

**Rating Action: Moody's upgrades DEPFA's debt and deposit ratings to A2; changes outlook to Positive**

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27 Jun 2018

**Rating agency also assigns first-time A2/P-1 Counterparty Risk Ratings**

Frankfurt am Main, June 27, 2018 -- Moody's Investors Service has today upgraded the senior unsecured debt ratings of DEPFA BANK plc (DEPFA) to A2 from Baa2. Concurrently, the rating agency upgraded the long-term deposit ratings of DEPFA and its wholly owned subsidiary DEPFA ACS BANK DAC (DEPFA ACS) to A2 from Baa2 and the banks' short-term deposit ratings to P-1 from P-2. Furthermore, Moody's upgraded the banks' Baseline Credit Assessments (BCA) and Adjusted BCAs to baa3 from ba3, and also upgraded both banks' Counterparty Risk Assessments (CR Assessments) to A2(cr)/P-1(cr) from Baa2(cr)/P-2(cr). The outlook on the long-term ratings has been changed to Positive from Ratings under Review. Finally, Moody's assigned first-time A2/P-1 Counterparty Risk Ratings to DEPFA and DEPFA ACS.

Today's rating actions conclude Moody's review for upgrade initiated on 23 March 2018, which confirmed DEPFA's substantial progress in its wind-down process, in particular following a second asset-liability transaction executed with DEPFA's German government-owned parent FMS Wertmanagement (FMS-WM, senior unsecured Aaa stable) in late 2017. This transaction, combined with further maturities and disposals, have significantly improved capitalisation and leverage, providing comfortable loss absorption buffers against the background of the continued unwinding of DEPFA's portfolios.

The backed hybrid instrument ratings of the DEPFA Funding II LP, DEPFA Funding III LP, and DEPFA Funding IV LP issuing vehicles were unaffected by today's rating action.

For a full list of all affected ratings, please refer to the end of this press release.

**RATINGS RATIONALE**

**SIGNIFICANTLY INCREASED SOLVENCY AMID SUCCESSFUL UNWINDING DRIVES RATINGS UPGRADE**

The upgrade of DEPFA's debt and deposit ratings, as well as DEPFA ACS' deposit ratings, reflects the upgrade of their BCAs by three notches to baa3. In particular, this is due to 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 49% to €18.6 billion during 2016 and 2017, and the 70% 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 78.7% as of December 2017, up 59 percentage points since December 2015, and a leverage ratio (tangible common equity to Moody's adjusted total assets) of 9.8% as of December 2017, compared to 3.3% as of December 2015;
- (3) Efforts to contain operating losses. During 2017, DEPFA generated a Moody's adjusted pre-tax profit (which excludes gains on sale) of €33 million compared to a pre-tax loss of €83 million in 2016. While some of the profitability improvements during 2017 were of a non-recurring nature and Moody's expects DEPFA to remain structurally lossmaking over the next few years, the positive operating result in 2017 helped the group to continue the unwinding of its balance sheet in a capital-preserving fashion.

The BCAs also take into account DEPFA's mono-line, highly concentrated asset profile that weighs on the ratings, as well as the funding and liquidity framework in place between DEPFA and FMS-WM, which provides several committed funding lines to DEPFA that are contractually agreed until 2025.

DEPFA ACS's rating inputs and ratings remain aligned with those of its parent, DEPFA, as Moody's considers the subsidiary to be a Highly Integrated and Harmonized (HIH) entity, as described in Moody's Banks methodology. The HIH status reflects the full operational integration of DEPFA ACS into DEPFA as a covered

bond funding vehicle.

#### UNCHANGED VERY HIGH GOVERNMENT SUPPORT ASSUMPTION

DEPFA group's ratings continue to incorporate Moody's assumption of a Very High level of government support, which takes into account Moody's assessment of FMS-WM's ongoing, strongly supportive assistance in the group's unwinding, which aims at avoiding distress and ensuring a smooth run-down of DEPFA's assets and liabilities. This assistance is illustrated by FMS-WM's direct funding support, as well as its systematic purchase of DEPFA group's liabilities in order to facilitate an accelerated run-down.

In deriving the group's ratings, Moody's does not apply the rating agency's Advanced Loss-Given-Failure (LGF) analysis, because of the high share of liabilities being owned by FMS-WM and DEPFA effectively being in liquidation, which makes it unlikely that resolution measures, such as bail-in, would be applied to DEPFA. Instead Moody's applies the Basic LGF approach, which provides zero notches of rating uplift for senior debt and deposits, and one notch of rating uplift for the CR Assessment. The senior debt and deposit ratings thus incorporate four notches of government support, while the CR Assessment incorporates three notches.

