

Rating Action: Moody's affirms Commerzbank's senior unsecured debt instrument ratings at Baa1

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Baseline Credit Assessment (BCA) upgraded to baa2 and deposit ratings upgraded to A1; outlook stable

Frankfurt am Main, August 03, 2018 -- Moody's Investors Service (Moody's) today affirmed Commerzbank AG's (Commerzbank) senior unsecured debt instrument ratings at Baa1 (and reclassified the instruments to junior senior unsecured) and upgraded the bank's long-term deposit rating to A1 from A2. Concurrently, the rating agency upgraded Commerzbank's and its subsidiary's Commerzbank Finance & Covered Bond S.A.'s (CFCB) Baseline Credit Assessment (BCA) and Adjusted BCA to baa2 from baa3 and took various additional rating actions.

Today's rating actions combine the effects of Commerzbank's (and CFCB's) improved standalone financial strength with the effects of the legal change to the German banks' insolvency rank order which took effect on 21 July 2018.

The legal changes re-introduced an option for banks to issue "plain vanilla" preferred senior unsecured liabilities ("senior unsecured debt class"), as well as to issue new contractually non-preferred debt ("junior senior unsecured debt class") which will rank alongside outstanding legacy "plain vanilla" senior unsecured instruments. Moody's believes that following the legal change, the likelihood of government support being available for most of the senior unsecured instruments outstanding on 20 July 2018 has declined, as under the revised legislation those instruments remain subordinated to future (preferred) senior unsecured bank debt.

Following the change in law, the legal hierarchy of bank claims in Germany is now consistent with most other European Union (EU) countries, where statutes do not provide full preference to deposits over senior unsecured debt; the amended application of Moody's Advanced Loss Given Failure (LGF) analysis reflects the revised hierarchy of claims.

A full list of affected ratings and rating inputs can be found at the end of this press release.

RATINGS RATIONALE

UPGRADE OF COMMERZBANK'S BASELINE CREDIT ASSESSMENT (BCA)

The one-notch upgrade of Commerzbank's BCA to baa2 reflects the bank's achievements in de-risking the bank; its progress in executing its strategic program "Commerzbank 4.0" launched in October 2016; as well as sustaining its solid capitalisation, despite regulatory pressures and the full adoption of IFRS 9 earlier this year.

During 2017 and the first quarter of 2018, Commerzbank has further de-risked its balance sheet and successfully reduced its non-core portfolio, in particular exposures to the shipping industry and in commercial real estate (CRE), to a combined EUR2.6 billion, or 12% of its Common Equity Tier 1 (CET1) capital as of 31 March 2018, down from EUR7.3 billion, or 28%, respectively, as of end-2016.

As of 31 March 2018, and including the full effects from the adoption and implementation of the IFRS 9 accounting regime, Commerzbank reported a CET1 ratio of 13.3% (a Moody's adjusted Tangible Common Equity ratio of 14.0%), up 100 and 30 basis points, respectively, from year-end 2016. Rebuilding solid capitalisation metrics has improved the bank's ability to withstand sudden market shocks, and added flexibility with regard to the further wind-down of its non-core portfolio.

The assessment also takes account of Moody's expectation that the bank's very low profitability will improve only gradually and remain noticeably below that of European peers. This assessment incorporates the potential strain on earnings from persistently low interest rates, as well as continued challenges to improve profit contribution of the bank's two core segments, retail and corporate banking with a clear focus on Germany. In addition, Germany will remain a highly competitive banking market, and thereby limit Commerzbank's profitability prospects.

LEGAL CHANGE DRIVES VARYING ADVANCED LGF RESULTS AND GOVERNMENT SUPPORT ASSUMPTIONS

In addition to the upgrade of the bank's BCA, the rating action was prompted by a legal change to the German bank debt insolvency rank order which took effect on 21 July 2018. Germany's transposition into national law of an amendment to the EU's Bank Recovery and Resolution Directive (BRRD) has enabled banks to issue contractually subordinated senior unsecured bonds ("non-preferred", or junior senior bonds) that would fully count against the banks' regulatory minimum requirements for own funds and eligible liabilities (MREL) as well as ("preferred") senior unsecured bonds that rank alongside other senior unsecured liabilities, including the most junior class of deposits. Based on the changes in law, the legal hierarchy of bank claims in Germany is now consistent with most EU countries, where statutes do not provide full preference to deposits over senior unsecured debt.

