MOODY'S
INVESTORS SERVICE

Rating Action: Moody's upgrades Mortgage Covered Bonds of Deutsche Pfandbriefbank AG

Global Credit Research - 11 Nov 2015

Frankfurt am Main, November 11, 2015 -- Moody's Investors Service has upgraded to Aa1 from Aa2 ratings assigned to mortgage covered bonds issued by Deutsche Pfandbriefbank AG (Pfandbriefbank; not rated) under the German Pfandbrief Act.

RATINGS RATIONALE

Moody's upgrade follows Pfandbriefbank's decision to enter into an agreement to maintain over-collateralisation (OC) for its mortgage covered bonds on an unstressed net present value (NPV) basis in a form that Moody's considers "committed". This agreement has been signed and comes into effect on 9 November 2015. The OC comes in the form of a contract for the benefit of a third party, the bondholders. The commitment will apply to all currently outstanding and to all future mortgage covered bonds issued under Pfandbriefbank's debt issuance programme.

Under the agreement, Pfandbriefbank initially provides for 3.0% OC in committed form. Pfandbriefbank's agreement tracks the level of OC consistent with the Aa3 rating as long as the mortgage covered bonds are rated Aa1 or better. OC consistent with an Aa3 rating is 2.5%. For covered bonds issued under the German Pfandbrief Act, Moody's gives value for uncommitted OC which allows for a two notch uplift of the covered bond rating over and above the rating that is achievable with the higher of committed or statutory OC.

The minimum OC level consistent with an Aa1 rating target is 11.0%.

The level of committed OC will be based on the most recent published OC level consistent with an Aa3 rating (as it is published, for example, in Moody's performance overviews). If the covered bonds have been downgraded to a rating below Aa1, the last published OC level consistent with an Aa3 rating would apply. The maximum committed OC to be posted under the agreement is 6.0%.

Under Moody's rating approach only limited value is given to collateral that is not considered "committed". Moody's considers over-collateralisation (OC) to be "committed" if the issuer's discretion to remove this is sufficiently restricted.

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 event); and (2) the stressed losses on the cover pool assets following a CB anchor event.

The cover pool losses for this programme are 16.3%. 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 9.2% and collateral risk of 7.1%.

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 10.6%.

The over-collateralisation in the mortgage cover pool is 27.1%, of which Pfandbriefbank provides 3.0% on a "committed" basis. The minimum OC level consistent with the Aa1 rating target is 11.0%, of which the issuer should provide 2.5% in a "committed" form (numbers in present value terms). These numbers show that Moody's is relying on "uncommitted" OC in its expected loss analysis.

All numbers in this section are based on Moody's most recent modelling based on data as per 30 June 2015.

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.

For Pfandbriefbank's mortgage covered bonds, Moody's has assigned 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 this programme is zero notches. This implies that Moody's might downgrade the covered bonds because of a TPI cap if it lowers the CB anchor by one notch 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 August 2015. Please see the Credit Policy 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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