S&P Global Ratings

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Hamburg Commercial Bank AG And Deutsche Pfandbriefbank AG Ratings Removed From CreditWatch Negative And Affirmed

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- Despite Hamburg Commercial Bank AG and Deutsche Pfandbriefbank AG's sizeable bail-in buffers, we see their resolution strategy as the key determinant to whether senior preferred creditors would continue to be paid on time and in full if the banks failed.
- We now see a slightly reduced risk that the banks would be targeted for insolvency instead of an open bank bail-in resolution.
- We are therefore affirming our ratings on both banks and removing them from CreditWatch negative.
- Our negative outlooks on the two banks reflect the continued possibility that we could remove additional loss-absorbing capacity (ALAC) uplift from our ratings and sustained downside risks arising from the weakened economic environment.

FRANKFURT (S&P Global Ratings) Dec. 15, 2020--S&P Global Ratings today affirmed its long- and short-term issuer credit ratings on German banks Hamburg Commercial Bank AG (HCOB; BBB/A-2) and Deutsche Pfandbriefbank AG (pbb; A-/A-2) and removed them from CreditWatch, where we placed them with negative implications on Aug. 27, 2020, and Sept. 15, 2020, respectively.

We also affirmed the resolution counterparty ratings of 'BBB+/A-2' for HCOB and 'A/A-1' for pbb (see the Ratings List for full details).

The outlooks on the long term issuer credit ratings on both banks are negative.

The affirmations reflect our developing view on the EU Single Resolution Board's (SRB's) stance toward midsize banks under its supervision, like Germany's pbb and HCOB. Although the banks continue to maintain sizeable bail-in buffers, the SRB resolution strategy for them is likely to be the key determinant of whether senior preferred creditors would continue to be paid on time and in full if the banks failed. We removed the ratings on both pbb and HCOB from CreditWatch negative because we see slightly reduced risk of a sustained shift in the resolution strategy, and because we expect that the SRB's stance will only become clearer in the coming 12 months or more.

In late summer, we perceived a shift in the regulatory stance, suggesting that the two banks might be targeted for modified liquidation rather than an open bank bail-in resolution. However, the situation is highly nuanced--the banks are significant institutions in Germany under European Central Bank (ECB) and SRB supervision, with established resolution plans, and large subordinated bail-in buffers already available. These buffers could facilitate a bail-in of senior nonpreferred creditors to ensure full and timely payment for senior preferred creditors should these banks fail. However, the use of resolution tools, like bail-in, depends heavily on the public interest assessment (PIA)--the regulatory assessment of whether it would be in the public interest to do so.

In its 2021-2023 work program, published on Nov. 30, 2020, the SRB confirmed that it will review its PIA policy. We expect that this could carry important implications for its stance toward pbb and HCOB, although we will also look for indications of its resolution strategy beyond this policy review. If we conclude that the SRB's resolution strategy for these two banks would likely not ensure the full and timely payment on all their senior preferred obligations, we would remove the ALAC uplift that we currently incorporate in the long term issuer credit ratings. We would likely also withdraw our resolution counterparty ratings on both banks.

Deutsche Pfandbriefbank AG

Pbb does not publish its minimum requirement for own funds and eligible liabilities (MREL), but currently targets its own buffer of at least 8% of its total liabilities and own funds (TLOF). Although the bank has not announced a significant revision to its MREL, we consider it possible, indicating a potentially durable revision in the SRB's resolution strategy for the bank.

We acknowledge that pbb currently has a sizable MREL ratio of about 14% of TLOF, mainly due to a retroactive German law implemented on Jan. 1, 2017, that turned certain long-term senior unsecured bonds into subordinated instruments in a resolution and liquidation scenario. Under our ALAC measure, this translates into a ratio of ALAC to S&P Global Ratings' risk-weighted assets (RWAs) of above 20%, currently the highest of any European bank we rate. Even without any new issuances, the ratio will remain well above our 8% threshold for a two-notch uplift over the next two years. However, eligibility for ALAC uplift hinges not only on the buffer, but also that there is a supportive resolution strategy.

In our view, pbb has so far demonstrated resilience against difficult operating conditions in its main markets in Europe and the U.S. In the first nine months of 2020, it reported manageable net loan-loss provisions of €84 million that led to pre-tax profit declining to €106 million from €187 million one year ago. Those results somewhat exceeded our previous conservative expectations of recession-affected performance in 2020. However, we now assume that beyond some specific commercial real estate (CRE) segments, such as hotels or retail, that suffered immediately (about 5% or 16% of pbb's total CRE exposure respectively), the overall impact on pbb's asset quality will emerge more gradually in 2021-2022. We expect moderate further loss provisioning in fourth-quarter 2020 and in 2021. However, we also note relatively higher single-name concentrations intrinsic with its business model that could yet lead to material losses.

