MOODY'S INVESTORS SERVICE

Credit Opinion: DekaBank Deutsche Girozentrale

Global Credit Research - 28 Jan 2016

Frankfurt am Main, Germany

Ratings

Category	**Moody's Rating**
Outlook	Stable
Bank Deposits	Aa2/P-1
Baseline Credit Assessment	baa2
Adjusted Baseline Credit Assessment	a3
Counterparty Risk Assessment	Aa2(cr)/P-1(cr)
Senior Unsecured -Dom Curr	Aa3
Subordinate -Dom Curr	Baa1
Pref. Stock Non-cumulative -Dom Curr	Baa3
Other Short Term -Dom Curr	(P)P-1

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Key Indicators

DekaBank Deutsche Girozentrale (Consolidated Financials)[1]

	[2]**6-15**	[2]**12-14**	[3]**12-13**	[3]**12-12**	[3]**12-11**	**Avg.**
Total Assets (EUR billion)	**112.6**	**113.2**	**116.1**	**129.8**	**133.7**	[4]**-4.2**
Total Assets (USD billion)	**125.5**	**136.9**	**159.9**	**171.1**	**173.6**	[4]**-7.8**
Tangible Common Equity (EUR billion)	**4.3**	**4.1**	**3.7**	**3.5**	**3.3**	[4]**7.0**
Tangible Common Equity (USD billion)	**4.8**	**5.0**	**5.2**	**4.7**	**4.3**	[4]**3.0**
Problem Loans / Gross Loans (%)	**2.4**	**2.2**	**2.3**	**2.7**	**2.5**	[5]**2.4**
Tangible Common Equity / Risk Weighted Assets (%)	**14.8**	**14.7**	**16.7**	**15.0**	**13.1**	[6]**14.7**
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	**13.1**	**12.2**	**16.0**	**21.9**	**22.4**	[5]**17.1**
Net Interest Margin (%)	**0.2**	**0.3**	**0.2**	**0.2**	**0.2**	[5]**0.2**
PPI / Average RWA (%)	**3.0**	**3.2**	**2.4**	**3.0**	**2.4**	[6]**3.1**
Net Income / Tangible Assets (%)	**0.4**	**0.5**	**0.3**	**0.3**	**0.2**	[5]**0.3**
Cost / Income Ratio (%)	**54.4**	**50.9**	**65.7**	**56.4**	**60.7**	[5]**57.6**
Market Funds / Tangible Banking Assets (%)	**65.3**	**69.1**	**70.3**	**77.3**	**77.2**	[5]**71.9**
Liquid Banking Assets / Tangible Banking Assets (%)	**48.6**	**43.7**	**45.4**	**45.6**	**45.9**	[5]**45.8**
Gross loans / Due to customers (%)	**76.3**	**85.3**	**99.1**	**132.7**	**130.7**	[5]**104.8**

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 26 January, we upgraded DekaBank Deutsche Girozentrale's (DekaBank's) long-term deposit ratings to Aa2 from Aa3 and affirmed the bank's Aa3 long-term debt ratings and Prime-1 short-term debt and deposit ratings. We also changed the outlooks on the Aa3 long-term debt ratings and the Aa2 deposit ratings to stable, from negative (for senior debt) and positive (for deposits) previously. DekaBank's baa2 baseline credit assessment (BCA), its a3 Adjusted BCA, its Aa2(cr)/Prime-1(cr) Counterparty Risk (CR) Assessments and various subordinated instrument ratings (see details at the back of this report) were unaffected by this rating action.

The upgrade of DekaBank's deposit ratings resulted from the subordination of certain senior unsecured debt obligations relative to other senior liabilities including deposits into Germany's insolvency legislation which will take effect from January 2017. The changed legislation implies a higher severity of loss in resolution for senior unsecured debt instruments, i.e., bonds and notes issued to the market or privately placed with non-retail investors, because these will no longer benefit from their current pari-passu status with junior deposits. Conversely, for junior deposits the new law implies a lower severity of loss as these will benefit from the subordination of debt instruments.

To mirror the revised creditor ranking in resolution for German banks in our rating assessment for DekaBank, we adjusted our Advanced Loss Given Failure (LGF) analysis, which takes into account the severity of loss faced by the different liability classes in resolution. These adjustments resulted in three notches of uplift (instead of two previously) for deposits and an unchanged two notches for senior debt.

DekaBank's long-term senior unsecured debt and deposit ratings reflect: (1) the bank's baa2 BCA; (2) its a3 adjusted BCA, which incorporates 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 results of our LGF analysis, which provides three notches of rating uplift for deposits and two notches for senior debt from the a3 adjusted BCA; and (4) our assumption of moderate government support, yielding one notch of support uplift for DekaBank's debt and deposit ratings.

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 continue to address this weakness and further improve its absolute capital levels.

