MOODY'S
INVESTORS SERVICE

Rating Action: Moody's reviews Depfa ACS Bank's public sector covered bonds for downgrade

Global Credit Research - 14 Sep 2016

London, 14 September 2016 -- Moody's Investors Service has today placed on review for downgrade the Aa2 rating assigned to the public sector covered bonds issued by Depfa ACS Bank ("the issuer"; deposits Ba1 on review for upgrade; adjusted baseline credit assessment b2 on review for upgrade; counterparty risk (CR) assessment Baa3(cr) on review for upgrade).

RATINGS RATIONALE

Today's rating action is prompted by a shortfall in the level of over-collateralisation (OC) in the programme. As of 30 June 2016, the programme's OC is 7.6%, while the minimum level of OC consistent with the Aa2 rating is 9.5%. At the same time, the issuer's CR assessment is on review for upgrade. For further details, please see "Moody's places DEPFA's and DEPFA ACS' Ba1/Not-Prime ratings on review for upgrade", published on 8 June 2016 (https://www.moodys.com/viewresearchdoc.aspx?docid=PR_350096).

During the review of the rating assigned to the issuer's covered bonds, Moody's will consider the impact of both any change in the issuer's CR assessment and 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 16.5%. 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%, of which the issuer provides 5% in a "committed" form. The minimum OC level consistent with the Aa2 rating is 9.5%, of which the issuer should provide 2.5% 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 0 notches. This implies that Moody's might downgrade the covered bonds because of a TPI cap if it lowers the CB anchor by 1 notch, 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 Ratings 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.

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.

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