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# Sparkassen-Finanzgruppe Hessen-Thueringen / Landesbank Hessen-Thueringen Girozentrale


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# Sparkassen-Finanzgruppe Hessen-Thueringen / Landesbank Hessen-Thueringen Girozentrale

*(**Editor's Note:** The scores shown below relate to the group credit profile of Sparkassen-Finanzgruppe Hessen-Thueringen, leading to issuer credit ratings of A/Stable/A-1 on core group members. A complete ratings list appears at the end of the article, in the "Ratings Detail" section.)*

| SACP | a | + | Support | 0 | + | Additional Factors | 0 |
|---|---|---|---|---|---|---|---|

| | | |
|---|---|---|
| Anchor | a- | |
| Business Position | Adequate | 0 |
| Capital and Earnings | Strong | +1 |
| Risk Position | Adequate | 0 |
| Funding | Average | 0 |
| Liquidity | Adequate | |

| | |
|---|---|
| ALAC Support | 0 |
| GRE Support | 0 |
| Group Support | 0 |
| Sovereign Support | 0 |

| Issuer Credit Rating |
|---|
| A/Stable/A-1 |

## Major Rating Factors

| Strengths: | Weaknesses: |
|---|---|
| • Strong level of solidarity and cooperation between group members based on ownership and mutual protection scheme.<br>• Solid retail market position by member savings banks in two German states, and risk-averse relationship-based business approach by Landesbank Hessen-Thueringen (Helaba).<br>• Strong capitalization from sound earnings retention. | • High cost base of member savings banks.<br>• Revenue margin pressure on deposit-funded business model.<br>• Concentration risk in commercial real estate lending by Helaba. |

**Outlook: Stable**

The core member banks of Germany-based Sparkassen-Finanzgruppe Hessen-Thueringen (SFHT) include the 49 regional savings banks and their 69%-owned central bank Landesbank Hessen-Thueringen Girozentrale (Helaba).

The stable outlook reflects both S&P Global Ratings' assumption of continued stability in SFHT's group credit profile (GCP) and that we are unlikely to change our view of its highly strategic group status to the German savings banks network. The highly strategic group status of SFHT for the German savings banks network effectively puts a floor on the long-term ratings on individual SFHT savings banks and Helaba at 'A', given the German savings banks' current GCP. The stable outlook includes our assumption of continued earnings stability and a prudent risk profile of Helaba's wholesale banking activities, given that Helaba contributes roughly 40% to the SFHT's group's pretax profit and capital. We also assume that the level of cohesion and cooperation within the German savings banks sector will remain high and that the aggregate creditworthiness of the German network of savings banks will remain stable.

A downgrade would require a combination of a weaker assessment of the German savings banks' nationwide network or SFHT's links with it, and of the unsupported GCP of SFHT member banks. While we consider this unlikely, both might occur if profitability were to erode, such that it prevented SFHT or nationwide savings banks from covering their normalized credit losses, or if capitalization were to weaken below a projected risk-adjusted capital (RAC) ratio of 10%. We might also revise down our assessment of the unsupported GCP of SFHT if we considered the group's 'a-' anchor had weakened, for example if the group was focusing more materially on foreign markets with much higher economic risk. However, we see a weaker anchor as a remote scenario, reflecting the group's high share of domestic lending of currently about 78%, and that we recently revised the economic risk trend for German banks' domestic operations to stable.

We would consider an upgrade over the next 12-24 months should earnings generation continue to exceed our projections, such that SFHT's RAC ratio were to surpass the 15% benchmark sustainably. However, in light of diminishing earnings retention capacity compared with projected loan growth, we believe this scenario has a low likelihood over the next 18-24 months.

## Rationale

We equalize our ratings on each savings bank and Helaba with our view of SFHT's GCP at 'a'. The equalization with the GCP reflects the core group status of member savings banks and Helaba within SFHT. SFHT's GCP is neither enhanced nor constrained by our assessment of the nationwide German savings banks' GCP of 'a+' and our view that SFHT, including Helaba, is a highly strategic subgroup of the German savings banks. The 'a' at the regional level means that we consider SFHT to be a strong subgroup of the German savings banks network.

SFHT's business profile differs from other mainly retail banking-oriented regional savings banks groups because its GCP includes a material share of wholesale banking activities through majority-owned Helaba. We therefore base our ratings on our view that SFHT's member banks will maintain a strong business focus on Germany, supporting the 'a-' anchor. They also reflect the group's solid aggregate business position, supported by the savings banks' dominant position in regional retail banking and complemented by Helaba's function as its central bank and by its more wholesale-oriented businesses. A rating constraint remains the sensitivity of the savings banks' revenues to a sustained low-interest-rate environment.

We anticipate that the group will maintain strong capital and earnings based on our forecast that the aggregate RAC ratio will remain at 13.5%-14.5% over the next 18-24 months.

We continue to assess the group's aggregate risk position as a neutral rating factor thanks to Helaba's and the savings banks' risk-averse culture and relationship-based strategies offsetting sizable exposure to commercial real estate markets.

