

Rating Action: Moody's places DEPFA's and DEPFA ACS' Ba1/Not-Prime ratings on review for upgrade

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DEPFA's b2 baseline credit assessment also placed on review for upgrade

Frankfurt am Main, June 08, 2016 -- Moody's Investors Service has today placed on review for upgrade DEPFA Bank plc's (DEPFA) Ba1 long-term senior unsecured debt and deposit ratings and its Not-Prime short-term deposit ratings, as well as the Ba1/Not-Prime deposit ratings of its fully owned subsidiary DEPFA ACS Bank (DEPFA ACS). Concurrently, Moody's placed on review for upgrade the banks' b2 baseline credit assessments (BCAs) as well as their Baa3(cr)/Prime-3(cr) Counterparty Risk Assessments.

Today's rating actions reflect Moody's assessment that DEPFA's and DEPFA ACS's BCAs are under upward pressure considering improving capitalisation as a result of a faster-than-expected wind-down of DEPFA group's assets. In addition, DEPFA's debt and deposit ratings and DEPFA ACS' deposit ratings may benefit from higher rating uplift as a result of Moody's Advanced Loss Given Failure (LGF) analysis, which takes into account the severity of loss faced by the different liability classes in resolution. Such higher uplift may be triggered by DEPFA's liability profile displaying a growing volume of subordinated instruments and/or senior debt relative to total assets.

Moody's said that, considering that the review is driven by two separate considerations for DEPFA's ratings, it does not rule out an upgrade by more than one notch.

A full list of affected ratings can be found at the end of this press release.

RATINGS RATIONALE

KEY DRIVERS OF THE REVIEW FOR UPGRADE

The review for upgrade of DEPFA's debt and deposit ratings, as well as DEPFA ACS' deposit ratings, reflects upward pressure on their b2 BCAs. In particular, this reflects a combination of DEPFA's:

- (1) Good progress in unwinding the group's balance sheet and risk-weighted assets, as illustrated by the decrease of total assets by 24% year-on-year to EUR37 billion as at year-end 2015, and the 27% decrease year-on-year of risk-weighted assets;
- (2) Sustained efforts to contain operating losses, which Moody's expects will help the group to continue the unwinding of its balance sheet in a capital-preserving fashion; and
- (3) The resulting improvement of DEPFA's regulatory capital adequacy ratios. DEPFA reported a fully-loaded common equity Tier 1 ratio of 20.1% as of December 2015, up 4.6 percentage points year-on-year.

In addition, Moody's said that it sees potential for higher rating uplift based on its assessment of a gradually reducing severity of loss in resolution for both senior debt investors and depositors. In particular, the result of Moody's Advanced LGF analysis could benefit from an increasing volume of subordinated instruments at the group level relative to total assets. For instance, if DEPFA abstains from buying back any further subordinated debt instruments (after redeeming a modest amount of hybrid capital in 2015), while continuing to reduce assets and non-subordinated liabilities, the resulting change in DEPFA's liability profile bears potential for a third notch of rating uplift. The group's current Ba1 debt and deposit ratings include two notches of uplift from Moody's Advanced LGF analysis.

FOCUS OF THE REVIEW

Moody's said that the review for upgrade will focus on two main drivers for DEPFA's and DEPFA ACS' ratings:

Firstly, the agency will assess the bank's potential for keeping up a good pace of risk-weighted asset reduction as well as for cost containment. This is because both of these could help the group to preserve capital and

maintain a suitable capital cushion for unexpected losses to the group's asset base and, more importantly, for expected operating losses during the unwinding. In this context, Moody's notes that it expects DEPFA to remain structurally lossmaking over the next few years.

Secondly, Moody's will assess DEPFA's strategy for reducing different liability classes as the group's asset base will continue to shrink, resulting in lower funding requirements. The rating agency expects that DEPFA will carefully balance the benefits of redeeming early the most subordinated and therefore most expensive liabilities on the one hand, while maintaining healthy amounts of subordination for the benefit of senior unsecured investors on the other hand.

WHAT COULD CHANGE THE RATING UP/DOWN

DEPFA's debt and deposit ratings and DEPFA ACS' deposit ratings could be upgraded as a result of: (1) An upgrade of its standalone BCA; (2) higher rating uplift as a result of Moody's Advanced LGF analysis, which could be triggered by a reduction in the estimated severity of loss in resolution; and/or (3) Moody's assessment of higher-than-expected support being available from the group's ultimate owner, the German government (Aaa stable).

An upgrade of DEPFA's and DEPFA ACS's BCAs could result from sustained improvements in capitalisation and an indication that the recently improved level of capitalisation will be sufficient to absorb the anticipated remaining costs of the wind-down.

Moody's does not expect downward pressure on DEPFA's ratings as indicated by the review for upgrade. However, downward pressure could principally be exerted by: (1) A large unexpected loss or similar set-backs in DEPFA's efforts to unwind its balance sheet in a capital-preserving fashion; (2) a large buy-back of hybrid instruments, if this materially reduces the volume of subordinated instruments relative to total assets; and/or (3) indications of the German government withdrawing its backing for the Irish banks.

LIST OF AFFECTED RATINGS

DEPFA Bank plc:

The following ratings, rating inputs and rating assessments assigned to DEPFA Bank plc were placed on review for upgrade:

- the Ba1/Non-Prime long- and short-term bank deposit ratings (local and foreign currency)
- the Ba1 long- term senior unsecured debt ratings (local and foreign currency)
- the b2 BCA and b2 Adjusted BCA
- the Baa3(cr)/Prime-3(cr) long- and short-term Counterparty Risk Assessment

DEPFA ACS Bank:

The following ratings, rating inputs and rating assessments assigned to DEPFA ACS Bank were placed on review for upgrade:

- the Ba1/Non-Prime long- and short-term bank deposit ratings (local and foreign currency)
- the b2 BCA and b2 Adjusted BCA
- the Baa3(cr)/Prime-3(cr) long- and short-term Counterparty Risk Assessment

DEPFA Bank Plc New York Branch:

The following ratings and rating assessments assigned to DEPFA Bank Plc New York Branch were placed on review for upgrade:

- the Ba1/Non-Prime long- and short-term bank deposit ratings (local and foreign currency)
- the Ba1 long-term deposit note/CD program (local currency)
- the Baa3(cr)/Prime-3(cr) long- and short-term Counterparty Risk Assessment

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in January 2016. Please see the Ratings Methodologies page on www.moody.com for a copy of this methodology.

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