S&P Global Ratings

RatingsDirect®

DEPFA Bank PLC

Primary Credit Analyst:
Michal Selbka, Frankfurt +49 (0) 69-33999-300; michal.selbka@spglobal.com

Secondary Contact:
Bernd Ackermann, Frankfurt (49) 69-33-999-153; bernd.ackermann@spglobal.com

Table Of Contents

DEPFA Bank PLC

SACP	bbb-	
Anchor	bbb-	
Business Position	Adequate	0
Capital and Earnings	Very Strong	+2
Risk Position	Weak	-2
Funding	Average	0
Liquidity	Adequate	

+

Support	+3
ALAC Support	0
GRE Support	+3
Group Support	0
Sovereign Support	0

+

Additional Factors	0

Issuer Credit Rating

A-/Stable/A-2

Major Rating Factors

Strengths:	Weaknesses:
• High likelihood of extraordinary government support from Germany, underpinned by the ownership by the government-owned FMS Wertmanagement Anstalt des oeffentlichen Rechts (FMSW). • Very strong capitalization underpinned by the accelerated wind-down of the balance sheet. • Advanced integration of the operational units and processes with the FMSW, including funding and liquidity support if needed.	• Return to profitability not expected in the foreseeable future. • Concentration risk in the public sector. • Constraints for accelerated wind-down of some of its assets.

1791662 | 302488166

Outlook: Stable

Our outlook on Ireland-based DEPFA Bank PLC (DEPFA) is stable. This reflects our view that DEPFA will remain the orderly wind-down unit within FMSW and will continue to benefit from the strong commitment of the German government until the wind-down is completed. However, we note that Germany has no obligation to support DEPFA directly, in contrast to its obligation to support FMSW.

We regard the possibility for privatization of DEPFA to be unlikely, given the current advanced status of accelerated wind-down proceedings and the increasing level of operational integration with FMSW.

We might lower the ratings on DEPFA in the next two years if, for example, sizable losses cause a sharp fall in the bank's capitalization or if the likelihood of government support diminished.

We see a positive rating action, given DEPFA's current business model of a wind-down entity, as remote. It would require either strengthening of Germany's already high commitment to the bank or further improvement of our current banking industry risk assessment in Ireland.

Rationale

Our ratings on DEPFA reflect its anchor of 'bbb-', which represents our view of economic conditions in the countries in which the bank operates and banking industry risk in the Republic of Ireland.

We assess DEPFA's stand-alone credit profile (SACP) at 'bbb-', incorporating our view of the support DEPFA has received from the German government through capital injections and asset transfers. We also take into account ongoing government support and further operational integration with FMSW, because we cannot segregate benefits deriving from government ownership through FMSW from our stand-alone analysis of the bank.

We consider DEPFA's business position to be adequate. This is based on our view that management will continue the orderly wind-down of the balance sheet with ongoing implicit support from FMSW. We assess the bank's capital and earnings as very strong. We assess DEPFA's risk position as weak, mainly owing to the bank's high concentration risks. We view its funding as average and its liquidity as adequate, reflecting the bank's current sound funding and liquidity profile and our expectation of the ongoing implicit government support.

Although DEPFA is based in Ireland, we consider the German government to be a more likely source of support in the event of stress due to its indirect 100% ownership via FMSW. Our long-term counterparty credit rating on DEPFA is three notches higher than the SACP, reflecting our view that we regard DEPFA as a government-related entity (GRE) and believe there is a high likelihood of timely and sufficient extraordinary support from the German government to DEPFA if needed.

Anchor: 'bbb-'

Under our bank criteria, we use our Banking Industry Country Risk Assessment economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our anchor for a commercial bank operating solely in Ireland is 'bbb-', based on an economic risk score of '5' and an industry risk score of '6'.

To assess the economic risk for DEPFA, we use the weighted-average of its exposures in countries of operation. Because DEPFA's lending business is outside Ireland and its borrowers are located in countries with stronger economic conditions than Ireland, our weighted economic risk score on the bank is better than that on Irish lending institutions with higher proportions of domestic loans. However, both economic and banking risk assessments combined currently result in the same anchor for DEPFA and other domestic financial institutions in Ireland.

During the run-down process, we expect that the weighted economic risk score could fluctuate, but we do not expect this to have an impact on the rating. Based on the weighted economic risk score of '3' and the industry score of '6', we determine the anchor for DEPFA also at 'bbb-'.