We also factor in SFHT's refinancing availability from its large regional retail branch network, close relationships with domestic corporate clients, and funding diversification courtesy of Helaba.

We consider Helaba to be a core member of SFHT and include it in SFHT's GCP. This reflects its majority ownership by and continued integration with the savings banks, and that it can benefit from an additional regional reserve fund, which was set up by Helaba and the savings banks in the region to support each other, if needed. Helaba also acts as central bank for about 40% of all savings banks in Germany.

### Anchor: 'a-' reflecting lending exposure predominantly to Germany

Our bank criteria use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating (ICR). Our anchor for a commercial bank operating mainly in Germany is 'a-', based on an economic risk score of '1' and an industry risk score of '3'. We view the economic risk trend and the industry risk trend in the German banking industry as stable.

Our 'a-' anchor for SFHT reflects the group entities' domicile in Germany, where they are regulated, and our view of the blended economic risk of the markets in which it operates. About 80% of the group's exposure to the private sector and to local and regional governments is domestic. This has a favorable impact on the anchor, because we view Germany as having the lowest economic risk of all banking systems globally. About 20% of SFHT's credit exposure is in countries with higher economic risks, due to Helaba's activities abroad—mainly in commercial real estate lending and corporate finance. We project that the portfolio composition will remain broadly stable, given that the purely domestic savings banks' balance sheets are likely to grow faster than Helaba's. Helaba is slightly increasing the share of foreign corporate exposures, but its corporate exposures account only for about 40% of the group's total private sector and regional government exposures.

Our economic risk assessment reflects Germany's highly diversified and competitive economy, and we continue to expect that Germany's robust export-led economy will stay robust amidst a broader European recovery over our forecast horizon until 2020. We believe that the impact of the U.K.'s referendum decision to leave the EU (Brexit) is manageable and has only a limited negative effect for the German economy. Industry risk benefits from Germany's extensive funding market and banks' domestic funding surpluses, as well as from material improvements that have been made to strengthen banking regulation and supervision given ongoing EU-wide regulatory harmonization and convergence as banks implement Basel III. However, we believe that strong competition in German markets, coupled with an ultra-low interest rate environment, remain drags on profitability, although this is currently mitigated by historically low credit losses in Germany.

We believe that a nationwide credit-driven housing bubble is less likely in light of limited credit growth and historically favorable affordability ratios, which suggest a house price undervaluation in Germany until the end of our forecast horizon by the end of 2020. We forecast that the risk of elevated increases in inflation house price will soften below 2% in 2019 and 2020 on par with expected GDP growth. This is after elevated forecast levels of about 4.6% between 2017 and 2018 in the context of recent years' favorable economic conditions amid robust economic fundamentals, strong national and international demand, tight housing supply in Germany's economic centers, a buoyant labor market, high net immigration, and low interest rates.

We continue to regard industry risk for German banks as an intermediate risk in line with many European banking industries, which benefits from Germany's extensive funding market and banks' domestic funding surpluses, as well as from material improvements that have been made to strengthen banking regulation and supervision given ongoing EU-wide regulatory harmonization and convergence under Basel III. Returns in the German banking industry compared well with many European banking industries in recent years' due to ongoing historically low credit losses in Germany. However, we believe that low interest rate environment coupled with high competition remain a drag on profitability, which is partly compensated the German banking industries progress in counterbalancing measures to improve its lower cost efficiency and fee generation.

**Table 1**

| S-Finanzgruppe Hessen-Thueringen -- Key Figures | | | | | |
|---|---|---|---|---|---|
| | --Year ended Dec. 31-- | | | | |
| | **2016** | **2015** | **2014** | **2013** | **2012** |
| Adjusted assets | 256,510 | 260,162 | 264,203 | 261,342 | 282,201 |
| Customer loans (gross) | 156,472 | 154,147 | 150,038 | 148,958 | 148,882 |
| Adjusted common equity | 17,155 | 17,304 | 16,292 | 15,738 | 14,618 |
| Operating revenues | 5,228 | 5,164 | 5,356 | 5,193 | 5,116 |
| Noninterest expenses | 3,494 | 3,461 | 3,590 | 3,583 | 3,407 |
| Core earnings | 1,183 | 1,067 | 1,189 | 1,063 | 1,026 |

## Business position: Dominant retail franchise in Hesse and Thuringia

In our business position assessment for SFHT, we consider positively the highly predictable business volumes of the member savings banks. We also view positively the prudent and relationship-based strategy of Helaba's wholesale banking, which is active in business lines that we consider to be more cyclical. These benefits are partly offset by the savings banks' sensitivity to a sustained low-interest-rate environment. Also, given its focus on the two German states of Hesse and Thuringia, SFHT does not benefit from the same degree of diversification and strong nationwide market position as its higher scored peer, Cooperative Banking Sector Germany. Savings banks business contributes about 60% to the group's pretax profit based on SFHT's segment reporting. This includes the savings banks' earnings from retail clients and small and midsize enterprises (SMEs), and profits from cooperation between Helaba and the savings banks. Helaba's other commercial activities contribute the other 40%, of which currently more than half is from its commercial real estate activities.

