

## Research Update:

### Commerzbank Downgraded To 'A-/A-2' On Expected Longer Restructuring After CreditWatch Resolution; Outlook Negative

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## Research Update:

# Commerzbank Downgraded To 'A-/A-2' On Expected Longer Restructuring After CreditWatch Resolution; Outlook Negative

## Overview

- We have reviewed Germany-based Commerzbank's ability to strengthen its business model and reduce its large noncore loan book over the next two years.
- We are lowering our ratings on Commerzbank to 'A-/A-2' from 'A/A-1' and removing them from CreditWatch negative because the bank will likely face increasing difficulties in achieving a stronger and sustainable performance.
- The negative outlook on Commerzbank indicates the possibility of a downgrade if the expected tangible progress in Commerzbank's derisking is more than offset by the negative trends we see in economic risks across many European banking sectors, including Germany's.

## Rating Action

On May 28, 2013, Standard & Poor's Ratings Services lowered its long- and short-term counterparty credit ratings and its senior unsecured debt ratings on Germany-based Commerzbank AG to 'A-/A-2' from 'A/A-1'. We also we lowered our issue ratings on Commerzbank's nondeferrable senior subordinated debt to 'BB+' from 'BBB'. At the same time, we removed these ratings from CreditWatch with negative implications, where we placed them on Feb. 7, 2013. The outlook on Commerzbank is negative.

In addition, we took various rating actions on hybrid capital instruments issued by members of the Commerzbank group. We raised our issue ratings to 'B+' from 'C' on the hybrid Tier1 instruments issued by Commerzbank Capital Funding Trust I, II, and III (Commerzbank FT I-III), as well by UT2 Funding PLC. We raised our issue ratings to 'BB' from 'CCC' on the Tier 1 hybrids issued by Dresdner Funding Trust I (Dresdner FT I). We affirmed the 'C' issue ratings on hybrids issued by HT1 Funding GmbH.

## Rationale

The downgrade follows our review of Commerzbank's recent financials and discussions with its management on the bank's future prospects.

We anticipate that Commerzbank needs more time to restructure its currently unbalanced business model. We think it will take the bank longer than we

previously anticipated to manage down its considerably high risk in its noncore loan books. In our opinion, Commerzbank will have an increasingly tough time generating stronger, more stable, and sustainable earnings in core businesses that would be closer to levels at similarly rated banks. Consequently, we have lowered our assessments of Commerzbank's risk position and business position.

We continue to view the domestic commercial and retail banking businesses as central to Commerzbank's future strategy, while projecting that the performance and domestic market position in corporate banking will remain sound. However, we foresee a softening in tailwinds from the German economy. Commerzbank's corporate business is not sufficient to offset weaknesses in other business segments.

Commerzbank still has broad restructuring needs to improve the efficiency of its moderate retail franchise. In our view, this is apparent from the €493 million in one-time restructuring charges the bank booked, in particular for retail operations, in the first quarter of 2013.

Equally important for Commerzbank is to further reduce its high credit risk concentrations, and improve its loan performance, which we view as below the average of economic risk levels at peers. Still, we acknowledge tangible restructuring results achieved to date, and believe that Commerzbank will make further progress in its transition.

We also think Commerzbank is coming up against mounting hurdles to improve its business position and risk position, in line with our more negative economic forecasts for its main markets, including Germany, over the next two years. We currently foresee a 0.5% recession across the eurozone (European Economic and Monetary Union) this year and only weak GDP recovery in 2014. Difficult economic and financial market conditions across Europe make Commerzbank vulnerable to its high-risk lending concentrations in sizable noncore segments in which it operates, particularly commercial real estate and shipping.

We assess Commerzbank's stand-alone credit profile (SACP) at 'bbb-'. We factor into the rating two notches of uplift from the SACP, reflecting our view that the bank's "high" systemic importance in Germany remains unchanged. We also now include one notch to reflect our expectation of Commerzbank's ongoing positive transition, despite the difficult operating environment. If Commerzbank markedly improved the quality of its loan book and reduced its sensitivity to economic trends, we would likely remove this one notch and revise up our assessment of the risk position. This would leave the long-term rating unchanged.