In our base case, we expect our risk-adjusted capital (RAC) ratio for the bank will remain comfortably above 10% over the coming two years, also supported by pbb's removal of the 2019-dividend proposal in line with the ECB's recommendation. It remains possible that the payout from 2020 earnings will also be reduced. In our view, this provides a further buffer to absorb increases in credit losses.

Outlook

The negative outlook on pbb reflects continued uncertainty around its resolution strategy and the potential removal of the ALAC uplift within the next 12-24 months. In the context of the COVID-19 pandemic, we note also rising economic and industry risks for the German banking sector on top of increasing economic risks in pbb's other countries of operations.

Downside scenario:

We would likely lower the 'A-' long-term issuer credit rating and withdraw the 'A' long-term resolution counterparty rating if we conclude that pbb would not be targeted for a well-defined bail-in-led resolution that would ensure the full and timely payment on the bank's senior preferred obligations. This would not affect our issue ratings on the bank's senior nonpreferred and other hybrid capital instruments, because they are notched with reference to our 'bbb' assessment of pbb's stand-alone credit profile (SACP).

We could also lower the SACP, issuer credit, and issue ratings in the next 12-24 months, if we see deeper pressure on economic and industry risks in Germany and/or pbb's other key countries of operation. A downgrade could be spurred by a negative revision in our capital projection, for example, because impairments appear likely to bring the bank's RAC ratio below the 10% threshold.

Upside scenario:

A revision of the outlook to stable depends on two positive developments. First, if we conclude that the SRB's resolution strategy for pbb would likely ensure full and timely payment on the bank's senior preferred obligations. This also depends on pbb maintaining its existing high ALAC buffer. Second, we would need to consider that risks for the banking sector had stabilized and that pbb will sustainably maintain a favorable capital position and asset quality.

Hamburg Commercial Bank AG

HCOB currently meets its MREL of 6.1% of TLOF comfortably. The bank's ALAC ratio is above 10% and, even without any new issuances, we expect that it will remain well above our 8% threshold for a two-notch uplift over the next two years. Should we remove the ALAC uplift, we would likely also remove the negative adjustment notch currently reflected in the long term issuer credit rating. As a result, we would likely lower the rating only by one notch to 'BBB-', leaving it in line with our current 'bbb-' assessment of HCOB's SACP.

Looking beyond its resolvability, HCOB shows improving earnings metrics, albeit from relatively poor levels compared with those of peers with similar credit profiles. HCOB's deleveraging over 2020 was stronger than expected, with an expected reduction in S&P Global Ratings RWAs of about 17% until year-end. This pushed up the bank's capitalization between year-end 2019 and June 30, 2020--the regulatory Common Equity Tier 1 ratio rose to 21.7% from 18.5%, and our RAC ratio to 13.1% from 11.6%. Under our base case, the RAC ratio could increase to close to 15% by year-end 2022, considering a further moderate reduction in RWA's and full earnings retention over 2021 and 2022.

However, we remain mindful that HCOB's asset-quality metrics could weaken in 2021 when government support programs will run off and requirements around insolvency filings resume in Germany. For first-half 2020, HCOB reported net new loan-loss provisions of €94 million or 64 basis points (bps), including the reversal of some general provisions (model overlay) built in previous years. As part of the bank's de-risking program, it actively reduced nonperforming and performing exposure. This should somewhat attenuate the need for additional provisions in 2021.

Nevertheless, similar to peers', we consider HCOB's asset quality susceptible to a weaker macroeconomic environment than our current base case for Germany of a 5.6% GDP contraction in 2020 and a 3.7% growth recovery in 2021. We assume that HCOB will have built loan-loss reserves that cover 2.0%-2.5% of gross customer loans at year-end 2020. For 2021, we assume credit losses of about 60 bps, for example, from stage migrations or customers not able to resume payments after moratoria run out. Over 2020, we started to see tangible progress on the bank's cost restructuring. After an expected cost reduction of 20% in S&P Global Ratings-adjusted metrics over 2020, we expect further double-digit percentage drops in 2021 and 2022. This should support improving profitability metrics in 2021 and 2022, despite current revenue headwinds.

HCOB's financial performance over 2020 and 2021 will be crucial for its transition to the private banks deposit protection scheme. We expect HCOB will comply with the agreed terms to ensure senior membership in the private deposit protection scheme toward year-end 2021, so long as the economic environment does not deteriorate further beyond our base case.