We anticipate that the savings banks within SFHT will continue to maintain strong market penetration in retail banking and SME corporate banking products with a demonstrably loyal customer base in its home region. This results in revenues with a high annuity character, mainly from interest income. Market shares range between approximately 30% and 45% in areas such as accounts, deposits, and mortgage products, based on a dense network of about 2,000 branches and self-service centers, and very positive recognition of the nationwide savings banks brand. The savings banks' public-law status and regional roots, coupled with strong capitalization, also reinforce clients' confidence. Accordingly, the banks have benefited from a "flight to quality" since the onset of the financial and sovereign debt crisis in 2007. These benefits are partly offset by the savings banks' revenue concentration in interest income from commoditized banking products, coupled with a relatively large and inflexible cost base. This leads to an above-average sensitivity of the savings banks' profitability to the sustained low-interest-rate environment.

**Table 2**

**Segment Pretax Profit Composition S-Finanzgruppe Hessen-Thueringen**

| | --Financial year ended Dec. 31-- | |
|---|---|---|
| **(Mil. €)** | **2016** | **2015** |
| Commercial Real Estate | 407 | 380 |
| Corporate Finance | (39) | 106 |
| Financial Markets | 126 | 128 |
| Public Sector Promotion and Infrastructure | 22 | 27 |
| Retail, SME, Savings Banks | 1,075 | 1,002 |
| Other/consolidation | 5 | (163) |
| Total | 1,596 | 1,480 |

SME--Small and midsize enterprise.

Helaba complements the savings banks' business as SFHT's central institution, and fully owns the largest savings bank in the region, Frankfurter Sparkasse. However, it sources its earnings mainly from activities in commercial real estate (where it is one of the largest players in Germany), corporate finance, financial markets business, and asset management--all both domestically and abroad. We consider such wholesale banking activities generally to be cyclical. However, Helaba has built a track record of prudently managing these activities. What's more, its relationship-based approach appears to have benefited the bank's market position, while several peers have been subject to business restructurings.

Since the acquisition of the former WestLB's business with savings banks in 2012, Helaba has also expanded its role as central bank for the savings banks in the German states of North Rhine-Westphalia and Brandenburg. It now acts as the designated central bank for about 40% of savings banks across Germany. This has increased its importance to the nationwide savings banks sector and adds stability and diversity to Helaba's business profile by gaining access to new customers and additional business volumes. It also improves its access to stable funding from the savings banks in these large regions.

Overall, we believe there is good collaboration between SFHT member banks, as well as strategic coordination and oversight within the group. This mitigates the inherent strategic challenges for the sector of being a group of separate legal entities with independent management, which tends to slow down decision-making, in our view. Still, some of the member savings banks appear to be less effective at exploiting their full market potential. We assume that peer pressure and oversight will support these banks in improving their effectiveness as the low-interest-rate environment increasingly eats into banks' interest margins. Countermeasures will also include additional branch closures. However, even after such closures, SFHT member banks will still maintain by far the largest retail banking franchise in their regions.

**Table 3**

| S-Finanzgruppe Hessen-Thueringen -- Business Position | | | | | |
|---|---|---|---|---|---|
| | --Year ended Dec. 31-- | | | | |
| | **2016** | **2015** | **2014** | **2013** | **2012** |
| Total revenues from business line (mil. €) | 5,228 | 5,164 | 5,358 | 5,193 | 5,116 |
| Commercial banking/total revenues from business line | 9.49 | 9.95 | 9.50 | 9.90 | 9.32 |
| Retail banking/total revenues from business line | 44.74 | 46.94 | 45.30 | 47.22 | 47.48 |
| Commercial & retail banking/total revenues from business line | 54.23 | 56.89 | 54.80 | 57.12 | 56.80 |
| Corporate finance/total revenues from business line | 6.20 | 6.49 | 5.24 | 4.78 | 5.06 |
| Asset management/total revenues from business line | 0.00 | 0.00 | 0.00 | 0.00 | 0.47 |
| Other revenues/total revenues from business line | 39.58 | 36.62 | 39.96 | 38.11 | 37.67 |
| Investment banking/total revenues from business line | 6.20 | 6.49 | 5.24 | 4.78 | 5.06 |
| Return on equity | 6.19 | 5.86 | 6.84 | 6.46 | 6.83 |

### Capital and earnings: Strong capital buffers due to earnings retention

We base our assessment of capital and earnings primarily on our projection that SFHT on a consolidated basis will be able to maintain a RAC ratio between 13.5% and 14.5%, well above the 10% threshold that is commensurate with our strong assessment. It also reflects our view that the savings banks and Helaba will be able to comply with current and future regulatory capital requirements coming into effect under Basel III. Member banks' capital levels have increased substantially over the past 10 years, based on earnings retention that has outpaced low growth rates in risk assets.