Legally, the new non-preferred instruments will rank *pari passu* with the majority of outstanding senior unsecured instruments issued until 20 July 2018, to the extent the latter instruments were subject to Germany's statutory subordination under the previous insolvency ranking.

-- CONSEQUENCES FOR MOODY'S ANALYTICAL APPROACH

The *pari passu* ranking of new junior senior unsecured debt with legacy (statutorily subordinated) senior unsecured instruments makes it less likely that German authorities would selectively support the legacy instruments (which today's rating action reclassified into junior senior unsecured debt), following clarification that the German authorities expect these liabilities to bear losses in a resolution. Furthermore, any selective support could give rise to claims by adversely selected creditors that the No Creditor Worse Off principle established in the BRRD had been breached.

In response to the change in the German insolvency and resolution hierarchy, Moody's has today reclassified certain instruments issued by German banks, including Commerzbank. Complex structured debt instruments, which were previously treated as senior senior unsecured debt, have been reclassified as senior unsecured debt. In addition, legacy (statutorily subordinated) "plain vanilla" debt instruments, which Moody's previously classified as senior unsecured debt, will now be treated as junior senior unsecured debt.

Following the re-introduction of a class of "plain vanilla" senior unsecured debt that ranks alongside junior deposits, the rating agency now applies an alternative liability ranking when undertaking its Advanced LGF analysis for German banks. As with other EU countries where the most junior tranche of deposits does not enjoy preference over senior unsecured debt, Moody's considers the results of both the formal legal position (*pari passu*, or "de jure" scenario), with a 75% probability, and an alternative liability ranking reflecting resolution authority discretion (full depositor preference, or "de facto" scenario), to which the rating agency assigns a 25% probability. Prior to the change in the law, Moody's applied a single waterfall for German bank liabilities which reflected the full preference for German deposits over the senior unsecured instruments now reclassified as junior senior unsecured debt.

The combination of applying the amended liability ranking under Moody's Advanced LGF analysis and the revised assessment of the applicability of government support for certain debt instruments has resulted in various rating actions on affected instruments and rating classes as detailed below.

RATING CLASS SPECIFIC CONSIDERATIONS

-- AFFIRMATION OF INSTRUMENTS RECLASSIFIED AS JUNIOR SENIOR UNSECURED DEBT

Moody's believes that there would be a low likelihood of government support for junior senior unsecured bank bonds, which are designed to bear losses in a bank resolution. For systemically important banking groups like Commerzbank, Moody's previously assigned one notch of rating uplift for (statutorily subordinated) instruments that have now been reclassified as junior senior unsecured debt.

The reduction of government support assumptions for these securities has led to the removal of one notch of rating uplift, previously factored into these ratings. The resulting negative effect on Commerzbank's (junior) senior unsecured debt ratings is, however, balanced by the one-notch upgrade of its BCA, leading to an affirmation of Commerzbank's (junior) senior unsecured instrument ratings. Furthermore, the securities reclassified as junior senior unsecured debt no longer carry rating outlooks, in line with Moody's general practice of not assigning outlooks to this debt class.

-- UPGRADE OF INSTRUMENTS RECLASSIFIED AS SENIOR UNSECURED DEBT

The upgrade of Commerzbank's (senior) senior unsecured debt instruments with structural features follows the one-notch upgrade of the bank's BCA. The loss-given-failure of these debt instruments is however not affected by the revised German insolvency and banking laws and remains extremely low, leading to three notches of rating uplift from Commerzbank's baa2 Adjusted BCA. The rating agency continues to consider there is a moderate probability of government support for this more senior debt, leading to an additional notch of rating uplift from government support. At the same time, Moody's reclassified these rated instruments as senior unsecured debt (previously senior senior unsecured debt) and changed the outlook to stable from positive.

