,445	1,355	1,285	1,177	1,114
Other operating income	-374	-351	812	294	782
Total operating income	4,693	4,400	5,067	4,366	4,831
Operating costs	3,822	3,583	3,295	3,339	3,302
Pre-impairment operating profit	871	817	1,772	1,027	1,529
Loan and other impairment charges	869	815	366	400	188
Operating profit	2	2	1,406	627	1,341
Other non-operating items (net)	5	5	4	97	130
Tax	25	23	272	169	323
Net income	-17	-16	1,138	555	1,148
Other comprehensive income	-31	-29	-162	50	-64
Fitch comprehensive income	-48	-45	976	605	1,084
Summary balance sheet					
Assets					
Gross loans	213,882	200,527	190,490	187,006	183,935
- Of which impaired	2,347	2,200	2,300	2,000	1,653
Loan loss allowances	1,551	1,454	1,317	1,124	824
Net loans	212,331	199,073	189,173	185,882	183,111
Interbank	13,774	12,914	13,859	17,053	15,558
Derivatives	13,102	12,284	16,120	23,467	19,417
Other securities and earning assets	55,847	52,360	61,080	64,292	66,303
Total earning assets	295,054	276,631	280,232	290,694	284,389
Cash and due from banks	53,154	49,835	47,327	37,307	20,051
Other assets	5,350	5,016	4,425	4,232	4,525
Total assets	353,559	331,482	331,984	332,233	308,965
Liabilities					
Customer deposits	180,653	169,373	167,590	163,859	152,595
Interbank and other short-term funding	76,648	71,862	70,203	63,880	51,052
Other long-term funding	47,811	44,826	45,357	49,012	49,914
Trading liabilities and derivatives	18,143	17,010	19,835	26,342	26,959
Total funding and derivatives	323,255	303,071	302,985	303,093	280,520
Other liabilities	4,279	4,012	4,495	5,016	4,878
Preference shares and hybrid capital	27	25	25	543	591
Total equity	25,997	24,374	24,479	23,581	22,976
Total liabilities and equity	353,559	331,482	331,984	332,233	308,965
Exchange rate		USD1 = EUR0.937559	USD1 = EUR0.884173	USD1 = EUR0.821963	USD1 = EUR0.89015

Source: Fitch Ratings, Fitch Solutions

Summary Financials and Key Ratios

	31 Dec 22	31 Dec 21	31 Dec 20	31 Dec 19
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	0.0	1.0	0.5	1.1
Net interest income/average earning assets	1.2	1.0	1.0	1.1
Non-interest expense/gross revenue	81.9	65.8	76.9	68.9
Net income/average equity	-0.1	4.7	2.4	5.1
Asset quality				
Impaired loans ratio	1.1	1.2	1.1	0.9
Growth in gross loans	5.3	1.9	1.7	13.4
Loan loss allowances/impaired loans	66.1	57.3	56.2	49.9
Loan impairment charges/average gross loans	0.2	0.2	0.2	0.1
Capitalisation				
Common equity Tier 1 ratio	17.8	17.8	18.6	18.6
Tangible common equity/tangible assets	6.9	7.1	6.9	7.2
Funding and liquidity				
Gross loans/customer deposits	118.4	113.7	114.1	120.5
Liquidity coverage ratio	197.2	176.8	194.3	204.0
Customer deposits/total non-equity funding	58.4	58.3	58.1	58.2
Net stable funding ratio	121.3	120.1	n.a.	n.a.

Source: Fitch Ratings, Fitch Solutions

Support Assessment

Commercial Banks: Government Support	
Typical D-SIB GSR for sovereign's rating level (assuming high propensity)	a+ to a-
Actual jurisdiction D-SIB GSR	ns
Government Support Rating	ns
Government ability to support D-SIBs	
Sovereign Rating	AAA/ Stable
Size of banking system	Negative
Structure of banking system	Neutral
Sovereign financial flexibility (for rating level)	Positive
Government propensity to support D-SIBs	
Resolution legislation	Negative
Support stance	Negative
Government propensity to support bank	
Systemic importance	Neutral
Liability structure	Neutral
Ownership	Neutral

The colours indicate the weighting of each KRD in the assessment.
Higher influence Moderate influence Lower influence

The GSR of 'ns' reflects Fitch's view that senior creditors of the bank cannot rely on full extraordinary support from the sovereign if the bank becomes non-viable, due to the EU's Bank Recovery and Resolution Directive.

Subsidiaries and Affiliates

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 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.

Helaba Asset Services' IDRs and Shareholder Support Rating are primarily sensitive to a change in Helaba's IDRs.

Environmental, Social and Governance Considerations

FitchRatings **Sparkassen-Finanzgruppe Hessen-Thueringen**

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

Sparkassen-Finanzgruppe Hessen-Thueringen has 5 ESG potential rating drivers

- Sparkassen-Finanzgruppe Hessen-Thueringen has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- Governance is minimally relevant to the rating and is not currently a driver.

			ESG Relevance to Credit Rating
key driver	0	issues	5
driver	0	issues	4
potential driver	5	issues	3
not a rating driver	4	issues	2
	5	issues	1

Environmental (E) Relevance Scores

General Issues	E Score	Sector-Specific Issues	Reference	E Relevance
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Business Profile (incl. Management & governance); Risk Profile; Asset Quality	1

Social (S) Relevance Scores

General Issues	S Score	Sector-Specific Issues	Reference	S Relevance
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Business Profile (incl. Management & governance); Risk Profile	5
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Business Profile (incl. Management & governance); Risk Profile	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Business Profile (incl. Management & governance)	3
Employee Wellbeing	1	n.a.	n.a.	2
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Business Profile (incl. Management & governance); Financial Profile	1

Governance (G) Relevance Scores

General Issues	G Score	Sector-Specific Issues	Reference	G Relevance
Management Strategy	3	Operational implementation of strategy	Business Profile (incl. Management & governance)	5
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Business Profile (incl. Management & governance); Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Business Profile (incl. Management & governance)	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Business Profile (incl. Management & governance)	2
				1

How to Read This Page
ESG relevance scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant to the credit rating and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the ESG general issues and the sector-specific issues that are most relevant to each industry group. Relevance scores are assigned to each sector-specific issue, signaling the credit-relevance of the sector-specific issues to the issuer's overall credit rating. The Criteria Reference column highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis. The vertical color bars are visualizations of the frequency of occurrence of the highest constituent relevance scores. They do not represent an aggregate of the relevance scores or aggregate ESG credit relevance.

The Credit-Relevant ESG Derivation table's far right column is a visualization of the frequency of occurrence of the highest ESG relevance scores across the combined E, S and G categories. The three columns to the left of ESG Relevance to Credit Rating summarize rating relevance and impact to credit from ESG issues. The box on the far left identifies any ESG Relevance Sub-factor issues that are drivers or potential drivers of the issuer's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the relevance score. All scores of '4' and '5' are assumed to result in a negative impact unless indicated with a '+' sign for positive impact.h scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI), the Sustainability Accounting Standards Board (SASB), and the World Bank.

CREDIT-RELEVANT ESG SCALE

How relevant are E, S and G issues to the overall credit rating?

5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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