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## Research Update:

### German Commerzbank Long-Term Rating Raised To 'A-' On Higher ALAC Buffer; Outlook Neg; Sr Subordinated Debt Cut To 'BBB'

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## Research Update:

# German Commerzbank Long-Term Rating Raised To 'A-' On Higher ALAC Buffer; Outlook Neg; Sr Subordinated Debt Cut To 'BBB'

## Overview

- A recent retroactive German law change has significantly increased Commerzbank's additional loss-absorbing capacity buffer, which should protect more-senior creditors in a resolution scenario.
- We are therefore raising our long-term issuer credit rating on Commerzbank AG to 'A-' from 'BBB+'.
- We are raising to 'A-' from 'BBB+' the issue ratings on instruments that we continue to view as senior unsecured debt under the new law, and lowering to 'BBB' from 'BBB+' the issue ratings on instruments that we have reclassified as senior subordinated debt.
- The negative outlook on Commerzbank reflects that we might lower our ratings if economic risks in Germany were to worsen within the next two years.

## Rating Action

On March 28, 2017, S&P Global Ratings raised its long-term counterparty credit rating on Commerzbank AG to 'A-' from 'BBB+'. This rating was removed from CreditWatch, where it was placed with positive implications on Dec. 15, 2016. The outlook is negative. The short-term issuer credit rating was affirmed at 'A-2' and also was removed from CreditWatch with positive implications.

At the same time, we raised our long-term issue ratings on instruments we have reclassified as senior subordinated under Germany's recently-introduced law to 'BBB' from 'BBB+'. We raised our long-term issue ratings on instruments we determined as remaining senior unsecured to 'A-' from 'BBB+'. All of these issue ratings were removed from CreditWatch, where we had placed them with developing implications on Dec. 15, 2016.

In addition, we raised our long-term issuer credit rating on Commerzbank's strategically important Polish subsidiary mBank to 'BBB+' from 'BBB', in line with the action on Commerzbank (see rating list for details).

## Rationale

The upgrade reflects Commerzbank's materially enlarged additional loss-absorbing capacity (ALAC) buffer, after taking account of standard term debt reclassified as senior subordinated instruments under the new,

retroactive German law that was introduced in January 2017. The authorities' action was negative for those instruments since they could well be bailed in in a resolution scenario. However, the buffer that they create would likely serve to better support the servicing of the senior unsecured debt and pari passu liabilities if the bank fails. Our upgrade also acknowledges the progress that management has made in restructuring Commerzbank. While this task is not yet complete and we still have some doubts about its ability to generate sufficient shareholder returns absent a cyclical recovery, we now see a much reduced risk of setbacks and negative surprises.

We have revised up Commerzbank's group credit profile (GCP) by one notch above its stand-alone credit profile (SACP), because we estimate the bank's ALAC ratio at about 7% (pro forma, including the senior subordinated instruments at year-end 2016), and forecast that the bank will maintain an ALAC buffer of between 6% and 7% over the next two years, comfortably above the 5% threshold for a one-notch uplift. In our calculations, we exclude instruments issued under non-EU law that do not explicitly refer to the bail-in power, given the risk that the bail-in by the European regulator could possibly be challenged by investors holding these instruments. We will continue to monitor the development of the bank's bail-in buffer once the regulatory minimum requirement for own funds and eligible liabilities (MREL) buffer requirement is clear and as management then clarifies how it will address this.

Our assessment of Commerzbank's SACP remains unchanged at 'bbb+'. This assessment acknowledges the progress that management has already made in restructuring the bank, reducing the nonstrategic asset portfolio, and restoring a degree of profitability. While the bank continues to have some problem exposures to industries such as shipping, we remain cautious but now see these as likely to be manageable and absorbable within pre-provision earnings, as they were in 2016, rather than as an immediate risk to its capitalization. With the bank's Basle III fully phased-in common equity Tier 1 ratio at 12.3% at end-2016 and likely to climb a little from there, we similarly expect the bank's risk-adjusted capital (RAC) ratio--our measure for capital adequacy--will rise to about 11.0% by year-end 2018, from about 10.4% at year-end 2016.

Despite its downsizing over recent years, the bank retains a leading franchise in German corporate banking, particularly among large and midsize enterprises and in trade finance, and maintains its retail banking division's strong focus on private wealth management. At this stage, though, we continue to see some challenges ahead for Commerzbank, notably delivering sufficient shareholder returns absent a cyclical recovery. We currently anticipate that the bank will generate only a 4%-6% return on equity even in 2018. We note, for example, that banks rated in the 'A' category are typically national champions with sound business models and stronger earnings than Commerzbank currently achieves.