-- UPGRADE OF LONG-TERM ISSUER RATINGS

The long-term issuer ratings of Commerzbank and CFCB reflect the banks' ability to honour the most senior "plain vanilla" (or ordinary) senior unsecured debt instruments and debt-like obligations. Following the reintroduction of a "plain vanilla" (preferred) senior unsecured debt class, the issuer ratings now map to this debt class, which benefits from the subordination of the junior senior debt from which the issuer ratings were previously derived. As a result, and further taking account of the one-notch upgrade of Commerzbank's and CFCB's BCA, Commerzbank's and CFCB's issuer ratings were today upgraded by three notches to A1 from Baa1. The outlook remained stable.

-- UPGRADE OF LONG-TERM DEPOSIT AND COUNTERPARTY RISK (CR) RATINGS, AND CR ASSESSMENTS

The rating agency upgraded Commerzbank's long-term deposit and CR ratings to A1 from A2, and its CR Assessments to A1(cr) from A2 (cr), reflecting the one-notch upgrade of the bank's BCA. Changes in the creditor hierarchy had no rating impact and these debt classes continue to benefit from three notches of rating uplift as a result of Moody's Advanced LGF analysis. At the same time, the previous government support assumptions for Commerzbank's long-term deposit and CR ratings and its CR Assessments remained unchanged and continue to result in one notch of additional rating uplift. The outlook on the long-term deposit ratings was changed to stable from positive.

-- AFFIRMATION OF ALL SHORT-TERM PROGRAM RATINGS

Following today's rating action, Moody's short-term program ratings map to the long-term senior unsecured debt rating category, which has been reclassified from senior senior unsecured debt previously. In January 2016, because of the statutory subordination of long-term senior unsecured bonds, but not money market obligations, the rating agency anchored short-term debt ratings to deposits, reflecting the preferred legal position of short-term instruments. With the change in legislation and the resulting pari passu ranking of senior unsecured debt with deposits, short-term instruments are appropriately positioned by re-anchoring these instruments to long-term senior unsecured debt. This re-anchoring had no effect on Commerzbank's short-term program ratings, which were all affirmed at P-1 and (P)P-1.

-- UPGRADE OF LONG-TERM PROGRAM RATINGS AND ASSIGNMENT OF JUNIOR SENIOR UNSECURED DEBT PROGRAM RATINGS

Since 21 July 2018, German banks can make use of the aforementioned option to issue either contractually non-preferred (junior) senior unsecured debt or (preferred) senior unsecured debt without such contractual clarifications. The latter will benefit from a higher priority position in the bank insolvency ranking.

Moody's reflects these distinct issuance options through today's assignment of (P)Baa1 junior senior unsecured program ratings for those of Commerzbank's programs that explicitly foresee both options. The newly assigned ratings of junior senior unsecured programs reflect the rating levels of outstanding bonds of the same respective seniority level.

For Commerzbank's senior unsecured program ratings, these program ratings now reflect the ranking of (preferred) senior unsecured debt new issuances. Accordingly, the rating agency upgraded the senior unsecured program ratings to (P)A1 from (P)Baa1, following the rationale outlined for the bank's issuer ratings. Moody's further upgraded subordinate program ratings to (P)Baa3 from (P)Ba1, which reflects the upgrade of the bank's BCA.

Further, Moody's withdrew the previously assigned (P)A2 senior senior unsecured program ratings. This reflects that the statutory distinction of seniority levels based on structural coupon and principal repayment components of bonds issued under these programs has legally ceased to exist for all bonds newly issued since

21 July 2018.

-- COMMERZBANK FINANCE & COVERED BOND S.A. (CFCB)

The upgrade of CFCB's BCA to baa2 from baa3 as well as its long-term issuer rating to A1 from Baa1 with a stable outlook reflects the upgrade of Commerzbank's ratings. In Moody's opinion, the Luxembourg entity's operations are very closely integrated with those of its parent, which holds all of CFCB's senior unsecured funding. Accordingly, CFCB's ratings follow Commerzbank's ratings and the above detailed rationale similarly applies for CFCB's affected debt classes.

