MOODY'S INVESTORS SERVICE

Credit Opinion: DekaBank Deutsche Girozentrale

Global Credit Research - 30 Jul 2015

Frankfurt am Main, Germany

Ratings

Category	Moody's Rating
Outlook	Positive(m)
Bank Deposits	Aa3/P-1
Bkd Bank Deposits	Aaa/P-1
Baseline Credit Assessment	baa2
Adjusted Baseline Credit Assessment	a3
Senior Unsecured -Dom Curr	Aa3
Subordinate MTN -Dom Curr	(P)Baa1
Pref. Stock Non-cumulative -Dom Curr	Baa3
Bkd Commercial Paper -Dom Curr	P-1
Other Short Term -Dom Curr	(P)P-1

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Key Indicators

DekaBank Deutsche Girozentrale (Consolidated Financials)[1]

	[2]**12-14**	[3]**12-13**	[3]**12-12**	[3]**12-11**	[3]**12-10**	**Avg.**
Total Assets (EUR billion)	**113.2**	**116.1**	**129.8**	**133.7**	**130.3**	[4]**-3.5**
Total Assets (USD billion)	**136.9**	**159.9**	**171.1**	**173.6**	**174.8**	[4]**-5.9**
Tangible Common Equity (EUR billion)	**4.1**	**3.7**	**3.5**	**3.3**	**4.1**	[4]**0.4**
Tangible Common Equity (USD billion)	**5.0**	**5.2**	**4.7**	**4.3**	**5.4**	[4]**-2.1**
Problem Loans / Gross Loans (%)	**2.2**	**2.3**	**2.7**	**2.5**	**1.6**	[5]**2.3**
Tangible Common Equity / Risk Weighted Assets (%)	**14.7**	**16.7**	**15.0**	**13.1**	**15.8**	[6]**14.7**
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	**12.2**	**16.0**	**21.9**	**22.4**	**10.5**	[5]**16.6**
Net Interest Margin (%)	**0.3**	**0.2**	**0.2**	**0.2**	**0.3**	[5]**0.2**
PPI / Average RWA (%)	**3.2**	**2.4**	**3.0**	**2.4**	**3.3**	[6]**3.2**
Net Income / Tangible Assets (%)	**0.5**	**0.3**	**0.3**	**0.2**	**0.5**	[5]**0.4**
Cost / Income Ratio (%)	**50.9**	**65.7**	**56.4**	**60.7**	**49.8**	[5]**56.7**
Market Funds / Tangible Banking Assets (%)	**69.1**	**70.3**	**77.3**	**77.2**	**78.3**	[5]**74.5**
Liquid Banking Assets / Tangible Banking Assets (%)	**43.7**	**45.4**	**45.6**	**45.9**	**47.5**	[5]**45.6**
Gross Loans / Total Deposits (%)	**47.7**	**49.7**	**76.4**	**66.4**	**129.2**	[5]**73.9**

Source: Moody's

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; IFRS [3] Basel II; IFRS [4] Compound Annual Growth Rate based on IFRS reporting periods [5] IFRS reporting periods have been used for average calculation [6] Basel III - fully-loaded or transitional phase-in & IFRS reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

On 19 June, we upgraded DekaBank Deutsche Girozentrale's (DekaBank's) long-term debt and deposit ratings to Aa3 from A1 and affirmed the bank's Prime-1 short-term debt and deposit ratings and the Aaa rating for backed subordinated debt. We also upgraded various subordinated instrument ratings (see details at the back of this report) and assigned a Counterparty Risk (CR) Assessment of Aa2(cr)/Prime-1(cr) to DekaBank.

