

Rating Action: Moody's confirms the Aa2 rating assigned to Depfa ACS Bank's public sector covered bonds

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London, 21 October 2016 -- Moody's Investors Service has today confirmed the Aa2 rating assigned to the public sector covered bonds issued by Depfa ACS Bank ("the issuer"; deposits Baa2; adjusted baseline credit assessment ba3; counterparty risk (CR) assessment Baa2(cr)). This rating action concludes the review of the above rating initiated on 14 September, 2016.

RATINGS RATIONALE

Today's rating action is prompted by the upgrade of the issuer's CR assessment to Baa2(cr) from Baa3(cr) on review for upgrade. The Aa2 rating assigned to the issuer's covered bonds had been placed on review for downgrade because of a shortfall in the level of over-collateralisation (OC). With the upgrade of the CR assessment, as of 30 June 2016, the minimum level of OC consistent with the Aa2 rating is 6.0% and the programme's OC is 7.6%.

For further details on the upgrade of the issuer's CR assessment, please see "Moody's upgrades DEPFA Bank and DEPFA ACS to Baa2/Prime-2; changes outlook to stable", published on 19 October 2016 (https://www.moodys.com/viewresearchdoc.aspx?docid=PR_356469).

On 14 October 2016, the issuer announced a transaction expected to involve the cancellation of €4.0 billion of its covered bonds and the sale of €4.2 billion of its cover pool assets. This transaction, and the redemption of certain covered bonds maturing later in 2016, could reduce currency mismatches in this programme. Moody's will continue to monitor the impact of any further changes to the level of OC in the programme and/or its credit and market risks as the wind-down of the issuer and its parent, Depfa Bank, accelerates.

KEY RATING ASSUMPTIONS/FACTORS

Moody's determines covered bond ratings using a two-step process: an expected loss analysis and a TPI framework analysis.

EXPECTED LOSS: Moody's uses its Covered Bond Model (COBOL) to determine a rating based on the expected loss on the bond. COBOL determines expected loss as (1) a function of the probability that the issuer will cease making payments under the covered bonds (a CB anchor event); and (2) the stressed losses on the cover pool assets following a CB anchor event.

The CB anchor for this programme is CR assessment plus 1 notch. The CR assessment reflects an issuer's ability to avoid defaulting on certain senior bank operating obligations and contractual commitments, including covered bonds. Moody's may use a CB anchor of CR assessment plus one notch in the European Union or otherwise where an operational resolution regime is particularly likely to ensure continuity of covered bond payments.

The cover pool losses for this programme are 16.4%. This is an estimate of the losses Moody's currently models following a CB anchor event. Moody's splits cover pool losses between market risk of 12.4% and collateral risk of 4.0%. Market risk measures losses stemming from refinancing risk and risks related to interest-rate and currency mismatches (these losses may also include certain legal risks). Collateral risk measures losses resulting directly from cover pool assets' credit quality. Moody's derives collateral risk from the collateral score, which for this programme is currently 8.1%. The over-collateralisation (OC) in the cover pool is 7.6%, and the issuer provides 5.0% OC in a "committed" form. The minimum OC level consistent with the Aa2 rating is 6.0%, of which the issuer should provide 0.5% in a "committed" form. These numbers, which are in nominal value terms and calculated using exchange rates as of 30 June 2016 rather than the exchange rates under the cover pool's currency swaps, show that Moody's is relying on "uncommitted" OC in its expected loss analysis.

All numbers in this section are based on Moody's most recent modelling (based on data provided by the issuer as of 30 June 2016).

TPI FRAMEWORK: Moody's assigns a "timely payment indicator" (TPI), which measures the likelihood of timely payments to covered bondholders following a CB anchor event. The TPI framework limits the covered bond rating to a certain number of notches above the CB anchor.

For the issuer's public sector covered bonds, Moody's has assigned a TPI of "Probable-High".

Factors that would lead to an upgrade or downgrade of the ratings:

The CB anchor is the main determinant of a covered bond programme's rating robustness. A change in the level of the CB anchor could lead to an upgrade or downgrade of the covered bonds. The TPI Leeway measures the number of notches by which Moody's might lower the CB anchor before the rating agency downgrades the covered bonds because of TPI framework constraints.

Based on the current TPI of "Probable-High", the TPI Leeway for this programme is 1 notch. This implies that Moody's might downgrade the covered bonds because of a TPI cap if it lowers the CB anchor by 2 notches, all other variables being equal.

A multiple-notch downgrade of the covered bonds might occur in certain circumstances, such as (1) a country ceiling or sovereign downgrade capping a covered bond rating or negatively affecting the CB Anchor and the TPI; (2) a multiple-notch downgrade of the CB Anchor; or (3) a material reduction of the value of the cover pool.

RATING METHODOLOGY

The principal methodology used in these ratings was "Moody's Approach to Rating Covered Bonds" published in August 2015. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions of the disclosure form.

Moody's did not use any stress scenario simulations in its analysis.

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