WHAT COULD CHANGE THE RATINGS UP/DOWN

Although considered unlikely at present, an upgrade of Commerzbank's long-term ratings could be triggered by a higher BCA. Further upward pressure on Commerzbank's baa2 BCA could result from a combination of (1) a persistent and significant strengthening of the bank's profitability across economic cycles; (2) a further meaningful and sustained improvement of its capital ratios and balance sheet leverage; (3) a further reduction in problem loans, including lower sector concentrations; and (4) a material decrease of Commerzbank's moderate reliance on wholesale funding sources coupled with a further build-up of high-quality liquid assets.

In addition, junior senior and subordinated instrument ratings could be upgraded due to lower loss-given-failure, for example if subordination were to increase, although this seems unlikely at present.

A downgrade of Commerzbank's long-term ratings could be triggered following (1) a deterioration of the bank's financial fundamentals supporting its BCA and; (2) fewer notches of rating uplift as a result of Moody's Advanced LGF analysis; or (3) a lower likelihood of government support.

A downgrade of the bank's BCA could result from (1) a weakening of the operating environment in Germany; (2) a meaningful deterioration of its asset quality and capital adequacy metrics; (3) a material deviation from the bank's currently pursued Germany-focused retail and corporate banking model; and/or (4) a significant weakening of the bank's Combined Liquidity profile.

Moreover, downward rating pressure could result from a significant decrease in the bank's bail-in-able debt cushion, leading to a higher loss severity of Commerzbank's deposits, senior unsecured debt and/or junior senior unsecured debt at failure, resulting in a lower rating uplift as a result of Moody's Advanced LGF analysis.

LIST OF AFFECTED RATINGS

Issuer: Commerzbank AG

..Upgrades:

-Adjusted Baseline Credit Assessment, upgraded to baa2 from baa3
-Baseline Credit Assessment, upgraded to baa2 from baa3
-Long-term Counterparty Risk Assessment, upgraded to A1(cr) from A2(cr)
-Long-term Counterparty Risk Ratings, upgraded to A1 from A2
-Long-term Bank Deposits, upgraded to A1 Stable from A2 Positive
-Long-term Issuer Rating, upgraded to A1 Stable from Baa1 Stable
-Senior Unsecured Medium-Term Note Program, upgraded to (P)A1 from (P)Baa1
-Subordinate, upgraded to Baa3 from Ba1
-Subordinate Medium-Term Note Program, upgraded to (P)Baa3 from (P)Ba1

..Upgrades and reclassification:

-Senior Senior Unsecured, upgraded to A1 Stable from A2 Positive, reclassified to Senior Unsecured

..Affirmations:

....Short-term Counterparty Risk Assessment, affirmed P-1(cr)

....Short-term Counterparty Risk Ratings, affirmed P-1

....Short-term Bank Deposits, affirmed P-1

....Other Short Term, affirmed (P)P-1

....Commercial Paper, affirmed P-1

Affirmations and reclassification:

....Senior Unsecured, affirmed Baa1, reclassified to Junior Senior Unsecured with no outlook

..Withdrawals:

....Senior Senior Unsecured Medium-Term Note Program, previously rated (P)A2

Assignments:

....Junior Senior Medium-Term Note Program, assigned (P)Baa1

..Outlook Action:

....Outlook changed to Stable from Positive(m)

Issuer: Commerzbank AG, London Branch

..Upgrades:

....Long-term Counterparty Risk Assessment, upgraded to A1(cr) from A2(cr)

....Long-term Counterparty Risk Ratings, upgraded to A1 from A2

..Affirmations:

....Short-term Counterparty Risk Assessment, affirmed P-1(cr)

....Short-term Counterparty Risk Ratings, affirmed P-1

....Commercial Paper, affirmed P-1

..Outlook Action:

....Outlook changed to Stable from Positive(m)

Issuer: Commerzbank AG, New York Branch

..Upgrades:

