FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Helaba at 'A+'; Assigns 'bbb' Viability Rating

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Fitch Ratings - Frankfurt am Main - 16 Dec 2024: Fitch Ratings has affirmed Landesbank Hessen-Thueringen Girozentrale's (Helaba) Long-Term Issuer Default Rating (IDR) and the Long-Term IDRs of 48 savings banks in Hesse and Thuringia at 'A+' with Stable Outlooks, based on their membership of Sparkassen-Finanzgruppe's (Sparkassen) (SFG, A+/Stable/F1+) institutional protection scheme (IPS). Fitch has also assigned Helaba a Viability Rating (VR) of 'bbb'.

Fitch has affirmed and withdrawn the ratings of Sparkassen-Finanzgruppe Hessen-Thueringen (SFG-HT) following a reorganisation of its regional mutual support mechanism and the decision to gradually dissolve the regional reserve fund. The latter acts as a supplementary layer of protection to SFG's nationwide IPS and is a key element supporting SFG-HT's ratings. The reform of SFG's IPS, which will come into force in 2025, also weakens the incentive for SFG-HT's members to support each other at a regional level, beyond the amounts left in the regional reserve fund. This is because support is expected to be forthcoming from the national IPS. Accordingly, Fitch will no longer provide ratings or analytical coverage for SFG-HT, but will continue to rate its members.

A full list of rating actions is below. A full list of rated SFG members is available at www.fitchratings.com.

KEY RATING DRIVERS

SFG's Support Drives IDRs: Helaba's IDRs and newly-assigned Shareholder Support Rating (SSR) are aligned with the IDRs of SFG, the German savings bank network. This reflects Fitch's view that there is a very high probability that SFG, which owns 66% of Helaba, would provide timely support if needed, based on Helaba's membership of the IPS. The Stable Outlook on Helaba's Long-Term IDR mirrors that on SFG.

We believe that support would also be available from the state of Hesse, which holds a 30% stake in the bank, but Helaba's SSR does not factor in support from the federal state as it is based on the lower of the owners' ratings. Fitch uses SFG's Long-Term IDR as the anchor rating because support would need to be forthcoming from both SFG and the state of Hesse to avoid triggering state-aid considerations and resolution under the German Recovery and Resolution Act if Helaba fails.

Helaba's VR reflects the bank's largely wholesale-driven business model, weaker profitability compared with international peers and large exposure to cyclical asset classes, which has recently resulted in a deterioration of its asset quality. This is mitigated by its adequate capitalisation and access to the savings banks' excess liquidity.

German Corporate Bank: Helaba has a largely wholesale-driven business model focused on corporate and asset-based lending, including commercial real estate (CRE) financing, and institutional clients. This is balanced by the bank's close cooperation with the savings banks in Hesse and Thuringia. Together with Helaba, they form an economic unit whose cohesion is supported by a common business and risk strategy, which are unchanged with the exception of the dissolution of the reserve fund.

Earnings in Helaba's regional retail franchise also compensated credit losses in its CRE segment when interest rates rose. Asset management and rents from a portfolio of residential investment properties also provide additional revenue diversification. Similar to German peers, intense competition in most of Helaba's products limits its pricing power and weighs on its profitability.

Significant Sector Concentrations: Helaba is largely exposed to cyclical asset classes, mainly CRE and export-oriented corporates. Underwriting standards and risk monitoring are broadly in line with market practice, but the bank's exposure to CRE development, office properties and CRE in the US is higher than peers. Market risk is adequately hedged.

Deteriorating Asset Quality: Helaba's impaired loans ratio increased to 3.1% in 1H24 (end-2022: 0.8%) driven by defaults in its CRE portfolio. We project the ratio to continue to increase also in 2025, albeit at a slower rate, driven by an increase of corporate defaults and further CRE loan impairments. We expect loan impairment charges (LICs) to remain above their historical average, but to gradually decline yoy in 2024 and 2025 as the bank releases management overlays to absorb new LICs. Impaired loans coverage is significantly below that of peers, reflecting the CRE loans' collateralisation.

Improved Profitability: We expect Helaba's operating profit to remain at around 1% of risk-weighted assets (RWAs) in the next two years. Helaba's operating profit/RWAs peaked at 1.3% in 1H24, sustained by higher deposit margins and the non-recurrence of impairment losses in the bank's residential investment property portfolio, which offset higher LICs. However, average profitability is structurally weaker than most large international peers, burdened by lower margins and higher costs.

Adequate Capitalisation: Helaba's common equity Tier 1 (CET1) ratio (end-September 2024: 13.7%) is adequate in light of its business model and risk profile. In the next two years the ratio should benefit from sound earnings retention, RWA optimisation measures and temporary positive effects from the implementation of Basel III end-game rules. These should compensate higher RWAs in the bank's CRE and corporate portfolios and offer room for potential growth.