SFHT's consolidated regulatory core equity Tier 1 ratio under Basel III fully-loaded rules stood at a very high 19.6% at year-end 2016. This ratio is based on equity determined by using International Financial Reporting Standards (IFRS) accounting rules. For Helaba alone, its fully-loaded common equity Tier 1 ratio was 13.8% on the same reporting. This ratio is favorable, but might fall because of potential new rules from the Basel committee designed to reduce the volatility of regulatory risk-weighted assets, in particular by the introduction of risk-weight floors for banks, such as Helaba, that apply internal ratings-based approaches.

Our RAC ratio for SFHT (before adjustments) further improved slightly to 13.8% from 13.7% one year before. Despite our ongoing projection that profitability will come under pressure from the low-interest-rate environment, we anticipate that aggregate capital levels will continue to improve slightly but with diminishing pace over the next two years. We project that it will remain within the 13.5%-14.5% range over the next 18-24 months. The ratio for Helaba on a stand-alone basis remains with 8.5% at adequate but substantially lower levels than for SFHT as a whole and shows that capital is unevenly split among SFHT members.

The improvement in 2016 is due to ongoing earnings retention in combination with only moderate loan growth over the last year. The updated RAC ratio also includes the changes from our revised risk-adjusted capital framework methodology which has been updated in July 2017. SFHT's RAC ratio here benefits from the revised treatment of investments in insurance subsidiaries and minority investments in financial institutions. The equity stakes mainly in SV SparkassenVersicherung and other banking entities of the savings banks sector are now deducted from total adjusted capital (TAC) instead of applying risk charges on the investments, which is a beneficial treatment for entities with RAC ratios significantly above 8%. This positive effect is almost mitigated by the incorporation of risks related to credit value adjustment and central counterparty exposures and a more conservative treatment of deferred tax assets. Combining all elements, the effect from the revised criteria has been almost neutral.

Our RAC ratio generally benefits from the very low economic risk in Germany, which leads to lower risk weights for domestic exposure by the savings banks than under the banks' regulatory standardized approach. This is more than offset by higher risk-weights that we apply to Helaba's corporate exposures. Our RAC projection considers that earnings might come increasingly under pressure from the low-interest-rate environment leading to a potential reduction in net interest income by up to €350 million by 2018 compared with 2016. This is due to the stronger-than-expected results in 2016, a sticky cost base, and a gradual reversal of credit loss provisioning requirements to levels more in line with historical averages. We also assume that the ownership structure will continue to support high earnings retention.

**Table 4**

**S-Finanzgruppe Hessen-Thueringen -- Capital And Earnings**

| | --Year ended Dec. 31-- | | | | |
|---|---|---|---|---|---|
| **(Mil. €)** | **2016** | **2015** | **2014** | **2013** | **2012** |
| Criteria reflected in RAC ratios | 2017 RAC Criteria | 2010 RAC Criteria | 2010 RAC Criteria | 2010 RAC Criteria | 2010 RAC Criteria |
| S&P RAC ratio before diversification | 13.85 | 13.74 | 12.74 | 11.26 | 11.20 |
| S&P RAC ratio after diversification | 13.28 | 14.33 | 13.50 | 12.75 | 12.16 |
| Adjusted common equity/total adjusted capital | 89.93 | 90.01 | 89.46 | 89.13 | 88.39 |
| Net interest income/operating revenues | 56.69 | 59.08 | 56.24 | 57.06 | 57.25 |
| Fee income/operating revenues | 18.52 | 18.26 | 16.52 | 16.41 | 15.81 |
| Market-sensitive income/operating revenues | 8.21 | 6.58 | 7.80 | 8.42 | 9.21 |
| Noninterest expenses/operating revenues | 66.83 | 67.02 | 67.03 | 69.00 | 66.59 |
| Preprovision operating income/average assets | 0.67 | 0.65 | 0.67 | 0.59 | 0.65 |
| Core earnings/average managed assets | 0.46 | 0.41 | 0.45 | 0.39 | 0.39 |

RAC--Risk-adjusted capital.

**Table 5**

**S-Finanzgruppe Hessen-Thueringen Risk-Adjusted Capital Framework Data**

| **(Mil. €)** | **Exposure*** | **Basel III RWA** | **Average Basel III RW (%)** | **S&P Global RWA** | **Average S&P Global RW (%)** |
|---|---|---|---|---|---|
| **Credit risk** | | | | | |
| Government and central banks | 60,293 | 2,016 | 3 | 2,528 | 4 |
| Institutions and CCPs | 41,370 | 5,123 | 12 | 8,470 | 20 |
| Corporate | 99,511 | 53,508 | 54 | 65,896 | 66 |
| Retail | 44,350 | 20,031 | 45 | 16,358 | 37 |
| Of which mortgage | 25,951 | 8,037 | 31 | 5,217 | 20 |
| Securitization§ | 316 | 162 | 51 | 255 | 81 |
| Other assets† | 3,191 | 2,949 | 92 | 5,339 | 167 |
| Total credit risk | 249,030 | 83,788 | 34 | 98,845 | 40 |