The upgrades of the Tier 1 hybrids issued by Commerzbank FT I-III and UT2 Funding PLC reflect the resumption of coupon servicing in 2012. We also take into account our expectation that sufficient distributable profits for future coupon payments should generally be available. Because we view some financial uncertainties linked to Commerzbank's transition process, we widened the differential between the SACP and the hybrid ratings to four notches from the

three notches we typically assign for similar structures.

The upgrade of the Dresdner FT I Tier 1 hybrids reflects our view that Commerzbank's regulatory capital ratios will easily exceed the regulatory minimum requirements, regulatory intervention has become less likely due to restructuring progress, and the bank will likely meet its coupon payments due on June 30.

We affirmed the ratings on the hybrids issued by HT1 Funding GmbH, because we anticipate that Commerzbank will not resume coupon payments on this instrument this year. Germany-based global multiline insurer Allianz SE might, however, pay indemnities on this instrument as in 2012.

## Outlook

The negative outlook on Commerzbank indicates the possibility of a downgrade if the expected tangible progress in Commerzbank's derisking is more than offset by the negative trends we see in economic risks across many European banking sectors, including Germany's.

Commerzbank's creditworthiness could deteriorate if we were to lower our economic risk assessments in its main operating regions, which could prompt us to revise down our anchor for Commerzbank to 'bbb+' from 'a-'. Similarly, Commerzbank's risk position is vulnerable to its generally high-risk lending concentrations and its below-average credit performance in some loan segments.

Our maintenance of the one-notch uplift we factor into the long-term rating for Commerzbank's positive transition relies on its successful execution of its repositioning and restructuring plans over a two-year horizon.

A revision of the outlook to stable would most likely come on the back of economic improvements in the main markets where Commerzbank operates. Similarly, our uncertainty about a potential weakening in Commerzbank's creditworthiness could decrease if it made quicker-than-anticipated progress in reducing riskier loans in noncore businesses, while maintaining adequate capital and earnings.

## Ratings Score Snapshot

	To	From
Issuer Credit Rating	A-/Negative/A-2	A/Watch Neg/A-1
SACP	bbb-	bbb+
Anchor	a-	a-
Business Position	Moderate (-1)	Adequate (0)
Capital and Earnings	Adequate (0)	Adequate (0)
Risk Position	Weak (-2)	Moderate (-1)

Funding and Liquidity	Average and Adequate (0)	Average and Adequate (0)
Support	+2	+2
GRE Support	0	0
Group Support	0	0
Sovereign Support	+2	+2
Additional Factors	+1	0

## Related Criteria And Research

### Related criteria

- Group Rating Methodology, May 7, 2013
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

### Related research

- Germany-Based Commerzbank 'A/A-1' Ratings Placed On CreditWatch Negative After Announcing €720 Million Loss For Q4 2012, Feb. 7, 2013

## Ratings List

### Downgraded; CreditWatch Action

	To	From
Commerzbank AG		
Counterparty Credit Rating	A-/Negative/A-2	A/Watch Neg/A-1
Senior Unsecured	A-	A/Watch Neg
Subordinated	BB+	BBB/Watch Neg
Commercial Paper	A-2	A-1/Watch Neg
Dresdner Funding Trust IV		
Subordinated	BB+	BBB/Watch Neg

### Ratings Affirmed

HT1 Funding GmbH	
Junior Subordinated	C

### Upgraded

	To	From
Commerzbank Capital Funding Trust I		
Preferred Stock	B+	C
Commerzbank Capital Funding Trust II		
Preferred Stock	B+	C

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Commerzbank Capital Funding Trust III Preference Stock	B+	C
Dresdner Funding Trust I Junior Subordinated	BB	CCC
UT2 Funding PLC Junior Subordinated	B+	C

NB. This list does not include all ratings affected.

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