

Rating Action: Moody's places DEPFA's and DEPFA ACS' Baa2 ratings on review for upgrade

Global Credit Research - 23 Mar 2018

Rating agency upgrades rating of DEPFA Funding III LP to Caa2(hyb) from Ca(hyb)

Frankfurt am Main, March 23, 2018 -- Moody's Investors Service has today placed on review for upgrade the Baa2 senior unsecured debt ratings of DEPFA BANK plc (DEPFA). Concurrently, the rating agency placed the Baa2/P-2 deposit ratings of DEPFA and its wholly owned subsidiary DEPFA ACS BANK DAC (DEPFA ACS) on review for upgrade. Furthermore, Moody's placed on review for upgrade the banks' ba3 Baseline Credit Assessments (BCA) and ba3 Adjusted BCAs, as well as their Baa2(cr)/P-2(cr) Counterparty Risk Assessments (CR Assessments). The outlook on the long-term ratings has been changed to Ratings under Review from Stable.

Today's rating actions reflect Moody's assessment that DEPFA's and DEPFA ACS' BCAs are under upward pressure considering improving capitalisation and reduced asset risk as a result of the continued successful wind-down of DEPFA group's assets. Given the faster than anticipated pace and financial implications of the wind-down, the rating agency does not rule out an upgrade by more than one notch.

Moody's also upgraded DEPFA Funding III LP's backed hybrid instrument rating to Caa2(hyb) from Ca(hyb) due to a decline in its expected loss rate. At the same time, the rating agency affirmed the backed hybrid instrument ratings of DEPFA Funding II LP and DEPFA Funding IV LP at Ca(hyb) and Caa2(hyb), respectively.

For a full list of all affected ratings, please refer to 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 respective ba3 BCAs. In particular, this reflects a combination of DEPFA's:

- (1) Further significant progress in unwinding the group's balance sheet and risk-weighted assets, as illustrated by the decrease of total assets by 35% to €24 billion in the 18 months to June 2017, and the 58% decrease of risk-weighted assets during the same period;
- (2) The resulting improvement of DEPFA's regulatory capital adequacy ratios and leverage. DEPFA reported a fully-loaded common equity Tier 1 ratio of 51.5% as of June 2017, up 32 percentage points since December 2015, and a leverage ratio (tangible common equity to Moody's adjusted total assets) of 6.9% as of June 2017, compared to 3.3% as of December 2015;
- (3) Efforts to contain operating losses. During the first half of 2017, DEPFA reduced its operating loss to €2 million from €54 million in the respective 2016 period.

FOCUS OF THE REVIEW

DEPFA is expected to publish its 2017 Annual Report on 29 March 2018 and Moody's will assess the bank's progress in risk-weighted asset reduction, in particular in light of a second asset-liability transaction executed with DEPFA's parent FMS Wertmanagement in November 2017, which took nominal €2 billion of exposures off DEPFA's balance sheet. This transaction and further maturities and disposals should have increased capitalisation ratios further, supported by potential gains on sale.

Furthermore, the rating agency will assess the bank's cost containment efforts and overall profitability outlook. While Moody's expects DEPFA to remain structurally lossmaking over the next few years, any sustained progress towards break-even would help the group to continue the unwinding of its balance sheet in a capital-preserving fashion.

UPGRADE OF ONE HYBRID INSTRUMENT AND AFFIRMATION OF TWO HYBRID RATINGS

Moody's bases the ratings of the Tier 1 preferred securities issued by DEPFA's funding vehicles on the assumption that DEPFA will never pay any coupons on these non-performing, perpetual instruments. While the rating agency assumed a wind-down period of 15 years previously, it has now shortened that time span to eight years, reflecting the faster than expected balance sheet reduction. Upon dissolution of DEPFA, Moody's expects that the hybrid bond instruments will be redeemed at par.