Table 1

Depfa Bank PLC Key Figures					
	--Year-ended Dec. 31--				
(Mil. €)	**2016***	**2015**	**2014**	**2013**	**2012**
Adjusted assets	39,094.0	36,712.0	48,516.0	49,117.0	73,286.0
Customer loans (gross)	8,070.0	6,897.0	9,692.0	15,290.0	18,627.0
Adjusted common equity	793.0	844.0	864.0	1,016.0	1,013.0
Operating revenues	(2.0)	(1.0)	(79.0)	(24.0)	144.0
Noninterest expenses	48.0	79.0	90.0	96.0	174.0
Core earnings	(51.0)	(72.0)	(122.0)	(62.0)	6.1

*Data as of June 30.

Business position: Wind-down under FMSW

We assess DEPFA's business position as adequate, owing to the high risk already indicated by the Irish industry risk score of '6'. Our assessment is based on Germany's commitment to facilitate an acceleration where possible but all-in-all an orderly rundown of the bank's operations under the roof of and with ongoing implicit support from FMSW.

Following the former asset transfers to FMSW, DEPFA group's €39 billion remaining balance sheet as of the first half (H1) of 2016 is dominated by international public sector assets that serve as collateral for the covered bonds issued by its subsidiaries, Ireland-based DEPFA ACS Bank, and Luxembourg-based DEPFA Pfandbrief Bank International S.A. (DEPFA PBI).

The DEPFA group is not taking on any new lending business, and its business model is limited to the orderly run-down of assets under the supervision of the direct owner FMSW and indirectly the German government. This process has been recently accelerated by the buyback and cancellation of certain covered bonds amounting to around €4.8 billion in nominal terms, followed by the sale of the underlying assets to FMSW in November 2016.

DEPFA's management executes a consistent strategy in line with the resolution plan established in coordination with the owner. The set-up and the run-down strategy of DEPFA is similar to that of other run-down entities in Germany, apart from the fact that due to the indirect and cross-border ownership, various wind-down acceleration or consolidation options exist. A high concentration of revenues is intrinsic to the bank's set-up but reflects DEPFA's status as a run-down entity and given a very comfortable capital buffer, in our view, does not represent a threat to the stability of the bank.

Table 2

Depfa Bank PLC Business Position					
		--Year-ended Dec. 31--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Total revenues from business line (mil. €)	(1.0)	22.0	(76.0)	74.0	205.0
Other revenues/total revenues from business line	100.0	100.0	100.0	100.0	100.0
Return on equity	(13.7)	(5.9)	(17.0)	3.7	4.6

*Data as of June 30.

Capital and earnings: Very strong capital buffer for the write-down

We view DEPFA's capital and earnings as very strong. As of the end of 2015, DEPFA's risk-adjusted capital (RAC) ratio was 29.1%. We expect that the ratio is likely to further increase over the next two years depending on the pace of the buyback of covered bonds accompanied by the sale of the respective assets and future capital distribution plans between FMSW and DEPFA. In addition, our RAC forecast also remains sensitive to single-obligor credit events but following the ownership transfer to FMSW, we see additional certainty to the capital forecast in the run-down process because we expect FMSW to provide ongoing support to DEPFA in case of tail events.

We regard the quality of the bank's earnings and the earnings capacity as weaknesses. DEPFA is no longer authorized to conduct new banking business and we expect it to continue to be loss making in 2016 and in the years following. However, we believe the negative earnings to be marginal and unlikely to meaningfully endanger its capital position. An already existent, additional buffer is expected to come from the accelerated wind-down proceedings and we expect this to be sufficient to protect DEPFA from any deterioration in credit quality of its portfolio. Single-obligor/industry concentrations are not considered in our RAC ratio before diversification. However, we reflect them in the risk position assessment.

Table 3

Depfa Bank PLC Capital And Earnings					
		--Year-ended Dec. 31--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Tier 1 capital ratio	32.3	33.0	27.2	48.3	37.6
S&P RAC ratio before diversification	N/A	29.1	25.4	22.1	20.9
S&P RAC ratio after diversification	N/A	5.7	10.0	11.8	11.7
Adjusted common equity/total adjusted capital	75.2	75.2	75.2	75.2	75.2
Net interest income/operating revenues	(150.0)	1,200.0	27.8	141.7	17.4
Fee income/operating revenues	50.0	100.0	2.5	62.5	(13.2)
Market-sensitive income/operating revenues	250.0	100.0	82.3	241.7	24.3
Noninterest expenses/operating revenues	(2,400.0)	(7,900.0)	(113.9)	(400.0)	120.8
Preprovision operating income/average assets	(0.3)	(0.2)	(0.3)	(0.2)	(0.0)

Table 3

Depfa Bank PLC Capital And Earnings (cont.)