The upgrades of DekaBank's long-term deposit and senior unsecured debt ratings reflect:

(1) the affirmation of the bank's baa2 baseline credit assessment (BCA); (2) the affirmation of the bank's a3 Adjusted BCA, thereby incorporating "very high" affiliate support from Sparkassen-Finanzgruppe (corporate family rating Aa2 stable, BCA a2) because DekaBank is fully-owned by the savings bank members of this group, which continues to result in two notches of rating uplift; (3) the introduction of our Advanced Loss Given Failure (LGF) analysis, which takes into account the severity of loss faced by the different liability classes in resolution and provides two notches of uplift from the a3 Adjusted BCA; (4) the adverse effect of our reduced "moderate" government support assumptions, yielding just one notch of support uplift instead of the previous two-notch uplift.

The affirmation of DekaBank's baa2 BCA reflects not only the group's modest asset risk, satisfactory regulatory capital ratios and strong funding position, but also the constraints of its considerable balance-sheet leverage. The BCA level incorporates our expectation that DekaBank will address this weakness and gradually improve its absolute capital levels.

DEKABANK'S RATINGS ARE SUPPORTED BY ITS STRONG+ MACRO PROFILE

Almost three quarters of DekaBank's assets are in Germany with the remainder mostly in the stronger European Union (EU) countries, resulting in a macro score of Strong+.

German banks benefit from operating in an environment with very high economic, institutional and government financial strength and very low susceptibility to event risk. Low and declining private sector debt and a stable housing price cycle support credit conditions. Funding conditions benefit from a strong domestic deposit base and good wholesale market access. However, operating conditions for the German banking system are constrained by high fragmentation in an over-saturated market, low fee income generation and intensifying competition for domestic business.

RATING DRIVERS

- Capitalisation is sound in the context of its low-risk asset profile, although leverage remains high

- Risk-adjusted profitability is robust

- Dependence on wholesale funds is mitigated by DekaBank's highly liquid balance sheet

- DekaBank enjoys strong support from Sparkassen-Finanzgruppe

- Senior creditors benefit from ample subordinated instruments, which provide a buffer in resolution

Rating Outlook

The outlook on the long-term deposit rating is positive while that of the long-term senior unsecured debt rating is negative. The different outlooks reflect the potential for legislation in Germany that could subordinate senior debt to deposits to the benefit of depositors and to the detriment of senior unsecured creditors. Such a modified insolvency order in Germany would place diverging pressures on DekaBank's senior debt and deposit ratings.

What Could Change the Rating - Up

Upward pressure on the baa2 BCA would be subject to a sustained lowering of the bank's concentration risk to financial intermediaries, along with a significant improvement in its absolute capital levels and the leverage ratio.

The introduction of full depositor preference into Germany's insolvency legislation could also place upward pressure on deposit ratings, as reflected in the positive outlook.

What Could Change the Rating - Down

We do not expect negative pressure on the Aa3 deposit rating, although a downgrade of DekaBank's BCA or a deterioration in the financial profile of the German Savings Banks Association would adversely influence the ratings. In addition, the introduction of full depositor preference into Germany's insolvency legislation could place downward pressure on the senior unsecured debt ratings.

The BCA will come under pressure if additional risks emerge from DekaBank's commercial banking activities, or if the bank fails to gradually improve its leverage ratio.

DETAILED RATING CONSIDERATIONS

DekaBank is a fully fledged asset management and securities service provider for Sparkassen-Finanzgruppe. DekaBank supports the savings banks in the entire investment and advisory process for securities-related business and provides capital market-related trading and sales services, as well as treasury facilities, including liquidity, asset and liability management, and funding to private and institutional clients.

CAPITALISATION IS SOUND IN THE CONTEXT OF THE LOW-RISK ASSET PROFILE, ALTHOUGH LEVERAGE REMAINS HIGH

The prospect of resilient core earnings and good capital retention capacity underpin our view that DekaBank will be able to further improve its capital base during 2015-16. Despite a satisfactory common equity Tier 1 (CET1) ratio and sound economic capital buffers, DekaBank will need to bolster its capital base further in order to achieve a regulatory leverage ratio of 4% (which we estimate was 3.5% as of year-end 2014), a level more in line with the market and similarly rated peers. However, the relatively high leverage is balanced by DekaBank's strong asset profile, which benefits from the mostly secured nature of its lending to financial intermediaries.

