MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades Commerzbank to Baa1 and Hypothekenbank Frankfurt to Baa3; outlooks stable

Global Credit Research - 23 Apr 2013

Frankfurt am Main, April 23, 2013 -- Moody's Investors Service has today downgraded by one notch the long-term senior debt and deposit ratings of Commerzbank AG (Commerzbank) to Baa1 from A3 negative, and those of Commerzbank International S.A. (CISAL) to Baa2 from Baa1 negative. The short-term ratings of both banks were affirmed at Prime-2. The long and short-term debt ratings for Hypothekenbank Frankfurt AG (HF) were downgraded to Baa3/P-3 from Baa2/P-2 negative. The outlook on all of these ratings is now stable.

The one-notch downgrades of the long-term debt ratings for all three banks and, in HF's case, of the short-term debt rating to P-3, were prompted by the one-notch lowering of Commerzbank's baseline credit assessment (BCA) to ba1 from baa3 -- which is equivalent to a D+ bank financial strength rating (BFSR) -- and HF's standalone BCA to caa2 from caa1, equivalent to an E BFSR. As CISAL's standalone BCA is maintained at a level of no more than two rating notches above Commerzbank's BCA, its BCA was lowered to baa2 from baa1, which is equivalent to a C- BFSR.

A combination of bank-specific and external factors drove Moody's to lower Commerzbank's BCA, including (1) persistent franchise pressures in the context of both the cost of legacy portfolios and weaknesses in core banking activities; and (2) sustained weak intrinsic earnings power, as indicated by weak fiscal 2012 results, particularly in some of its core banking franchises, due to inefficient cost structures and the challenging German retail banking environment. Although Commerzbank's overall capitalisation provides a buffer against losses in a mildly adverse scenario, Moody's believes that longer-term franchise and earnings weaknesses materially expose Commerzbank to asset vulnerabilities and tail risk in a situation of renewed setbacks in the euro area debt crisis. In the rating agency's view, the challenges Commerzbank is facing are more consistent with a ba1 BCA.

Moody's also downgraded Commerzbank's senior subordinated debt ratings to Ba2 from Ba1, and changed the outlook to stable. These ratings continue to be rated one notch below the bank's adjusted BCA of ba1.

HF's senior subordinated debt was downgraded to B1 from Ba3 and its outlook changed to stable. These ratings continue to be positioned two notches below the bank's adjusted BCA of ba2, which incorporates parental but not government support.

Furthermore, the rating agency took several actions on the group's hybrid capital instruments, thereby affirming or upgrading some hybrids issued by Commerzbank group entities that maintained or resumed full performance, and downgrading the hybrid instruments issued by HF and its special purpose vehicles reflecting Moody's assessment that the performance of these instruments is largely impaired during the wind-down process of HF.

For a detailed list of ratings affected, refer to the end of the press release.

RATINGS RATIONALE

-- COMMERZBANK: LOWERING OF STANDALONE BCA

Moody's lowered Commerzbank's standalone BCA to reflect several bank-specific factors, in particular franchise pressures and the bank's operational weakness, which materially constrains its internal capital generation capacity. Challenging market conditions in the German retail banking market, in particular persistently low interest rates, are exacerbating the revenue pressures exerted by the ongoing downsizing exercise and highlighting the group's unfavourable cost structures that have led to poor results in the group's Private Clients segment, despite its material scale.

Whilst the rating agency acknowledges steps taken towards addressing this weakness, it expects that Commerzbank's profitability will be constrained for the next few years given the EUR2.0 billion investments and additional EUR0.5 billion restructuring costs that will be spent during 2013-14 and the time required until visible operational benefits can be achieved from the restructuring. Moody's expects that the restructuring, combined with the continued losses incurred by Commerzbank's non-core assets (NCA) segment will cause some quarterly losses. A large impairment of deferred tax assets in the fourth quarter of 2012 was a reflection of a downward correction in Commerzbank's medium-term profit forecasts.