Outlook

The negative outlook on HCOB reflects continued uncertainty around its resolution strategy and the potential removal of the ALAC uplift within the next 12-24 months. We also continue to monitor management's progress in business development and its influence on the balance sheet, in the context of an unsupportive macroeconomic and competitive environment that will likely persist well into 2021.

Downside scenario: We would likely lower the 'BBB/A-2' ratings and withdraw the 'BBB+' long-term resolution counterparty rating if we conclude that HCOB would not be targeted for a well-defined bail-in-led resolution that would ensure the full and timely payment on the bank's senior preferred obligations.

We could also lower the SACP and issuer credit ratings if we see deeper pressure from economic and industry risks in Germany and, at the same time, limited improvement in HOCB's return to sustainable profitability levels or a robust balance sheet.

Upside scenario: A revision of the outlook to stable depends on the occurrence of two positive developments. First, if we conclude that the SRB's resolution strategy for HCOB would likely ensure full and timely payment on the bank's senior preferred obligations. This also depends on HCOB maintaining its existing high ALAC buffer. Second, we would need to see that HCOB had not suffered particularly from the 2020 recession and that downside risks to our 2021 base case were receding.

Ratings Score Snapshot

Deutsche Pfandbriefbank AG

	To	From
Issuer Credit Ratings	A-/Negative/A-2	A-/Watch Neg/A-2
SACP	bbb	bbb
Anchor	a-	a-
Business Position	Weak (-2)	Weak (-2)
Capital & Earnings	Strong (+1)	Strong (+1)
Risk Position	Moderate (-1)	Moderate (-1)
Funding and Liquidity	Average and Adequate (0)	Average and Adequate (0)
Support	(2)	(2)

Deutsche Pfandbriefbank AG (cont.)

	To	From
ALAC Support	(2)	(2)
GRE Support	(0)	(0)
Group Support	(0)	(0)
Sovereign Support	(0)	(0)
Additional factors	(0)	(0)
Resolution Counterparty Rating	A-/--/A-	A-/Watch Neg/A-1
Senior Unsecured	A-	A-/Watch Neg

Hamburg Commercial Bank AG

	To	From
Issuer Credit Ratings	BBB/Negative/A-2	BBB/Watch Neg/A-2
SACP	bbb-	bbb-
Anchor	a-	a-
Business Position	Weak (-2)	Weak (-2)
Capital & Earnings	Strong (+1)	Strong (+1)
Risk Position	Moderate (-1)	Moderate (-1)
Funding and Liquidity	Below Average and Adequate (-1)	Below Average and Adequate (-1)
Support	(2)	(2)
ALAC Support	(2)	(2)
GRE Support	(0)	(0)
Group Support	(0)	(0)
Sovereign Support	(0)	(0)
Additional factors	(-1)	(-1)
Resolution Counterparty Rating	BBB+/--/A-2	BBB+/Watch Neg/A-2

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- 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
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015

- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Europe's Middle Ranking Banks Face A Peculiar Resolvability Conundrum, Dec. 3, 2020
- The Resolution Story For Europe's Banks: More Flexibility For Now, More Resilience Eventually, Sept. 28, 2020
- Deutsche Pfandbriefbank 'A-' Rating Placed On CreditWatch Negative On Resolution Strategy Uncertainty, Sept. 15, 2020
- Hamburg Commercial Bank 'BBB/A-2' Ratings Placed On CreditWatch Negative On Resolution Strategy Uncertainty, Aug. 27, 2020
- Deutsche Pfandbriefbank AG, July 23, 2020
- Hamburg Commercial Bank AG, July 20, 2020

Ratings List

************ Deutsche Pfandbriefbank AG ************		
Ratings Affirmed		
Deutsche Pfandbriefbank AG		
Analytical Factors		
Local Currency	bbb	
Deutsche Pfandbriefbank AG		
Senior Subordinated	BBB-	
Subordinated	BB+	
Junior Subordinated	BB-	
Commercial Paper	A-2	
Ratings Affirmed; CreditWatch/Outlook Action		
	To	**From**
Deutsche Pfandbriefbank AG		
Issuer Credit Rating	A-/Negative/A-2	A-/Watch Neg/A-2
Resolution Counterparty Rating	A/A-1	A/Watch Neg/A-1
Deutsche Pfandbriefbank AG		
Senior Unsecured	A-	A-/Watch Neg

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Ratings Affirmed; CreditWatch/Outlook Action		
	To	**From**
Hamburg Commercial Bank AG		
Issuer Credit Rating	BBB/Negative/A-2	BBB/Watch Neg/A-2
Resolution Counterparty Rating	BBB+/A-2	BBB+/Watch Neg/A-2

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. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on 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.