The bank's 13.4% transitional CET1 ratio and the 11.8% fully phased-in CET1 ratio as of December 2014, under the Capital Requirements Regulation (CRR) and the fourth Capital Requirements Directive (CRD IV), illustrate that DekaBank's regulatory capitalisation is satisfactory.

Notwithstanding DekaBank's sound risk profile and strong mitigants to asset risks in the form of collateral, we take the view that its low 2.4 % three-year average problem loan ratio does not adequately capture all relevant risks. To take account of risks relating to the bank's substantial market risk as well as borrower and sector concentrations, we adjust the Asset Risk score downward to baa2 (see the BCA scorecard at the end of this report). A downward adjustment of the Capital score to baa2 captures the bank's relatively high TCE-based leverage (Tangible Common Equity relative to Tangible Assets), which was a modest 4.1 % as of December 2014.

Risk to capital, while not negligible, remains manageable. DekaBank runs considerable market risk related to investments and derivative positions, which represented more than a third of the bank's risk-weighted assets (RWA) as of year-end 2014. We acknowledge that RWA movements often reflect small duration mismatches of hedged positions (under the standardised approach for market risk, which DekaBank uses), rather than higher economic risk. However, we also note the resulting scope for capital ratio volatility. RWA for market risk was higher at EUR10.4 billion under CRR/CRD IV, compared with EUR6.8 billion under CRD III as of December 2013.

RISK-ADJUSTED PROFITABILITY IS ROBUST

Despite revenue pressures, DekaBank improved overall performance in 2014. We expect a stable trend for 2015, not least because net sales in the mutual funds business turned positive in H2 2014, a trend which has continued during 2015. This will support a sustained recovery in fee income and offset expected adverse effects, in particular continued pressure on net interest income (NII). Implementation of the Markets in Financial Instruments Directive (MiFID II), which will govern the permissibility of sales commission and other requirements for strengthening investor protection, could negatively affect DekaBank's profitability from 2017.

Owing to its strong and profitable asset-management franchise, DekaBank's risk-adjusted profitability is robust and represents an important cushion for credit and market-related losses. As the preferred retail asset manager of the savings bank sector and a leading provider of institutional investment funds, DekaBank commands a resilient fee and commission income (FCI) from asset-management activities, which accounted for 65 % of core revenues (including the trading result) in 2014. DekaBank's NII may remain under pressure for an extended period, which is expressed in a ba2 profitability score.

DekaBank reported an improved economic result for 2014 of EUR541 million, an 8% increase from 2013, benefitting from a broadly stable total income of EUR1.44 billion and slightly reduced administrative costs of

EUR885 million (a 1% decrease on the previous year), as well as lower restructuring costs of EUR14 million, down from EUR39 million in 2013. DekaBank's quality of earnings remains robust, given that an 8% increase in FCI to EUR1 billion more than offset a 13% erosion of NII to EUR326 million. Risk charges of just EUR4 million were at a record low. The bank's reported economic result includes several items not shown in the IFRS income statement, such as valuation gains and losses from hedged lending as well as issuance business to better represent the true economic position, possible future charges and actuarial gains and losses from pension provisions.

DEPENDENCE ON WHOLESALE FUNDS IS MITIGATED BY DEKABANK'S HIGHLY LIQUID BALANCE SHEET

DekaBank is highly dependent on wholesale funds. Almost two thirds of the balance sheet is funded through interbank repo and other short-term products, specifically institutional deposits and commercial paper. This dependence is balanced by DekaBank's easy access to recurring funds from the savings banks sector, substantial regular excess cash from its mutual funds franchise and high liquidity balances. The modestly sized EUR23 billion loan book (as of December 2014) is sufficiently matched by medium- and long-term funds.