Moreover, the group's depressed intrinsic earnings power represents a low buffer against the intermittently large credit and valuation losses and the negative one-off effects that Moody's expects will recur for some time in the context of the group's major business overhaul, multi-year downsizing, and withdrawal from various international markets, in addition to the risk posed by the euro area debt crisis. Commerzbank, which holds large exposures to the more pressured countries in Europe's periphery is therefore more exposed than many of its peers to suffer losses that, in a downside scenario, may materially exceed its earnings and erode capital. In such an adverse scenario, Moody's also expects that the commercial real estate and ship finance portfolios, that together represent more than half of the EUR151 billion NCA segment (which is subject to unwinding), will likely require high levels of provisioning during 2013-14. Commerzbank's shipping exposure in default grew by EUR1.5 billion during 2012 to reach EUR4.5 billion, or 24% of the total ship finance portfolio, and Moody's expects a similarly negative momentum during 2013 and early 2014.

Commerzbank's solid progress in enhancing its capital structure and regulatory capitalisation is an important mitigating factor to the risks described above. However, Moody's believes that this does not fully offset the downside risk from Commerzbank's fundamental restructuring and higher-risk assets, which is better reflected by the ba1 standalone BCA.

-- COMMERZBANK: DOWNGRADE OF DEBT RATINGS

The downgrade of Commerzbank's long-term debt and deposit ratings to Baa1 reflects the one-notch lowering of its standalone credit assessment. The rating agency says that its assumptions for systemic support are unchanged and therefore continue to provide the long-term ratings with three notches of uplift from the BCA.

-- HF: LOWERING OF STANDALONE BCA

The lowering of HF's BCA to caa2 reflects the constraints stemming from its sizeable and concentrated exposures to commercial real estate (CRE), its large holdings of higher-risk public sector assets and the persistent loss generation of these portfolios. In the context of increasing downside risk represented by HF's large holdings of Italian and Spanish public sector and CRE assets, Moody's says that despite improved capital levels, the bank's fragility and dependence on parental assistance is better reflected by the caa2 BCA. In the context of pressured sovereign credit profiles and the recent setbacks in the efforts of European leaders to resolve the euro area debt crisis, these constraints represent a major burden for HF and the whole group.

-- HF: DOWNGRADE OF DEBT RATINGS

Through the existing profit and loss transfer agreement -- and as the principal provider of senior unsecured debt -- Commerzbank bears a very high degree of responsibility for HF's obligations, which strongly mitigates HF's downside risk. This benefit is not reflected in HF's standalone BCA, but in six out of the total eight notches of ratings uplift that Moody's continues to factor into HF's Baa3/P-3 deposit ratings. The rating also benefits from two notches of systemic support which recognises the bank's size and continued (albeit decreasing) systemic importance as one of Germany's largest issuers of covered bonds (Pfandbriefe). Moody's says that its assumptions for parental and systemic support remain unchanged after today's rating action.

-- CISAL: LOWERING OF STANDALONE BCA

The lowering of CISAL's BCA to baa2 reflects that, in the absence of any ring-fencing of the Luxembourg entity, and given CISAL's upstream lending exposure to the parent bank, CISAL's BCA remains capped two notches above the BCA of its parent bank.

-- CISAL: DOWNGRADE OF DEBT RATINGS

As Commerzbank's ba1 BCA reflects a lower level of financial strength relative to CISAL's, its Baa2 debt and deposit ratings principally reflect the bank's baa2 BCA and do not benefit from any rating uplift, even though Moody's assumes that support from Commerzbank would be available in case of need, which is underpinned by a Letter of Comfort. Moody's does not expect that foreign-owned banks such as CISAL would benefit from systemic support from Luxemburg authorities. Overall support assumptions therefore do not provide rating uplift for CISAL's long-term debt and deposit ratings.

RATIONALE FOR STABLE OUTLOOK

The stable outlook on Commerzbank's and its subsidiaries' standalone BFSRs reflects that, at the lower levels, the ratings already include Moody's expectations of Commerzbank (1) allocating major resources to its restructuring of core businesses; (2) posting depressed results for an extended period; and/or (3) suffering set-backs in its gradual progress in derisking the balance sheet (as reflected in risk-weighted assets) and improving capital ratios.

The stable outlooks on the banks' long-term debt ratings reflect the stable outlooks on their standalone BFSRs and the fact that the rating agency does not expect that Commerzbank will become materially less systemically important over the next six to eight quarters. It also factors in Moody's expectation that the German government will maintain a material stake over this period.