The hybrid ratings therefore reflect Moody's approach of discounting expected coupon losses to calculate the respective expected total impairment. Taking into account revised coupon rate assumptions and the shorter wind-down horizon, the rating agency upgraded the backed rating of DEPFA Funding III LP to Caa2(hyb) from Ca(hyb). The revised assumptions did not sufficiently change the expected loss for the instruments issued by DEPFA Funding II LP and DEPFA Funding IV LP, which led Moody's to affirm their backed ratings at Ca(hyb) and Caa2(hyb), respectively.

WHAT COULD CHANGE THE RATING - UP / DOWN

As indicated by the rating review for upgrade, Moody's expects to upgrade, possibly by more than one notch, DEPFA's ratings. If DEPFA continued its positive trend during the second half of 2017 of deleveraging, containing operating losses, and preserving its capitalisation, the ba3 BCAs of DEPFA and DEPFA ACS could be upgraded by several notches. This would also lead to higher long-term debt and deposit ratings and potentially higher short-term deposit ratings, as reflected in the review for upgrade.

Moody's does not expect downward pressure on the banks' ratings as indicated by the review for upgrade. However, the banks' ratings could be downgraded if a material fundamental and joint deterioration of DEPFA's solvency and liquidity profile results in significant pressure on the banks' BCAs, and/or if Moody's reduces its government supports assumptions, both of which it considers highly unlikely at present.

LIST OF AFFECTED RATINGS

Issuer: DEPFA BANK plc

..Placed on Review for Upgrade:

....Adjusted Baseline Credit Assessment, currently ba3

....Baseline Credit Assessment, currently ba3

....Long-term Bank Deposits, currently Baa2, outlook changed to Rating under Review from Stable

....Short-term Bank Deposits, currently P-2

....Long-term Counterparty Risk Assessment, currently Baa2(cr)

....Short-term Counterparty Risk Assessment, currently P-2(cr)

....Senior Unsecured Regular Bond/Debenture, currently Baa2, outlook changed to Rating under Review from Stable

..Outlook Action:

....Outlook changed to Rating under Review from Stable

Issuer: DEPFA ACS BANK DAC

..Placed on Review for Upgrade:

....Adjusted Baseline Credit Assessment, currently ba3

....Baseline Credit Assessment, currently ba3

....Long-term Counterparty Risk Assessment, currently Baa2(cr)

....Short-term Counterparty Risk Assessment, currently P-2(cr)

...Long-term Bank Deposits, currently Baa2, outlook changed to Rating under Review from Stable

...Short-term Bank Deposits, currently P-2

..Outlook Action:

...Outlook changed to Rating under Review from Stable

Issuer: DEPFA Funding II LP

..Affirmation:

...Backed Preferred Stock Non-cumulative, affirmed Ca(hyb)

..No Outlook assigned

Issuer: DEPFA Funding III LP

..Upgrade:

...Backed Preferred Stock Non-cumulative, upgraded to Caa2(hyb) from Ca(hyb)

..No Outlook assigned

Issuer: DEPFA Funding IV LP

..Affirmation:

...Backed Preferred Stock Non-cumulative, affirmed Caa2(hyb)

..No Outlook assigned

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in September 2017. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures

for each credit rating.

Goetz Thurm
Vice President - Senior Analyst
Financial Institutions Group
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main 60322
Germany
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Carola Schuler
MD - Banking
Financial Institutions Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main 60322
Germany
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454



© 2018 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND ITS RATINGS AFFILIATES ("MIS") ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND MOODY'S PUBLICATIONS MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY'S CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS OR MOODY'S PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY ANY PERSON AS A BENCHMARK AS THAT TERM IS DEFINED FOR REGULATORY PURPOSES AND MUST NOT BE USED IN ANY WAY THAT COULD RESULT IN THEM BEING CONSIDERED A BENCHMARK.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the Moody's publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any rating, agreed to pay to Moody's Investors Service, Inc. for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moodys.com under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an

opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be reckless and inappropriate for retail investors to use MOODY'S credit ratings or publications when making an investment decision. If in doubt you should contact your financial or other professional adviser.

Additional terms for Japan only: Moody's Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJKK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000.

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.