		--Year-ended Dec. 31--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Core earnings/average managed assets	(0.3)	(0.2)	(0.2)	(0.1)	0.0

*Data as of June 30. RAC--Risk-adjusted capital. N/A--Not applicable.

Table 4

Depfa Bank PLC Risk-Adjusted Capital Framework Data

	Exposure*	Basel II RWA	Average Basel II RW (%)	S&P Global Ratings RWA	Average S&P Global Ratings RW (%)
Credit risk					
Government and central banks	18,451,881,615	1,046,977,456	6	1,476,658,067	8
Institutions	2,233,001,778	705,675,425	32	471,487,386	21
Corporate	1,165,623,076	418,896,981	36	853,058,875	73
Retail	0	0	0	0	0
Of which mortgage	0	0	0	0	0
Securitization§	3,328,748,457	665,749,691	20	665,749,691	20
Other assets	10,280,117	10,280,117	100	18,614,355	181
Total credit risk	25,189,535,043	2,847,579,671	11	3,485,568,374	14
Market risk					
Equity in the banking book†	0	0	0	0	0
Trading book market risk	--	68,057,584	--	102,086,376	--
Total market risk	--	68,057,584	--	102,086,376	--
Insurance risk					
Total insurance risk	--	--	--	0	--
Operational risk					
Total operational risk	--	89,071,250	--	267,213,750	--
		Basel II RWA		**S&P Global Ratings RWA**	**% of S&P Global Ratings RWA**
Diversification adjustments					
RWA before diversification		3,988,324,873		3,854,868,500	100
Total Diversification/Concentration Adjustments		--		15,920,012,112	413
RWA after diversification		3,988,324,873		19,774,880,612	513
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		1,318,000,000	33.0	1,122,520,000	29.1
Capital ratio after adjustments‡		1,318,000,000	33.0	1,122,520,000	5.7

Table 4

Depfa Bank PLC Risk-Adjusted Capital Framework Data (cont.)

*Exposure at default. §Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡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, 2015, S&P Global Ratings.

Risk position: High concentration risk continues

We assess DEPFA's risk position as weak, mainly reflecting high concentration risks. While not our base case, these may result in strong fluctuations of risk costs and impair the bank's capitalization. We consider that DEPFA has high sector and single-name concentrations on public-sector entities and we expect the concentrations to further increase, given the specifics of a wind-down process or accelerated reduction of its balance sheet that may predominantly address more liquid assets and liabilities in the first run.

These risks are mitigated by the bank's significantly improved portfolio quality following the past transfer of complex and risky noncore assets to FMSW. The current portfolio composition should display much smaller losses under stress compared with the unfavorable loan-loss track record before the asset transfer. Former losses resulted mainly from business that was not eligible for covered bond pools and the remaining assets relate mainly to covered bonds.

The increase in total assets and total liabilities of the DEPFA group in H1 2016 is temporary and results from the market related changes, that is, foreign currency and interest rates effects.

Table 5

Depfa Bank PLC Risk Position

		--Year-ended Dec. 31--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Growth in customer loans	34.0	(28.8)	(36.6)	(17.9)	(67.3)
Total diversification adjustment / S&P RWA before diversification	N.M.	413.0	152.4	86.6	77.8
Total managed assets/adjusted common equity (x)	49.3	43.5	56.2	48.4	72.4
New loan loss provisions/average customer loans	0.0	(0.0)	(0.1)	(0.0)	(0.1)
Gross nonperforming assets/customer loans + other real estate owned	1.3	1.5	1.0	0.6	0.5
Loan loss reserves/gross nonperforming assets	6.7	5.6	10.4	114.9	113.3

*Data as of June 30. RWA--Risk-weighted assets. N.M.--Not meaningful.

Funding and liquidity: Match-funded but with reliance on implicit government support

We view DEPFA's funding as average and its liquidity as adequate, reflecting the bank's current sound funding and liquidity profile and our expectation of the ongoing implicit government support. Following its restructuring and transfer of assets to FMSW, DEPFA remains broadly secured and match-funded over the full extent of contractual run-off but, in our view, and even more in the event of the shift in the interest rate environment, DEPFA is also structurally reliant on ongoing implicit government support through FMSW. However, we anticipate that the additional funding needs for DEPFA's remaining portfolio will be very limited over its lifetime and will decline further during the wind-down.

S&P Global Ratings' calculated liquidity ratio (broad liquid assets/short-term wholesale funding) was at 2x as of December 2015 and our stable funding ratio was at 229%. The ratios underline the healthy balance sheet structure.