**Table 5**

**S-Finanzgruppe Hessen-Thueringen Risk-Adjusted Capital Framework Data (cont.)**

| | | | | | |
|---|---|---|---|---|---|
| **Credit valuation adjustment** | | | | | |
| Total credit valuation adjustment | -- | 753 | -- | 2,166 | -- |
| **Market risk** | | | | | |
| Equity in the banking book | 8,612 | 7,159 | 83 | 26,316 | 306 |
| Trading book market risk | -- | 3,834 | -- | 5,023 | -- |
| Total market risk | -- | 10,993 | -- | 31,339 | -- |
| **Operational risk** | | | | | |
| Total operational risk | -- | 8,771 | -- | 5,399 | -- |
| | | **Basel III RWA** | | **S&P Global RWA** | **% of S&P Global RWA** |
| **Diversification adjustments** | | | | | |
| RWA before diversification | | 104,305 | | 137,750 | 100 |
| Total Diversification/Concentration Adjustments | | -- | | 5,901 | 4 |
| RWA after diversification | | 104,305 | | 143,651 | 104 |
| | | **Tier 1 capital** | **Tier 1 ratio (%)** | **Total adjusted capital** | **S&P Global RAC ratio (%)** |
| **Capital ratio** | | | | | |
| Capital ratio before adjustments | | 21,118 | 20.2 | 19,075 | 13.8 |
| Capital ratio after adjustments‡ | | 21,118 | 20.2 | 19,075 | 13.3 |

*Exposure at default. §Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. †Other assets includes deferred tax assets (DTAs) not deducted from ACE. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of Dec. 31, 2016, S&P Global Ratings.

## Risk position: Benefits from a high share of granular retail loans, lower risk appetite, and support from the German economy

SFHT's loss track record through the recent financial and sovereign debt crisis has been better than peers in Germany with similar geographic and business profiles. We expect this to continue, given both the savings banks' and Helaba's prudent risk appetite. We balance the savings banks' highly granular retail loan portfolios in Germany against Helaba's well-managed, but more cyclical and concentrated, exposures. In our opinion, the group will continue to benefit from a robust economic environment in Germany over the next two years. We also consider that capital is not fully fungible within the group, as the banks are legally independent and separately regulated.

SFHT's groupwide risk discipline benefits from joint risk-management guidelines, harmonized rating and scoring systems, monitoring by SFHT's audit department for the savings banks, and risk-reward contributions to the protection scheme. The group also benefits from a high proportion of collateralized, granular domestic residential mortgage loans and stable housing markets in Germany. This has reduced domestic credit losses to historical lows. The decrease in 2016 in the group's new credit loss provisions compared with 2015 is mainly driven by historical low loss provisions of only €3 million on Helaba's commercial real estate portfolio and by the release of some portfolio-based provisions with reserving character made at Helaba in 2015. Because the savings banks operate only in their own regions and are constrained by individual regulatory limits on single loans, the single-name concentration risk for the group from individual savings banks is negligible.

In our view, SFHT's exposure to the commercial real estate sector by Helaba represents the biggest industry concentration risk. Helaba's credit volume in this segment is about €33 billion. About 57% of this exposure is outside Germany, mainly the U.S. and the U.K. These risks are partly mitigated by what we see as the savings banks' and Helaba's risk-averse cultures. Helaba's credit losses on international commercial real estate and corporate financing have been materially lower than those of many other specialized peers. We see this as an illustration of Helaba's generally more-prudent underwriting and conservative risk culture. Helaba's exposure to commercial real estate in the U.K. is about €3.4 billion, mainly in London and Southern England. Although exposure quality might suffer following the U.K.'s referendum decision to leave the EU, we believe that the impact on Helaba and SFHT should be immaterial to our ratings. The exposures' loan-to-value ratios are almost entirely below 70%, of which the vast majority (87% in total), are below 60%. The exposure to financial institutions tenants is minimal. We also consider Helaba's traditional focus on strong sponsors with long-standing relationships as ratings positive.

In 2016, Helaba's shipping exposure has been the main driver of loan-loss provisions. However, with only €0.9 billion of exposure by end-June 2017, it is smaller than peers and continues to shrink. Helaba considers more than half of the portfolio as problematic, but we consider it is well provisioned. Therefore, the portfolio is unlikely to materially impact our capital figures for Helaba, and especially not for SFHT as a whole.

**Table 6**

| S-Finanzgruppe Hessen-Thueringen -- Risk Position | | | | | |
|---|---|---|---|---|---|
| | --Year ended Dec. 31-- | | | | |
| | 2016 | 2015 | 2014 | 2013 | 2012 |
| Growth in customer loans | 1.51 | 2.74 | 0.73 | 0.05 | 5.64 |
| Total diversification adjustment / S&P RWA before diversification | 4.11 | (4.17) | (5.61) | (11.70) | (7.90) |
| Total managed assets/adjusted common equity (x) | 14.96 | 15.04 | 16.23 | 16.62 | 19.32 |
| New loan loss provisions/average customer loans | 0.06 | 0.14 | 0.05 | 0.15 | 0.19 |

RWA--Risk-weighted assets.