Sound Funding and Liquidity: Helaba is primarily wholesale funded, which is reflected in a moderately higher loans/deposits ratio than commercial bank peers. However, the bank benefits from moderate capital market funding requirements, due to the bank's privileged placement capacity within the savings banks sector. Its liquidity is sound, underpinned by a large portfolio of cash and liquid securities and low encumbrance of collateral pools eligible for covered bonds.

RATING SENSITIVITIES

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

A downgrade of SFG's IDRs would lead to a downgrade of Helaba's IDRs and SSR.

Helaba's VR would likely be downgraded if the bank's impaired loans ratio increases above 5% for an extended period, or if heightened LICs weigh on its profitability lowering its operating profit/RWAs ratio below 0.5% in the longer term.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

An upgrade of SFG's Long-Term IDR would lead to an upgrade of Helaba's Long-Term IDR and SSR.

An upgrade of Helaba's VR would be contingent on lowering the impaired loans ratio below 3% on a sustained basis and maintaining the operating profit/RWAs ratio above 1%. An upgrade would also require the CET1 ratio to increase and remain above 14%.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

Helaba's Derivative Counterparty Rating (DCR), long-term deposit ratings and senior preferred debt ratings are one notch above the bank's Long-Term IDR. This reflects the protection of preferred creditors arising from the bank's large resolution buffers, including senior non-preferred and more junior debt. For the same reason, the senior non-preferred and legacy senior unsecured debt ratings are in line with the bank's Long-Term IDR.

Helaba's short-term deposit and senior preferred debt ratings are the only short-term ratings mapping to the respective long-term deposit and senior preferred ratings.

The 'AAA' ratings of Helaba's grandfathered state-guaranteed senior unsecured and Tier 2 subordinated notes reflect our view of the creditworthiness of the federal states of Hesse and Thuringia, which is closely linked to that of Germany (AAA/Stable), and our expectation that Hesse and Thuringia will honour their guarantees. Fitch believes that the senior and subordinated instruments are equally protected because the guarantee does not differentiate between seniorities.

The rating of Helaba's non-guaranteed Tier 2 subordinated bond is notched down twice from Helaba's Long-Term IDR to reflect poor recoveries in case of non-performance. Fitch uses Helaba's Long-Term IDR rather than its VR as the anchor rating because we expect shareholder support from SFG to be extended to the bank's Tier 2 instruments under the IPS statutes, which we believe has reduced the likelihood of regulatory resolution measures at Helaba.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

Helaba's DCR, deposit, senior preferred and non-preferred debt ratings are sensitive to changes to Helaba's IDR. 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.

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 changes in SFG's IDR. The subordinated debt could also be downgraded if Fitch no longer believes that shareholder support would be extended to subordinated creditors, or that such support is moderately less likely for subordinated creditors than for senior creditors.

SUBSIDIARIES & AFFILIATES: KEY RATING DRIVERS

The IDRs of the 48 saving banks in Hesse and Thuringia are group ratings backed by their membership of SFG's IPS. The scheme has an impeccable record of providing protection to depositors by safeguarding its member banks' viability. Members of the group share a common strategy and brand and joint marketing activities.

The savings banks' deposit ratings are aligned with SFG's IDRs due to the banks' lack of material resolution debt buffers that would provide their depositors with additional protection if SFG fails to ensure its members' viability. This also applies to Frankfurter Sparkasse, which is owned by Helaba but not part of its resolution perimeter. Each savings bank is predominantly deposit-funded and regulated individually as a less significant institution. The German regulators' preferred resolution strategy for the savings banks consists of standard insolvency procedures in the highly unlikely event SFG's IPS would fail to protect their viability. Consequently, the savings banks have no incentive to build up resolution buffers.

Before withdrawal, SFG-HT's ratings were underpinned by the strong local retail franchises of the group's savings bank members, which are complemented by Helaba's wholesale activities, the close integration of SFG-HT's members, and the group's sound asset quality, strong capitalisation and improved profitability.

SFG-HT's Government Support Rating reflected our 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: RATING SENSITIVITIES

The savings banks' ratings are sensitive to changes in SFG's IDRs.

SFG-HT ratings: not relevant.

VR ADJUSTMENTS

The business profile score of 'bbb' has been assigned below the 'a' implied category score, due to the following adjustment reason: business model (negative).

The asset quality score of 'bbb' has been assigned below the 'a' implied category score, due to the following adjustment reason: concentrations (negative).

The capitalisation and leverage score of 'bbb+' has been assigned below the 'a' implied category score, due to the following adjustment reason: business model and risk profile (negative).

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

The IDRs of Helaba and of the 48 savings banks in Hesse and Thuringia are linked to SFG's IDRs.

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's creditworthiness and, by extension, to Germany's ratings.

ESG CONSIDERATIONS

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 www.fitchratings.com/esg.

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 15 Mar 2024) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Frankfurter Sparkasse	EU Issued, UK Endorsed
Kasseler Sparkasse	EU Issued, UK Endorsed
Kreissparkasse Eichsfeld	EU Issued, UK Endorsed
Kreissparkasse Gelnhausen	EU Issued, UK Endorsed
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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
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