With our January rating action, we also withdrew certain "backed" Aaa/Prime-1 legacy ratings of DekaBank for liabilities that fall under the grandfathering (a statutory guaranty) of the bank's public sector owners, but have become obsolete following final expiries. The withdrawals relate to backed ratings for long-term deposits, long-term subordinated debt and short-term debt and deposit. DekaBank's Aaa backed long-term senior debt rating remains in place for grandfathered instruments that continue to be outstanding.

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's ratings are supported by its Strong+ Macro Profile

- 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 Aa2 long-term deposit ratings and the Aa3 long-term senior unsecured debt ratings is stable.

What Could Change the Rating - Up

Upward pressure on the baa2 BCA would develop in the event of 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.

Positive pressure on the long-term debt ratings could also arise should DekaBank materially raise its volume of subordinated instruments, thereby lowering the loss-given-failure for this liability class in resolution. The same does not apply to DekaBank's deposit ratings because, with three notches of rating uplift from the adjusted BCA, the deposit ratings already benefit from the highest possible LGF result.

What Could Change the Rating - Down

A downgrade of DekaBank's BCA or a deterioration in the financial profile of the German Savings Banks Association would adversely influence the ratings. The BCA could come under pressure if additional risks emerge from DekaBank's commercial banking activities, or if the bank fails to gradually improve its leverage ratio.

Negative pressure on the long-term debt ratings could arise if DekaBank's volume of unsecured debt instruments decreases relative to its total banking assets.

DETAILED RATING CONSIDERATIONS

DekaBank is a fully fledged asset management and securities service provider for Sparkassen-Finanzgruppe. It supports the savings banks in the entire investment and advisory process for securities-related business. It also 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 improve its capital base further during 2016, following good progress made in H1 2015. Despite a satisfactory common equity Tier 1 (CET1) ratio and sound economic capital buffers, DekaBank's absolute capital base remains modest compared with similarly rated peers, based on its fully phased-in regulatory leverage ratio of 3.9% as of June 2015 . However, this ratio marks an improvement from the level as of year-end 2014. Additionally, the bank's current leverage is balanced by its strong asset profile, which benefits from the mostly secured nature of its lending to financial intermediaries.

The bank's 14.4% transitional CET1 ratio and the 13.2% fully phased-in CET1 ratio as of June 2015 under the Capital Requirements Regulation and Directive (CRR/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. Our 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 3.8% as of June 2015 .

Risk to capital, while not negligible, remains manageable. DekaBank runs considerable market risk related to investments and derivative positions, which represented 35% of the bank's risk-weighted assets (RWAs) as of June 2015. 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. RWAs for market risk was broadly stable at EUR10.3 billion under CRR/CRD IV during the six months to June 2015.

RISK-ADJUSTED PROFITABILITY IS ROBUST

Despite significant pressures on its net interest income (NII) and higher bank levies, DekaBank improved its performance during the nine months to September 2015, which was mostly driven by strong fee income. We expect a mildly weakening trend for Q4 2015 and 2016, even though net sales in the mutual funds business are likely to remain robust. However, the nine-months result included a positive one-off effect relating to pension provisions, and we expect the low risk charges during the period to gradually normalise from 2016.

Investors' rising risk aversion, resulting from an extended high volatility in global markets, could have adverse implications on DekaBank's net sales performance of mutual and institutional funds. 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 from asset-management activities, which accounted for 71% of core revenues (including the trading result) in the nine months to September 2015. DekaBank's NII could remain under pressure for an extended period, which is expressed in its ba2 Profitability score.

DekaBank reported an improved economic result of EUR456 million for the nine months to September 2015, a 1% increase year-on-year. This broadly st able result benefitted from higher total income of EUR1.14 billion (+4%) which was offset by higher administrative costs of EUR685 million. The latter marks a 6% increase year-on-year which, however, was mostly driven by a materially higher bank levy. DekaBank's earnings quality remains robust, given that a 12% increase in fee and commission income to EUR807 million could largely offset the 44% erosion of NII to EUR143 million. 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 modest volume of EUR24 b illion customer loans (as of June 2015) 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 domestic regulatory requirements. 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 material liquidity. To capture these benefits, we adjust the initial Funding Structure score to ba3, while the Combined Liquidity score is higher at baa3.

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

Almost three quarters of DekaBank's assets are in Germany (Aaa), 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.

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 and a 5% run-off in preferred deposits. These ratios are in line with our standard assumptions. In line with the new German insolvency legislation that will effectively subordinate senior bonds and notes to deposits in resolution from January 2017, we base our calculation on the assumption that deposits are preferred to most senior unsecured debt instruments.

For deposits, our LGF analysis indicates an extremely low loss-given-failure, leading to a three-notch uplift from the bank's a3 adjusted BCA.

For senior debt, our LGF analysis indicates a very low loss-given-failure, leading to a two-notch uplift 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 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	14.8%	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	3	0	aa3	1	Aa2	Aa2
Senior unsecured bank debt	2	0	a1	1	Aa3	
Dated subordinated bank debt	-1	0	baa1	0	Baa1	
Non-cumulative bank preference shares	-1	-2	baa3	0	Baa3(hyb)	

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