VARIOUS RATING ACTIONS ON SUBORDINATED DEBT AND HYBRIDS (COMMERZBANK GROUP)

-- DOWNGRADE OF SUBORDINATED DEBT RATINGS

The downgrade and outlook change to Ba2/stable of Commerzbank's senior subordinated debt ratings mirror the one-notch lowering and stable outlook of Commerzbank's adjusted BCA. The downgrade and outlook change also applies to the debt instrument issued by Dresdner Funding Trust IV, as this displays the same risk profile as Commerzbank's senior subordinated debt. These ratings continue to be rated one notch below Commerzbank's adjusted BCA of ba1.

The downgrade and outlook change to B1/stable of HF's senior subordinated debt ratings reflect the one-notch lowering and stable outlook of HF's adjusted BCA. The same downgrade and outlook change applies to its Tier III programme whose rating is maintained at the same level as senior subordinated debt. These ratings continue to be positioned two notches below the bank's adjusted BCA of ba2, which incorporates parental but not government support.

-- UPGRADED AND AFFIRMED HYBRIDS

Due to these instruments becoming fully serviced in 2013 Moody's has reverted to its 'standard' approach of notching the ratings off Commerzbank's ba1 adjusted BCA for the following instruments: (1) Trust Preferred Securities issued by Commerzbank Capital Funding Trust I, II and III upgraded to B1 (hyb) from Caa1 (hyb), positioned three notches below Commerzbank's adjusted BCA; (2) Tier 1 Capital Securities issued by HT1 Funding GmbH affirmed at Ba3 (hyb), positioned two notches below Commerzbank's adjusted BCA; and (3) Dated Upper Tier 2 Capital Securities issued by UT2 Funding plc affirmed at B1 (hyb), three notches below Commerzbank's adjusted BCA. These instruments were previously underperforming for a period of four years until 2012 (for the financial year 2011), during which time the hybrid ratings were based on expected loss as is standard for non-performing hybrid instruments.

The outlook on the hybrid ratings for these instruments is stable, in line with the stable outlook on Commerzbank's BCA.

-- DOWNGRADED HYBRIDS

The Dated Silent Partnership Certificates issued by Dresdner Funding Trust I have been performing throughout the last five years and were therefore previously notched off Commerzbank's adjusted BCA. Their downgrade to Ba3 (hyb) from Ba2 (hyb) reflects the one-notch lowering of Commerzbank's adjusted BCA. The outlook on this instrument is now stable.

HF's two Upper Tier 2 instruments (Genussscheine) were downgraded to C (hyb), and its Trust Preferred Securities issued by Eurohypo Capital Funding Trust I and II were downgraded to Ca (hyb). These instruments have been reported to have suffered further principal write downs in 2013 for 2012 (after substantial write downs in previous years) and/or continued coupon losses. Coupon payments are not expected for the next five years.

Whilst Moody's had previously assumed some potential for recoveries for HF's cumulative Upper Tier 2 instruments which have been written down by more than 70%, recoveries are no longer expected until their respective maturities in 2013 and 2017. These ratings do not carry outlooks.

WHAT COULD CHANGE THE RATINGS UP/DOWN

A severe worsening of the euro area debt crisis could adversely affect both HF's ratings and those of Commerzbank and its other subsidiaries, in particular if Italy and Spain's credit profile were to come under further pressure.

Positive ratings pressure on the ratings of Commerzbank and its other European subsidiaries would be subject to a material reduction of its non-core assets and/or a containment of the risks posed by these assets. Visible results in Commerzbank's restructuring and improving profitability would also be important factors for rating upgrade considerations.

Full list of affected ratings

---HYBRID SECURITIES

- Trust Preferred Securities issued by Commerzbank Capital Funding Trust I, II and III, upgraded to B1 (hyb) from Caa1 (hyb);

- Tier 1 Capital Securities issued by HT1 Funding GmbH affirmed at Ba3 (hyb);

- Dated Upper Tier 2 Capital Securities issued by UT2 Funding plc affirmed at B1 (hyb);

- Dated Silent Partnership Certificates issued by Dresdner Funding Trust I, downgraded to Ba3 (hyb) from Ba2 (hyb);

- Two Upper Tier 2 instruments (Genussscheine), downgraded to C (hyb) from B3 (hyb) and Caa3 (hyb), respectively.

-Trust Preferred Securities issued by Eurohypo Capital Funding Trust I and II, downgraded to Ca (hyb) from Caa2 (hyb);

The principal methodology used in these ratings was Moody's Consolidated Global Bank Rating published in June 2012. Please see the Credit Policy 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 rating action on the support provider and in relation to each particular 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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