#### RATIONALE FOR THE POSITIVE OUTLOOK

The Positive outlook on the A2 ratings of the DEPFA group reflect further upward pressure on DEPFA's and DEPFA ACS's baa3 BCAs, owing to potentially further improving capitalisation and reduced asset risk as a result of the continued wind-down of DEPFA group's assets.

#### ASSIGNMENT OF COUNTERPARTY RISK RATINGS

Moody's Counterparty Risk Ratings (CRR) are opinions of the ability of entities to honor the uncollateralized portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honored. CRR liabilities typically relate to transactions with unrelated parties. Examples of CRR liabilities include the uncollateralized portion of payables arising from derivatives transactions and the uncollateralized portion of liabilities under sale and repurchase agreements. CRRs are not applicable to funding commitments or other obligations associated with covered bonds, letters of credit, guarantees, servicer and trustee obligations, and other similar obligations that arise from a bank performing its essential operating functions.

As for the other ratings of the DEPFA group, in assigning A2/P-1 CRRs to DEPFA and DEPFA ACS, Moody's starts with the banks' baa3 Adjusted BCAs and applies the Basic LGF approach, which provides one notch of rating uplift for CRR liabilities. Moody's also assumes a Very High level of government support, which results in three additional notches of expected loss mitigation.

#### WHAT COULD CHANGE THE RATINGS - UP / DOWN

Positive pressure on the banks' ratings could arise if fundamental improvements warrant an upgrade of the banks' BCAs, and/or if additional support measures lead Moody's to revise upwards its assumptions for government support. If the group continues its positive trend of deleveraging, reducing costs, containing operating losses and effectively preserving capital, the baa3 BCAs of DEPFA and DEPFA ACS could be upgraded. This would also lead to higher long-term debt and deposit ratings, as reflected in the positive outlook.

Moody's does not expect downward pressure on the banks' long-term ratings as indicated by the positive outlook. However, the banks' ratings could be downgraded if a 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. The banks' BCAs could be downgraded due to (i) a fundamental deterioration in asset quality; and/or (ii) a material reduction in capitalisation levels because of special dividends being paid to FMS-WM; and/or (iii) failure to contain operating losses, especially if these losses reduce capital levels faster than currently anticipated.

#### LIST OF AFFECTED RATINGS

Issuer: DEPFA BANK plc

..Upgrades:

...Adjusted Baseline Credit Assessment, upgraded to baa3 from ba3

...Baseline Credit Assessment, upgraded to baa3 from ba3  
...Long-term Counterparty Risk Assessment, upgraded to A2(cr) from Baa2(cr)  
...Short-term Counterparty Risk Assessment, upgraded to P-1(cr) from P-2(cr)  
...Short-term Bank Deposits, upgraded to P-1 from P-2  
...Senior Unsecured Regular Bond/Debenture, upgraded to A2 Positive from Baa2 Ratings under Review  
...Long-term Bank Deposits, upgraded to A2 Positive from Baa2 Ratings under Review

..Assignments:

...Long-term Counterparty Risk Rating (Local and Foreign Currency), assigned A2  
...Short-term Counterparty Risk Rating (Local and Foreign Currency), assigned P-1

..Outlook Action:

...Outlook changed to Positive from Rating under Review

Issuer: DEPFA ACS BANK DAC

..Upgrades:

...Adjusted Baseline Credit Assessment, upgraded to baa3 from ba3  
...Baseline Credit Assessment, upgraded to baa3 from ba3  
...Long-term Counterparty Risk Assessment, upgraded to A2(cr) from Baa2(cr)  
...Short-term Counterparty Risk Assessment, upgraded to P-1(cr) from P-2(cr)  
...Short-term Bank Deposits, upgraded to P-1 from P-2  
...Long-term Bank Deposits, upgraded to A2 Positive from Baa2 Ratings under Review

..Assignments:

...Long-term Counterparty Risk Rating (Local and Foreign Currency), assigned A2  
...Short-term Counterparty Risk Rating (Local and Foreign Currency), assigned P-1

..Outlook Action:

...Outlook changed to Positive from Rating under Review

The principal methodology used in these ratings was Banks published in June 2018. Please see the Rating Methodologies page on [www.moodys.com](http://www.moodys.com) for a copy of this methodology.

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