### Funding and liquidity: Benefit from SFHT's sizable regional retail deposit franchise

We continue to anticipate that SFHT's funding and liquidity will remain neutral for the rating, given that these two factors are in line with some large European peers. We view positively the group's refinancing availability from its large regional retail branch network, its close relationships with domestic retail and corporate clients, and its franchise for issuing longer-term Pfandbriefe (covered bonds). In our view, however, funding and liquidity are not fully fungible within the group.

The savings banks are very well funded and have a strong granular retail deposit base, which creates sizable surplus liquidity. SFHT's strong regional franchise and broad branch network support the stability of its customer deposits. Moreover, their liquidity benefits from sizable high-quality securities eligible for sale-and-repurchase transactions. The banks' excess funding is mainly channeled to Helaba.

Helaba contributes to SFHT's funding access and diversity, but it is to a significant degree wholesale funded (including covered bonds) and exposed to potentially tighter access to funding and higher financing costs under stressed conditions. That said, Helaba has for many years applied a largely matched funding policy to mitigate funding and liquidity risks, which we regard as ratings positive. A high level of covered bonds issuance and good access to refinancing in Germany's Pfandbrief market support its franchise, and Helaba's wholesale funding sources are generally very diverse. We also regard Helaba's improved access to funding from the savings banks in North Rhine-Westphalia and Brandenburg, through its role as their central bank, as ratings positive. Moreover, Helaba owns Frankfurter Sparkasse, which affords it direct access to a granular retail deposits. We continue to view as positive Helaba's prudent liquidity management.

SFHT's aggregate loan-to-deposit ratio was about 125% at year-end 2016, reflecting that Helaba's operations are not fully deposit funded such as those of the savings banks. However, our stable funding ratio of slightly above 100% demonstrates the overall balanced funding profile of the group. SFHT's broad liquid assets to short-term wholesale funding ratio of 1.12x as of year-end 2016 underpins our adequate view of the group's liquidity position. The savings banks and Helaba's large securities portfolio, including substantial amounts of liquid assets bolsters this ratio, in our view.