....Long-term Counterparty Risk Assessment, upgraded to A1(cr) from A2(cr)

....Long-term Counterparty Risk Ratings, upgraded to A1 from A2

....Senior Unsecured Medium-Term Note Program, upgraded to (P)A1 from (P)Baa1

....Subordinate Medium-Term Note Program, upgraded to (P)Baa3 from (P)Ba1

..Affirmations:

....Short-term Counterparty Risk Assessment, affirmed P-1(cr)

....Short-term Counterparty Risk Ratings, affirmed P-1

....Other Short Term, affirmed (P)P-1

..Outlook Action:

....Outlook remains Stable

Issuer: Commerzbank Finance & Covered Bond S.A.

..Upgrades:

....Adjusted Baseline Credit Assessment, upgraded to baa2 from baa3

....Baseline Credit Assessment, upgraded to baa2 from baa3

....Long-term Counterparty Risk Assessment, upgraded to A1(cr) from A2(cr)

....Long-term Counterparty Risk Ratings, upgraded to A1 from A2

....Long-term Issuer Rating, upgraded to A1 Stable from Baa1 Stable

..Affirmations:

....Short-term Counterparty Risk Assessment, affirmed P-1(cr)

....Short-term Counterparty Risk Ratings, affirmed P-1

..Outlook Action:

....Outlook remains Stable

Issuer: Commerzbank U.S. Finance Inc.

..Upgrade:

....Backed Senior Unsecured Medium-Term Note Program, upgraded to (P)A1 from (P)Baa1

..Affirmation:

....Backed Commercial Paper, affirmed P-1

..No Outlook assigned

Issuer: Dresdner Bank AG (Debts assumed by Commerzbank AG)

..Upgrades:

....Subordinate, upgraded to Baa3 from Ba1

..Upgrades and reclassification:

....Senior Senior Unsecured, upgraded to A1 Stable from A2 Positive, reclassified to Senior Unsecured

Affirmations and reclassification:

....Senior Unsecured, affirmed Baa1, reclassified to Junior Senior Unsecured with no outlook

..No Outlook assigned

Issuer: Dresdner Funding Trust I

..Upgrade:

....Preferred Stock Non-cumulative, upgraded to Ba1(hyb) from Ba2(hyb)

..No Outlook assigned

Issuer: Dresdner Funding Trust IV

..Upgrade:

....Senior Subordinated, upgraded to Baa3 from Ba1

..No Outlook assigned

Issuer: Dresdner U.S. Finance Inc.

..Affirmation:

....Backed Commercial Paper, affirmed P-1

..No Outlook assigned

Issuer: Eurohypo AG (Old) (Debt assumed by Commerzbank AG)

..Upgrade:

....Subordinate, upgraded to Baa3 from Ba1

..No Outlook assigned

Issuer: HT1 Funding GmbH

..Upgrade:

....Preferred Stock Non-cumulative, upgraded to Ba1(hyb) from Ba2(hyb)

..No Outlook assigned

Issuer: Hypothekenbank Frankfurt AG (Debts assumed by Commerzbank AG)

..Upgrades:

....Subordinate, upgraded to Baa3 from Ba1

..Upgrade and reclassification:

....Senior Senior Unsecured, upgraded to A1 Stable from A2 Positive, reclassified to Senior Unsecured

Affirmations and reclassification:

....Senior Unsecured, affirmed Baa1, reclassified to Junior Senior Unsecured with no outlook

..No Outlook assigned

Issuer: Hypothekenbank in Essen AG (Debt assumed by Commerzbank AG)

..Upgrade:

....Subordinate, upgraded to Baa3 from Ba1

..No Outlook assigned

Issuer: RHEINHYP Rheinische Hypothekenbank AG (Debts assumed by Commerzbank AG)

..Upgrade:

....Subordinate, upgraded to Baa3 from Ba1

Affirmations and reclassification:

....Senior Unsecured, affirmed Baa1, reclassified to Junior Senior Unsecured with no outlook

..No Outlook assigned

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in August 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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