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Research Update:

German Commerzbank Ratings Affirmed Following Risk-Adjusted Capital Criteria Revision; UCO Removed; Outlook Negative

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Overview

- On July 20, 2017, we published an update to our risk-adjusted capital (RAC) framework methodology.
- Under the new methodology, we estimate that Commerzbank's pro forma RAC ratio at end-2016 declined by roughly 140 basis points to about 9%, mainly from the introduction of credit value adjustment charges and our now more conservative treatment of deferred tax assets.
- We expect that Commerzbank will recover its capital ratios over the coming two years on the back of restored profitability and related earnings retention, further risk reductions in nonstrategic portfolios, and finalized restructuring.
- We are affirming our 'A-/A-2' ratings on the bank, and removing the under criteria observation designation previously assigned to the long-term ratings.
- 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, or the bank fails to replenish its capitalization.

Rating Action

On Aug. 8, 2017, S&P Global Ratings affirmed its 'A-' long-term and 'A-2' short-term counterparty credit ratings on Germany-based Commerzbank AG. The outlook on Commerzbank is negative. We also affirmed our issue ratings on the bank's debt.

In addition, we affirmed our 'BBB+/A-2' long- and short-term counterparty credit ratings on mBank, Commerzbank's strategically important Polish subsidiary. The outlook is negative.

With our criteria review complete, we removed the UCO (under criteria observation) designation that we had assigned to the long-term credit rating on Commerzbank, the issue ratings on its debt, and the long-term issuer credit on mBank.

Rationale

The affirmation follows our review of the effect on Commerzbank of our revised risk-adjusted capital (RAC) framework, which we published on July 20, 2017

(see "Risk-Adjusted Capital Framework Methodology," on RatingsDirect). We think that Commerzbank will sufficiently improve its capitalization in the next two years, thereby offsetting constraints on its capital metrics under our new RAC methodology for evaluating the capital adequacy of a bank and certain nonbank financial institutions.

We continue to assess Commerzbank's capitalization as neutral on aggregate, in conjunction with our view of its risk position in light of management's progress in restructuring the bank, reducing the nonstrategic asset portfolio, and restoring profitability. While we continue to see the bank's exposure to industries such as shipping as problematic, we do not think they pose an immediate risk to the bank's capitalization in 2017. We assume that these exposures are manageable and absorbable within pre-provision earnings, as they were in 2016.

We believe that Commerzbank's mid-year 2017 results, which the bank announced on Aug. 2, 2017, are almost in line with our previous expectations but indicate a somewhat more rapid and less costly restructuring progress. The bank posted a €292 million pre-tax loss at end-June, mainly due to an €807 million one-time restructuring charge required for the full financial year compared with the bank's original forecast of restructuring charges of €550 million each year over 2017-2018. Despite this setback, Commerzbank forecasts a small profit by end-2017. Moreover, the bank management improved its credit cost forecast to €800 million by year-end 2017 as part of its de-risking measures, reflecting in particular an expected 38% reduction of its shipping portfolio to €3 billion and a drop in related credit costs to €450 million in its entire exit restructuring portfolio by year-end 2017 compared to Commerzbank's previous guidance of €450 million-€600 million in its shipping portfolio only. At this stage, however, we continue to foresee some challenges for Commerzbank, notably in delivering sufficient shareholder returns absent a cyclical recovery. We anticipate that the bank will generate only a 3%-6% return on equity over our forecast horizon.

We expect that, during the next two years, Commerzbank will aim to maintain a strong capital position, in our view. As such, we anticipate that the bank will restore its capital ratios modestly to above 10% under our revised RAC methodology, based on improved profitability and related earnings retention into capital, further risk reductions in nonstrategic portfolios, and finalized restructuring. We estimate that Commerzbank's pro forma RAC ratio at end-2016 declined by roughly 140 basis points to about 9% due to the application of our revised RAC methodology, mainly from introduction of credit value adjustment charges and our now more conservative treatment of deferred tax assets. However, we believe that the level of Commerzbank's nonperforming loans and loan loss provisions remain above those of many of its peers with similar weighted economic risk exposure.

The ratings on Commerzbank continue to be supported by our view of the robust German economy and the bank's leading franchise in German corporate banking, particularly among large and midsize enterprises and in trade finance. We also acknowledge that Commerzbank maintains its retail banking division's strong

focus on private wealth management, despite its downsizing over recent years.

We also factor into our assessment of Commerzbank's creditworthiness the benefits from additional loss-absorbing capacity (ALAC) support. We estimate that the bank will continue to moderately improve its total loss-absorbing capacity to roughly 7.0%-7.5% by 2018, comfortably above the 5% threshold for a one-notch rating uplift. Commerzbank's ALAC buffer grew after accounting for the reclassification of standard term debt as senior subordinated instruments under the retroactive change to German law that was introduced in January 2017.

The ratings and outlook on mBank mirror those on Commerzbank. This is because we continue to view mBank as strategically important to Commerzbank. We note that mBank's estimated RAC ratio, based on our revised methodology, is unchanged at about 10.1%. As such, our ratings on mBank continue to benefit from two notches for potential group support.

Outlook

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

If German economic risk heightened, we would likely revise the anchor for Commerzbank downward 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 replenish our forecast RAC ratio above the 10% threshold that supports our assessment of its capital and earnings. Although a weakening in German economic risk could challenge our assessments of both the anchor and Commerzbank's capital and earnings, we currently see downside risk to both the stand-alone credit profile and rating as limited to one notch at most.

We could revise the outlook to stable if we reassessed our economic risk trend for the German banking industry to stable, or if we observed 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
SACP	bbb+
Anchor	a-

Business Position	Moderate (-1)
Capital and Earnings	Strong (+1)
Risk Position	Moderate (-1)
Funding and Liquidity	Average and Adequate (0)
Support	+1
ALAC Support	+1
GRE Support	0
Group Support	0
Sovereign Support	0
Additional Factors	0

Related Criteria

- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables, June 1, 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: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

Ratings List

Ratings Affirmed

Commerzbank AG

Counterparty Credit Rating	A-/Negative/A-2
Senior Unsecured	A-
Senior Unsecured	A-p
Subordinated	BBB
Subordinated	BBB-
Subordinated	cnA
Commercial Paper	A-2
mBank	
Counterparty Credit Rating	BBB+/Negative/A-2
Commerzbank U.S. Finance Inc.	
Commercial Paper [1]	A-2
Dresdner Funding Trust I	
Junior Subordinated [1]	BB
Dresdner Funding Trust IV	
Subordinated [1]	BBB-
HTI Funding GmbH	
Junior Subordinated [1]	BB-
mFinance France S.A	
Senior Unsecured [2]	BBB+

[1] Guaranteed by Commerzbank AG.

[2] Guaranteed by mBank.

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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