

Rating Action: Moody's assigns first-time Aa1 long-term ratings to DZ HYP AG; outlook negative

16 Feb 2021

Frankfurt am Main, February 16, 2021 -- Moody's Investors Service (Moody's) has today assigned first-time Aa1 long-term deposit and issuer ratings as well as long-term Counterparty Risk Ratings (CRRs) to DZ HYP AG (DZ HYP). Concurrently, the rating agency assigned a ba1 Baseline Credit Assessment (BCA), an a2 Adjusted BCA, (P)Aa1 long-term senior unsecured program ratings and (P)A2 junior senior unsecured program ratings to DZ HYP. Further, Moody's assigned P-1 short-term deposit and issuer ratings, as well as P-1 short-term CRRs and a Aa1(cr)/P-1(cr) Counterparty Risk Assessment (CR Assessment) to the bank. The outlook on DZ HYP's long-term deposit and issuer ratings is negative.

A full list of assigned ratings and rating inputs can be found at the end of this press release.

RATINGS RATIONALE

-- BASELINE CREDIT ASSESSMENT

The ba1 BCA of DZ HYP is constrained by the bank operating what the rating agency considers a monoline business model as a commercial real estate lending specialist, exposing the bank to considerable concentration risks. The bank's BCA further reflects the bank's very strong asset quality and satisfactory funding profile, benefiting from access to ample surplus liquidity in the German cooperative banking sector. DZ HYP's weak standalone capitalisation is mitigated by a control and profit-and-loss transfer agreement ("P&L transfer agreement") with the bank's parent DZ BANK AG (DZ BANK, deposits Aa1/senior unsecured Aa1 negative, BCA baa2) which exempts DZ HYP from regulatory minimum capital requirements at single entity level.

Moody's expects DZ HYP's problem loan ratio to weaken only moderately from its very strong level of 0.2% as of June 2020 and profitability to remain low but positive within the context of a challenging economic environment shaped by the coronavirus pandemic. DZ HYP's asset quality benefits from a lower-risk profile of the bank's commercial real estate lending. During the first six months of 2020, new lending business of DZ HYP has been lower than during the same period last year across all lending areas of DZ HYP, which include supplementary activities in residential mortgage and public sector lending, but the credit performance of the bank's loan book has remained strong.

Moody's does not have any particular governance concerns for DZ HYP. The bank has not shown any material governance shortfall in recent years and its risk management framework is commensurate with its risk appetite.

-- ADJUSTED BASELINE CREDIT ASSESSMENT

In Moody's view, the contractual commitment of DZ BANK to absorb DZ HYP's losses in case of need, paired with the standalone membership of DZ HYP in the institutional protection scheme of Germany's cooperative banking sector, Genossenschaftliche FinanzGruppe (G-Finanzgruppe) justify DZ HYP's Adjusted BCA to be aligned with the Adjusted BCA of its parent DZ BANK.

DZ BANK own 96.4% of DZ HYP's shares, and the rating agency considers DZ HYP a core part of the group's operations as the sole dedicated commercial real estate lender within G-Finanzgruppe. The alignment of DZ HYP's Adjusted BCA with that of its parent is further underpinned by an extended track record of support provision for individual subsidiaries of DZ BANK and member banks of G-Finanzgruppe.

G-Finanzgruppe's support materially reduces the probability of default because the cooperative group's cross-sector support mechanism aims to stabilise its members by avoiding any form of loss participation by creditors or bail-in.

-- LONG-TERM DEPOSIT, ISSUER AND COUNTERPARTY RISK RATINGS

DZ HYP's Aa1 long-term deposit and issuer ratings as well as its (P)Aa1 senior unsecured program ratings

reflect the bank's ba1 BCA and its a2 Adjusted BCA and the outcome of Moody's Advanced Loss Given Failure (LGF) analysis. The LGF analysis takes into account the severity of losses faced by the different liability classes in resolution and results in three notches of rating uplift from the bank's Adjusted BCA. In addition, Moody's assumes a moderate probability of government support for DZ HYP's senior liabilities, leading to one notch of rating uplift.