Table 6

Depfa Bank PLC Funding And Liquidity					
		--Year-ended Dec. 31--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Core deposits/funding base	7.0	3.9	4.4	10.8	17.4
Customer loans (net)/customer deposits	418.9	664.5	632.8	370.3	203.9
Long-term funding ratio	65.8	68.2	71.9	85.0	85.3
Stable funding ratio	200.6	228.6	224.5	191.6	207.4
Short-term wholesale funding/funding base	35.9	33.4	29.3	15.6	15.1
Broad liquid assets/short-term wholesale funding (x)	1.8	2.0	2.2	3.7	4.1
Net broad liquid assets/short-term customer deposits	891.8	1,398.0	1,212.7	2,134.6	524.0
Short-term wholesale funding/total wholesale funding	37.7	34.0	30.1	17.2	18.1
Narrow liquid assets/3-month wholesale funding (x)	3.8	4.5	2.9	4.2	8.6

*Data as of June 30.

External support: Three-notch uplift to the SACP due to the bank's GRE status

We apply a three-notch uplift to the SACP due to the bank's GRE status.

Although DEPFA is based in Ireland, we consider the German government to be a more likely source of support in the event of stress mainly due to its indirect 100% ownership via FMSW. The long-term counterparty credit rating is three notches higher than the SACP, reflecting our view that DEPFA is a GRE and our belief that there is a high likelihood of timely and sufficient extraordinary support from the German government to DEPFA group if needed.

This is based on our assessment of DEPFA's:

- Important role for the German government in ensuring a controlled run-off of assets to safeguard confidence in the German banking sector and to minimize costs for the government, as the owner of the bank, and ultimately for taxpayers. Additionally, around 30% of overall DEPFA's exposure relates to Germany.
- Very strong link with the German government. Until the wind-down is complete, we believe there is a low probability of the bank changing ownership or of the German government withdrawing its support from DEPFA. This reflects the government's commitment; indirect, but full control; and track record of support.

We believe that the prospect of extraordinary government support for German banks is uncertain, following the full implementation of the EU Bank Recovery and Resolution Directive, including bail-in powers, in January 2015. However, we generally believe that resolution frameworks are less likely to impede state owners' willingness to provide extraordinary support to banks we consider as GREs, including DEPFA group.

Despite the reduced predictability of government support to systemically important commercial banks, we expect Germany to remain highly supportive of DEPFA till the orderly run-down is completed. We deem the German government's propensity to support as not in doubt. In addition, the government has sufficient financial resources to support the DEPFA group.

Additional rating factors: None

No additional factors affect this rating.

DEPFA ACS Bank

We base our rating on DEPFA ACS Bank on its core group status to DEPFA and equalize the ratings.

Related Criteria

- Group Rating Methodology -- Nov. 19, 2013
- Banking Industry Country Risk Assessment Methodology And Assumptions -- Nov. 9, 2011
- Banks: Rating Methodology and Assumptions -- Nov. 9, 2011
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions -- July 17, 2013
- Bank Capital Methodology And Assumptions -- Dec. 6, 2010
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework -- June 22, 2012
- Commercial Paper I: Banks -- March 23, 2004
- Use Of CreditWatch And Outlooks -- Sept. 14, 2009
- Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity -- Apr. 27, 2015
- Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions – January 29, 2015
- Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks - May 04, 2010
- Rating Government-Related Entities: Methodology And Assumptions - March 25, 2015

Related Research

- Banking Industry Country Risk Assessment Update: January 2017 , Jan. 17, 2017
- Banking Industry Country Risk Assessment: Ireland, Jan. 13, 2017
- FMS Wertmanagement Anstalt des oeffentlichen Rechts, Sept. 19, 2016
- Luxembourg-Based DEPFA Pfandbrief Bank International 'A-/A-2' Ratings Affirmed; Then Withdrawn At The Bank's Request, Dec. 23, 2016

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 January 27, 2017)	
Depfa Bank PLC	
Counterparty Credit Rating	A-/Stable/A-2
Senior Unsecured	A-
Counterparty Credit Ratings History	
01-Dec-2014	A-/Stable/A-2
19-May-2014	BBB/Positive/A-2
14-Feb-2014	BBB/Watch Neg/A-2
Sovereign Rating	
Ireland (Republic of)	A+/Stable/A-1
Related Entities	
Depfa ACS Bank	
Issuer Credit Rating	A-/Stable/A-2
FMS Wertmanagement Anstalt des oeffentlichen Rechts	
Issuer Credit Rating	AAA/Stable/A-1+
Commercial Paper	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.

Additional Contact:
Financial Institutions Ratings Europe; FIG_Europe@spglobal.com