Structurally, DekaBank is slightly overfunded, with no liquidity shortfalls in short- and long-term buckets. Full coverage also applies in its "combined stress scenario", a stress test introduced in compliance with local regulatory requirements (Minimum Requirements for Risk Management for Banks or MaRisk). The German savings bank sector regularly provides stable funding, especially with medium- and long-term maturities. Taken together, sector funds and excess cash from the mutual funds franchise provide a material amount of liquidity. To capture these benefits, we adjust the initial Funding Structure score to ba3, while the Combined Liquidity score is higher at baa3.

NOTCHING CONSIDERATIONS

AFFILIATE SUPPORT

DekaBank benefits from cross-sector support from Sparkassen-Finanzgruppe. Cross-sector support materially reduces the probability of default, as it would be available to stabilise a distressed member bank and not just compensate for losses in resolution.

We consider the readiness of the sector to support DekaBank to be very high, given the bank's key service function for the sector and its 100% ownership by the sector's savings banks. Cross-sector support continues to provide two notches of rating uplift to DekaBank's debt, deposit and subordinated instrument ratings.

LOSS GIVEN FAILURE

In our Advanced LGF analysis, we consider the risks faced by the different debt and deposit classes across the liability structure in resolution. We assume residual tangible common equity of 3% and losses post-failure of 8% of tangible banking assets, a 25% run-off in "junior" wholesale deposits, a 5% run-off in preferred deposits, and assign a 25% probability to deposits being preferred to senior unsecured debt. These ratios are in line with our standard assumptions.

For deposits and senior unsecured debt issued by DekaBank, our LGF analysis indicates a very low loss-given-failure, leading to a two-notch uplift, respectively, from the bank's a3 Adjusted BCA.

For senior subordinated debt, rated Baa1, our LGF analysis indicates a high loss-given-failure, leading to a positioning one-notch below the bank's Adjusted BCA.

The perpetual Additional Tier 1 (AT1) notes issued in 2014 are rated Baa3(hyb), three notches below the Adjusted BCA, in line with our framework for rating non-viability Contingent Convertible Securities.

GOVERNMENT SUPPORT

Although German banks operate in an environment of materially weakened prospects for financial assistance from the government, we maintain one notch of rating uplift in our senior unsecured debt and deposit ratings for members of the Sparkassen-Finanzgruppe, reflecting our assumptions of a moderate support probability. Our revised government support assumptions reflect the large size and high systemic relevance of Sparkassen-Finanzgruppe.

ABOUT MOODY'S BANK RATINGS

About Moody's Bank Scorecard

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Factors

DekaBank Deutsche Girozentrale

Macro Factors	
Weighted Macro Profile	**Strong +**

Financial Profile						
Factor	**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	2.4%	a2	←→	baa2	Market risk	Non lending credit risk
Capital						
TCE / RWA	14.7%	a1	←→	baa2	Nominal leverage	Risk-weighted capitalisation
Profitability						
Net Income / Tangible Assets	0.4%	ba2	←→	ba2		
Combined Solvency Score		a3		baa3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	69.1%	caa1	←→	ba3	Market funding quality	Term structure
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	43.7%	aa3	←→	a3	Asset encumbrance	
Combined Liquidity Score		ba1		baa3		

Financial Profile	**baa3**

Qualitative Adjustments	**Adjustment**
Business Diversification	0
Opacity and Complexity	0
Corporate Behavior	0
Total Qualitative Adjustments	**0**

Sovereign or Affiliate constraint	Aaa

Scorecard Calculated BCA range	**baa2 - ba1**
Assigned BCA	**baa2**
Affiliate Support notching	**2**
Adjusted BCA	**a3**

Instrument Class	**Loss Given Failure notching**	**Additional notching**	**Preliminary Rating Assessment**	**Government Support notching**	**Local Currency rating**	**Foreign Currency rating**
Deposits	2	0	a1	1	Aa3	Aa3
Senior unsecured bank debt	2	0	a1	1	Aa3	
Dated subordinated bank debt	-1	0	baa1	0	(P)Baa1	
Non-cumulative bank preference shares	-1	-2	baa3	0	Baa3(hyb)	

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