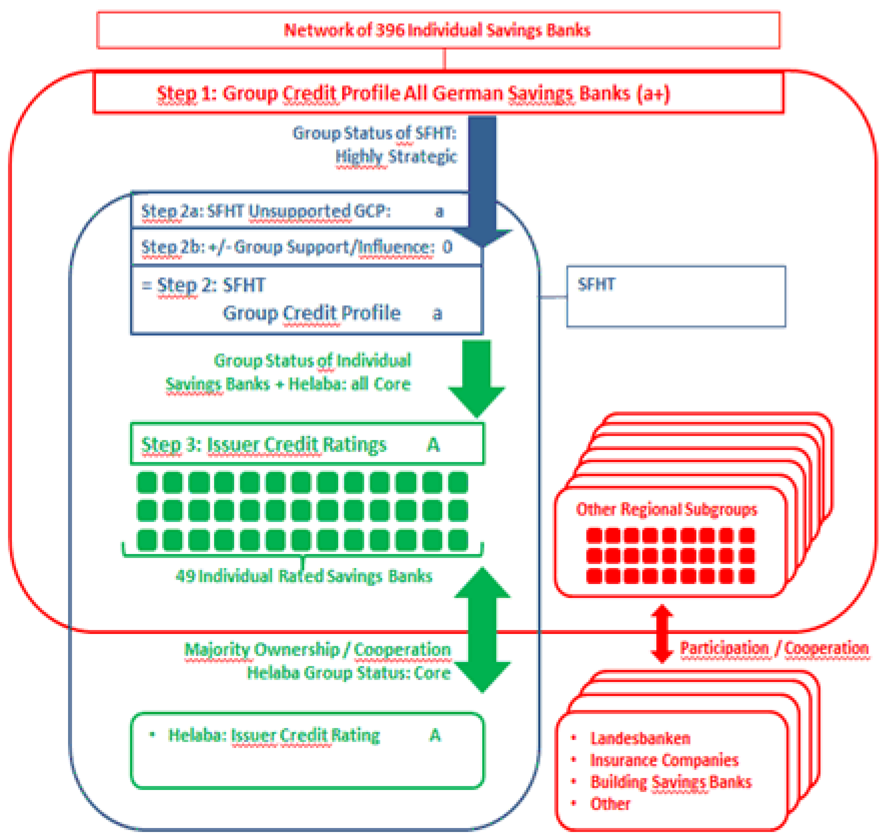
**Table 7**

| S-Finanzgruppe Hessen-Thueringen -- Funding And Liquidity | | | | | |
|---|---|---|---|---|---|
| | --Year ended Dec. 31-- | | | | |
| **(Mil. €)** | **2016** | **2015** | **2014** | **2013** | **2012** |
| Core deposits/funding base | 57.38 | 55.81 | 53.30 | 51.22 | 48.74 |
| Customer loans (net)/customer deposits | 125.13 | 123.93 | 125.72 | 127.50 | 125.32 |
| Long term funding ratio | 78.79 | 75.60 | 74.10 | 71.70 | 70.66 |
| Stable funding ratio | 100.66 | 98.45 | 98.20 | 96.25 | 99.90 |
| Short-term wholesale funding/funding base | 23.27 | 26.60 | 28.14 | 30.58 | 31.46 |
| Broad liquid assets/short-term wholesale funding (x) | 1.12 | 1.04 | 1.06 | 1.00 | 1.08 |
| Net broad liquid assets/short-term customer deposits | 5.84 | 2.36 | 3.73 | (0.24) | 7.13 |
| Short-term wholesale funding/total wholesale funding | 53.49 | 59.05 | 59.16 | 61.62 | 60.43 |

### External support:Individual bank's ratings based on core group status

Our ratings are based on SFHT's member banks' aggregate strength, given that we consider them to be a group of integrated, albeit legally independent institutions. (see "Credit FAQ: How We Rate German Savings Banks," published Aug. 19, 2016). We consider SFHT, including Helaba, to be a highly-strategic subgroup to the nationwide network of German savings banks, to which we assign a GCP of 'a+'. This is neutral to the GCP of SFHT, however, given that we consider SFHT's unsupported GCP at 'a' already, which means that no uplift is possible for being a member of the nationwide network. Since we regard all SFHT savings banks and Helaba to be core members to SFHT, we equalize our ratings on each bank with the 'a' GCP on SFHT (see chart).

**Analytical Steps In Rating Members Of Sparkassen-Finanzgruppe Hessen-Thueringen**






We also regard Helaba as a core group member and include it in our GCP on SFHT. This reflects that the savings banks in Hesse and Thuringia own 68.85% in Helaba and are actively involved in the supervision of its strategies. In addition, SFHT savings banks and Helaba strengthened their ties by creating a regional reserve fund in 2004 on top of the German savings banks' nationwide institutional protection scheme. The size of the regional reserve fund was €522 million at year-end 2016 and its goal is to prevent the insolvency of member institutions while also protecting depositors. It underscores the savings banks' commitment to each other and to Helaba. It differs from the nationwide mutual protection scheme of the German savings banks association by tying Helaba directly to its associated savings banks. Under the national scheme, Landesbanks are expected to support each other under a separate pillar that excludes savings banks, although they might ultimately receive support from savings banks under certain conditions.

Since June 2015, we have regarded the prospect of extraordinary government support for German banks as uncertain, in view of the authorities' clear intent to avoid taxpayer bail-outs of failing banks, and the well-advanced and effective resolution framework. At the same time, we view the German resolution regime as effective under our additional loss-absorbing capacity (ALAC) criteria. This contains a well-defined bail-in process under which authorities would permit nonviable systemically important banks to continue critical functions as going concerns following a bail-in of eligible liabilities.

However, our assessment of SFHT's GCP does not include support from ALAC. We believe that regulators would apply a resolution framework to individual institutions in SFHT and not to the group as a whole. Apart from Helaba, it is unlikely that individual savings banks would be subject to a well-defined bail-in resolution process, given their small size, limited complexity, and low systemic importance in Germany as stand-alone entities. We believe that group support is the strongest external support element for member institutions including Helaba.

### Additional rating factors: None

No additional factors affect this rating

### Grandfathered debt ratings

The 'AA-' ratings on several of Helaba's obligations are supported by the grandfathered statutory guarantees (Gewährträgerhaftung) of its government owners, the States of Hesse (AA/Positive/A-1+) and Thuringia (not rated). The savings banks also guarantee Helaba's grandfathered obligations. As the grandfathering guarantee is, strictly speaking, not explicit about timeliness of payment, we believe that timeliness of payment hinges on the strong ongoing ownership commitment. Our ratings refer to Hesse as the strongest guarantor. In our view, the grandfathered debt benefits from an extremely high likelihood of extraordinary government support from Hesse as we define it, based on our assessment of its critical role for and very strong link with the respective guarantors. See also "Four German Banks On Watch Positive, Various Banks' Snr Unsecured Debt On Watch Developing Or Neg, Pending Notes Review ," published Dec. 15, 2016.

Any positive or negative rating action on the grandfathered debt would most likely be based on the following factors:

- Developments that could lead us to change our assessment of the role for or link with the respective states with regard to grandfathered debt; or
- Positive or negative rating actions on the guarantors.