The 'BBB' issue ratings on the bank's senior subordinated debt are now one notch below the 'bbb+' SACP, reflecting their status as bail-in instruments. These senior subordinated bonds consist of standard, long-term, fixed- or

floating-rate notes. The new 'A-' issue ratings on instruments that we continue to regard as senior unsecured debt are in line with the rating on Commerzbank. Commerzbank's senior unsecured instruments primarily comprise structured notes, and our understanding is that they continue to rank alongside liabilities such as corporate and institutional deposits and short-term money market instruments.

Our rating action on mBank reflects our one notch revision of Commerzbank's GCP to 'a-' from 'bbb+', and our unchanged view of mBank's strategically important group status to Commerzbank. As a result, our ratings on this subsidiary now benefit from two notches for potential future group support and could include a third notch in the currently remote event that we upgrade Commerzbank further.

## Outlook

The negative outlook reflects that we might lower our ratings within the next two years if economic risks in Germany were to worsen. We currently assign observe a negative economic risk trend in the German banking system because of potentially higher anticipated credit expansion and house prices.

If German economic risk was to rise, we would likely revise the anchor for Commerzbank to 'bbb+' from 'a-', given the bank's international asset allocations and its focus on export-oriented German corporate customers. Moreover, our negative outlook reflects the risk that the bank would fail to sustain our forecast RAC ratio above the 10% threshold that supports our assessment of its capital earnings. Although a weakening in German economic risk could challenge both these assessments, we currently see downside risk to both the SACP and rating as limited to one notch at most.

We could revise the outlook to stable if we were to reassess our economic risk trend for the German banking industry to stable, or, alternatively, if we were to see material improvements well beyond our base case in the bank's capital and ALAC buffers to further protect senior creditors.

## Ratings Score Snapshot

Issuer Credit Rating	A-/Negative/A-2	BBB+/Watch Pos/A-2
Anchor:	a-	a-
GCP	a-	bbb+
SACP	bbb+	bbb+
Business Position:	Moderate (-1)	Moderate (-1)
Capital and Earnings:	Strong (+1)	Strong (+1)
Risk Position:	Moderate (-1)	Moderate (-1)
Funding and	Average and	Average and

Liquidity	Adequate (0)	Adequate(0)
Support	+1	0
ALAC Support	+1	0
GRE Support	0	0
Group Support	0	0
Sovereign Support	0	0
Additional Factors	0	0
mBank		
Issuer Credit Rating	BBB+/Negative/A-2	BBB/Watch Pos/A-2

## Related Criteria

- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables, June 01, 2016
- Criteria - Financial Institutions - Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- General Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Assessing Bank Branch Creditworthiness, Oct. 14, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 09, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 09, 2011
- Criteria - Financial Institutions - Banks: Bank Capital Methodology And Assumptions, Dec. 06, 2010
- Criteria - Financial Institutions - Banks: Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks, May 04, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General Criteria: Rating Implications Of Exchange Offers And Similar Restructurings, Update, May 12, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

## Related Research

- Various Rating Actions Taken On Four Systemically Important German Banks On Improved Loss-Absorbing Capacity, March 28, 2017
- Various German Banks' Snr Unsecured Debt Lowered/Affirmed After Notes Review; Off Watch; Four Banks Remain On Watch, Feb. 9, 2017
- Four German Banks On Watch Positive, Various Banks' Snr Unsecured Debt On Watch Developing Or Neg, Pending Notes Review, Dec. 15, 2016
- Full Analysis: Commerzbank AG, March 24, 2016

## Ratings List

Upgraded; CreditWatch/Outlook Action; Ratings Affirmed

	To	From
Commerzbank AG		
Counterparty Credit Rating	A-/Negative/A-2	BBB+/Watch Pos/A-2
mBank		
Counterparty Credit Rating	BBB+/Negative/A-2	BBB/Watch Pos/A-2

Upgraded; CreditWatch Action

	To	From
Commerzbank AG		
Senior Unsecured	A-	BBB+/Watch Dev
Senior Unsecured	A-p	BBB+p/Watch Pos
mFinance France S.A		
Senior Unsecured[1]	BBB+	BBB/Watch Pos

Downgraded; CreditWatch/Outlook Action

	To	From
Commerzbank AG		
Subordinated[2]	BBB	BBB+/Watch Dev
Subordinated[2]	cnA	cnA+/Watch Dev

Ratings Affirmed; CreditWatch Action

	To	From
Commerzbank AG		
Commercial Paper	A-2	A-2/Watch Pos
Commerzbank U.S. Finance Inc.		
Commercial Paper[3]	A-2	A-2/Watch Pos

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Ratings Affirmed

Commerzbank AG

Subordinated BBB-

Dresdner Funding Trust I

Junior Subordinated BB

Dresdner Funding Trust IV

Subordinated BBB-

HT1 Funding GmbH

Junior Subordinated BB-

[1]Guaranteed by mBank.

[2]Previously rated as senior unsecured.

[3]Guaranteed by Commerzbank AG.

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