MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades Deutsche Hypo's Public-Sector Pfandbriefe, confirms Mortgage Pfandbriefe

Global Credit Research - 07 Jul 2017

London, 07 July 2017 -- Moody's Investors Service has today downgraded to Aa2 from Aa1 (on review for downgrade) the public-sector Pfandbriefe issued by Deutsche Hypothekenbank (Actien-Gesellschaft) (Deutsche Hypo; CR assessment Baa2(cr)). At the same time we confirmed the Aa1 ratings assigned to its mortgage Pfandbriefe.

This rating action concludes the review for downgrade of both Pfandbriefe initiated on 19 April 2017.

RATINGS RATIONALE

Today's rating action is prompted by the downgrade of the issuer's counterparty risk (CR) assessment. For further details, see "Moody's downgrades NORD/LB's and its subsidiaries' deposits to Baa2 and senior unsecured ratings to Baa3, outlook negative", published on 30 June 2017.

Moody's has downgraded the public sector Pfandbriefe to Aa2,because looking forward, it does not expect over-collateralisation (OC) in excess of the 2% (on a stressed NPV basis) required by the German Pfandbrief Act,which is consistent with a Aa2 rating.

Moody's has confirmed the Aa1 rating assigned to the mortgage Pfandbriefe because looking forward, it expects that OC will be maintained at a level consistent with a Aa1 rating.

KEY RATING ASSUMPTIONS/FACTORS

Moody's determines covered bond ratings using a two-step process: an expected loss analysis and a TPI framework analysis.

EXPECTED LOSS: Moody's uses its Covered Bond Model (COBOL) to determine a rating based on the expected loss on the bond. COBOL determines expected loss as (1) a function of the probability that the issuer will cease making payments under the covered bonds (a CB anchor); and (2) the stressed losses on the cover pool assets should the issuer cease making payments under the covered bonds (i.e., a CB anchor event).

The CB anchor for both programmes is CR assessment plus one notch. The CR assessment reflects an issuer's ability to avoid defaulting on certain senior bank operating obligations and contractual commitments, including covered bonds. Moody's may use a CB anchor of CR assessment plus one notch in the European Union or otherwise where an operational resolution regime is particularly likely to ensure continuity of covered bond payments.

--- Deutsche Hypo Mortgage Pfandbriefe ---

The cover pool losses for this programme are 17.5%. This is an estimate of the losses Moody's currently models following a CB anchor event. Moody's splits cover pool losses between market risk of 11.3% and collateral risk of 6.2%. Market risk measures losses stemming from refinancing risk and risks related to interest-rate and currency mismatches (these losses may also include certain legal risks). Collateral risk measures losses resulting directly from cover pool assets' credit quality. Moody's derives collateral risk from the collateral score, which for this programme is currently 9.3%.

The over-collateralisation in the cover pool is 20.0%, of which Deutsche Hypo provides 2.0% on a "committed" basis. The minimum OC level consistent with the Aa1 rating is 15.5%, of which the issuer should provide 0.0% in a "committed" form (all numbers on present value basis). These numbers show that Moody's is relying on "uncommitted" OC in its expected loss analysis.

All numbers in this section are based on the most recent Performance Overview (based on data as per 31 December 2016), with the exception of the OC level consistent with the current rating.

--- Deutsche Hypo Public-Sector Pfandbriefe ---

The cover pool losses for this programme are 12.0%. This is an estimate of the losses Moody's currently models following a CB anchor event. Moody's splits cover pool losses between market risk of 9.0% and collateral risk of 3.1%. Market risk measures losses stemming from refinancing risk and risks related to interest-rate and currency mismatches (these losses may also include certain legal risks). Collateral risk measures losses resulting directly from cover pool assets' credit quality. Moody's derives collateral risk from the collateral score, which for this programme is currently 6.1%.

The over-collateralisation in the cover pool is 14.5%, of which Deutsche Hypo provides 2.0% on a "committed" basis. The minimum OC level consistent with the Aa2 rating is 2.0%, of which the issuer should provide 0.0% in a "committed" form (all numbers on present value basis). These numbers show that Moody's is not relying on "uncommitted" OC in its expected loss analysis.

All numbers in this section are based on the most recent Performance Overview (based on data as per 31 December 2016), with the exception of the OC level consistent with the current rating.

For further details on cover pool losses, collateral risk, market risk, collateral score and TPI Leeway across covered bond programmes rated by Moody's please refer to "Moody's Global Covered Bonds Monitoring Overview", published quarterly.

TPI FRAMEWORK: Moody's assigns a "timely payment indicator" (TPI), which measures the likelihood of timely payments to covered bondholders following a CB anchor event. The TPI framework limits the covered bond rating to a certain number of notches above the CB anchor.

The mortgage and public-sector Pfandbriefe have a TPI of High.

Factors that would lead to an upgrade or downgrade of the ratings:

The CB anchor is the main determinant of a covered bond programme's rating robustness. A change in the level of the CB anchor could lead to an upgrade or downgrade of the covered bonds. The TPI Leeway measures the number of notches by which Moody's might lower the CB anchor before the rating agency downgrades the covered bonds because of TPI framework constraints.

Based on the current TPI of "High", the TPI Leeway for Deutsche Hypo's mortgage Pfandbriefe is one notch. This implies that Moody's might downgrade the covered bonds because of a TPI cap if it lowers the CB anchor by two notches, all other variables being equal.

Based on the current TPI of "High", the TPI Leeway for Deutsche Hypo's public-sector Pfandbriefe is two notches. This implies that Moody's might downgrade the covered bonds because of a TPI cap if it lowers the CB anchor by two notches, all other variables being equal.

A multiple-notch downgrade of the covered bonds might occur in certain circumstances, such as (1) a country ceiling or sovereign downgrade capping a covered bond rating or negatively affecting the CB Anchor and the TPI; (2) a multiple-notch downgrade of the CB Anchor; or (3) a material reduction of the value of the cover pool.

RATING METHODOLOGY

The principal methodology used in these ratings was "Moody's Approach to Rating Covered Bonds" published in December 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions of the disclosure form.

Moody's did not use any stress scenario simulations in its analysis.

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