## Related Criteria

- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Financial Institutions - Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011

- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

## Related Research

- Banking Industry Country Risk Assessment: Germany, Oct. 11, 2017
- Various German Banks' Snr Unsecured Debt Lowered/Affirmed After Notes Review; Off Watch; Four Banks Remain On Watch, Feb. 9, 2017
- Credit FAQ: How we rate German Savings Banks, Aug. 19, 2016
- Ratings Affirmed On Various German Savings Banks, Helaba, And DekaBank On Capital Strengthening And Integration, Aug. 19, 2016
- GRE Criteria Review Of Six German And Austrian Banks' Grandfathered Debt Results In Four Downgrades And Two Affirmations, Sept. 20, 2012

**Anchor Matrix**

| Industry Risk | Economic Risk | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **1** | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| 1 | a | a | a- | bbb+ | bbb+ | bbb | - | - | - | - |
| 2 | a | a- | a- | bbb+ | bbb | bbb | bbb- | - | - | - |
| **3** | **a-** | a- | bbb+ | bbb+ | bbb | bbb- | bbb- | bb+ | - | - |
| 4 | bbb+ | bbb+ | bbb+ | bbb | bbb | bbb- | bb+ | bb | bb | - |
| 5 | bbb+ | bbb | bbb | bbb | bbb- | bbb- | bb+ | bb | bb- | b+ |
| 6 | bbb | bbb | bbb- | bbb- | bbb- | bb+ | bb | bb | bb- | b+ |
| 7 | - | bbb- | bbb- | bb+ | bb+ | bb | bb | bb- | b+ | b+ |
| 8 | - | - | bb+ | bb | bb | bb | bb- | bb- | b+ | b |
| 9 | - | - | - | bb | bb- | bb- | b+ | b+ | b+ | b |
| 10 | - | - | - | - | b+ | b+ | b+ | b | b | b- |

**Ratings Detail (As Of November 10, 2017)**

| | | |
|---|---|---|
| **Landesbank Hessen-Thueringen Girozentrale** | | |
| Counterparty Credit Rating | | A/Stable/A-1 |
| Commercial Paper | | |
| *Foreign Currency* | | A-1 |
| Senior Subordinated | | A- |
| **Counterparty Credit Ratings History** | | |
| 16-Sep-2010 | *Foreign Currency* | A/Stable/A-1 |
| 06-May-2009 | | A/Negative/A-1 |
| 02-Oct-2008 | | A/Stable/A-1 |
| 16-Sep-2010 | *Local Currency* | A/Stable/A-1 |
| 06-May-2009 | | A/Negative/A-1 |
| 02-Oct-2008 | | A/Stable/A-1 |

| Ratings Detail (As Of November 10, 2017) (cont.) | |
|---|---|
| **Sovereign Rating** | |
| Germany (Federal Republic of) | AAA/Stable/A-1+ |
| **Related Entities** | |
| **Frankfurter Sparkasse** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Kasseler Sparkasse** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Kreissparkasse Eichsfeld** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Kreissparkasse Gelnhausen** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Kreissparkasse Gotha** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Kreissparkasse Gross-Gerau** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Kreissparkasse Hildburghausen** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Kreissparkasse Limburg** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Kreissparkasse Nordhausen** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Kreissparkasse Saale-Orla** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Kreissparkasse Saalfeld-Rudolstadt** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Kreissparkasse Schluechtern** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Kreissparkasse Schwalm-Eder** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Kreissparkasse Weilburg** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Kyffhaeusersparkasse** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Nassauische Sparkasse** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Sparkasse Altenburger Land** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Sparkasse Arnstadt-Ilmenau** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Sparkasse Bad Hersfeld-Rotenburg** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Sparkasse Battenberg** | |
| Issuer Credit Rating | A/Stable/A-1 |

| Ratings Detail (As Of November 10, 2017) (cont.) | |
|---|---|
| **Sparkasse Bensheim** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Sparkasse Dieburg** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Sparkasse Dillenburg** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Sparkasse Fulda** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Sparkasse Gera-Greiz** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Sparkasse Giessen** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Sparkasse Gruenberg** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Sparkasse Hanau** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Sparkasse Jena-Saale-Holzland** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Sparkasse Langen-Seligenstadt** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Sparkasse Laubach-Hungen** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Sparkasse Marburg-Biedenkopf** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Sparkasse Mittelthueringen** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Sparkasse Oberhessen** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Sparkasse Odenwaldkreis** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Sparkasse Rhoen-Rennsteig** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Sparkasse Sonneberg** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Sparkasse Starkenburg** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Sparkasse Unstrut-Hainich** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Sparkasse Waldeck-Frankenberg** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Sparkasse Werra-Meissner** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Sparkasse Wetzlar** | |
| Issuer Credit Rating | A/Stable/A-1 |

| Ratings Detail (As Of November 10, 2017) (cont.) | |
|---|---|
| **Stadtsparkasse Borken** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Stadtsparkasse Grebenstein** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Stadtsparkasse Schwalmstadt** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Stadt- und Kreis-Sparkasse Darmstadt** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Staedtische Sparkasse Offenbach am Main** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Taunus-Sparkasse** | |
| Issuer Credit Rating | A/Stable/A-1 |
| **Wartburg-Sparkasse** | |
| Issuer Credit Rating | A/Stable/A-1 |

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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