Rating Action: Moody's assigns definitive Aaa ratings to DZ HYP AG - Mortgage Covered Bonds

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Frankfurt am Main, June 16, 2021 -- Moody's Investors Service ("Moody's") has today assigned definitive Aaa long-term ratings to the mortgage covered bonds (Hypothekenpfandbriefe or covered bonds) issued by DZ HYP AG (the issuer/DZ HYP, deposits/senior unsecured rating Aa1 negative; adjusted baseline credit assessment a2; counterparty risk (CR) assessment Aa1(cr)) which are governed by the German Pfandbrief Act.

RATINGS RATIONALE

A covered bond benefits from: (1) the issuer's promise to pay interest and principal on the bonds; and (2) following a CB anchor event, the economic benefit of a collateral pool (the cover pool). The ratings therefore reflect the following factors:

(1) The credit strength of DZ HYP and a CB anchor of CR assessment plus 1 notch.

(2) Following a CB anchor event the value of the cover pool. The stressed level of losses on the cover pool assets following a CB anchor event (cover pool losses) for this transaction is 17.4%.

Moody's considered the following factors in its analysis of the cover pool's value:

a) The credit quality of the assets backing the covered bonds. The mortgage covered bonds are backed primarily by German commercial and residential mortgage loans. The collateral score for the cover pool is 11.8%.

b) The legal framework. Notable aspects of the German Pfandbrief legislation include:

(i) The legal requirement for the issuer to maintain 2% over-collateralisation (OC) on a stressed present value basis.

(ii) The framework imposes a loan-to-value (LTV) ratio threshold of 60% based on a clearly defined lending value.

(iii) The issuer must also cover potential liquidity gaps over the next 180 days between payments expected to be received under the cover pool assets and the payments due under the outstanding covered bonds.

c) The exposure to market risk, which is 9.5% for this cover pool.

d) The over-collateralisation (OC) in the cover pool is 22.0%, of which DZ HYP provides 2.0% on a "committed" basis (see Key Rating Assumptions/Factors, below).

The TPI assigned to this transaction is High. Moody's TPI framework does not constrain the ratings.

At present, the total value of the assets included in the cover pool is approximately EUR 38.1 billion, comprising 14,688 commercial mortgage loans, 95,034 residential mortgage loans, and substitute assets. The commercial mortgage loans have a weighted average (WA) seasoning of 52 months and a WA LTV ratio of 69.6%. The residential mortgage loans have a WA seasoning of 74 months and a WA loan-to-value (LTV) ratio of 54.4%.

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 CB anchor for this programme is CR assessment plus 1 notch.

The cover pool losses for DZ HYP’s mortgage covered bonds are 17.4%. 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 9.5% and collateral risk of 7.9%. 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 11.8%.

The over-collateralisation in the cover pool is 22.0%, of which DZ HYP provides 2.0% on a "committed" basis. Under Moody's COBOL model, the minimum OC consistent with the Aaa ratings is 0.0%, of which 0.0% needs to be in "committed" form to be given full value (numbers in present value terms). These numbers show that Moody's is not relying on "uncommitted" OC in its expected loss analysis.

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 "Covered Bonds Sector Update", published quarterly.

TPI FRAMEWORK: Moody's assigns a "timely payment indicator" (TPI), which is our assessment of the likelihood of timely payment of interest and principal to covered bondholders following a CB anchor event. TPIs are assessed as Very High, High, Probable-High, Probable, Improbable or Very Improbable. The TPI framework limits the covered bond ratings to a certain number of notches above the CB anchor.

For DZ HYP - Mortgage Covered Bonds, Moody's has assigned a TPI of High.

RATING METHODOLOGY


Please note that a Request for Comment was published in which Moody's requested market feedback on potential revisions to one or more of the methodologies used in determining these Credit Ratings. If the revised methodologies are implemented as proposed, it is not currently expected that Credit Ratings referenced in this press release will be affected.

Request for Comments can be found on the rating methodologies page on www.moodys.com.

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 seven notches. This implies that Moody's might downgrade the covered bonds because of a TPI cap if it lowers the CB anchor by eight 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.

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

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