DZ HYP is subject to the EU Bank Recovery and Resolution Directive, which Moody's considers an operational resolution regime. For DZ HYP as a domestic subsidiary with close ties to its parent bank, Moody's expects resolution measures to be taken at the level of DZ BANK, being the most senior group entity. Accordingly, the rating agency applies the outcome of its LGF analysis based on DZ BANK's resolution perimeter to DZ HYP.

Moody's assessment of government support reflects DZ HYP's membership in G-Finanzgruppe, which Moody's considers as a whole a systemic group within the German banking system.

-- RATIONALE FOR THE NEGATIVE OUTLOOK

The negative outlook on the long-term deposit and issuer ratings reflects Moody's view that the weak operating environment for banks in Germany could undermine the overall strength of Germany's cooperative banking sector, resulting in reduced affiliate support for DZ HYP and a lower Adjusted BCA and ratings.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

As indicated by the negative outlook, upward pressure on the ratings is currently unlikely. An upgrade of DZ HYP's ratings could be triggered by an improvement in the cooperative sector's financial strength, or by an enormous improvement in the intrinsic strength of DZ BANK, both of which may result in a higher Adjusted BCA of DZ HYP.

Additional rating uplift from Moody's Advanced LGF analysis could only occur for DZ HYP's junior senior unsecured program ratings. With three notches of rating uplift over the Adjusted BCA the bank's deposit and senior unsecured debt ratings already benefit from the highest-possible LGF result.

DZ HYP's BCA could be upgraded as a result of a combined improvement in the bank's solvency and liquidity metrics. A stronger combined solvency score could result from a sustainable improvement in profitability of DZ HYP, a risk reduction in DZ HYP's securities portfolio or a higher capitalisation at the level of DZ BANK. An improvement in the combined liquidity score could result from a reduced reliance on market funding or from a marked increase in liquid resources.

A downgrade of DZ HYP's ratings could arise from a downgrade of its Adjusted BCA, which would highly likely only be a result of a downgrade of its parent's Adjusted BCA, in case the cooperative sector's financial strength deteriorates, or if the results of the Advanced LGF analysis performed on the basis of the capital and liability structure of DZ BANK weaken as a result of a decline in the amount of liabilities designed to absorb losses in resolution.

A downgrade of DZ HYP's BCA would likely be offset by a higher affiliate support notching. DZ HYP's BCA could be downgraded in case of a sustainably higher dependence on market funding, as a result of a significant weakening of DZ BANK's capitalisation, or if asset losses were to rise and weaken asset quality beyond the rating agency's current expectations.

LIST OF ASSIGNED RATINGS

Issuer: DZ HYP AG

..Assignments:

....Long-term Counterparty Risk Ratings, assigned Aa1

....Short-term Counterparty Risk Ratings, assigned P-1

....Long-term Counterparty Risk Assessment, assigned Aa1(cr)

....Short-term Counterparty Risk Assessment, assigned P-1(cr)

....Long-term Bank Deposits, assigned Aa1, outlook assigned Negative

...Short-term Bank Deposits, assigned P-1
...Baseline Credit Assessment, assigned ba1
...Adjusted Baseline Credit Assessment, assigned a2
...Long-term Issuer Ratings, assigned Aa1, outlook assigned Negative
...Short-term Issuer Ratings, assigned P-1
...Senior Unsecured Medium-Term Note Program, assigned (P)Aa1
...Junior Senior Unsecured Medium-Term Note Program, assigned (P)A2
..Outlook Action:
...Outlook assigned Negative

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks Methodology published in November 2019 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1147865 . Alternatively, 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 in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1243406 .

At least one ESG consideration was material to the credit rating action(s) announced and described above.

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